Jus Corpus Law Journal

Open Access Law Journal – Copyright © 2026 – ISSN 2582-7820

Editor-in-Chief – Prof. (Dr.) Rhishikesh Dave; Publisher – Ayush Pandey

Directors' Duties in the Zone of Insolvency: Balancing Shareholder Interests and Creditor Protection

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Received 26 May 2026; *Accepted* 26 June 2026; *Published* 30 June 2026

The corporate form rests on a basic bargain. Shareholders put up the risk capital, and in return, the directors they appoint run the enterprise mainly in their interest. While the company stays solvent, that bargain holds. Once it begins to slide into financial distress, though, the economic logic behind shareholder primacy starts to invert. As liabilities approach or overtake assets, it is the creditors rather than the shareholders who feel the marginal consequences of managerial risk-taking, for the shareholders' residual claim has by then shrunk to little or nothing. This article looks at the contested space, usually called the 'zone of insolvency' or the 'twilight zone', in which directors' duties are said to move from shareholders toward creditors. It sets out the doctrinal and theoretical roots of that shift and compares how three jurisdictions have handled it: the United Kingdom through wrongful trading, the United States (Delaware) through fiduciary doctrine, and Australia through insolvent-trading liability. It then assesses the Indian position under the Companies Act, 2013 and the Insolvency and Bankruptcy Code, 2016. The argument advanced here is that Indian law has built a strong, creditor-centric structure that operates once insolvency proceedings begin, but has left the period leading up to them largely unregulated. Section 66(2) of the Code bites only in retrospect, and only during the resolution process; nothing in the statute tells directors how to conduct themselves as insolvency approaches. That governance gap, the article argues, opens the door both to premature destruction of value and to opportunistic asset stripping, and it calls for focused legislative reform.

Keywords: *zone of insolvency, directors' duties, fiduciary duties, creditors' interests, wrongful trading.*

INTRODUCTION

Corporate failure is not a malfunction of the market economy; it is a structural feature of it. Enterprises collapse often, and when they do, the losses fall on lenders, employees, suppliers and the wider economy. That reality has pushed the conduct of directors in the run-up to insolvency to the centre of modern company law. The question is no longer just how to wind up a failed company efficiently, but how to govern the behaviour of those steering it through the precarious months before failure becomes certain. Those months are when the most consequential managerial decisions are taken, and they are also the easiest to abuse.

The separation of ownership from control that Berle and Means described almost a century ago[1] left directors in charge of assets they do not own, exposed to incentives that do not always match those of the people financing the enterprise. So long as a company is comfortably solvent, the law manages this tension through shareholder primacy: directors run the company for its members, who, as residual claimants, have the keenest interest in maximising its value. The orthodoxy found its bluntest expression in the claim that the social responsibility of business is to increase its profits.[2] The neatness of that arrangement, though, depends on one assumption: that the shareholders still have something left to lose.

That assumption breaks down as a company nears insolvency. A company is a legal person distinct from its members,[3] and directors owe their duties to the company itself, not to the shareholders one by one.[4] While the enterprise remains solvent, the interests of the company and of its members are taken to run together. Once the assets fall below the liabilities, however, the shareholders' stake becomes an option that is, financially speaking, out of the money. Further risk-taking can do them no harm, since they have nothing more to lose; what it does instead is push risk onto the creditors, whose recoveries dwindle with each speculative bet. The usual alignment between directors and members falls apart, and the law has to decide whose interests the directors should now serve.

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[1] Adolf A Berle and Gardiner C Means, *The Modern Corporation and Private Property* (Macmillan 1933)
[2] Milton Friedman, 'The Social Responsibility of Business is to Increase its Profits' *The New York Times* (13 September 1970) <https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html> accessed 22 May 2026
[3] *Salomon v Salomon & Co Ltd* [1897] AC 22
[4] *Percival v Wright* [1902] 2 Ch 421

The way insolvency law has developed gives a fairly clear answer to that question. Modern regimes have shifted from a debtor-centred model to a creditor-centred one, treating the collective interest of creditors as the organising idea once distress sets in. India made exactly that move with the Insolvency and Bankruptcy Code, 2016, swapping a fragmented, debtor-friendly regime for a time-bound, creditor-in-control process run through the National Company Law Tribunal.[5] Yet a creditor-focused process that only switches on after default has crystallised says nothing about how directors should act in the months before the company crosses into formal insolvency. The article sets out to examine that silence.

