The life of a company depends upon the fine balance between its management, led by its Board of Directors and shareholders, and non-shareholder constituencies acting as the risk bearers. The Board of Directors therefore is subject to fiduciary duties towards both these constituencies at all financial phases of the company—solvency, insolvency and borderline insolvency. The director liability framework in India is currently split with obligations enshrined under the Companies Act, of 2013 during solvency and Insolvency and Bankruptcy Code of 2016 during insolvency and borderline stage. The lack of judicial interpretation and scholarly discourse on the insolvent and borderline insolvent director liability framework has resulted in several practical challenges. To understand parallels, this paper comparatively analyzes the liability framework as existing under the corporate and insolvency laws of the United States and the United Kingdom with the Indian insolvency law. This paper suggests that there is a need to align the Indian corporate and insolvency law through statutory measures to increase the remedial protections available to creditors during
borderline insolvency. This paper also highlights mitigation measures which can be undertaken by management to reduce the scope of director liability until legislative or judicial clarity is provided on the framework.

Keywords: Director liability framework; borderline insolvency; wrongful trading liability; derivative actions; out-of-court restructuring; Insolvency and Bankruptcy Code, 2016

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1. INTRODUCTION: DIRECTOR RESPONSIBILITY DURING CORPORATE FAILURE

A company’s status as an artificial legal entity relies upon the wisdom and actions undertaken by its board of directors. Accordingly, to protect the interests of the company, corporate law envisages a certain set of affirmative and negative duties upon the board of directors. The nature of these duties varies, but they generally include the duty of care, loyalty, the avoidance of any conflicts of interest, acting in good faith, promoting the objectives of the company, and initiating insolvency/liquidation proceedings. Further, since the company does not operate in isolation but works within the business environment, these duties must be exercised towards the company and with respect to various stakeholders, including shareholders, workers, creditors, communities, governments, and regulators.

Throughout a corporation’s lifecycle, it might go through the following stages, in the context of insolvency: solvency, borderline insolvency (“borderline” and “twilight zone” are used synonymously), and insolvency. The nature of directors’ duties varies during these stages. It is undisputed that the primary set of duties in the solvency stage lies towards the shareholders, unless non-shareholders have contracted for managerial protection. The

1 See SV Inv. Partners, LLC v. Thought Works, Inc., 7 A.3d 973, 987 (Del. Ch. 2010) (stating certain circumstances in which a corporation cannot diminish its ability to pay debt); In re Abbott Lab’ys. Derivative S’holders Litig., 325 F.3d 795, 808 (7th Cir. 2003) (finding that Delaware law requires directors to act according to their duties of care, loyalty, and good faith); In re Doctors Hosp. of Hyde Park, Inc., 474 F.3d 421, 428 (7th Cir. 2007) (noting that a director’s fiduciary duty extends towards creditors in the event of insolvency); N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007) (finding that directors have a fiduciary duty to manage a corporation for the benefit of its shareholders).

2 See Weaver v. Kellogg, 216 B.R. 563, 582–84 (S.D. Tex. 1997) (finding the degree of a director’s fiduciary duty to creditors dependent on vicinity to insolvency and that gross negligence constitutes breach of the duty of care); Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 938 (Del. 2003) (holding that a board cannot enter into contracts that void its fiduciary duties to shareholders); Lenahan L. O’Connell et al., An Organizational Field Approach to Corporate Rationality: The Role of Stakeholder Activism, 15 BUS. ETHICS Q. 93, 93–94 (2005) (describing corporations as organizations “nested in environments,” whose actions impact those occupying corporate environments, including workers and government officials).

3 The private contract between debtors and creditors may provide for a contractual clause to afford duty of primacy over unsecured creditors during the
decisions made by directors during the solvency stage are generally in respect to the expansion of business, the purchase of additional assets, and the increase and diversification of business capital. Since shareholders are the primary risk bearers during solvency, directors’ actions most directly affect shareholders. Thus, in solvency, shareholders, including creditors, do not have a direct remedy against directors. The policy rationale behind this protection lies in the genesis of company ownership being vested in shareholders and the opportunity for creditors to negotiate special protections through their debt obligation contracts. Creditor bargaining

4 See Brown v. Vencap Inv. Corp., 1984 Tenn. App. LEXIS 3424, 1, 28–32 (Tenn. Ct. App. Mar. 31, 1984) (holding that shareholders, but not creditors, have rights of action against directors for mismanagement, in part because shareholders are liable for the losses); Radhabari Tea Co. v. Bhattacharjee, 2010 SCC Online Gauhati HC 231, 300, 322 (holding that unless minority shareholders can show fraud or other bad-faith acting, they cannot sue directors for offering shares at a board-approved price during an insolvency proceeding) (India).

5 See Katz v. Oak Indus. Inc., 508 A.2d 873, 879 (Del. Ch. 1986) (finding that courts can provide protection against risks to bondholders by upholding concrete indenture provisions negotiated between creditors and corporations); Metropo. Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504, 1517 (S.D.N.Y. 1989) (noting that courts have used the implied covenant of good faith and fair dealing to ensure that bondholders received fair bargains through contract); Uppal Housing Pvt. Ltd., 2019 SCC Online New Delhi HC 10604, paras. 40–42 (holding that shareholders are not inherently parties to creditor-corporation contracts, which are supreme in the insolvency context absent a showing of misrepresentation or mismanagement).

6 The proposition is long-recognized but expressly explained in N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101–02 (Del. 2007) (holding that creditors cannot assert claims of a breach of fiduciary duty against directors prior to insolvency, but once a corporation is insolvent, creditors have standing to maintain such claims) and Berg & Berg Enters. v. Boyle, 178 Cal. App. 4th 1020, 1039 (2009) (reviewing the economic justification behind the general rule of “no duty owned to creditors” prior to insolvency, finding that when a corporation is solvent, the shareholders are the “residual claimants of the

https://scholarship.law.upenn.edu/alr/vol18/iss1/3
capacity is protected by a lack of privity between non-shareholder groups (such as creditors) and the company and the presence of remedial measures for creditors, such as the clawback of fraudulent conveyance and the implied covenants of good faith and fair dealing.\(^7\)

Similarly, during the insolvency stage, there is a shift in directors’ duties towards the creditors, who become residual risk-bearers. The best interests during this stage lies in the conservation of the company’s remaining assets for revival or repayment of the obligated debt.\(^8\) While courts are divided over the complete termination of the duties of directors towards shareholders during the insolvency stage, there is some consensus that duties are primarily owed towards creditors, and, if afforded by statutory law, towards shareholders.\(^9\) Thus, absent relevant statutory protections, shareholders are not afforded standing against directors during insolvency. The policy rationale behind this approach is to provide protection to creditors as they lend debt with an expectation of earning interest, which can only be secured if corporate assets are

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7 See Rutheford B. Campbell & Christopher W. Frost, Managers’ Fiduciary Duties in Financially Distressed Corporations: Chaos in Delaware (and Elsewhere), 32 J. CORP. L. 491, 493, 516–17 (2007) (arguing that creditors are not without protection, but can rely on fraudulent conveyance statutes and ex ante contract provisions to offset risk).

8 See Wood v. Drummer, 30 F. Cas. 435, 436, 439-40 (C.C.D. Me. 1824) (No. 17,944) (holding that creditors have a primary claim to a corporation’s capital in the event of insolvency, while stockholders have a residual claim after all debt is repaid).

9 See Arnold v. Knapp, 75 W. Va. 804, 811 (1915) (reviewing “settled [law] that when a corporation becomes insolvent, or in a failing condition, the officers and directors no longer represent the stockholders, but by the fact of insolvency, become trustees for the creditors”); Bank Leumi-Le-Israel v. Sunbelt Indus., 485 F. Supp. 556, 559 (S.D. Ga. 1980) (stating that when a corporation is insolvent, director duties are primarily towards creditors and secondarily towards stockholders); see also Fredrick Tung, Gap Filling in the Zone of Insolvency, 1 J. Bus. & Tech. L. 607, 622, 631 (2007) (arguing against applying director fiduciary duties towards creditors when a firm is at or near insolvency because the creditors are often sufficiently sophisticated to offset risk via contract negotiations and that states already provide other causes of action for creditors, such as fraudulent transfer or veil piercing).
conserved,\(^{10}\) resulting in a deepening of the insolvency.\(^{11}\) The shifting of duties during insolvency is fruitful only when there is clarity over the legislative determination of insolvency. The Insolvency and Bankruptcy Code of 2016 (India) (hereinafter “IBC”),\(^{12}\) by envisaging a default-based cash flow test, provides sufficient grounds for understanding the ramifications of certain determinations of insolvency.\(^{13}\) The remedies available to creditors during the insolvency stage include injuncting the directors from transferring, encumbering, or liquidating corporate assets, or from engaging in transactions which result in preferential treatment towards different categories of creditors.\(^{14}\)

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\(^{10}\) See Elina Chechelnitsky, D&O Insurance in Bankruptcy: Just Another Business Contract, 14 FORDHAM J. CORP. & FIN. L. 825, 833 (2009) (highlighting that creditors lend to firms with sole purpose of “recover[ing] their money with interest”).

\(^{11}\) See Trenwick Am. Litig. Tr. v. Ernst & Young, L.L.P., 906 A.2d 168, 204–05 (Del. Ch. 2006) (rejecting a cause of action for deepening insolvency, finding that Delaware law does not require an insolvent company to cease operations, liquidate, or abstain from incurring additional debt). The phrase “deepening insolvency” refers to instances where the insolvent corporation or its creditors are harmed when a director fraudulently disposes of corporate property. See Stephen M. Packman, Directors and Officers in the Zone of Insolvency: Take Action with Caution to Avoid Personal Exposure, 193 N.J. L.J., Aug. 18, 2008, at 3 (providing that the concept of “deepening insolvency” is premised on a director’s obligation to avoid the accordanсе of additional debt to negligently or fraudulently extend the life of the firm).

\(^{12}\) The Insolvency and Bankruptcy Code, 2016 (India).

