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The Insolvency and Bankruptcy Code, 2016: A Turning Point in India's Economic Reforms

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ABSTRACT

This paper seeks to examine the historical background and impact of the Insolvency and Bankruptcy code, 2016 on the Indian Economy. It will also delve into previous legislations relating to Bankruptcy and Liquidation. This paper aims to establish the reasons why previous legislation relating to insolvency were ineffective and why there was a need to introduce a comprehensive legislation. The article expressly examines the paradigm shift from debtor-centric to creditor-centric approaches within this framework. This article highlights some of the important aspects of the code, including the creation of the Insolvency and Bankruptcy Board of India, the development of a time-bound process for case settlement, and the protection of creditors interests. The implementation of the Insolvency and Bankruptcy Code, 2016, was highly anticipated and well received by investors. It has shown to be beneficial in improving the ease of doing business in India by empowering creditors and making necessary changes to the priority list.

KEYWORDS

Insolvency And Bankruptcy Code, 2016, Creditor-Centric Approach, Ease of Doing Business, Time-Bound Process, Insolvency and Bankruptcy Board of India (IBBI)

STATEMENT OF PROBLEM

The ineffectiveness and fragmentation of India's pre-2016 bankruptcy laws, which resulted in prolonged legal proceedings, poor recovery rates, and a rise in Non-Performing Assets (NPAs) in the banking industry, is the issue this study attempts to address.

Although the Insolvency and Bankruptcy Code (IBC) was introduced with the intention of streamlining the insolvency process, obstacles like delays, uneven treatment of creditors, and overworked judicial bodies continue to exist. This essay explores the development of the IBC, its effects on the Indian economy, and the continued difficulties in putting it into practice.

RESEARCH QUESTIONS

- I. What changes occurred to India's bankruptcy and insolvency laws before the Insolvency and Bankruptcy Code (IBC), 2016 was passed?
- II. How has the IBC aided in the expansion of India's economy, namely in terms of facilitating trade and encouraging confidence among investors?
- III. What are the key legal interpretations and important cases that have influenced how the IBC is interpreted and applied?
- IV. What challenges and limitations still persist in the implementation of the IBC, especially regarding delays, creditor rights, and the functioning of insolvency tribunals?

RESEARCH OBJECTIVES

- I. To trace the historical evolution of India's insolvency and bankruptcy laws leading up to the enactment of the Insolvency and Bankruptcy Code (IBC), 2016.
- II. To identify and analyze the shortcomings of the pre-IBC insolvency framework that led to inefficiencies in resolving financial distress.
- III. To examine key judicial interventions and landmark cases that have influenced the interpretation and application of the IBC.

INTRODUCTION

The Insolvency and Bankruptcy Code of 2016¹ (IBC) has been a significant legal reform in India since its independence. Before its implementation, India's insolvency system was chaotic, ineffective, and marred by lengthy legal disputes. There were several complex laws that individuals and companies facing financial distress had to navigate, including the Presidency Towns

¹ Tushti Arya & Priyank Rao, IBC: Past, Present and Future of the 2016 Code, 6 INT'L J.L. MGMT. & HUMAN. 154 (2023).

Insolvency Act, 1909, the Provincial Insolvency Act, 1920, the Sick Industrial Companies Act (SICA), 1985, the Recovery of Debts Due to Banks and Financial Institutions Act (RDDBFI), 1993, and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002. These laws hindered India's economic development, leading to poor recovery rates and excessive reliance on judicial intervention. Prior to the implementation of the IBC, India was dealing with a growing problem of Non-Performing Assets (NPAs), especially in the banking industry, posing a challenge to public sector banks, which held a substantial portion of corporate debt. Insolvency resolution under the previous legal system was a cumbersome procedure that could take years or even decades to settle a single case.

According to a study² conducted by the Reserve Bank of India (RBI) on Non-Performing Assets (NPAs) recovered by Scheduled Commercial Banks through various mechanisms, it was observed that the amount recovered during 2019-20 was significantly higher than through any other method. These alternative methods include legislation such as the SARFAESI Act, 2002, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, and Lok Adalats. A similar trend was noted in the preceding two years (2017-18 and 2018-19), though this pattern was disrupted in 2020-21, primarily due to the suspension of proceedings as a result of the pandemic. This stands as a notable accomplishment, especially considering the Code has been in effect for only eight years.

LEGISLATIONS PRIOR TO THE IMPLEMENTATION OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016

The legal framework governing insolvency and bankruptcy prior to the enactment of the Code is as follows:

- i. **Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920:** These acts resembled laws from the British era and governed individual insolvency, primarily for small and medium-sized debtors. They did not, however, adequately handle the complications of corporate insolvency, which resulted in inefficiencies and disruptions.
- ii. **Sick Industrial Companies (Special Provisions) Act, 1985 (SICA):** This legislation was perceived as a failure because of the prolonged processes, even though its goal was to revive ill industrial businesses. The SICA-

² C.D.B.J. Kattadiyil & B.A. Islamov, Analysis of Outcomes of IBC on Managing the Economic Development of India, 12 INT'L J. MGMT. 7 (2021).

established Board for Industrial and Financial Reconstruction (BIFR) frequently took years to assess a company's financial stability, which prolonged the resolution process.