The Research Problem: The problem can be put as one question with two sides. When do directors stop acting solely for shareholders, and when, correspondingly, must creditors' interests come first? The trouble is that financial distress is a continuum rather than an event. A company does not cross from health into insolvency at a single identifiable moment; it declines gradually, often without anyone noticing, and frequently while the directors themselves cannot tell whether recovery is still within reach. A rule that demands an abrupt change of duty at some unmarked point on that slope risks being either hopelessly vague or unfairly punitive. For any legal system, the task is to find a trigger that is both principled and workable, and to attach to it duties that protect creditors without freezing genuine attempts at rescue.

RESEARCH QUESTIONS

1. What is the zone of insolvency, and how is it to be identified?
2. How and why do directors' duties change as a company moves deeper into distress?
3. How have courts in the leading jurisdictions read those duties?
4. Does Indian law regulate directors' conduct within the zone adequately, or does it leave a gap that needs fixing?

RESEARCH OBJECTIVES

From these questions, the objectives are straightforward: to set out the content of directors' duties in the run-up to formal insolvency; to trace the judicial developments that have shaped

[5] *M/S Innoventive Industries Ltd v ICICI Bank & Anr* (2018) 1 SCC 407

them; to set the Indian position alongside that of the United Kingdom, the United States and Australia; and, based on that comparison, to propose reforms suited to Indian conditions.

Research Methodology: The study is doctrinal. It works through close reading of statutory text and case law, supported by a comparative survey of the main common-law jurisdictions and by empirical data from the Insolvency and Bankruptcy Board of India and the Reserve Bank of India. The comparison is not made to import foreign doctrine wholesale, but to draw out the design choices any mature insolvency system has to make, and then to measure the Indian framework against them.

THE CONCEPT OF THE ZONE OF INSOLVENCY

Meaning and Origin: The phrase 'zone of insolvency' came into the legal vocabulary from American corporate law. In Credit Lyonnais Bank Nederland NV v Pathe Communications Corp, Chancellor Allen suggested, in a footnote whose later fame far outran its modest beginnings, that a company in the 'vicinity of insolvency' owes its obligations not to the shareholders alone but to the broader community of interest the enterprise represents.[6] The image of a zone captures something real: distress arrives gradually, not all at once. There is a band of decline, short of actual insolvency but well past comfortable solvency, within which the calculus of corporate decisions changes even though the company is still trading.

It matters to keep financial distress separate from actual insolvency. Actual insolvency is a settled state in which the company can no longer meet its obligations. The zone of insolvency describes the approach to that state: the period in which insolvency has become a real and foreseeable risk but has not yet arrived. Directors inside the zone are in an awkward position. They keep full managerial power and full responsibility for the company's fortunes, yet the economic ground beneath their mandate has started to move. The law's job is to spell out what that shifting ground asks of them.

Tests for Insolvency: Two tests are normally used to locate the boundary of insolvency, and they approach the zone from opposite sides. The cash-flow test asks whether the company can pay its debts as they fall due; its concern is liquidity and commercial reality. The balance-sheet test asks whether the company's liabilities, contingent and prospective ones included,

[6] *Credit Lyonnais Bank Nederland NV v Pathe Communications Corp* [1991] WL 277613

exceed its assets; its concern is solvency in the accounting sense. A company can pass one test and fail the other. It may be a balance-sheet solvent yet unable to scrape together the cash for an immediate demand, or it may be trading profitably on credit while its accumulated liabilities have quietly crept past its assets. The Indian Code uses a payment-default trigger to start proceedings, but the deeper economic question that marks out the zone, whether insolvency has become a real prospect, still turns on cash-flow and balance-sheet judgment.

Taken together, the two tests produce not a single bright line but a set of warning signs. Persistent failure to service debt, growing contingent exposures, a shrinking net worth, dependence on ever costlier borrowing, deferred statutory payments: in combination, these point to entry into the zone. What matters legally is that they are, or should be, visible to a reasonably diligent director. That visibility is the hinge on which liability for misconduct in the zone finally turns.

Why the Concept Emerged: Three reasons account for the concept's emergence. The first is protecting creditors against the asymmetric risk just described: once the equity is gone, directors who keep gambling are gambling with creditors' money, and the law steps in to check that moral hazard. The second is preventing asset stripping. A distressed company is badly exposed to having value drained away, whether through preferential payments to favoured creditors, transfers at an undervalue to connected parties, or the simple dissipation of assets that ought to be kept for the general body of creditors. The third is accountability in a wider sense: the idea that those who control a failing enterprise must answer for choices that decide whether creditors are paid or left to absorb avoidable losses. The zone of insolvency, then, is less a precise legal location than a signal that the usual rules of corporate self-interest must give way to a duty of stewardship.