\(^{13}\) See generally Robert J. Stearn & Cory D. Kandestin, Delaware’s Solvency Test: What is it and Does it Make Sense? A Comparison of Solvency Tests under the Bankruptcy Code and Delaware Law, 36 DEL. J. CORP. L. 165, 165-87 (2011) (providing the two tests recognized under Delaware law: the “balance sheet” test and the “cash flow test”; the former established by the Bankruptcy Code and the latter brought forth by courts to better aid the valuation of insolvent debtors); Andrew Keay, Challenging Payments Made by Insolvent or Near Insolvent Companies, 3 NOTTINGHAM INSOLVENCY & BUS. L. J. 215, 215-17, 227 (2015) (detailing U.K. law, which incorporates both tests (not named as such) into a single analysis through which creditor claims will be viewed in light of contextual circumstances); Stephen R. McDonnell, Geyer v. Ingersoll Publ’ns Co.: Insolvency Shifts Directors’ Burden from Shareholders to Creditors, 19 DEL. J. CORP. L. 177, 196 (1994) (arguing that jurisdictional variance in the definition and tests for insolvency makes predicting whether a director may be liable towards creditors “very difficult, if not impossible”).

\(^{14}\) See Joseph J. Norton, Relationship of Shareholders to Corporate Creditors upon Dissolution: Nature and Implications of the “Trust Fund” Doctrine of Corporate Assets, 30 BUS. LAW. 1061, 1069, 1072 (1975) (noting that while courts will not force a firm to void a sale or transfer of an asset on behalf of a creditor, they will enforce the creditor’s equity in the proceeds from such an action).
During the borderline or twilight stage, wherein a company faces economic and financial crisis, there is a shift in director duties. The shifting of directors’ duties during borderline insolvency remains a dilemma for courts, practitioners, and academics due to the absence of legislative codification. One school of thought perceives that during the borderline stage, directors owe duties towards the shareholders since this does not necessarily lead to insolvency. Another school of thought suggests that directors’ duties must be exercised towards creditors, as the stage amounts to impeding circumstances which may result in insolvency of the company. Accordingly, the legal remedies

15 See generally Ryan Purslowe, Decisions in the Twilight Zone of Insolvency—Should Directors Be Afforded a New Safe Harbour?, 13 U. NOTRE DAME AUSTL. L. REV. 113, 113–14 (2011) (detailing that Australian corporate directors have a duty towards creditors to prevent their company from trading while insolvent, which raises difficulties in the twilight period where the future of the company’s finances is uncertain).


17 See generally Hallinan v. Republic Bank & Tr. Co., 519 F. Supp. 2d 340, 349 n.10 (S.D.N.Y. 2007) (finding that creditors can bring claims when debtors enter the zone of insolvency); In re Adelphia Commc’ns Corp., 323 B.R. 345, 386 n.140 (Bankr. S.D.N.Y. 2005) (restating the common rule that “when a corporation becomes insolvent or enters into the zone of insolvency, the fiduciary duties of a corporation expand from its stockholders to its creditors”); Nancy A. Peterman & Sherri Morissette, Directors Duties in the Zone of Insolvency: The Quandry of the Nonprofit Corp., 23 AM. BANKR. INST. J., Mar. 2004 (writing that the shift of director fiduciary duties during the borderline stage also applies in the non-profit context).

18 See, e.g., Carriero v. Jobs.com, Inc., 393 F.3d 508, 534 n.24 (5th Cir. 2004) (noting that once directors are aware of the firm’s insolvency or proximity to insolvency, they have expanded fiduciary duties to all of the corporation’s creditors); Roselink Investors, L.L.C. v. Shenkman, 386 F. Supp. 2d 209, 215 (S.D.N.Y. 2004) (finding that a subsidiary owes fiduciary duties to its parent corporation and its creditors when it enters the zone of insolvency).
available to shareholders and non-shareholders also vary during the borderline stage, ranging from direct action to derivative action claims. The stark distinction between these schools of thought will be discussed in the succeeding sections.

A literature review of the shifting of duties suggests that the law on subject has undergone excessive scrutiny, which has, in fact, resulted in expansive application of the duties beyond known ventures, which is further discussed in the succeeding sections. The theoretical background to this shifting of duties lies in the application of the “business judgment rule” and “trust fund doctrine.” Although corollaries of each other, both of these principles impose an obligation upon the directors to act in the best interests of the company. The variance towards different stakeholders depends upon the interpretation accorded over the years by judicial and legislative lawmakers.

This paper is organized as follows: Part Two covers the doctrine of the Business Judgment Rule and the Trust Fund Doctrine, as well as the legal framework of director responsibility as applicable in the U.S. and U.K. Part Three seeks to understand the Indian director responsibility framework as provided during solvency, insolvency,

19 See Terrence Arnold, Directors’ Duties in an Insolvency or Near Insolvency Situation and Remedies Available to Creditors, JUD. COLLOQUIUM H.K., Sept. 2015, para. 46 (comparing remedies available to creditors in New Zealand and Canada, with derivative actions and oppression claims being available in the former, but not the latter).


24 See generally Id. (discussing the changes in jurisprudence and statutes affecting fiduciary responsibilities).
and borderline insolvency. Part Four analyzes the challenges associated with the existing Indian framework on director responsibility and discusses possible solutions. Section Five concludes with the liability mitigation measures which can be undertaken by the directors until the challenges associated with the existing framework are resolved.


The foundational basis for director duties towards various stakeholders of a company is built on the Business Judgment Rule and the Trust Fund Doctrine. The business judgment rule is a presumptive and affirmative duty cast upon the board of directors which assumes that all the actions and decisions they undertake, based upon their commercial wisdom, are necessarily in the best interest of the company.\(^{25}\) The legal effect of this rule is that it absolves the directors from corporate and personal liability for good faith and honest errors in making business judgments.\(^{26}\) It is not a substantive rule of protection but rather a set of evidentiary premises rebuttable in nature.\(^{27}\) The rule was essentially developed as a judicial creation by U.S. courts to protect company directors from imposition of civil liability for the decisions they make on behalf of a company\(^ {28}\) and was gradually adopted across the world to make debtor-friendly legislation.\(^ {29}\)

\(^{25}\) See Insolvency and Bankruptcy Board of India, Note on Director’s Liabilities in Respect of Avoidance Transactions § 27.1 (2021) (defining the business judgment rule).

\(^{26}\) See Michele Ubelaker, Director Liability under the Business Judgment Rule: Fact or Fiction?, 35 Sw. L.J. 775, 775–76 (1981) (defining the business judgment rule’s application).

\(^{27}\) See Andrew Keay et. al., Business Judgment and Director Accountability: A Study of Case-Law Over Time, 20 J. Corp. L. Stud. 359, 359–61 (2020) (confirming that the business judgement rule is not a substantive rule).


Under this rule, the plaintiff can present evidence to contradict the actions of the board of directors as not being in the best interests of a company. In a negative sense, the rule of jurisdiction of the courts to test the validity of director conduct while serving in the capacity of the officer of the company. The policy rationale outlining the rule is that in its absence, directors would often remain under the threat of legal action brought by an aggrieved stakeholder. However, there are certain circumstances under which safe harbor cannot be granted to directors under the rule such as fraud, undervaluation of corporate property, conflict of interest, non-arm’s length related transactions, unfair contracts, etc. Similarly, when directors engage in inter-corporate transactions or self-dealing not for the benefit of the company, then the protection of the rule is not accorded.

The trust fund doctrine, on the other hand, presupposes negative liability upon the directors to not utilize corporate assets in a manner prejudicial to the company’s interest or to the detriment of stakeholders. The trust fund is not a “trust” in a legalistic sense, however, as corporate assets have to be held in “quasi-trust” for preservation during the liquidation of a company. The essence of

33 See generally FDIC v. Sea Pines Co., 692 F.2d 973, 976–77 (4th Cir. 1982) (holding that the acts of the defendant were unjust and fundamentally unfair).
35 The doctrine was applied initially by courts during the stage of liquidation. However, with its extension in Wood v. Drummer, 30 F. Cas. 435, 436 (C.C.D. Me. 1824) (No. 17,944) and Credit Lyonnais Bank Nederland, N.V. v. Pathe Comm’ns Corp., No. 12150, 1991 Del. Ch. LEXIS 215 (Del. Ch. Dec. 30, 1991). It was made applicable in stages of borderline insolvency as well. See Ann E. Conaway Stilson, Re-examining the Fiduciary Paradigm at Corporate Insolvency and Dissolution:
the doctrine is that the company assets are held in a trust for
distribution amongst creditors, imposing a fiduciary duty upon the
directors to not dispose of those assets in contravention of the rights
of creditors. Thus, a legal duty is cast upon the directors to act for
the benefit of creditors and not necessarily for shareholders. The
document, a judicial creation, was incorporated for certain directors’
obligations during insolvency; however, it has been expanded to
cover instances of solvency and borderline insolvency, as
highlighted in the succeeding paragraphs. Similarly, the remedies
also depend upon their application in the respective life cycle of the
company and the existing protections available to shareholder and
non-shareholder constituencies.

Historically, the director responsibility framework evolved quite
differently in the U.S. compared to the U.K. In the U.S., they
developed primarily through judicial interpretation of general
statutory laws, whereas in the U.K., specific protections were
provided within the statute itself. While Sundaresh has provided
a succinct account of the development of the legal position of the
shifting of duties in the context of U.S. and U.K. laws, it is essential

Defining Director’s Duties to Creditors, 20 Del. J. Corp. L. 1, 76–78 (1995) (stating the
application of the business judgment rule).

(holding that Jewel Recovery did not meet the standard for relief under Delaware’s
trust fund doctrine).

37 See Wood v. Drummer, 30 F. Cas. 435, 436 (C.C.D. Me. 1824) (No. 17,944);
James Ellis & Charles Sayre, Trust-Fund Doctrine Revisited, 24 Wash. L. Rev. & State
Bar J. 134, 134 (1949) (stating that the trust fund doctrine’s foundation as judge
made law).

38 See in general Neil Ruben, Duty to Creditors in Insolvency and the Zone of the
Delaware’s usage of trust fund doctrine).

