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Open Access Law Journal, ISSN (O): 3049-0057

Editor-in-Chief – Prof. (Dr.) Amit Kashyap; Publisher – Reet Parihar

A Critical Examination of the Philosophical Foundations of the Insolvency and Bankruptcy Code, 2016: The Transition from Debtor to Creditor Perspective

Anopaishe Violet Maposa, 4th B.A. LL.B. (Hons.), Lovely Professional University

Published on: 25th October 2025

Abstract

The Insolvency and Bankruptcy Code (IBC), passed and assented to in 2016, is a reformation of Indian Economic Legislation. This paper analyses the foundational shift brought by the IBC, moving away from the debtor-in-possession approach to a much more reliable creditor-in control model. By conducting a qualitative assessment of the code's framework and comparing it to the earlier laws, the likes of SICA (the Sick Industrial Companies (Special Provisions) Act),1985, and RDDBFI (the Recovery of Debts Due to Banks and Financial Institutions Act), 1993, the research highlights how grounded in the Creditors' Bargain Theory the IBC is. The paper acknowledges that while the change has improved creditor recovery and, in turn, nurtured a credit culture, it has brought, along with it, notable tension, with particular concern to the rights of operational creditors and the overarching aim of corporate rehabilitation. The conclusion of the study determined that the Indian Judiciary had been helpful int the framework's refinement, endeavouring to balance principles of fair treatment, and the inherent value of business sustenance, with the code's creditor-centric focus.

Keywords: *Insolvency and Bankruptcy Code, 2016, Debtor-in-possession, Creditor-in-control, Creditors' Bargain Theory, SICA, Corporate Insolvency Resolution Process (CIRP), Philosophy of Bankruptcy Law.*

1. Introduction

1.1. Background of the Study

India used to operate under a set of fragmented insolvency laws, the likes of SICA, the RDDBFI Act, and the Companies Act,1956, before upgrading to the Insolvency and Bankruptcy Code (IBC). This system that preceded the IBF proved, rather, ineffective, often resulting in drawn-out litigation, minimal recovery rates, and an environment that favours debtors, thereby allowing failing promoters to keep control of distressed firms indefinitely. The IBC's enactment in 2016 aimed to rectify these shortcomings, combine existing regulations, ensure faster resolutions, and encourage and promote entrepreneurship, all while factoring in the interests of various stakeholders.

1.2. Problem Statement

Ever since the IBC was passed, all the attention has largely been aimed at its economic impact, with little towards the philosophical principles it is based off. This paper, hence, has the objective of tackling this issue by analysing the shift to a creditor-in-control framework from the previous debtor-in-possession model, pinpointing the justifications, practical outcomes, and the legal challenges that would have come as a result.

1.3. Research Questions

1. In what ways is the change from a debtor-in-possession model to a creditor-in-control framework shown by the structure of the Insolvency and Bankruptcy Code (IBC)?
2. Is the transition validated by the Creditors' Bargain Theory, and to what extent?
3. What challenges and discrepancies (significant ones) are a result of this creditor-centric model, especially giving particular focus to operational creditors and the aspiration of corporate rescue?
4. How has the Indian Judiciary interpreted and modified this philosophical shift?

1.4. Objectives of the Study

- To outline the philosophical evolution of insolvency law within India.
- To dissect the provisions of the IBC that set up the creditor-in-control paradigm.
- To critically evaluate how the IBC corresponds with the Creditors' Bargain Theory.
- To assess the Judiciary's interpretation of this change in thinking, through landmark Supreme Court and NCLT rulings.
- To pinpoint the limitations and propose a more balanced view for the future.

1.5. Hypothesis

While the creditor-in-control model underpinning the IBC is a necessary correction to prior practices, it inherently creates tension between effective debt recovery and fair treatment of all stakeholders. The judiciary, though not always successful, is actively striving to negotiate this tension.

2. Research Methodology

The research uses both qualitative and doctrinal approaches.

Type of Research: Descriptive and analytical.