THE THEORETICAL FOUNDATION OF DIRECTORS' DUTIES

Fiduciary Duties: Directors are fiduciaries. Standing in a relationship of trust and confidence with the company, they carry a cluster of duties that shape how they may use their powers. The duty of loyalty obliges them to act in good faith in what they take to be the company's interests and to keep their personal interests from colliding with their duties. The duty of care obliges them to bring the diligence, skill and judgement reasonably expected of someone in their office and with their knowledge and experience. Underlying both is the duty of good faith, which demands honesty of purpose in the way the office is discharged.[7] These duties are not fixed. Their content depends on the circumstances in which they have to be performed, and distress changes that content profoundly.

Shareholder Primacy Theory: The dominant theory of the corporation, especially in the Anglo-American tradition, treats maximising shareholder wealth as the proper aim of corporate governance.[8] The justification is part economic, part structural. Shareholders are the firm's residual claimants: paid last, after fixed claimants such as creditors and employees, they have the strongest reason to want the firm run well. Because their return is whatever is left over, maximising that residual is, on this view, the same as maximising the value of the whole enterprise, to everyone's benefit. It is a coherent and powerful theory, but only while the residual stays positive. Its whole logic assumes that shareholders gain or lose from decisions at the margin, and that assumption falls apart in the zone of insolvency.

Stakeholder Theory: Stakeholder theory offers a rival account, in which the corporation is a web of relationships among employees, creditors, suppliers, customers and the community, each with a genuine claim on those who manage it. In its most developed form, the theory casts directors as mediating hierarchs, balancing the competing claims of the various contributors to corporate production rather than serving any one constituency.[9] Indian company law has a markedly stakeholder-oriented flavour: the statutory statement of directors' duties tells directors to act for the company's members and, in the same breath, for its employees, the community and the environment. What that formulation says, and what it leaves out, is taken up below.

Creditor Wealth Maximisation Theory: The bridge between solvency and insolvency is the idea of the shifting residual claimant. As a company's net worth slides toward zero, the residual claimant changes its identity, moving from the shareholders to the creditors. From that point, it is the creditors whose recoveries rise and fall with managerial decisions; they

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[7] Companies Act 2013, s 166(2)
[8] Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (HUP 1996) 36–39
[9] Margaret M Blair and Lynn A Stout, 'A Team Production Theory of Corporate Law' (1999) 85(2) Virginia Law Review 247 <https://josephmahoney.web.illinois.edu/BA549_Fall%202018/Session%204/4_Blair_Stout%20(1999).pdf> accessed 22 May 2026

are now the ones bearing the risk at the margin.[10] If shareholder primacy rests on the idea that management should be loyal to the residual claimant, then the same idea, taken honestly, requires that loyalty to follow the residual claim across to the creditors. Creditor wealth maximisation is thus not a break with the logic of shareholder primacy but its honest continuation under different financial conditions. That the duty tracks the residual, and that the residual moves, is the analytical heart of the whole subject.

THE EVOLUTION OF DIRECTORS' DUTIES ACROSS THE SPECTRUM OF DISTRESS

The Position Before Financial Distress: While a company is solvent and trading normally, its directors owe their duties to the company, and they discharge them by acting in the interests of the shareholders as a body. The members are, in substance, the owners of the undertaking, and the law does not ask directors to put them behind creditors who have bargained for fixed returns and protected themselves by contract.[11] During this phase, creditors are expected to rely on their security, their covenants and their contractual remedies, not on fiduciary protection. Here, shareholder primacy operates without qualification.

The Position During Financial Distress: As the company enters the zone of insolvency, a gradual reorientation sets in. The directors' duty to the company comes to take in, and finally to demand, regard for the interests of creditors. This is the ground the English authorities have mapped, starting from the principle that directors of a company that is insolvent, or of doubtful solvency, must have regard to its creditors' interests in running its affairs.[12] This reorientation is less a handing of the duty to a new beneficiary than a change in the content of the duty already owed to the company: in distress, the company's interest comes more and more to be identified with the interest of those who will be paid from its assets if it fails.[13] The directors do not stop serving the company; they serve it on different terms.