39 See generally James Rosenthal, The Corporate “Trust Fund” Doctrine is Alive
And Well in Ohio, Ohio Law., July/Aug. 2012, at 24 (contrasting Ohio’s trust fund
docline and associated protections with Delaware’s doctrine).

40 See Richard M. Cieri & Michael J. Riela, Protecting Directors and Officers of
Corporations That Are Insolvent or in the Zone or Vicinity of Insolvency: Important
(stating the U.S.’s framework for director responsibility); see also Gautam Sundaresh, In
Whose Interests Should a Company Be Run? Fiduciary Duties of Directors
During Corporate Failure in India: Looking to the West for Answers, 8 Mich. Bus. &

41 See Sundaresh, supra note 40, at 297–98 (analysing the development of
corporate fiduciary duties in the U.S. and U.K.).
to understand its impact on development of the nascent Indian insolvency laws vis-à-vis corporate laws.

2.1. Director Liability Framework in the U.S.:

The Model Business Corporation Act of 2002, which provides for minimum corporate governance norms for U.S. companies, states that a director has a duty of good faith, care, and loyalty. The extent of recognition of these duties was left upon the state legislations, with § 141 of the Delaware General Corporation Law of 1899 providing that directors and officers of all corporations shall have duties as defined by the bylaws. Further, § 102(b)(7) of the Delaware General Corporation Law of 1899 states that the bylaws must not restrict the personal liability of directors in any manner in regard to their fiduciary duties. The term ‘fiduciary duties’ was not defined by the General Corporation Law of 1899, and the Delaware Courts interpreted it to cover both the Business Judgement Rule and the Trust Fund Doctrine. The U.S. courts have often held that the directors are vested with the duty of care and are liable towards shareholders, though not ordinarily towards bondholders or creditors. Similarly, § 548 of the U.S. Bankruptcy Code provides for avoidance of fraudulent transfers made within the period of two years which involve intentionally fraudulent transfer or undervalued consideration outside the

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43 The reference to Delaware state law is made as a majority of U.S. corporations are incorporated in this jurisdiction, making the state law applicable to them. See Stephen M. Bainbridge, The Business Judgment Rule as Abstention Doctrine, 57 VAND. L. REV. 83, 121 (2004) (discussing the close scrutiny of Delaware chancery court cases).

44 DEL. CODE ANN. tit. 8, § 102(b)(7) (1899).


46 In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 749 (Del. Ch. 2005).

ordinary course of business. The creditors at this stage are entitled to very limited protection under the "implied covenant of good faith" found in commercial contracts, and directors are constantly under the threat of legal action by the shareholders for granting contractual protection not specified under the law. The judicial interpretation in the U.S. on creditor rights during insolvency and borderline insolvency underwent a significant change due to a multiplicity of lawsuits filed by creditors against directors over the disposal of corporate assets. Gradually, the U.S. courts accorded that during insolvency, primacy must be given to creditors' expectations for the preservation of value of the company. This resulted in creditors being allowed to pursue direct action claims against the board of directors for the breach of fiduciary duties.

The shifting of duties during borderline insolvency remained a legal and policy challenge. This resulted in several divergent court decisions due to a lack of clarity until the Delaware Chancery Court's decision in Credit Lyonnais Bank v. Pathe Communications. The court in this case was faced with a judicial determination of the board of directors of the debtor company due to a challenge by the creditor bank on account of repetitive defaults and based upon conditions under the agreement to the leveraged buyout financing of the debtor company. The court held that "where a corporation is operating in the vicinity of insolvency, the board of directors is not merely the agent of the residue risk bearers, but owes its duty to the

55 Id. at *1–*3.
corporate enterprise,” and, accordingly, companies during borderline insolvency need to take into consideration the interests of all categories of stakeholders, including shareholders, creditors, suppliers, customers, etc.56

The Credit Lyonnaies judgment provided groundbreaking guidance to the board of directors, as their fiduciary duties were extended to cover creditors even prior to the initiation of formal insolvency proceedings. 57 Different bankruptcy courts made varying interpretations of the judgment, with one of the most immediate and expansive interpretations being that courts were not obligated to distinguish between the two instances of insolvency—based upon facts and claims of breach of fiduciary duties. 58 A restrictive interpretation of the judgment was applicable where the creditors evidenced actual fraud or preference by the directors. 59 Accordingly, under the latter approach, the creditors were required to prove that the fraud involved the disposal of assets for the benefit of shareholders, but to the prejudice of the “entire” corporate enterprise and not in favour of “any” particular creditor class, 60 thereby shielding the directors. This resulted in the “law of fiduciary duty being used to fill gaps in the legal position that did not exist” as a matter of ex abundati caute for which the creditors already possessed statutory protections in the nature of avoidable transactions under the law on implied covenants of good faith and fraudulent conveyance, leading to an overprotection of creditors. 61

The Delaware Supreme Court later overruled Credit Lyonnaies in North American Catholic Educational Programming Foundation, Inc. v.
Gheewala,62 holding that the former created a situation wherein the directors were left vulnerable to legal action by creditors as and when the company neared financial distress, resulting in a complete altering of their functioning.63 The court observed:

When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners.64

Thus, Gheewalla reverted to a rationale of existing remedies available for creditors and merely allowed recourse to derivative actions claims in exceptional circumstances.65 This meant that the borderline stage was not to be considered a triggering event for the shifting of duties, and the safe harbour of the business judgment rule was applicable to companies. In effect, in the United States, as of now, directors owe no direct fiduciary duties to creditors simply by virtue of the company being in the borderline stage.66

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63 Id.; see also Anna Manasco Dionne, Living on the Edge: Fiduciary Duties, Business Judgment and Expensive Uncertainty in the Zone of Insolvency, 13 STAN. J.L., BUS. & FIN. 188, 188–90 (2007) (noting the set of doctrinal problems and practical costs of creditors’ ability to litigate when the extent of Delaware directors’ fiduciary duties to creditors during financial distress remains unclear).
64 Gheewalla, 930 A.2d at 101.
65 These include instances of decisions which have had an adverse impact on the company. See Bryan Anderson, Gheewalla and Insolvency: Creating Greater Certainty for Directors of Distressed Companies, 11 U. PA. J. BUS. L. 1031, 1045 (2009) (discussing the difficulty of determining the fiduciary duties of constituents in a financially distressed corporation).
2.2. Director Liability Framework in the U.K.

In the U.K., Chapter II of the Companies Act of 2006 incorporates the business judgement rule and imposes general fiduciary duties on directors during solvency.\(^67\) This includes the duty to promote success of the company (synonymous to the good faith statutory duty), exercise independent judgement, reasonable care and due diligence, avoid conflict of interest and declare related party transactions.\(^68\) The duties are assessed from the perspective of a reasonable man who has the expected general knowledge, skill, and experience of a director.\(^69\) These duties are subordinate to the interest of the company, meaning that derivative action claims can be initiated by shareholders for breach of these duties during solvency and non-shareholder constituencies are excluded from the protection.\(^70\) The trust fund doctrine, on the other hand, has been not been frequently drawn on by the courts due to express codification of director duties under § 172 of the Companies Act of 2006.\(^71\)

Section 172(3) of the Companies Act of 2006 shifts the directors’ duties toward creditors during actual insolvency due to their risk-bearing capacity.\(^72\) Moreover, courts in the U.K. have expansively interpreted § 172(3) to cover fiduciary duties of directors even during the borderline stage as compared to the U.S.\(^73\) For instance, in Colin Gwyer it was held that, where a company is insolvent or of

\(^{67}\) Companies Act 2006, c.2 (Eng.).

\(^{68}\) Id. §§ 172–177.

\(^{69}\) Richmond Pharmacology Ltd. v. Chester Overseas Ltd. [2014] EWHC (Ch) 2692, [68] (Eng.).


\(^{71}\) DANIEL ATTEMPBOROUGH, MISREADING THE DIRECTORS’ FIDUCIARY DUTY OF GOOD FAITH, 20 J. CORP. L. STUD. 73, 75 (2020).

\(^{72}\) Companies Act 2006, § 172(3) (Eng.); Re Pantone, 485 Ltd. [2002] 1 BCLC 266 [69] (Eng.); see also Colin Gwyer & Assocs. Ltd. v. London Wharf (Limehouse) Ltd. [2003] 2 BCLC 153 (Ch), [87] (Eng.) (claiming “the directors when considering the company’s interests must have regard to the interests of the creditors.”); John Armour, et al., SHAREHOLDER PRIMACY AND THE TRAJECTORY OF UK CORPORATE GOVERNANCE, 41 BRIT. J. INDUS. REL. 531, 541–45 (2003) (discussing the shifting primacies of shareholders and stakeholders when a corporation enters insolvency).

\(^{73}\) GHLM Trading Ltd. v. Maroo, [2012] EWHC (Ch) 61, [168] (Eng.).
doubtful solvency or on the verge of insolvency and it is the creditors’ money which is at risk the directors, when carrying out their duty to the Company, must consider the interests of the creditors as paramount. However, the risk-bearer during the borderline stage remained unclear due to incorporation of multiple insolvency determination criteria that seemed similar but were interpreted differently. Section 212 imposes liability of malfeasance where directors are held accountable for misapplication or retention of corporate property in breach of fiduciary or other duties, including negligence. However, where any payment is made for a proper corporate purpose and in the interests of the company’s creditors, then liability is exempted. Specifically with respect to borderline insolvency, §§ 213 and 214 of the Insolvency Act of 1986 imposes the fraudulent and wrongful trading standards liability upon directors pursuant to which they are not to misapply or retain corporate assets and avoid insolvent liquidation of the company. Sections 213 and 214 involve civil liability with discretion to the courts in ascertaining the extent of personal liability of directors with the objective of compensating creditors for the loss caused by the director’s conduct. The remedies available to aggrieved parties includes restoration of the

74 Colin Gwyer & Assocs. Ltd. v. London Wharf (Limehouse) Ltd. [2003] 2 BCLC 153 [74] (Eng.).
75 In multiple judgments, there have been references to criteria like “nearing insolvency,” “borderline insolvency,” “verge of insolvency,” and “doubtful solvency.” See The Liquidator of Wendy Fair (Heritage) Ltd. v. Hobday [2006] EWHC (Ch) 5803 [6] (Eng.) (using the term “nearing insolvency”); Eastford Ltd. v. Gillespie, Airdrie N. Ltd. [2010] CSOH 132 [22] (using the term “borderline insolvency”); Sundaresh, supra note 40, at 326–27 (listing a string of words used for the tests to determine the point at which fiduciary duties should shift to creditors pre-insolvency); Andrew Keay, The Shifting of Directors’ Duties in the Vicinity of Insolvency, 24 Int’l Insolvency Rev. 140, 153 (2015) (suggesting that, due to minute differences between these criteria, the nearer a company gets to actually being insolvent, the triggering of fiduciary duties of directors becomes more obvious).
77 GHLM Trading Ltd. v. Maroo, [2012] EWHC (Ch) 61 [29], [111] (Eng.); Re HLC Environmental Projects Ltd. (in liquidation) [2013] EWHC (Ch) 2876 [108] (Eng.).
79 Valentine v. Bangla Ltd. [2009] EWHC 1632 (Ch), [41] (Eng.); Re Ralls Builders Ltd. (in liquidation) [2016] EWHC 243 (Ch), [219]–[251] (Eng.).
property along with interest thereon. Further, § 214 of the Insolvency Act 1986 clearly articulates that the directors must undertake every step to minimise the potential loss to creditors during borderline insolvency. This seems to imply that creditors have recourse to direct and indirect action against directors, unlike in the U.S.