Data Collection: The study mainly uses primary sources, including:

- The Insolvency and Bankruptcy Code (2016), with associated regulations.
- Significant judgements from the Supreme Court of India, National Company Law Appellate Tribunal (NCLAT), and National Company Law Tribunal (NCLT).
- Insolvency Law Committee (ILC) reports.

Secondary Sources include:

- Academic text, journal articles, and insolvency law commentaries.
- Law Commission of India reports that contributed to the Insolvency and Bankruptcy Code.

Method of Analysis: a comparative assessment of the legal framework before and after the Insolvency and Bankruptcy Code (IBC) is to take place. The provisions that make up the IBC will be put through a critical analysis in relation to theoretical bankruptcy frameworks, with particular focus on the Creditors' Bargain Theory. Case law analysis will prove pivotal in the assessment, offering an interpretation of how the judiciary has addressed the philosophical foundations of the code.

3. Literature Review

Extensive examination in international scholarship has been conducted on bankruptcy law's philosophical dimensions.

- Creditors' Bargain Theory: drawn up by Douglas G. Baird and Thomas H. Jackson, it posits that bankruptcy law should mirror the hypothetical consensus that we anticipate creditors would come to among themselves if they were allowed to negotiate without the risk of incurring costs. The aim is to improve the total estate value for all creditors, giving them more importance over equity holders (debtors). The structure of the Insolvency and Bankruptcy Code (IBC), particularly the moratorium and the Committee of Creditors (CoC)-led process, shows the legislative implementation of this theory.
- Contra-Proposer Theories: other scholars, the likes of Lynn LoPucki and Elizabeth Warren, contend that bankruptcy law should, instead, pursue a wider range of social goals the mere

maximisation of creditor wealth. These goals are inclusive of safeguarding jobs, community preservation, and providing a fresh start for debtors. The pre-IBC framework, with SICA being the most notable mention, was typically in alignment with this perspective, emphasising company recovery and job security over creditor returns.[1]

- Indian Scholarship: primary analyses of the IBC, inclusive of those in academic works by Dr. S.R. Myneni, illustrate the code's goal of attaining prompt resolutions in insolvency proceedings. Insights into judicial patterns can be obtained Shri Amarakash Bansilal Sonani's case law[2] compilation. The prevailing influence of financial creditors in the CoC (Committee of Creditors), to the detriment of operational creditors has been critiqued by recent academic articles, revealing conflict between the code's practical implementation and its theoretical objectives.
- Gap in Literature: while the existing literature acknowledges the transition, a noteworthy contribution to its fundamental philosophical identity would be a concentrated, critical, evaluation connecting specific mechanisms of the IBC, like the powers of the CoC and the resolution professional's function.

4. Book Review

"Law of Insolvency & Bankruptcy" by Dr. S.R. Myneni[3]

The publication gives a foundational insight into the IBC. The strength is in the detailed, section-by-section examination of the code, giving comprehensibility to the intricate law. The IBC is successfully contrasted with prior legislation in the book, implicitly illustrating the shift in thinking investigated by this paper.

Relevance to this Research

When it comes to grasping key aspects of the IBC, the book is an essential resource, critical for the doctrinal analysis this paper presents, particularly with regard to the statutory provisions that show the creditor-in-control model (like the initiation process for CIRP and the CoC's powers).

Limitation: its emphasis, as an educational text, is more descriptive rather than critical analysis. Even though it delineates the law, as it stands, if fails to explore the philosophical conflicts, nor the more urgent issues of equity that, through litigation, have appeared. This paper has the intention of expanding upon the solid groundwork laid by Myeni, adding a layer of critical assessment.

[1] Jackson, Thomas H. The Logic and Limits of Bankruptcy Law. Harvard University Press, 1986.
[2] Sonani, Amarakash Bansilal. Supreme Court Leading Case Laws on Insolvency & Bankruptcy Code, 2016. Notion Press, 2021.
[3] Myneni, S.R. Law of Insolvency & Bankruptcy. Allahabad Law Agency, 2022.

5. Critical Appraisal: The Paradigm shift in Practice

5.1. The Pre-IBC "Debtor-in-Possession" Model

This model is exemplified by SICA. The Board for Industrial and Financial Reconstruction (BIFR) often let the existing management continue overseeing a company during its revival efforts. This method handled considerable loss of value, stripping of assets, and prolonged delays, fundamentally undermining creditor rights.