The Position After Insolvency: Once formal insolvency arrives, the creditors become the main, and often the only, beneficiaries of the directors' stewardship, or more usually of an

[10] Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 Georgetown Law Journal 439 <https://openyls.law.yale.edu/entities/publication/47662087-2b0c-4947-8034-e54982ee6590> accessed 22 May 2026

[11] *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] EWCA Civ J0216-1

[12] *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250

[13] *Bilta (UK) Ltd v Nazir (No 2)* [2015] UKSC 23

insolvency professional who takes the directors' place entirely. By this stage, the shareholders' interest has, in the ordinary case, been wiped out, and the whole machinery of the insolvency process is aimed at gathering and distributing whatever value remains for creditors. The path is one of steady displacement: from sole concern with the members, through a transitional phase of dual regard, to the eventual primacy of creditors. Most of the legal interest sits in that middle phase, because that is where directors still hold power and discretion, and where the law's guidance is at once most needed and most contested.

COMPARATIVE JURISPRUDENCE

No jurisdiction has dealt with the zone of insolvency easily, but three offer instructive and contrasting models. The United Kingdom regulates the period of distress mainly through statutory wrongful-trading liability, backed by a judicially developed duty to have regard to creditors. The United States, through Delaware law, has pulled back from a broad fiduciary approach toward a narrow, derivative conception of creditor protection. Australia pairs a strict insolvent-trading ban with a statutory safe harbour for genuine rescue. Each is a different answer to the same trade-off: protecting creditors while leaving room for legitimate risk.

The United Kingdom: The British framework rests on two pillars. The first is the statutory statement of directors' duties, under which a director must act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, subject, importantly, to an express saving for any rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors.[14] That saving is the statutory anchor for the creditor-regarding duty. The second pillar is the wrongful-trading regime, under which a director can be ordered to contribute personally to the company's assets where, at some point before insolvent liquidation or administration began, they knew or ought to have concluded that there was no reasonable prospect of avoiding it, and then failed to take every step they ought to have taken to limit the loss to creditors.[15] The remedy is compensatory, not penal: the contribution is measured by the extra depletion of the company's assets caused by trading on when it should have stopped.[16]

[14] Companies Act 2006 (UK), ss 172(1), 172(3)
[15] Insolvency Act 1986 (UK), ss 214, 213
[16] *Re Produce Marketing Consortium Ltd* [1989] BCLC 520

The content of the creditor-regarding duty has been refined through a line of cases that culminates in the leading modern authority on the point. In Sequana, the Supreme Court confirmed that directors owe no free-standing fiduciary duty to creditors; the duty to consider creditors' interests is instead a modification of the duty owed to the company, triggered once the directors know, or ought to know, that the company is insolvent or bordering on insolvency, or that an insolvent liquidation or administration is probable.[17] Below that threshold, the ordinary duty to promote the success of the company for the members holds sway; above it, creditors' interests come into the balance, carrying more weight as insolvency grows more likely, until at the point where insolvency is inevitable, they become paramount.[18] The British model is therefore graduated and fact-sensitive. It calls for no single switch of loyalties, but a sliding emphasis that tracks the directors' actual or constructive knowledge of the company's worsening position.[19]

The United States (Delaware): Delaware, whose corporate law governs most large American companies, once looked ready to embrace a broad duty to creditors in the vicinity of insolvency, resting on the well-known suggestion in Credit Lyonnais that distressed directors owe obligations to the firm's whole community of interest.[20] That trajectory was firmly cut short. In Gheewalla, the Delaware Supreme Court held that creditors of a corporation, even an actually insolvent one, have no direct claim against directors for breach of fiduciary duty; any remedy they have lies in a derivative action brought on the corporation's behalf.[21] The court refused the idea that nearness to insolvency, by itself, creates a special, directly enforceable duty to creditors, reasoning that such a duty would pull directors between irreconcilable obligations and would chill the very risk-taking a distressed company needs to recover.