However, the directors are granted exemption from the rigours of wrongful trading liability if they undertook measures to minimise the potential loss to the company’s creditors, subject to a clear nexus between loss sustained by the company and director decisions. This is elaborated in the later section of the paper. The standard for director liability during borderline insolvency, as held by the courts, is to guide the company directors to make intelligent and honest decisions which could be reasonably believed to be for the benefit of the company.

In the U.K., the scheme of avoidance transactions under the Insolvency Act of 1986 includes significant undervaluation of corporate property, preferring one creditor over another, and extortionate dealing involving grossly exorbitant credit payments.

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81 Insolvency Act 1986, c. 10, § 214(3) (Eng.) (“The court shall not make a declaration under this section with respect to any person if it is satisfied that after the condition specified in subsection (2)(b) was first satisfied in relation to him that person took every step with a view to minimising the potential loss to the company’s creditors as ([on the assumption that he had knowledge of the matter mentioned in subsection (2)(b)]) he ought to have taken.”).
83 In Re Continental Assurance Co. of London Plc (in liquidation) [2007] 2 BCLC 287 (refusing to impart liability because it had allowed the company to continue trading during borderline insolvency); see also Chan Ho, On Deepening Insolvency and Wrongful Trading, 20 J. INT’L BANKING & REGUL. 1 (2005) (outlining the defense available for a director if she took every step to minimize the potential loss to the company’s creditors).
85 Insolvency Act 1986, § 238 (Eng.).
86 Id. § 239; see In Re Cosy Seal Ltd. (in administration) [2016] EWHC (Ch) 1255, [140] (arguing that a preferential transaction can be set aside if the transaction positively improved the creditor’s position).
87 Insolvency Act 1986, § 244 (Eng.)
Director liability can be materially diminished if the company does not suffer losses on account of the concerned transaction.\textsuperscript{88} Thus the recourse to remedies against directors’ actions under the wrongful trading liability standard can be ordered during insolvent liquidation, whereas those under the Companies Act of 2006 can be ordered even during solvency or borderline insolvency,\textsuperscript{89} thereby providing creditors with an adequate safety net at all stages.

3. DIRECTOR RESPONSIBILITY FRAMEWORK IN INDIA

Prior to the enactment of the IBC, corporate insolvency for industrial companies\textsuperscript{90} was governed by the Sick Industrial Companies (Special Provisions) Act, 1985 (hereinafter “SICA”), whereas liquidation and winding-up for non-industrial entities was governed by the Companies Act of 2013.\textsuperscript{91} With the introduction of the IBC, the director responsibility frameworks for solvent companies is now solely governed by the Companies Act of(2013) and that of insolvent companies by the IBC.\textsuperscript{92} While the focus of this paper is on borderline insolvency, it is essential that the director responsibility framework, as is applicable in case of solvency, is deliberated due to fragmented director obligations under different legislations. In this section, the applicable framework for the different stages of the company in India is explained.

\textsuperscript{88} Re Ralls Builders Ltd (in liquidation) [2016] EWHC (Ch) 1812 [32].
\textsuperscript{89} Harry Rajak, Director and Officer Liability in The Zone of Insolvency: A Comparative Analysis, 11 POTCHEFSTROOM ELEC. L.J. 31, 48, 53–54 (2008).
\textsuperscript{90} An industrial company is defined as a company which owns one or more industrial undertakings and carries out work in one or more factories but excludes small scale industries and ancillary industries. See The Sick Industrial Companies (Special Provisions) Act, 1985, § 3(e) (India) (defining “‘industrial company’ as a company which owns one or more industrial undertakings”).
\textsuperscript{92} Joshi, supra note 16.
3.1. Solvency:

The Companies Act of 2013, read with the SEBI (Listing Obligations & Disclosure Requirements) Regulations of 2015, largely governs director-specific corporate governance of companies during solvency. It provisions for board committees, auditors and auditor standards, internal controls and mechanisms, and disclosure and transparency compliances. The director liability framework is governed by imputation of vicarious liability on directors responsible for conduct of business and on those who actually participated in commission of the offense. The Companies Act of 2013 under § 2(60) includes the whole-time director, independent directors and executive directors as “officers-in-default”, and these company representatives shall be liable for any penalty or punishment imposed by law enforcement authorities in accordance with the law time being in force.

The imputation of liability can be both civil and criminal under the Companies Act of 2013 depending upon the nature of the

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93 See generally SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (laying out regulations for companies during solvency).

94 SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015, Regs. 18, 19, 20, 21.


96 The Companies Act, 2013, § 2(60) (India) (“Definitions . . . . . . . . Officer who is in default”, . . . means any of the following officers of a company, namely:— (i) whole-time director; (ii) key managerial personnel; (iii) where there is no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified; (iv) any person who, under the immediate authority of the Board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records, authorises, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default; (v) any person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act, other than a person who gives advice to the Board in a professional capacity; (vi) every director, in respect of a contravention of any of the provisions of this Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings without objecting to the same, or where such contravention had taken place with his consent or connivance; (vii) in respect of the issue or transfer of any shares of a company, the share transfer agents, registrars and merchant bankers to the issue or transfer[.]”).

offense. For criminal liability there must be specific averments against the director showing as to how and in what manner the director was responsible for the conduct of the business of the company and if the person responsible to the company for the conduct of the business of the company, was not in charge of the conduct of the business of the company, then he can be made liable only if the offence was committed with his consent or connivance or as a result of his negligence.

Similarly, criminal liability can be imposed only if the statute stipulates the liability of directors and “there is sufficient evidence of the director’s active role coupled with criminal intent.” The imposition of civil liabilities depends upon a preponderance of probabilities, whereas for the imposition of criminal liabilities, the criminal conduct must be proved beyond a reasonable doubt.

The Companies Act of 2013 for the first time codified director fiduciary duties within the Indian director liability jurisprudence. Akin to the U.K., §§ 166 (2) – (6) of the Indian Companies Act of 2013 provides for the application of business judgment rule and civil obligations upon the directors who must act in good faith, foster the mission and vision of the company, and factor in the best interests of the company and its employees, shareholders, community, and environment. Similarly, § 166(7) of the Companies Act of 2013 incorporates the trust fund doctrine and imposition of penalty upon failure of fulfilment of duties as specified under § 166(2).

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100 Sunil Bharti Mittal v. CBI, (2015) 4 SCC 609, 638
101 See generally Rohitkumar Premkumar Gupta v. SEBI, 2021 SCC Online SAT 216, ¶ 20 (stating the standards for criminal prosecution).
102 See generally Vikramaditya Khanna & Shaun J. Mathew, The Role of Independent Directors in Controlled Firms in India: Preliminary Interview Evidence, 22 NAT’L L. SCH. INDIA REV. 35, 49 (2010) (displaying that the key matter for the Court was whether the director can make a decision based solely on the best interests of the firm, without being influenced by financial, social or other considerations that are not germane to the firm’s best interests); Harinagar Sugar Mills Ltd. v. Shyam Sundar Jhunjhunwala, AIR 1961 SC 1669 (holding the rule as, “wherever any shareholder has proposed to transfer his shares to some new member, the court shall presume that their motives are arbitrary and capricious, or their conduct is corrupt unless you choose to tell the Court what their reasons were would amount to altering the whole constitution of the company”). Sundaresh, supra note 40, at 336.
103 See Sundaresh, supra note 40, at 336 (stating the application of the trust fund doctrine).
However, unlike in the U.S. or the U.K., there has not been sufficient deliberation by courts on the scope of the § 166 fiduciary duties and the remedies available for their consequent breach. In the latest case dealing with the breach of fiduciary duties and derivative actions under the Companies Act of 2013, Rajeev Saumitra v. Neetu Singh, the Delhi High Court dealt with allegations that a director attempted to gain undue advantage for himself over his company, a potential breach of fiduciary duties.  

The Delhi High Court held that a breach of fiduciary duties under § 166 of the Companies Act of 2013 entitles the shareholder to the right to initiate an indirect action claim against the defaulting director. While the Court didn’t clarify if a direct action claim exists during solvency due to non-codification of derivative actions under the Companies Act of 2013, it can be implied that both direct and indirect action claims can be admitted on breach of director duties, as there exists no prohibition on the same.

