DIRECTORS' DUTIES IN THE TWILIGHT ZONE OF INSOLVENCY: IS A SEPARATE CREDITOR-ORIENTED DUTY NECESSARY IN INDIA?

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ABSTRACT

This paper looks closely at what corporate directors must do during the "twilight zone" of insolvency. When a company faces financial difficulties and moves closer to insolvency, there begins a conflict between the shareholders' and creditors' interests. This gives rise to an important question: should directors keep acting in the best interest of the company or should directors have a special legal duty to protect creditors? In India Section 166 of the Companies Act 2013 talks about the duties of directors while Section 66 of the Insolvency and Bankruptcy Code 2016 deals with fraudulent and wrongful trading. However the law does not clearly specify when directors must give more weight to creditors interest as insolvency looms. This paper looks at whether India needs an independent creditor-oriented duty or whether the current legal framework can be strengthened. By using doctrinal and comparative research the paper examines the legal approach used in the United Kingdom, Ireland, Australia and Singapore. The paper argues that creating a separate duty could lead to conflicting obligations and may lead to fragmentation of fiduciary duties and the following problems in their enforcement, which is likely to make it difficult for companies to go through the process of restructuring in accordance with the law. Instead the paper proposes amending section 166 by adding new provision to the law requiring the directors to take creditors' interests into account when there are signs of insolvency while preserving their duties to the company with appropriate enforcement mechanisms. This approach aims to protect creditors while not unnecessarily limiting business decisions.

INTRODUCTION

twilight zone of insolvency is the time before a company goes into insolvency where it faces serious financial difficulties. This brings up an important question about what directors are supposed to do. During this time a company might be in financial trouble but the directors must continue to manage the business and make choices that shape what happens next. As insolvency gets closer the goals of shareholders and creditors can start to clash. Shareholders might take chances to get their money back while creditors want to keep what is left of the company's money safe.

This paper answers the question of whether India should adopt a separate creditor-oriented fiduciary duty or whether this can be addressed by amending the existing legal framework. By adopting a doctrinal and comparative legal approach, it examines Indian statutory provisions alongside those of the United Kingdom, Ireland, Australia and Singapore. It suggest amending section 166 by providing clear standards for its application and enforcement, would provide a more balanced approach to protecting creditors while allowing directors to pursue legitimate corporate rescue efforts.

EXISTING INDIAN LEGAL FRAMEWORK

SECTION 166 OF THE COMPANIES ACT, 2013

Section 166 talks about the duties that the directors must follow in India. Section 166(2) says that directors must act in good faith for the benefit of all members of the company and for the interests of the company and the stakeholders that are named. Section 166(3) states that directors must act with care, skill, diligence and independent judgment.[1] Even though creditors are not expressly mentioned, the duty to act in the interest of the company may include the interest of the creditors when the company faces the insolvency threat. Yet section 166 does not mention under which circumstances the interests of creditors should prevail.

SECTION 66 OF INSOLVENCY AND BANKRUPTCY CODE, 2016:

section 66 differentiates between fraudulent and wrongful trading. Section 66(1) deals with business that is carried out with the intent to defraud creditors or for any other fraudulent aim

[1] The Companies Act, 2013, No. 18 of 2013, Sections 166(2) and 166(3) (India).

and which allows people who knowingly take part to be ordered to give money to the assets of the corporate debtor.[2] Section 66(2) deals with directors who were aware or should have been aware of the lack of reasonable chances of avoiding insolvency resolution proceedings but who does not act with due diligence to reduce the losses of creditors. The objective standard of diligence is determined based on what is expected from a person doing the same role.[3] Section 10A prohibits the submission of petition during the relevant pandemic suspension period. Likewise section 66(3) limits wrongful trading claims in regard to such defaults.[4] These rule set out liability for specific misconduct and not for a broad fiduciary duty the concerns all creditors

TRANSACTIONS SUBJECT TO AVOIDANCE AND PROTECTION OF COMPANY PROPERTY:

Sections 43–51 of the IBC deal with transactions that are capable of damaging the debtor's property, such as preferences and trades that are worth too little and credit arrangements that are too harsh.[5] Statutory provisions provide ways to reverse such transaction and bring back value. But the avoidance rule in section 43-51 deals with particular transaction rather than answering the question how directors should keep creditor interests in mind all the time when the company is in financial trouble.