Later decisions have hardened this narrow position. Creditors get derivative standing only once the company is actually insolvent, not somewhere in a vague zone of approaching insolvency.[22] Delaware has also firmly rejected 'deepening insolvency' as a freestanding cause of action: the theory that directors become liable simply by keeping a doomed company

[17] *BTI 2014 LLC v Sequana SA & Ors* [2022] UKSC 25 [11]–[12], [80]
[18] *HLC Environmental Projects Ltd, Re* [2013] EWHC 2876 (Ch) [88]–[92]
[19] *BTI 2014 LLC v Sequana SA & Ors* [2022] UKSC 25 [203]–[247]
[20] *Credit Lyonnais Bank Nederland NV v Pathe Communications Corp* [1991] WL 277613
[21] *North American Catholic Educational Programming Foundation Inc v Gheewalla* [2007] 930 A 2d 92
[22] *Quadrant Structured Products Co Ltd v Vertin, et al.* [2015] 115 A 3d 535 (Del Ch 2015)

alive and so enlarging its eventual deficit.[23] The Delaware model thus puts managerial flexibility and the business-judgment rule ahead of creditor protection. It trusts contract, security and the eventual insolvency process to look after creditors, and refuses to press fiduciary law into their service except by the indirect route of a derivative claim once insolvency has actually set in. Where the United Kingdom regulates the zone, Delaware mostly leaves it alone.

Australia: Australia sits in the middle, and by design, its scheme is the most explicit of the three. It's companies legislation places a direct statutory duty on directors to stop the company from incurring debts while it is insolvent, and a breach exposes the director to a civil penalty and to personal liability for the debts so incurred.[24] This prohibition on insolvent trading is among the strictest in the common-law world, and for years critics said it pushed directors into formal administration too early, encouraging them to abandon companies that, given patience, might have been saved. Parliament answered in 2017 with a safe harbour: a director who, having begun to suspect insolvency, works up one or more courses of action reasonably likely to produce a better outcome for the company than immediate administration or liquidation is shielded from insolvent-trading liability for debts incurred in pursuing it.[25] Australian case law also reflects the wider recognition that directors' duties have to make room for creditor interests as insolvency draws near.[26]

What makes the Australian model instructive is that it sets a stringent rule beside a carefully drawn exception. The strict prohibition deters directors from trading on creditors' backs, while the safe harbour keeps space open for honest, well-advised rescue. The model meets the field's central dilemma head-on, namely, how to deter the abuse of creditors without punishing the pursuit of recovery, and it answers not by diluting the duty but by marking out a protected path for those who behave responsibly. The Indian discussion will come back to this template.

[23] *Trenwick America Litigation Trust v Ernst & Young LLP* [2007] 906 A 2d 168 (Del Ch 2006)
[24] Corporations Act 2001 (Cth), s 588G
[25] *Ibid* s 588GA
[26] *The Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* [2008] WASC 239

THE INDIAN LEGAL FRAMEWORK

The Companies Act 2013: The statutory statement of directors' duties in Indian company law is striking both for what it contains and for what it omits. A director must act in good faith to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and the environment.[27] The formulation is plainly stakeholder-oriented, yet it makes no express mention of creditors at all. That omission matters. It means the general duties of directors under Indian company law are not, on their face, built to require the shift toward creditor interests that the zone of insolvency calls for. Whatever protection creditors have as insolvency nears must come from somewhere else: from the insolvency legislation, from the avoidance provisions, or from a creditor-regarding reading of the general duty that the Indian courts have yet to spell out.

The Act does lay heavier responsibilities on independent directors, who are meant to protect the interests of all stakeholders, minority shareholders above all, and to bring objectivity to the boardroom.[28] But those responsibilities, valuable as they are for governance at large, are not aimed at the particular problem of distress, and they do not supply the graduated, knowledge-based standard that the British and Australian models offer. In short, the general law of directors' duties in India assumes a solvent company run for its members and stakeholders; it says nothing direct about a company sliding toward insolvency.

The Insolvency and Bankruptcy Code 2016: Creditor protection finds its real home in the Code. The Code tackles management misconduct through a dedicated provision on fraudulent and wrongful trading. Where it emerges, during the corporate insolvency resolution process or a liquidation, that the company's business was carried on to defraud creditors or for any fraudulent purpose, those knowingly party to it may be ordered to contribute to the assets as the adjudicating authority directs. Separately, a director may be held liable where, before the resolution process began, they knew or ought to have known that there was no reasonable prospect of avoiding it and yet failed to exercise the due diligence expected in limiting the loss to creditors.[29] The wrongful-trading limb is, in

[27] Companies Act 2013, s 166(2)
[28] *Ibid* s 149(12)
[29] Insolvency and Bankruptcy Code 2016, ss 66(1), 66(2)

conception, the Indian counterpart of the British regime: a fault-based, knowledge-dependent liability for trading a doomed company onto the creditors' cost.