On the procedural front, directors are expected to exercise independent judgment with reasonable care, skill, and due diligence on par with the common law principles of fiduciary duties. Although directors owe fiduciary duties, they owe no contractual duty with respect to third parties except where they make themselves personally liable or induce a third party to act to their detriment. In the case that a third party proves such fraudulent misrepresentation, a director may be held personally liable to said

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105 Id.
106 See Umakanth Varottil, Delhi High Court on Directors’ Duties and Derivative Actions, INDIA CORPLAW (Feb. 28, 2016), https://indiacorplaw.in/2016/02/delhi-high-court-on-directors-duties.html [https://perma.cc/3VH9-SCLX] (clarifying there were no prohibitions on certain claims).
third party. However, over a period of time, certain exceptions have evolved for protection from liability for different categories of directors on account of their activities and involvement with company affairs. While independent directors are required to observe § 166 duties, they are only liable for the company’s acts of omission or commission that occurred with their knowledge or are attributable through board processes, and with their consent or connivance. A non-executive director is not considered an officer-in-default and is not liable for company defaults unless it is proven that he was at the helm of the decision-making process for the affairs of the company. Further, the companies must take all precautions to ensure that civil or criminal proceedings are not unnecessarily initiated against the independent or non-executive directors unless sufficient evidence exists.

3.2. Insolvency

The IBC follows a creditor-in-possession model of insolvency resolution, and the business affairs and operational decision-making lie with the appointed resolution professional. The resolution professional will work within the mandate and guidance of the Committee of Creditors (hereinafter “CoC”), and the elected board of directors of the company are ousted. Importantly, in India, under § 29A of the IBC, the promoters of the company are disqualified from becoming involved in the rehabilitation process

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109 See generally Khanna Mathew, supra note 102 (discussing potential liability for directors).

110 The Companies Act, 2013, § 149(12) (India).


112 See generally Ministry of Corporate Affairs, General Circular, 20/2020 (Issued on May 5, 2020) (discussing who assumes liability when directors have given consent).


114 Insolvency and Bankruptcy Code, 2016, § 17 (India); see also Ankeeta Gupta, Insolvency and Bankruptcy Code, 2016: A Paradigm Shift Within Insolvency Laws in India, 36 COPENHAGEN J. ASIAN STUD. 75, 84 (2019) (stating the mandates of the resolution professional).
and cannot submit a resolution plan for revival.\textsuperscript{115} While the policy rationale behind § 29A lies upon the moral argument of not diluting control of the revived company through the hands of the promoters which led to its insolvency,\textsuperscript{116} § 29A has also led to results hampering effective resolution. The lack of professional experience and business acumen of the resolution professional has resulted in an erosion of value\textsuperscript{117} and increased his burden when he is already obligated to perform various administrative and representative activities concerning the resolution.\textsuperscript{118} Similarly, there have been several attempts made to circumvent the strict rigors of § 29A by the promoters and the board of directors, which have resulted in the lifting of the corporate veil of the company.\textsuperscript{119} This has led to insurmountable transactional and insolvency costs for the eventual resolution applicant and haircuts for creditors in case of liquidation.\textsuperscript{120}

\textsuperscript{115} Insolvency and Bankruptcy Code, 2016, § 29A (India)
\textsuperscript{116} See Swiss Ribbons Pvt. Ltd. v. Union of India, 2019 SCC 73, ¶ 2 (describing the background of Section 29A)
\textsuperscript{118} See generally Golden Jubilee Hotels Ltd. v. EIHL Ltd., Unreported Judgments, 4881 of 2018, decided on Sept. 27, 2016 (Telangana HC) (stating the administrative duties of the resolution professional).
3.3. Borderline Insolvency:

Borderline insolvency, as discussed in the beginning, is the stage where the company is under financial stress (or where the net liabilities exceed the net assets), but it is has not entered formal insolvency proceedings. This twilight zone is critical for the survival of the company and the preservation of its value, whatever it may be worth. The IBC, while consolidating the winding-up provisions under the Companies Act of 2013, provides for directors’ liability not previously envisaged under any corporate legislation in India. Section 43 of the IBC imposes a duty upon the company (and indirectly upon the directors) to not prefer a particular creditor over fellow creditors, outside of the ordinary course of business, within the claw-back period of two years. If such an arrangement has been undertaken, the NCLT under § 44 of IBC will require the company to reverse the transaction and vest within itself the disposed property. Similarly, § 45 of the IBC also bars directors from significantly undervaluing corporate property and shall be required to reverse the transaction when it is declaring as void by the NCLT. Further, the directors are disallowed to carry on the business of the company with an intent to defraud creditors. This wrongful trading liability under § 66 of the IBC can be imposed only when “[the] director knew or ought to have known that the there was no reasonable prospect of avoiding the . . . insolvency [proceedings]” and “did not exercise due diligence in minimising the potential loss to the creditors.” The wrongful trading standard does not envisage a look-back period to ensure that dishonest directors are subjected to the liability even in view of lapse of time. The wrongful trading standard covers a broad spectrum of actions which directors can undertake to mitigate losses and they will be evaluated as having the capacity of a “reasonable competent

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121 Purslowe, supra note 15.
122 See K.S. Hareesh Kumar, Winding up of Companies Under Companies Act, 2013 & Insolvency & Bankruptcy Code, 2016, MGMT. ACCT., October 2017, at 48 (stating how the Insolvency and Bankruptcy Code consolidates the winding up provisions under the Companies Act, 2013).
123 Insolvency and Bankruptcy Code, 2016, § 44 (India).
124 Id. § 45.
125 Id. § 66.
director," which could include not incurring further debts and making active efforts to rehabilitate the company.\footnote{Id. at 28–29.} In addition to civil liability, directors are also subject to criminal penalties for defrauding creditors during both insolvency and borderline insolvency.\footnote{Insolvency and Bankruptcy Code, 2016, § 69 (India).} The concerned director of the company is subjected to imprisonment of a maximum term of five years, and/or with a maximum fine of one crore rupees for defrauding creditors.\footnote{Id.}

The jurisprudence and practice on undervalued and wrongful trading standards is yet to be developed in India. Accordingly, in scholarly discourse, there has been repeated reference to foreign judgements, especially from the U.K., for interpretation due to the similarity in statutory law. The “intent to defraud” standard\footnote{See Jitesh Maheshwari, SEBI’s Policy on Self-Trades, INDIACORPLAW (Sept. 4, 2017), https://indiacorplaw.in/2017/09/sebis-policy-self-trades.html [https://perma.cc/5V9Q-YPCM] (noting that while SEBI regulations do not define “intent to defraud/deceive,” SEBI clarified in its 2017 policy that the intention to deceive/defraud is a sine qua non for establishing manipulation in case of self-trades, and that accidental or unintentional self-trades are not covered under FUTP Regulations; however, this standard applies mainly in the context of fraudulent securities trading, and the “intention” definition in the insolvency context remains undefined).} can be proved when a director had actual or constructive knowledge that there were no reasonable prospects of receiving debt payments.\footnote{See BTI 2014 LCC v. Sequana S.A. [2019] EWCA (Civ) 112 [147] (holding that “a payment made to the prejudice of current or continuing creditors when a likelihood of a loss to them ought to have been known is capable of constituting misfeasance by the directors; and they may be made liable for it in an action of the present kind”).} Accordingly, when a company continues to incur debt with no reasonable prospect of payment to creditors, it is proper to infer an intention of carrying on business with an intent to defraud creditors.\footnote{Utsav Mitra, Emerging Jurisprudence on Corporate Insolvency: Director Duties in the Twilight Zone 7 (Oct. 10, 2019) (unpublished manuscript) (on file with the authors).} To determine if knowledge of commencement of insolvency duties can be imputed upon directors, the litmus test must be applied: whether a reasonable person, aware of the precarious condition of the corporation, would enter into such a transaction.\footnote{Morphitis v. Bernasconi, [2003] 2 BCLC 1.}
Thus, drawing from a comparative perspective, Indian directors can also be made liable where they acted dishonestly, but were negligent in exercising their fiduciary duties. Judicial bodies can reference the existing corporate position when reviewing the context of director liability during borderline insolvency to interpret the liability standards until there is legislative clarity. In fact, in *Jet Airways* and *Dhoot*, the NCLAT and NCLT referenced the extant international position on cross-border and group insolvency instances to resolve the dispute in absence of relevant legislative provisions.

4. CHALLENGES TO DIRECTOR RESPONSIBILITY FRAMEWORK & SOLUTIONS IN INDIA

Indian law on the duties of directors during the borderline insolvency stage has not seen a high judicial interpretation. This has led to several inconsistencies, for which authors in the succeeding section attempt to highlight and provide solutions. While the thrust of this paper focuses on borderline insolvency, it is essential that certain substantive and procedural changes are made regarding the solvent and insolvent stages of a company so that the efficiency of director liability framework during the borderline stage is strengthened.

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135 Jet Airways (India) Ltd. v. State Bank of India, 2019 SCC Online NCLT 12710 (emphasizing cross-border collaboration during an insolvency process).
136 State Bank of India v. Venugopal Dhoot, 2019 SCC Online NCLT 745 (holding that applying a blanket analysis across a group of insolvents is not valid and that each entity must be examined contextually).
4.1. Direct and Indirect Remedies for Creditors During Solvency

Section 166 of the Companies Act of 2013 does not incorporate “creditors” as an independent class of non-shareholder constituency. Therefore, it is important to understand when creditors are entitled to direct action claims pursuant to § 166 read with § 408. Our review of the limited § 166 cases suggest that there has not been a single case initiated as a direct-action claim by creditors for breach of director duties. This could be associated with the lack of codification of director duties under the erstwhile Companies Act of 1956 and the lack of express codification of the term “creditors” under the incumbent Companies Act of 2013. However, there has been an overreliance on the Companies Act of 2013 by creditors initiating oppression and mismanagement suits, possibly due to its wider scope of application. The Companies Act of 2013 covers actions including breach of fiduciary duties, conduct of management resulting in loss, the conducting of company affairs contrary to its charter or to the rights of