THE RELATIONSHIP BETWEEN CORPORATE DUTIES AND INSOLVENCY LIABILITY:

The Companies Act and the IBC establish different accountability and regulation systems. Section 166(7) of the Companies Act says that if a director breaks the rules that director may have to pay a fine but does not provide any remedy of compensation to the individual creditors under this provision. However, Section 66 of IBC offers contribution order that force people to contribute money to bring back value to the debtor. After the 2026 amendment section 47 allows creditors to make an application when certain transactions or trading are not reported by the resolution professional or liquidator.[6] Therefore the current law gives useful ways to fix

[2] The Insolvency and Bankruptcy Code, 2016, No. 31 of 2016, Section 66(1) (India).
[3] The Insolvency and Bankruptcy Code, 2016, No. 31 of 2016, Section 66(2) (India).
[4] The Insolvency and Bankruptcy Code, 2016, No. 31 of 2016, Sections 10A and 66(3) (India); The Insolvency and Bankruptcy Code (Amendment) Act, 2020, No. 17 of 2020, Sections 2 and 3 (India).
[5] The Insolvency and Bankruptcy Code, 2016, No. 31 of 2016, Sections 43, 45 and 50 (India).
[6] The Companies Act, 2013, No. 18 of 2013, Section 166(7) (India); The Insolvency and Bankruptcy Code (Amendment) Act, 2026, No. 6 of 2026, Sections 28 and 46 (India) (effective May 26, 2026).

the problems but there is still uncertainty about the duties of directors to prevent problems before the company officially goes into insolvency.

DOCTRINAL DEFICIENCIES: WHAT DOES INDIAN LAW ACTUALLY LACK?

The main uncertainty in Indian law is the question when directors should accord increased importance to creditors' interests. Just because a company is in financial doesn't mean that this shift should always take place because sometimes companies also faces temporary financial problems. If the directors wait till the insolvency to be imminent, then creditors will face more actions which can diminish the assets of the company. Section 166 does not name a trigger while Section 66(2) deals with situations where directors either know or should have known that avoiding insolvency was no longer possible.[7] Thus, it could be more prudent to rely on the probable insolvency as a trigger without affecting the routine business decisions.

Next is the content problem. When the directors interest become relevant the extent of directors' duties remains unclear. Are directors required to merely take creditors into account, give importance to their interest or should put creditors first when insolvency becomes inevitable? Uk supreme court in *BTI 2014 LLC v Sequana SA* recognised that the weight given to creditor interest changes as insolvency approaches.[8] However Indian law does not set out any such rules explicitly, which creates uncertainty about directors obligation during financial distress.

Section 166(7) imposes penalty for non-compliance with the new rules, however it does not give individual creditors explicit compensatory remedies.[9] Although section 47 of IBC provides little possibilities for creditors to initiate suing but these differs from direct enforcement of fiduciary duties.[10]

Another issue is the corporate rescue problem, where strict or uncertain liability may discourage directors from trying restructuring. They may turn to bankruptcy procedures instead of putting their personal liability at risk when making business decisions. There should be a fair mechanism that would allow distinguishing decision from genuine rescue efforts based on

[7] The Companies Act, 2013, No. 18 of 2013, Section 166 (India); The Insolvency and Bankruptcy Code, 2016, No. 31 of 2016, Section 66(2) (India).
[8] *BTI 2014 LLC v. Sequana SA*, [2022] UKSC 25, paras. 203, 303 (UK).
[9] The Companies Act, 2013, No. 18 of 2013, Section 166(7) (India).
[10] The Insolvency and Bankruptcy Code, 2016, No. 31 of 2016, Section 47 (India), as amended by the Insolvency and Bankruptcy Code (Amendment) Act, 2026.

the information available at the time of making the decision.