5.2. The IBC's "Creditor-in-Control" Structure

- **Initiation of CIRP:** the authority given to financial and operational creditors to initiate insolvency proceedings against a defaulting corporate debtor displays the first shift in power.
- **Moratorium:** the instantaneous enforcement of a moratorium upon admission hinders the debtors' ability to manage assets, ensuring that, for all creditors, the estate is protected.
- **Management Displacement:** the most significant shift pertains to the removal of the Board of Directors and appointing an Insolvency Resolution Professional (IRP) to take over the operations of the debtor.
- **The Committee of Creditors (CoC):** the body is central to the creditor-in-control framework. Spearheaded by financial creditors, based on voting share, the CoC possesses ultimate authority. It manages the approval of resolution plans, determination of the company's future (resolution or liquidation), and oversees the IRP.[4]

5.3. Theoretical Justification: The Creditors' Bargain

The IBC framework adheres to the Creditors' Bargain Theory's principles. The collective process, moratorium, and the crucial role of the CoC in shaping the future of the company are meant to prevent rushing to litigation and maximise the value of the estate for all creditors.

5.4. Critical Challenges and Judicial Refinement

The creditor-centric model has met significant hurdles, eliciting crucial judicial responses:

- **Operational Creditors vs. Financial Creditors**: in *Innoventive Industries Ltd. v. ICICI Bank*[5], the primacy of the IBC was affirmed by the Supreme Court. However, in *Swiss Ribbons Pvt. Ltd. v. Union of India*[6], while the legality of the distinction between classes of creditors was upheld, there was insistence from the Court that the CoC needed to consider the interests of all stakeholders, inclusive of operational creditors. The "Jaguar" Land Rover case and later amendments bring to light persisting

[4] LoPucki, Lynn M., & Warren, Elizabeth. Secured Credit: A Systems Approach. Aspen Publishers, 2018.
[5] Innoventive Industries Ltd v ICICI Bank and Another (2017) 14 SCC 584 (SC).
[6] Swiss Ribbons Pvt Ltd and Another v Union of India and Others (2019) 4 SCC 17 (SC).

difficulties in the balancing of the CoC's commercial decisions with being fair to operational creditors.

- **Commercial Wisdom of the CoC**: though not limitless, the Supreme Court often defers to the "commercial wisdom" of the CoC. When CoC decisions were arbitrary, discriminatory, or contrary to the code's provisions, Courts have intervened, in the role of the guardian against unrestricted creditor hegemony.
- **Resolution vs. Recovery**: notable tension is there regarding whether the design of the IBC is that of a tool of recovery for financial creditors, or a company revival mechanism. The elevated rates of liquidation and significant "haircuts" absorbed by creditors have triggered discussions over whether proper balance has been reached.

6. Conclusion and Findings

The Insolvency and Bankruptcy Code (IBC) of 2016 has transformed, distinctly, the ideological framework from one that is debtor-friendly to one with the creditors as the priority. The study uncovered that:

1. The transformation is firmly entrenched in the code via mechanisms like the CoC (Committee of Creditors) and management led by the Insolvency Resolution Professional (IRP).
2. The shift is grounded in the Creditors' Bargain Theory, whose aim is to maximise value via a process spearheaded by creditors.
3. The strategy has resulted in improved recovery rates and bolstered credit discipline, but it has also brought with it systematic issues, particularly concerning fair treatment of operational creditors and focusing on "creditor recovery" instead of aiming for "corporate rescue" in numerous cases.
4. The Indian Judiciary has had a significant role to shape the model, preserving the main idea of preserving the control of creditors, at the same time incorporating principles of fairness and justice to mitigate potential misuse.

Thus, the IBC is representative of a practical, yet flawed, implementation of a theoretical framework within a multifaceted socio-economic environment. The long-term viability is dependant on continuous legislative and judicial initiatives to enhance the system, ensuring that not only does it address the interests of secured creditors, but it also fosters a stable, and fair, credit landscape.