138 The Companies Act, 2013, § 166 (India).
140 The Companies Act, 2013, allows the NCLT to order regulation of conduct future affairs of the company, order the acquisition of shares or interests of any shareholders, levy restrictions on the transfer or allotment of the shares of the company, terminate, set aside, modify any agreement between the company and directors, set aside any transfer, delivery of goods, payment, execution or other act relating to property, effectuate the removal of directors, recover undue gains of directors, and impose costs. See Umakanth Varottil, Unpacking the Scope Of Oppression, Prejudice And Mismanagement Under Company Law In India 25 (Nat’l Univ. Sing. L., Working Paper No. 2020/020, 2020) (noting that evidence suggests shareholders rely on the oppression, prejudice, and mismanagement provision in Companies Act, 2013, far more than other remedies when initiating suits).
141 See Hemant D. Vakil v. RDI Print and Publ’g Pvt. Ltd. (1995) 84 CompCas 838, 67 (ruling that the committee of directors had acted in breach of fiduciary duties).
143 See S.M. Ramakrishna Rao v. Bangalore Race Club Ltd. (1970) 40 CompCas 674, 59 (holding that an examination of a director’s conduct relative to their fiduciary duties rests on the entity’s internal governance terms).
stakeholders,\textsuperscript{144} collusive disposal of corporate assets to directors,\textsuperscript{145} and diversion of corporate funds for benefit to a particular class of stakeholders.\textsuperscript{146}

While the scope of remedial measures in case of contravention of fiduciary duties is generally broader, in effect, however, under the Companies Act of 2013, the scope of oppression and mismanagement remedies has had a significant role to play than the former. As seen in \textit{Rajeev Saumitra} earlier, indirect derivative actions claims can be brought before courts by shareholders during solvency of the company.\textsuperscript{147} However, the distinguishing point is that, along with \textit{Rajeev Saumitra}, all of the other derivative action claims initiated before Indian courts have been shareholder-driven. Unlike the positions of the U.S. and the U.K., the lack of creditor-driven derivative claims give rise to suspicion about whether the legislative intent behind the derivative action framework was supposed to be made applicable to creditors.\textsuperscript{148}

As a response to this, a two-pronged alternative was suggested by \textit{Varottil}, the first part of which considers § 166 duties as a complete code of director duties and remedies thereof, thereby providing legal certainty.\textsuperscript{149} The second part considers § 166 as a partial codification, in addition to applicable common law principles, thereby providing for broad and basic principles with which courts can derive detailed discharge mechanism for directors.\textsuperscript{150} Certainly, there is a strong emphasis on having a

\textsuperscript{144} See generally Bhajirao G. Ghatke v. Bombay Docking Co. Ltd. (1984) 56 CompCas 428, 429 (ruling that an official administrator should be appointed to “set the company’s house in order” in response to a showing of board mismanagement).

\textsuperscript{145} See Col. Kuldip Singh Dhillon v. Paragaon Util. Financiers Ltd. (1986) 60 CompCas 1075 (finding mismanagement where a board neglected to take appropriate action against a director after it was clear he misappropriated funds).

\textsuperscript{146} See Bhaskar Stoneware Pipes Ltd. v. Rajindernath Bhaskar (1988) 63 CompCas 184, 37 (holding that the petitioner’s allegation of directors’ diversion of funds is “such as to show a systemic conduct of oppression of other groups” and thus is sufficient to make a claim pursuant to the Companies Act, 1956).

\textsuperscript{147} Rajeev Saumitra v. Neetu Singh, 2015 SCC OnLine Del. 12242


\textsuperscript{150} Id.
statutory amendment within the Companies Act of 2013 to expressly allow creditors to take recourse to derivative actions claims against recalcitrant directors, as they are key stakeholders during insolvency and borderline insolvency. A similar reference can be found in § 172 of the U.K. Companies Act of 2006, which, in addition to provisioning for fiduciary duties of directors, also takes into consideration that these duties must be exercised in light of the interests of creditors of the company.151

4.2. Wrongful Trading Liability during Borderline Insolvency

As discussed earlier in Section 3 of the paper, the wrongful trading standards under § 66 of the IBC imputes liability upon directors during borderline insolvency if the director had knowledge (actual or constructive) of impending insolvency of the company.152 Further, when directors omission to avoid the impending insolvency and also exercise due diligence to minimize losses to creditors also constitutes ground to impute § 66 the IBC liability.153 Moreover, bad commercial decisions leading to loss cannot be considered fraudulent trading.154 However, the case law is yet to develop in regard to the effective interpretation of the phrase “standard of knowledge,” although it is known that the standard takes into consideration subjective factors based on a fact-by-fact analysis to impute liability. As the terms “reasonable prospect of avoiding . . . insolvency,”155 “due diligence,”156 and “potential loss”157 are not defined within the IBC, it can result in interpretational problems among courts, leading to increased transactional costs for the parties.

Scholars also view that, since the jurisprudence on director liability imposed during borderline insolvency is still evolving in

152 Insolvency and Bankruptcy Code, 2016, § 66(2)(a) (India).
153 Id. §§ 66(2)(a)–(b).
155 The Insolvency and Bankruptcy Code, 2016, Bill No. 31, § 66(2)(a) (May 28, 2016) (India) (emphasis added).
156 Id. § 66(2)(b) (emphasis added).
157 Id. (emphasis added).
emerging economies (including that of India) where insolvency courts are not sophisticated, it is prudent to exclude the standard of knowledge to avoid commencement of insolvency proceedings as provided under § 66(2) of the IBC.\footnote{Aurelio Gurrea-Martinez, Towards an Optimal Model of Directors’ Duties in the Zone of Insolvency: An Economic and Comparative Approach, 21 J. CORP. L. STUD. 365, 389–90 (2021).} The U.S. and U.K. positions on director liability framework, as delineated in § 2, suggest that there must be a strong coherence and relation between the company (or solvency) law and insolvency law so that there is no isolated interpretation of the director’s duties. The absence of such correlation/guidance under the Indian Companies Act of 2013 for imposition of duties during borderline insolvency creates a situation as was prevalent prior to Gheewala in the United States. Prior to Gheewala, the directors were under the threat of creditors over every decision in favor of shareholders.\footnote{See Sundaresh, supra note 40, at 303.} There is clearly a need for a legislative amendment within the Companies Act 2013 that clarifies that the duty of directors must be in consonance with those taken in the interests of creditors under the IBC, similar to § 172(3) of U.K. Companies Act of 2006.\footnote{See The Companies Act, 2013, § 172(3) (India) (articulating the “[d]uty to Promote the Success of the Company . . . (3) [t]he duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company”).}

In fact, the wrongful trading standard under § 66 of the IBC could be tweaked to incorporate a standard of imposition of liability wherein the company would not be allowed to incur any new debts once the directors had knowledge that they will be unable to repay them.\footnote{See Corporations Act 2001 (Cth), s 588G (Austl.) (adopting a similar provision which states that “directors’ knowledge” of inability to pay debts can be ascertained if the director was aware at the concerned time that there existed grounds for suspicion, or a reasonable director in a like position in like circumstances be so aware; Additionally, incurring debt includes instances of the payment of dividends, the buyback of shares, redemption of shares, etc.); see also David Morrison, The Australian Insolvent Trading Prohibition: Why Does it Exist?, 11 INT’L. INSOLVENCY REV. 153, 154–56 (2002) (outlining the shift in Australian corporate law towards the enhanced protection of creditors); Jason Harris, Director Liability for Insolvent Trading: Is the Cure Worse than the Disease?, 23 AUSTL. J. CORP. L. 1, 2 (Oct. 1, 2009) (discussing the benefits and drawbacks of the increased powers granted to Australia’s corporate regulator).} This would help the distressed company to save costs associated with insolvency proceedings and also take care of the interests of the creditors by not utilizing funds in an inchoate
manner. In our opinion, the wrongful trading standard could also be made applicable in a phased manner with the existing standard under § 66(2) of the IBC made applicable upon top 1000 companies as determined by market capitalization. Consequently, the standard of not incurring fresh debts coupled with defense of duty to minimize potential loss to creditors, as already provided under § 66(2) of the IBC, can be made applicable to start-ups and small businesses to foster value creation.

The deterrent effect of the wrongful trading liability (for error-in-judgment and good faith risky business decisions, not for fraudulent or negligent actions) can be reduced by allowing the company directors to initiate out-of-court restructuring proceedings to rectify the impeding insolvency at the earliest and work in interest of shareholder and non-shareholder constituencies. This would have the effect of prioritizing the debts of existing creditors and protecting the interests of potential creditors from any instances of impending insolvency. The condition precedent towards this development is to have an appropriate non-adjudicatory proceeding infrastructure with experienced mediators and institutionalized valuers.

4.3. Lack of Effective Out-Of-Court Restructuring Mechanism within the IBC

Usually, early detection and resolution of financial distress is often helpful to save costs associated with formal insolvency proceedings. In court-administered insolvency regimes like that of the IBC, out-of-court restructuring and workouts reduce the burden of insolvency courts. The director liability framework as

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162 Insolvency and Bankruptcy Code, 2016, § 66(2) (India).
165 As per the National Company Law Tribunal (“NCLT”) statistics, more than 21,200 cases are pending before the NCLT as on December 31, 2020. Ministry of Corporate Affairs, Lok Sabha Starred Question No. 86, (Issued on Feb. 8, 2021).
See also OTIHIYA SEN ET AL., VIDHI CTR. FOR LEGAL POL’Y, DESIGNING A FRAMEWORK
provided under the Companies Act of 2013, read with the IBC, can be better complemented by incorporating an out-of-court restructuring mechanism within the IBC and allowing directors recourse to it right from the onset of borderline insolvency. While there exists out-of-court workout mechanisms independent of the IBC, their effect has been limited to only a certain category of creditors based upon a certain set of factors.

For example, the Reserve Bank of India’s (RBI) Prudential Framework for Resolution of Stressed Assets of 2019 provides for restructuring efforts in the form of a private agreement between the lender and debtor. However, it is only applicable upon RBI-regulated banking creditors. Similarly, a compromise or arrangement scheme under §§ 230-232 of the Companies Act of 2013 requires a dual majority of shareholders and creditors and becomes binding on all stakeholders only if 75% of the creditors agree to the proposal. Further, the RBI also rolled out other informal restructuring mechanisms like the Corporate Debt Restructuring of 2001 (as revised in 2003), the Strategic Debt Restructuring of 2015, and the Scheme for Sustainable Structuring of Stressed

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167 Id.