COMPARATIVE LEGAL ANALYSIS

THE UNITED KINGDOM: WITHOUT A SEPARATE FIDUCIARY DUTY

In the case *BTI 2014 LLC v Sequana SA* the UK supreme court emphasised the need for Directors to think about creditors interest when a company becomes insolvent, likely to be insolvent or likely to become insolvent.[11] The court further clarified that this is not a duty owed only to creditors but a change to the directors duty to the company. When insolvency becomes inevitable the interest of creditors become important.[12] Section 172(3) of The companies Act 2006 does not create a new duty, it keeps the existing statutory and common law rules about creditors interest.[13] so this illustrates how creditor protection can take place under the existing fiduciary regulations.

IRELAND: STATUTORY CODIFICATION WITHIN EXISTING COMPANY LAW

In Ireland, creditors interests are explicitly recognized under section 224A of the companies Act 2014. Directors are obliged to pay attention to creditors' interests and take measures to prevent insolvency when they suspect or should have suspected a possibility of their company becoming unable to settle its debts, this duty belongs to the company exclusively.[14] Unlike the UK judicial approach Ireland gives a clear statutory guidance, thus making it an important basis for amending section 166 in India.

AUSTRALIA:

Section 588G of Australia's corporation Act 2001 hold directors liable if they allow a company to take on debt in insolvency situations and section 588GA creates a conditional protection in the form of a safe harbour to directors who take steps that are likely to give a better result than immediate administrative or liquidation.[15] Australia's approach gives India a line between bad trading and reasonable efforts to rescue a company from financial distress. This supports

[11] *BTI 2014 LLC v. Sequana SA*, [2022] UKSC 25, paras. 203, 231 (UK) (trigger for the duty); *id.* para. 205 (duty is an aspect of the duty owed to the company).
[12] *BTI 2014 LLC v. Sequana SA*, [2022] UKSC 25, paras. 77, 81, 203–204 (UK).
[13] Companies Act 2006, c. 46, Section 172(3) (UK); *BTI 2014 LLC v. Sequana SA*, [2022] UKSC 25, paras. 69–71, 76, 153 (UK).
[14] Companies Act 2014, No. 38 of 2014, Section 224A (Ireland).
[15] Corporations Act 2001 (Cth), Sections 588G and 588GA (Australia).

creditors protection.

SINGAPORE

Section 239 of Singapore insolvency, restructuring and dissolution Act 2018 deals with wrongful trading when companies incur debts or liabilities with no reasonable prospect of meeting them in full, Individuals involved in this case knowingly, as well as officers who should have been aware of it, are personally accountable for their actions under this, the law allows the court to give relief to the person if he was acted honestly and fairly. The law further provides for prospective judicial declaration about a transaction.[16] Therefore Singapore law shows us how liability rule can give accountability and greater certainty without making a fiduciary duty. This strengthens creditor protection.

OTHER INTERNATIONAL APPROACHES:

Germany takes a strict approach to its insolvency legislation via section 15a and 15b of its insolvency code, which require companies to file for insolvency on time and limit some payments after insolvency.[17] New Zealand's companies Act 1993 stops reckless trading and obligations undertaken without any reasonable expectation of being fulfilled.[18] These jurisdictions demonstrate that creditors protection can also be ensured through clear limits on what directors can do.

LESSON FROM COMPARISON

The main lesson for India is to understand that creditors protection does not have to be a fiduciary duty. Ireland offers a model for changing section 166 where as Australia and Singapore shows why it is important to balance accountability with restructuring. Therefore India should use these ideas instead of creating a whole new law

IS A SEPARATE CREDITOR-ORIENTED DUTY NECESSARY IN INDIA?