The Code backs this provision with a battery of avoidance powers. Preferential transactions, undervalued transactions, transactions defrauding creditors and extortionate credit transactions entered into within set look-back periods can be unwound by the adjudicating authority, returning to the estate value that was improperly siphoned off as insolvency approached.[30] The Supreme Court has made clear that these provisions target different mischiefs and call for different enquiries, so that a transaction has to be tested separately under each head rather than swept together under some general notion of impropriety.[31] Collusive and related-party transactions meant to siphon value or to manufacture friendly creditors have likewise drawn judicial scrutiny and a refusal of standing in the resolution process.[32]

The Role of the Resolution Professional: One defining feature of the Indian model is that it displaces the board. When a company is admitted into the resolution process, a moratorium comes down, and management of its affairs passes to an interim resolution professional, and then to the resolution professional, who runs the company as a going concern under the watch of the committee of creditors.[33] The board's powers are suspended, and the directors are left with little beyond a duty to co-operate. Once proceedings are underway, this is a powerful way to protect creditors, because it removes the very people whose conduct may have caused the distress and replaces them with an officer answerable to the creditors and the tribunal. Its protective force, though, is by definition limited to the period after commencement. It does nothing about how directors behave before the company crosses the threshold, before the resolution professional turns up. The displacement of the board is creditor protection that arrives, in effect, a moment too late.

Judicial Interpretation: The higher judiciary has steadily read the Code as beneficial, creditor-protective legislation. The Supreme Court has upheld its constitutional validity and described it as an instrument that has closed the era in which defaulting promoters could

[30] *Ibid* ss 67, 43, 45, 49 and 50
[31] *Anuj Jain Interim Resolution Professional for Jaypee Infratech Ltd v Axis Bank Ltd* (2020) 4 SCALE 310
[32] *Phoenix ARC Pvt Ltd v Spade Financial Services Ltd and Ors* (2021) 3 SCC 475
[33] Insolvency and Bankruptcy Code 2016, ss 14, 17, 23 and 25

hang on to companies they had run into the ground.[34] It has affirmed the primacy of the committee of creditors' commercial wisdom in weighing resolution plans, and has kept judicial and tribunal interference with that collective decision to a minimum.[35] And it has read robustly the provisions that bar errant promoters from slipping back into control through a resolution plan.[36][37] This case law is unmistakably creditor-protective. Tellingly, though, almost all of it concerns the period after proceedings have begun. There is still little authority reading the wrongful-trading limb as a forward-looking standard for directors as insolvency approaches. The courts have raised an impressive structure of creditor protection based on the resolution process, but they have had scant occasion, and scant statutory material, to develop any doctrine for the twilight period that comes before it.

CHALLENGES IN THE INDIAN FRAMEWORK

The analysis so far brings out a set of connected weaknesses in the Indian treatment of the zone of insolvency. They fall under five heads.

First, Indian law gives no clear definition of the zone of insolvency. There is no statutory notion of an interval, short of formal default, in which directors' duties turn toward creditors. The general company-law duties leave creditors out, and the Code only switches on at default. The conceptual space that British and Australian law fills with deliberate standards is, in India, simply empty.

Second, and following from this, the trigger for any shift of duty is uncertain. The wrongful-trading provision hinges on the moment at which a director knew or ought to have known that there was no reasonable prospect of avoiding the resolution process. But that moment is fixed only in hindsight, by an adjudicating authority looking back after proceedings have started. It offers no guidance in the moment to a director who has to decide, in real time and under uncertainty, whether the company has entered the danger zone and what that entry now demands of them. A standard that can be applied only after the event is a poor guide to conduct before it.

[34] *Swiss Ribbons Pvt Ltd & Anr v Union of India & Ors* (2019) 4 SCC 17
[35] *Committee of Creditors of Essar Steel India Ltd Thru Autirised Signatory v Satish Kumar Gupta and Ors* (2020) 8 SCC 531
[36] Insolvency and Bankruptcy Code 2016, s 29A
[37] *ArcelorMittal India Pvt Ltd v Satish Kumar Gupta* (2019) 2 SCC 1

Third, directors are left to fend for themselves. There is no codified checklist of what a director should do when distress sets in: no duty to take professional advice, to call the board together to look at the company's solvency, to preserve assets, or to hold off on preferential dealings, the sort of duty that would turn an abstract obligation into concrete, auditable conduct. Directors of distressed Indian companies have to feel their way toward insolvency largely on instinct and the advice of their own advisers, with no statutory map to follow.