168 For example, if 1000 members holding 10,000 shares of Rs.10 participate in the scheme and vote, and of these, one member holding 3,000 shares votes against approval of the scheme and the remaining 999 members holding 7,000 shares vote in favour, the approval shall not be granted as even though all but one member vote in favour, their aggregate share value falls short of 75% of the total share value of Rs.10,000. See BS. Kyatanagoudar v. Maharashtra Apex Corporation Limited, ILR 2007 Kar 2157 (Karnataka) (reflecting the facts of that case).


170 Reserve Bank of India, Strategic Debt Restructuring Scheme, RBI/2014-15/627 (Issued on June 8, 2015).
but they all failed due to parallel conflicts amongst different legislation, leading to uncertainty over debt recovery.\textsuperscript{172}

Moreover, the non-recognition of outside court workouts within the IBC leads to increased burdens upon the insolvency courts.\textsuperscript{173} While Chapter III-A has been added to the IBC, recognizing pre-packaged insolvency for small business debtors,\textsuperscript{174} it is, necessary that this measure be extended to all kinds of debtors to provide mitigation measures to directors of large corporations as well. Further, the extension of prepacks to all categories of debtors can lead to the legitimization of the benefits of insolvency threats on violation of the restructuring agreement by the debtor and reduce the overall costs associated with resolution.\textsuperscript{175} Section 14 of the IBC, however, bars recoveries outside the IBC, including, \textit{inter alia}, the institution of commercial suits’ execution of judgment or decree and securitisation of property of the company.\textsuperscript{176} Since no express provision within the IBC allows for outside court recoveries, aside from the pre-packaged insolvency for small businesses, it is essential that these recoveries be exempted from the rigours of moratorium under § 14 of the IBC. This change will help to legitimize out-of-court recoveries within the formal insolvency framework.

\textsuperscript{171} Reserve Bank of India, Scheme for Sustainable Structuring of Stressed Assets, RBI/2015-16/422 (Issued on June 13, 2016).


\textsuperscript{174} Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021, § 8 (Apr. 4, 2021) (India).

\textsuperscript{175} \textit{SEN ET AL., supra} note 165, at 13.

4.4. Lack of Coordination of Promoters/Directors during Insolvency

The ownership structures of most Indian companies suggest that promoters of the company also act on the board of directors. Section 29A of the IBC was incorporated to disallow promoters and directors who have been responsible for its insolvency from running the operations of the company. It highlights not only the adoption of the creditor-in-possession model of insolvency resolution but also the stereotyping of the overall process. However, the resolution professional must be solely responsible for all legal compliance, even outside of the IBC, for the smooth functioning of the insolvent company. As a corollary, the company directors are not required to perform any kind of management functions except those incorporated under § 19 of the IBC. Even then, the duties of the professional under § 18 of the IBC are wide-ranging and include ascertaining financial positions, monitoring assets and operations of the company, receiving creditors’ claims, and taking control of the company’s assets. Thus, it is difficult for a single professional to...
undertake all of these duties and fulfill them in a timely manner as prescribed by the IBC.\footnote{Golden Jubilee Hotels Ltd. v. EIH Ltd., Civil Revision Petition (2018) SCC Online Tel 315 (Telangana).} Moreover, the increasing complexities in conducting business can, at times, lead to situations wherein the professional may not have adequate experience or knowledge of the concerned industry in which the company operates.\footnote{Subasri Realty Pvt. Ltd. v. N. Subramanian, 2017 SCC OnLine NCLAT 499.}

With the resolution professional as a profession being developed gradually in India, it is necessary that guidance of the erstwhile directors and management is undertaken to better preserve the value of the company.\footnote{Abhishek Mittapally & Kokila Jayaram, \textit{A Study of Insolvency Professionals in India, in INSOLVENCY AND BANKRUPTCY REGIME IN INDIA – A NARRATIVE}, supra note 173, at 199, 204–05.} In addition, a specialized class of insolvency professionals can be groomed and certified by the Insolvency and Bankruptcy Board of India (hereinafter “IBBI”) and thus have the requisite expertise in conducting investigations into avoidable transactions. The professionals can be asked to take into consideration the opinion of the directors of the company, as suspension of the board of directors under § 17 of the IBC is not tantamount to suspension of the managing director or other directors of the company.\footnote{Section 17 is the only provision of the IBC referring to the suspension of powers of the board of directors. Section 19 of the IBC merely states that company personnel including directors, promoters, employees etc. of the corporate debtor are required to extend assistance to insolvency professional but does not specifically allow the latter to take into consideration opinion of directors and other personnel. See Subasri Realty Pvt. Ltd. v. N. Subramanian, 2017 SCC OnLine NCLAT 499.} Further, the Companies Auditor’s Report Order of 2020\footnote{The Companies Auditor’s Report Order, 2020 is an audit report format for statutory audits under the Companies Act, 2013 which includes reporting upon, \textit{inter alia}, working capital, inventory, assets, guarantees, investments, statutory liabilities, and default in repayment of borrowings. Ministry of Corporate Affairs, S.O. 849(E) (Notified on Feb. 25, 2020).} can mandate the auditor’s report to contain any likely instances of avoidable transactions.\footnote{Balvinder Singh, \textit{IBC: Some Issues in the Processes and Improvements, in INSOLVENCY AND BANKRUPTCY REGIME IN INDIA – A NARRATIVE}, supra note 173, at 121, 125.} The development
can help in resolving fraudulent conveyances during the solvency stage itself and save time and costs during the corporate insolvency of the company. There is clearly a need for a clarificatory amendment within the IBC to increase the involvement of the erstwhile management and directors of the company within the insolvency resolution process to better facilitate the value preservation of the company.

4.5. Limited Deterrence Measures for Recalcitrant Directors

The civil consequences of the avoidable transactions regime under the IBC are limited to either claw-back remedial measures in the form of the recovery of disposed corporate property or the imposition of fines upon the errant directors. As the object of the wrongful trading liability standard is to encourage responsible ex-ante behaviour on the part of company directors, it is necessary that the deterrence effect of such opportunistic behaviour be penalized appropriately. A mechanism of director disqualification similar to § 9 of the U.K. Company Directors Disqualification Act of 1986 can be adopted to penalize and disqualify recalcitrant directors on account of their unfit character to represent a company. Section 9 of this U.K. law states that where the conduct of the director is unfit to be regarded as maintaining a management position role, even in matters arising out of or related to insolvency, a director disqualification order can be issued. While, in India, § 164 of Companies Act of 2013 does not provide contravention of wrongful trading liability as one of the grounds for director disqualification, a legislative amendment could be made to effectuate the spirit of the IBC. The pre-requisite to such a mechanism is having an


191 Company Directors Disqualification Act 1986, c. 46, § 6 (Eng.).
appropriate institutional setup between IBBI and the Registrar of Companies to coordinate the director disqualification system.\footnote{Debanshu Mukherjee & Dinkar Venkatasubramanian, Vidhi Ctr. for Legal Pol’y, Insolvency and Bankruptcy Code: The Journey So Far and the Road Ahead 39 (2018).}

An effective director disqualification system for recalcitrant directors can result in reputational loss and career damage and act as a warning for directors of other companies.\footnote{Consequences of Disqualification, Francis, Wilks & Jones, https://www.franciswilksandjones.co.uk/smes-directors-shareholders/director-services/director-disqualification/consequences-of-disqualification/ [https://perma.cc/FUK8-NSJA] (last visited Nov. 18, 2022); Samet Caliskan, Individual Behaviour, Regulatory Liability, and a Company’s Exposure to Risk: The Deterrent Effect of Individual Sanctions in UK Competition Law, 10 J. EUR. COMPETITION L. & PRAC. 386, 386-89 (2019)} Further, the mechanism can help in fostering and re-emphasizing directors’ duty to act in the best interest of the company, uninfluenced by his/her personal interests.\footnote{See Nicole Kar, Robert Walker & Glen Davies, Competition Disqualification Orders and the Lessons Which Can Be Learned from the Insolvency Context, 10 COMPETITION L.J. 306, 307 (2011) (explaining the public protection measures envisioned by Competition Disqualification Orders that remove unfit directors).} While the effectiveness of the deterrence measures within the wrongful trading liability standards remains to be tested, references from other commercial regulatory regimes suggest a strong need for internalizing the director disqualification mechanism.\footnote{See generally Competition Commission of India, Annual Report 2018-19 24 (2019) (stating that out of the aggregate penalty imposed of Rs. 13,881.73 crore, merely Rs. 0.37 crore was imposed on individuals and out of which only Rs. 0.10 crore was realized); Sec. & Exch. Bd. of India, Annual Report 2019-20, at 203 (2020) (stating that recovery of penalty proceedings was initiated for Rs. 6851.18 crore of which only Rs. 70.48 crore could be realized).} The statistics clearly highlight the need for a director disqualification mechanism for establishing an effective director compliance culture as envisaged within the IBC.