ARGUMENT IN FAVOUR

A separate creditor oriented duty would allow better protection for creditors prior to the

[16] Insolvency, Restructuring and Dissolution Act 2018, No. 40 of 2018, Section 239(1), (2), (10) and (12) (Singapore).
[17] Insolvenzordnung [Insolvency Code], Sections 15a and 15b (Germany).
[18] Companies Act 1993, No. 105 of 1993, Sections 135 and 136 (New Zealand).

commencement of insolvency proceedings. When a company is facing financial distress there are high possibilities of a director to make risky choices to protect the shareholders investment, despite the fact that these choices make things worse for the company by increasing debts and making it hard to pay back what is owed. Creditors can thus incur great losses, particularly if they are unsecured creditors or operational creditors.[19]

Section 166 of the Companies Act 2013 talks about the duties of the directors and Section 66 of the IBC deals with fraudulent and wrongful trading, Neither of these sections establishes any explicit fiduciary duty to creditors during impending insolvency.[20] This leaves a lot of questions about what directors should do when a company is in trouble.

Therefore creating a separate creditor oriented duty would extend the accountability of the directors, stop them from taking excessive risk and encourage them to pay more attention to the interests of creditors much earlier than they would normally do. The main reason for this to protect the interest of the creditors before financial harm becomes irreversible, rather than focusing on remedies for losses after they happen.[21]

ARGUMENT AGAINST

Creating a separate duty for creditors may lead to more confusion than help. Indian law has already stated the creditors duty through section 166 of the companies Act 2013 and about wrongful trading under section 66 of IBC.[22] Therefore introducing another fiduciary duty may result in overlapping of responsibilities, leading to an increase in litigation cases. Moreover the interest of creditors are not the same. it differs from secured and unsecured creditors. Whereas secured creditors may prefer immediate recovery, while unsecured creditors may benefit from continued business operation.[23] Another problem is not knowing when this duty would start. The risk of being personally liable may lead directors to avoid pursuing legitimate restructuring

[19] Andrew Keay, *The Director's Duty to Take into Account the Interests of Company Creditors: When Is It Triggered?*, 25 Melb. U. L. Rev. 315 (2001); Paul Davies, *Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency*, 7 Eur. Bus. Org. L. Rev. 301 (2006).
[20] The Companies Act, 2013, No. 18 of 2013, Section 166 (India); The Insolvency and Bankruptcy Code, 2016, No. 31 of 2016, Section 66 (India).
[21] The Insolvency and Bankruptcy Code, 2016, No. 31 of 2016, Section 66(2) (India) (liability arises only where wrongful trading is found during a corporate insolvency resolution process or liquidation); Riz Mokal, *Corporate Insolvency Law: Theory and Application* (Oxford University Press 2005).
[22] The Companies Act, 2013, No. 18 of 2013, Sections 166(2), 166(3) and 166(7) (India); The Insolvency and Bankruptcy Code, 2016, No. 31 of 2016, Sections 66(1) and 66(2) (India).
[23] The Insolvency and Bankruptcy Code, 2016, No. 31 of 2016, Sections 52 and 53 (India) (treatment of secured creditors and the order of priority among creditors in liquidation); Mokal, *supra*.

even if there is a possibility for recovery.[24]

WHAT SHOULD INDIA DO AND WHY?

India can make its current legal rules better by adding a new duty that is focused only on creditor, the best way to do this is through amending section 166 of the companies Act 2013 instead of having a new fiduciary duty.[25] The proposed amendment should make it clear that directors must think about what's best for all the creditors when the company is likely to face insolvency, while maintaining the duty towards the company. The amendment should also include a definite trigger, set an objective test for determining the actions of directors and a method for implementing the proposed amendment. This way, the current legal confusion about directors rule will become more clear without copying the IBC's rules about trading.[26]

RECOMMENDATIONS

1. AMENDING SECTION 166

Section 166 should explicitly acknowledge the creditors interests collectively when insolvency is in sight, as seen in *BTI 2014 LLC v. Sequana SA* and Ireland's statutory approach[27]

Below is a recommended provision

> Proposed section 166(3A): "If a director knows or should reasonably know that the company is likely to become insolvent then when carrying out duties owed to the company the director must give more weight to the collective interests of creditors as insolvency gets closer while still looking at any reasonable chance of saving the company".