Fourth, the threat of personal liability, cut loose from any clear standard of conduct, can produce perverse incentives. A director who fears that any decision to keep trading will later be branded wrongful, and who has no safe harbour for a good-faith rescue, may sensibly choose to abandon the company early rather than attempt a workout that could have saved value.[38] Liability that is excessive and unpredictable can hurt creditors just as much as liability that is too slight, because it destroys the going-concern value an orderly rescue would have preserved.

Fifth, the goals of rescue and of liquidation sit in unresolved tension. The Code aims to rehabilitate viable businesses, yet without a structured pre-insolvency duty, the period when rescue is most achievable, before the company collapses into formal proceedings, is the very period the law regulates least. The directors best placed to begin an early, value-preserving restructuring are given neither a duty to do so nor the protection that would make it safe to try.

CASE STUDIES AND EMPIRICAL CONTEXT

Illustrative Insolvencies: Several of the largest resolutions under the Code show what this governance gap costs in practice. The grounding and collapse of Jet Airways, admitted to the resolution process in 2019, raised sharp questions about how its former management had behaved while the airline's finances were deteriorating, and about whether earlier intervention might have saved value that was in the end lost. The consolidated resolution of Videocon Industries returned so little against the creditors' admitted claims that it caused public disquiet, and it laid bare how much value had drained away before the company ever entered formal proceedings. And the resolution of Bhushan Steel, finally acquired by a strategic applicant, came with allegations that the former promoters had diverted funds in

[38] *Usha Ananthasubramanian v Union of India* AIR 2020 SC 1061

the years before insolvency, allegations that drew the attention of investigative agencies and that illustrate exactly the asset-stripping the law of the zone is meant to deter.

What these cases share is that, by the time the resolution process started, much of the recoverable value had already gone. The decisive losses came not during the formal process, where the Code's machinery worked as intended, but in the unregulated run-up to it, while directors were still in control and the Code's protections had not yet kicked in. The cases bring the article's central claim into sharp focus: the period in which creditors suffer the most serious damage is the very period Indian law governs least.

The Empirical Picture: The aggregate data bear out the impression left by the leading cases. On the insolvency regulator's figures, creditors had recovered, up to September 2025, in the region of Rupees 3.99 trillion under approved resolution plans against admitted claims of about Rupees 12.31 trillion. That is a realisation of roughly thirty-two to thirty-three per cent, and an average haircut on admitted claims of about sixty-seven per cent. Part of that headline figure reflects value that had already eroded: a good share of resolved cases involved companies that were defunct or had long been stuck in earlier distress mechanisms, and their recoveries were lower still. But the sheer size of the average haircut is itself a measure of how much value is lost before the formal process, not during it.

The data also show a regime that resolves a minority of cases and liquidates the majority of the processes concluded by the same date. Around thirteen hundred had produced resolution plans, while close to three thousand had ended in liquidation orders, and both routes ran, on average, well past the statutory timeline, roughly six hundred days for resolutions and a little over five hundred for liquidations. Recovery rates have lately shown some improvement, rising in the most recent reporting period even as fewer cases were referred to the tribunal,[39] but the overall pattern holds: late entry, drawn-out process, heavy loss. Set against this, the disciplinary machinery of Indian company law has historically been turned less on substantive misconduct in distress than on procedural default. The mass disqualification of directors after the 2017 strike-off drive, which saw roughly three lakh directors disqualified for filing failures once more than two lakh defaulting companies had been de-registered, shows an enforcement effort aimed at compliance lapses rather than at

[39] *Report on Trend and Progress of Banking in India 2024–25* (Reserve Bank of India 2025)

how directors behave within the zone of insolvency.[40] The contrast is telling. The system is energetic in punishing those who fail to file, and comparatively quiet about those who trade a failing company into the ground.

POLICY ANALYSIS AND REFORM SUGGESTIONS

If the diagnosis is a governance gap in the approach to insolvency, the cure has to be a set of duties and protections built for that period. Five reforms are proposed here, drawing on the comparative experience surveyed above and on the recommendations of international standard-setting bodies.