- iii. **The Recovery of Debts Due to Banks and Financial Institutions Act, 1993:** In order to accelerate the recovery of loans owing to banks and other financial organizations, this Act established Debt Recovery Tribunals, or DRTs. But DRTs were overworked and unable to respond quickly, which added to the growing amount of non-performing assets (NPAs).
- iv. **Companies Act, 1956 (Winding up Provisions):** The Companies Act, 1956 controlled the process of winding up insolvent corporations in India prior to the implementation of the Insolvency and Bankruptcy Code, 2016. Sections 433 to 483 of Part VII, Chapter II of the Act, which contained the winding-up provisions, established the legal foundation for the dissolution of businesses that were insolvent or unable to pay their debts. However, there were several procedural delays, it took a long time, and it depended heavily on judicial intervention.
- v. **Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002:** Through the use of this legislation, secured creditors were able to obtain their loans without going through the legal system. Although this was a positive development, it only applied to secured creditors and excluded unsecured creditors.

THE EMERGENCE OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016

The Indian government realized it needed a modern, cohesive structure for insolvency. The Bankruptcy Law Reforms Committee's (BLRC) recommendations led to the creation of the IBC, which took effect on May 28, 2016.

OBJECTIVES OF THIS LEGISLATION

The IBC³ was designed to streamline the insolvency process and ensure quicker resolution. Its primary objectives were:

³ Geetansh Kathuria, IBC and Its Impact on the Indian Economy, 5 INDIAN J.L. & LEGAL RSCH. 1 (2023).

- Maximization of the value of assets of insolvent firms⁴.
- Balancing the interests of all stakeholders.
- Encouraging self-employment.
- Facilitating business in India more easily.

When it comes to effectively fulfilling the objectives of the Code, the latest newsletter from the Insolvency and Bankruptcy Board of India (IBBI) provides a comprehensive overview of statistical analysis, which is quite encouraging. There are several highlights worth mentioning:

- The implementation of the Code resulted in the successful resolution of 277 Corporate Debtors (CDs) with an asset value of Rs. 1.02 lakh crore, representing approximately 193 percent of the realizable value. This achievement stands in stark contrast to the inefficiency of the Board for Industrial and Financial Reconstruction, primarily attributed to its debtor-in-possession model.
- Furthermore, 1025 CDs were subjected to orders of liquidation, with the total liquidation assets valued at Rs. 0.42 lakh crore. Notably, 132 of these CDs have undergone complete liquidation, with an average liquidation duration of 10 years.
- The Code has also induced a significant behavioural transformation among debtors, instigating a proactive approach to distress resolution in its nascent stages. Noteworthy is the resolution of a substantial number of applications for the initiation of Corporate Insolvency Resolution Processes (CIRPs) involving CDs, with an underlying default amounting to Rs. 5,15,170 crores, prior to their admission.

KEY FEATURES OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016

The main goal⁵ of the IBC is to ensure that insolvency and bankruptcy cases are resolved within a specific timeframe, maximize the value of assets, and consider the interests of all stakeholders. Below are some of the key features of the IBC along

⁴ Vijay Kumar Singh, Modern Corporate Insolvency Regime in India: A Review, 2021 NLS BUS. L. REV. 22.

⁵ Anupam Mitra & Shyamal Banerjee, Impact of the Insolvency and Bankruptcy Code on India's Financial System: A Legal and Economic Analysis, 7 ASIAN J.L. & SOC'Y 221 (2020).

with the relevant sections:

❖ **The Corporate Insolvency Resolution Process (CIRP):** This is a key component of the Insolvency and Bankruptcy Code (IBC). Its goal is to either restructure or liquidate a company to address its insolvency issues. Section 6 specifies that the CIRP can be initiated by financial creditors, operational creditors, or the corporate debtor itself.

❖ **Initiation of CIRP (Sections 7, 8, and 9):**

- **Section 7:** Financial creditors (such as banks) can initiate the CIRP by applying with the National Company Law Tribunal (NCLT). They must demonstrate that the debtor has defaulted on a debt.
- **Section 8:** Operational creditors (such as suppliers of goods and services) must first issue a demand notice to the debtor before initiating the CIRP.
- **Section 9:** If the operational creditor's demand remains unmet, they can apply with the NCLT to start the insolvency resolution process.

❖ **Moratorium (Section 14):**

Once the National Company Law Tribunal (NCLT) admits Corporate Insolvency Resolution Process (CIRP), a moratorium period is declared. This is one of the most important features of the Insolvency and Bankruptcy Code (IBC). The moratorium prohibits: -

- Institution or continuation of suits or legal proceedings against the corporate debtor.
- Transfer or disposal of assets.
- Enforcement of security interests or recovery of property by creditors.

The moratorium provides the company with a "calm period" during which it can explore the possibility of revival without being hindered by litigation or asset seizures.