Even outside of these specific challenges, there remain several structural problems which require policy-based solutions. An optimal framework for director liability must also take into consideration the peculiarities of different categories of corporate debtors. Micro, small, and medium enterprises (MSMEs) form the backbone of the Indian economy, contributing almost 30\% of the GDP,\footnote{Ministry of Micro, Small and Medium Enters., Govt. of India, Annual Report 2018-19, at 27 (2019).} thereby effectuating the need for corporate MSMEs to have
specialized framework. The corporate MSMEs can be granted certain exemptions from the strict rigors of director liability obligations as financially they may not always be in a position to take into consideration the interest of different stakeholders at the same time.\footnote{\textit{World Bank Group, Saving Entrepreneurs, Saving Enterprises: Proposals on the Treatment of MSME Insolvency} 9 (2018); Hetal Doshi & Yashasvi Jain, \textit{The Insolvency and Bankruptcy Framework and Principle of Business Efficacy Across Different Jurisdictions}, 42 Kluwer Bus. L. Rev. 1, 51 (2021).} Accordingly, the avoidable transactions standards under the IBC should be made applicable in a phased manner based upon their growth, especially the onerous wrongful trading standard, wherein MSMEs may not be in a position to financially compete with the large conglomerates.\footnote{\textit{See generally Ronald Davis et al., Micro, Small, and Medium Enterprise Insolvency: A Modular Approach} (2018) (explaining the reasons that MSMEs are more likely to be dependent on favourable legal and regulatory climates than large businesses in order to survive).}

### 5. Measures To Mitigate Director Liability

In the absence of legislative and judicial guidance over borderline insolvency, it is suggested that the board of directors self-regulate their decisions and actions from the onset of financial distress until its completion by devising strategies which reduce the scope for imputation of liability.\footnote{\textit{See Bahram Vakil & Suharsh Sinha, Liability of Directors for ‘Wrongful Trading’ Under the Insolvency & Bankruptcy Code} (2020) (stating that “incentivise directors to take corrective action at the first onset of any financial distress rather than waiting till a time where saving the company as a going concern is no longer commercially viable”).} Scholars suggest measures such as thoroughly documenting all director decisions by weighing the balance of competing interests amongst different stakeholders and make informed, reasonable, and good-faith decisions in the interest of the company.\footnote{\textit{See generally Justin Wood, Director Duties and Creditor Protections in the Zone of Insolvency: A Comparison of the United States, Germany and Japan}, 26 Penn State Int’l L. Rev. 139 (2008) (analyzing the U.S. corporate law’s approach to the agency cost problem in the zone of insolvency).} Further, regular formal processes to review cash flow position, actual and contingent outstanding claims, and possibilities of outside court restructuring at the onset of financial distress can be implemented. The present section provides an overview of two such measures which can be undertaken by
directors independently to avoid good-faith director liability (in the nature of error in judgments or honest risky business decisions) for effective discharge of duties during borderline insolvency.

5.1. Compulsory Director & Officer Liability Insurance

During the lifetime of the corporation, not all decisions taken by the directors are detrimental towards any particular stakeholders. These decisions often involve legal and operational risks arising out of complexities in changing landscape of conducting business amidst the legal, economic, and financial constraints. Thus, director and officer (hereinafter “D&O”) liability insurance provides safeguards in the form of indemnification for personal liability arising out of negligence, default, misfeasance, misstatement, misrepresentation, breach of fiduciary duties or breach of trust by the company directors. However, guilty actions which involve elements of malice, connivance and bad faith in nature of fraud are not covered as part of insurance. Even in the context of insolvency, where the company has limited assets, D&O insurance liability aids directors to cover litigation costs. Since the directors are expected to act in the interest and betterment of the company, as per the business judgment rule, provisioning for D&O liability insurance presumes the trust of the company in its directors. While the legal coverage differs from policy to policy, most insurance policies cover defense and settlement costs, fines and penalties, environmental damages, and employment termination losses.

For a successful claim, the acts or decisions of directors must necessarily be borne out of an error in judgment or negligence, and,

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201 Li-Su Huang, Directors and Officers Liability Insurance and Default Risk, 47 GENEVA PAPERS ON RISK & INS. - ISSUES AND PRAC. 375, 376 (2021).
204 See Roberta Romano, What Went Wrong with Directors’ and Officers’ Liability Insurance, 14 DEL. J. CORP. L. 1, 6 (1989) (analyzing historical problems with corporate insurance).
205 Kuei-Fu Li & Yi-Ping Liao, Directors’ and Officers’ Liability Insurance and Investment Efficiency, 29 PAC.-BASIN FIN. J. 18, 20 (2014).
if the violation has been committed with the consent or connivance of the director, there will be no effect on the insurance. In the U.K. and the U.S., the law statutorily authorizes compulsory director and officer liability insurance to mitigate director liability risks against instances of negligence, default, breach of duty or breach of trust. While, in India, § 197(13) of Companies Act of 2013 recognizes the company practice of undertaking D&O insurances for their directors, Regulation 25 of SEBI (Listing Obligations & Disclosure Requirements) Regulations of 2015 mandates only the top 100 companies by market capitalization must undertake the insurance. On account of borderline insolvency duties being imposed upon the directors under the IBC, it can be mandated that all public and private companies compulsorily undertake D&O insurance policies to reduce the stereotyping of business risks by directors. Similarly, that insurance policy should cover the risks arising out of claims relating to personal liability in instances of avoidable transactions such as preference and undervalued transactions and wrongful trading liability under the IBC. This would ensure that directors undertake business decisions without the fear of litigation risk and in line with the spirit of entrepreneurship as envisaged by the IBC.

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206 Companies Act 2006, § 232 (Eng.)
207 Companies Act 2006, § 233 (Eng).
208 DEL. CODE ANN. tit. 8 § 145 (1899).
209 Andres Engert et al., Twilight in the Zone of Insolvency: Fiduciary Duty and Creditors of Troubled Companies - Comparative & International Perspectives, 1 J. BUS. & TECH. L. 313, 322 (2007).
210 The Companies Act, 2013, § 197(13) (India) (“Where any insurance is taken by a company on behalf of its managing director, whole-time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel.”).
211 SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg. 25(10) (“With effect from January 1, 2022, the top 1000 listed entities by market capitalization calculated as on March 31 of the preceding financial year, shall undertake Directors and Officers insurance for all their independent directors of such quantum and for such risks as may be determined by its board of directors.”).
5.2. Better Negotiation of Debt & Material Supply Contracts

The director’s role is to maintain a fine balance between running a business smoothly and preserving and enhancing the corporate value of the business’s assets. Towards this end, the negotiation of material supply contracts assumes importance in the context of borderline insolvency and director liability. Since the director liability framework often acts as a contractual gap-fillers to protect the interest of shareholders and creditors, it is important that these contracts precisely define the instance of default, the preconditions of initiation of insolvency resolution, and options for out-of-court restructuring. One way to accomplish this could be requiring that the contractual terms that govern defective supply and consequent breach of terms and conditions be detailed to reduce the instances of unforeseeable contractual liability.

Further, contracts can also provide for alternative modes of recovery outside of the IBC, both during solvency and borderline insolvency, with time-bound dispute resolution clauses to preserve the business relationships between a company and its creditors. The IBC does not explicitly invalidate ipso facto clauses in the event of insolvency admission. It is therefore essential that supply

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214 See generally Tung, supra note 9, at 615 (arguing that “[f]iduciary duty serves as the ultimate gap-filling device, completing the open-ended shareholder-manager contract with a hypothetical bargain crafted according to majoritarian default rules”).

215 Singh, supra note 173, at 122 (“Generally, complaints relating to short supply, defective supply, breach of terms and conditions should be detailed in the contract terms with clear timelines, to avoid any confusion.”).

216 It may include adjudicatory recovery before the Debt Recovery Tribunal under the Recovery of Debt Due to Banks and Financial Institutions (RDBFI) Act, 1993, the Negotiable Instruments Act, 1881, or administratively the Securitisation & Reconstruction of Financial Assets & Enforcement of Security Interest (SARFAESI) Act, 2002. The contract can also serve as a precondition, providing settlement recovery through mediation or conciliation. See Adam Brenneman & Pamela Arce, You Have Options: The Use of Alternative Dispute Resolution in Insolvency Proceedings, 13 PRATT’S J. BANKR. L. 336, 337 (2017) (analyzing the option of using arbitration and mediation to settle bankruptcy proceedings).

217 They are contractual provisions that permit one party to terminate the contract with its counterparty on occurrence of an “event of default”, which in context of insolvency implies admission of insolvency petition or commencement of formal insolvency proceedings. See generally Gujarat Urja Vikas Nigam Ltd. V. Amit Gupta, (2021) 7 SCC 209, para. 88 (defining ipso facto clauses as contractual provisions allowing a party to terminate the contract with its counterparty in the event of default).
contracts are drafted in a manner that protects the commercial relationship between the parties, even during the stage of financial distress resolution. While prescribing that restrictions on initiating simultaneous default claims against the corporate debtor and guarantor is unlawful, guarantee contracts can specifically debar the creditors from initiating simultaneous claims based upon the same set of debt and default against co-guarantors. Further, the invoice of debt and supply contracts as a matter of good corporate practice can also provide for the payment of an agreed rate of interest in the instance of default by any of the parties to avoid needless litigation. Overall, the company directors can use creative and detailed contractual terms to avoid unforeseeable liability of no fault of their own. This may also preserve the enterprising and risk-taking characteristics of the board.

6. CONCLUSION

The onset of financial distress within a corporate setup can result in hasty and negligent decision-making errors, which impact both shareholder and non-shareholder constituencies. The law on fiduciary duties aims to minimize and channelize the director liability upon the responsible person during the life cycle of the company. The corporate governance norms applicable to the company don’t end with solvency but strengthen their application from the borderline stage, leading to the efficient and disciplined value preservation of corporate assets. As seen in this paper, mature insolvency jurisdictions like the U.S. and U.K. have devised deterrence mechanisms for overt director behavior along with

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218 MUKHERJEE & VENKATASUBRAMANIAN, supra note 192, at 34–35.
220 Vishnu Kumar Agarwal v. Piramal Enterprise Ltd., (2019) 346 CompCas para. 32 (holding that while there is no bar for filing two simultaneous applications against the debtor and the guarantor, the application against one of the corporate debtors cannot be admitted against the other debtor), the question on whether simultaneous claims against co-guarantors can be barred as stated by the NCLAT in Piramal Case is pending in appeal before the Supreme Court of India.
221 See, e.g., Krishna Enterprises v. Gammon India Ltd., (2018) 144 CompCas para. 5 (showing that the appellant brought the action partly because of the agreement does not provide for an agreed rate of interest).
appropriate liability minimizing measures. The joint effect of fiduciary duties envisaged under the Companies Act of 2013 and the IBC leads to the pre-Gheewala situation, which makes directors susceptible to excessive and malicious litigation at the hands of opportunistic shareholders and creditors. The challenges highlighted to the Indian director liability framework above have resulted in a lack of understanding regarding trigger shifting of duties, nature, beneficiaries of such shifting at different stages, and the applicability of specific corporate governance norms during borderline insolvency. The ease of doing business can be amplified by clarifying (and, to a certain extent, modifying) the extant framework on director liability, as suggested in this paper. In effect, however, where governance norms are adhered to in letter and in spirit, the impact of financial distress can be averted to a considerable extent.