First, the zone of insolvency should be recognised in statute. Whether by amending the Code or the company law, Indian law should set out a duty on directors to have regard to creditors' interests once they know, or ought reasonably to know, that the company is insolvent or that insolvency has become a real prospect. International guidance points the same way: the UNCITRAL Legislative Guide recommends that an obligation toward creditors attach once insolvency is imminent or unavoidable,[41] and the European framework now requires member states to see that directors have due regard to creditors' interests where insolvency is likely.[42] A comparable, knowledge-based duty would give India the forward-looking standard that the wrongful-trading provision, applied only after the fact, cannot.

Second, the law should require early-warning and response mechanisms. Once defined indicators of distress appear, directors should be under a duty to assess the company's solvency, take professional advice, and weigh the options realistically open for protecting creditors. Turning the abstract duty into a sequence of concrete, documented steps would give directors a map to follow and give courts an objective benchmark for judging their conduct.

[40] 'Around 2.24 lakh companies have been struck-off till date for remaining inactive for a period of two (2) years or more;. Around 3.09 lakh Directors disqualified who were on the Board of Companies that have failed to file Financial Statements and/or Annual Returns for a continuous period of three (3) financial years during 2013-14 to 2015-16.' (*Press Information Bureau*, 05 November 2017) <https://www.pib.gov.in/PressReleasePage.aspx?PRID=1508281&reg=48&lang=2> accessed 22 May 2026

[41] *UNCITRAL Legislative Guide on Insolvency Law, Part Four: Directors' Obligations in the Period Approaching Insolvency (including in enterprise groups)* (United Nations 2013)

[42] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] OJ L172/18 art 19

Third, and this is essential, any tightening of duty has to come with a safe harbour for genuine rescue. The Australian model shows that a strict prohibition need not deter responsible workouts, provided directors who pursue a course reasonably likely to yield a better outcome than immediate insolvency is protected from liability for doing so.[43] Without that shelter, a heavier duty would only worsen the premature-abandonment problem identified above. The safe harbour is not a concession that weakens creditor protection; it is what makes a stringent duty workable, by keeping open the space for value-preserving rescue.

Fourth, disclosure obligations should be strengthened for companies in distress, so that a material decline in solvency reaches creditors and regulators in time for them to act, rather than staying hidden until the company collapses. Transparency as insolvency nears is a powerful discipline in itself, since much asset stripping relies on opacity.

Fifth, director education and structured compliance programmes should go alongside any statutory reform. A duty director do not understand will not be kept, and the technical nature of solvency assessment makes guidance essential. Steady efforts to educate directors about their obligations in distress, backed by practical guidance from the regulator, would help build a culture of early, responsible engagement with financial trouble in place of denial and delay.

CONCLUSION

How directors behave in the months before a company fails is among the most consequential and least disciplined episodes in corporate life. This article has argued that directors' duties are not fixed but follow the economic substance of the enterprise. While the company is solvent, the shareholders are its residual claimants and hold the loyalty of management; as it slides toward insolvency, that residual claim passes to the creditors, and the same logic that justified shareholder primacy now requires regard for creditors. The zone of insolvency is where that transition happens, and the law's central task is to steer directors through it without either licensing the abuse of creditors or smothering legitimate rescue.

[43] Corporations Act 2001 (Cth), s 588GA

The comparative survey has shown three ways of meeting that challenge: the British model of a graduated, knowledge-based creditor duty tied to wrongful-trading liability; the Delaware model of restraint, which declines to regulate the zone and trusts contract and the eventual insolvency process; and the Australian model of a strict prohibition softened by a carefully drawn safe harbour. Each strikes a defensible balance between the competing values at stake, and each has something to teach India.

The Indian position, by contrast, is strong after the threshold and silent before it. The Insolvency and Bankruptcy Code has built a powerful, creditor-centric process that engages once default has occurred, complete with the displacement of the board, the unwinding of improper transactions and the disqualification of errant promoters, and the courts have given that process a robustly protective reading. But the general duties of directors leave creditors out, the wrongful-trading provision works only in retrospect and only within the process, and the period in which value is most easily preserved or destroyed is left without any standard of conduct. The empirical record, with its heavy haircuts, long timelines and preponderance of liquidation over rescue, measures the cost of that omission. The way forward for Indian insolvency governance is therefore to carry its creditor-protective logic backwards, into the twilight period before formal proceedings, through a statutory duty pitched to the approach of insolvency and a safe harbour for those who respond to distress responsibly. Indian law has shown it can protect creditors once a company has fallen; the work still to be done is to govern the conduct of those who decide whether it falls at all.