2. ESTABLISHMENT OF A CLEAR STATUTORY TRIGGER.

This amendment should use a probability based statutory trigger for insolvency through

[24] Corporations Act 2001 (Cth), Section 588GA (Australia); Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017 (Cth), Schedule 1 (Australia); Gerard McCormack, *Corporate Rescue Law: An Anglo-American Perspective* (Edward Elgar 2008).
[25] The Companies Act, 2013, No. 18 of 2013, Section 166 (India); Companies Act 2006, c. 46, Section 172(3) (UK); Companies Act 2014, No. 38 of 2014, Section 224A (Ireland); *BTI 2014 LLC v. Sequana SA*, [2022] UKSC 25, paras. 69–71, 76, 153 (UK).
[26] *BTI 2014 LLC v. Sequana SA*, [2022] UKSC 25 (UK); Companies Act 2014, No. 38 of 2014, Section 224A (Ireland).

objective indicators which include failure to pay debts, problem with the balance sheet, reliable financial forecasts. All these indicators should be considered together in order to avoid false conclusions regarding temporary financial problems.

3. **ADOPTION OF A CONDITIONAL SAFE HARBOUR PROVISION:**

Based on Australia's section 588GA, directors who are trying to restructure the company, should get some protection from liability.[27] Such protection only applies if they have a proper financial report, seek professional advice and show that achieving a favourable outcome is possible. In case of fraud, asset misappropriation or recklessness option to use safe harbour would be questionable

4. **STRENGTHENING SECTION 66**

Enforcement of Section 66 should be improved by introducing clear standards for investigation, timelines for management in case of court proceedings and guidelines from IBBI. If litigation funding is allowed it should be under rules. And only with creditor approval. Priority payment to the funders will need explicit legal sanction. Such measures should augment applications from creditors under the amended Section 47 of the IBC.[28]

5. **MANDATORY RECORDS FROM THE BOARD DURING FINANCIAL DISTRESS:**

When certain financial signs appears the board should maintain records in respect of solvency considerations, alternative restructuring options and their impact on creditors when certain indicators of financial performance should arise. Board minutes and advice from expert should carry evidentiary weight. Courts should judge based on the information that was reasonably available at the time, not just whether the result failed

6. **CLARIFICATION OF PENALTIES AND REMEDIES UNDER SECTION 166**

Section 166(7) says fine can be between rs 1 lakh to rs 5 lakh, but does not expressly establish a general compensatory remedy for corporate losses arising from breach.[29] Therefore the new

[27] Corporations Act 2001 (Cth), Section 588GA (Australia).
[28] The Insolvency and Bankruptcy Code, 2016, No. 31 of 2016, Section 47 (India), as substituted by the Insolvency and Bankruptcy Code (Amendment) Act, 2026, No. 6 of 2026, Section 28.
[29] The Companies Act, 2013, No. 18 of 2013, Section 166(7) (India).

rule should let the company or an insolvency officer to recover money if losses were caused by a breach. Further no individual creditors should have unfettered claims. The remedies should ensure there is no double recovery under the IBC.

CONCLUSION

Creditors protection during impending insolvency is still an issue in Indian corporate law. This paper concludes that there is no need for a new creditor-oriented fiduciary obligation. Instead, it is suggested to amend section 166 of the Companies Act, 2013, in a way that creditors' interests are collectively taken into account in case of probable insolvency without compromising the duty of the directors to the company. Creation of a clear trigger pointy, effective method, enforcement tools, compensatory remedies and conditional protection will help achieve better creditor protection. These reforms, combined with enforcement of Section 66 of the Insolvency and Bankruptcy Code could would lead to greater accountability without any conflicts of interest or hindrance to the process of corporate revival.