❖ **Time- Bound Process (Section 12):**

One of the most crucial aspects of the IBC is its focus on a time-bound resolution process. According to Section 12, the entire CIRP must be completed within 180 days, with a possibility of extension by another 90 days, totaling 270 days. In exceptional cases, as

permitted through recent amendments, the resolution process can be extended up to 330 days. This emphasis on speed is intended to maintain the value of the assets and ensure that businesses are either restructured or liquidated promptly.

❖ **Liquidation Process (Section 33-54):**

If a viable resolution plan is not found within the Corporate Insolvency Resolution Process (CIRP) timeframe, the company will proceed to liquidation:

- Section 33 mandates liquidation if the Committee of Creditors (CoC) does not approve a resolution plan or if the resolution plan is not approved by the National Company Law Tribunal (NCLT).
- Section 36 deals with the formation of a liquidation estate, which includes all the company's assets. These assets will be sold to repay creditors.
- Section 53 outlines the order in which the liquidation proceeds are to be distributed. This "waterfall" mechanism gives priority to secured creditors and workmen's dues over unsecured creditors, with equity shareholders placed at the bottom of the priority list.

❖ **Insolvency and Bankruptcy Board of India (IBBI) (Sections 188-196):**

Sections 188-196 establish the Insolvency and Bankruptcy Board of India (IBBI) as the regulatory authority overseeing insolvency and bankruptcy processes. The IBBI is responsible for regulating insolvency professionals (IPs), insolvency professional agencies (IPAs), and information utilities (IUs). It has a significant role in creating guidelines, ensuring compliance, and guaranteeing the effective implementation of the IBC provisions.

THE IMPACT OF THE IBC ON THE INDIAN ECONOMY

- i. **Reduction in Non-Performing Assets⁶ (NPAs):** The implementation of the IBC⁷ has been a major success in reducing NPAs in the Indian banking sector. Prior to the introduction of the IBC, banks grappled with high NPAs, which hindered lending and economic growth. The IBC introduced a faster and more effective mechanism for

⁶ Nikita Mistry, Impact of IBC, 2016 on Non-Performing Assets with Respect to the RBI Circular, 2 INDIAN J. INTEGRATED RSCH. L. 1 (2022).

⁷ Kunal Singh & Muskan Singh, Insolvency and Bankruptcy Code (IBC) in India and Its Impact on the Economy, 3 JUS CORPUS L.J. 485 (2023).

resolving distressed assets, resulting in expedited recoveries.

- ii. **Ease of Doing Business:** Following the implementation of the IBC, India's ranking in the World Bank's Ease of Doing Business index saw a significant improvement. The introduction of a time-bound resolution process, transparency, and a creditor-friendly approach played a pivotal role in boosting investor confidence. In the 2019 Ease of Doing Business rankings, India's ranking improved to 63rd place from 130th in 2016, showcasing significant progress. This improvement can be largely attributed to the IBC's reforms in insolvency resolution, highlighting the constructive steps taken to enhance the business environment.
- iii. **Stimulation of Economic Growth:** The Insolvency and Bankruptcy Code (IBC) has played a crucial role in driving India's economic growth by facilitating the revival of viable businesses and ensuring the efficient liquidation of non-viable ones. This strategic allocation of resources is pivotal for the long-term sustainability of the economy.
- iv. **Preservation of Productive Assets:** The IBC's emphasis on revitalizing businesses through the Corporate Insolvency Resolution Process (CIRP) has been instrumental in enabling numerous companies to evade liquidation and sustain their operations, thereby safeguarding jobs and bolstering economic output. Notable success stories such as Jet Airways and Essar Steel underscore how the IBC has enabled the resurgence of financially distressed companies.
- v. **Enhanced Investor Confidence:** Through its improvements to the legal framework for insolvency and the provision of clearer guidelines for investors, the IBC has successfully attracted both domestic and foreign investment. This has instilled greater confidence in investors regarding the recovery of their investments, resulting in heightened capital inflows and increased economic activity.
- vi. **Boost to Entrepreneurship:** The IBC has played a vital role in fostering entrepreneurship by minimizing the fear of failure. It allows entrepreneurs to gracefully exit a struggling business through a transparent legal process, sparing them from prolonged legal battles.
- vii. **Protection of Creditor's Rights:** The IBC has enhanced

the rights of creditors, especially financial creditors. The formation of the Committee of Creditors (CoC), which is mainly composed of financial creditors, guarantees their authority over the resolution process. Unsecured creditors and operational creditors also have their claims acknowledged. The implementation of the Insolvency and Bankruptcy Code (IBC) has notably enhanced the overall recovery rate for creditors, as per data from the Insolvency and Bankruptcy Board of India (IBBI). In the initial years of IBC implementation, creditors experienced an improvement in recovery rates to 45%, compared to significantly lower rates under previous legislations such as the Sick Industrial Companies Act (SICA) or Debt Recovery Tribunals (DRTs).

viii. Resolution vs. Liquidation: The Insolvency and Bankruptcy Code (IBC) gives distressed enterprises a moratorium time to reorganize and promotes business resolution over liquidation, promising that viable businesses can be restored.

LANDMARK CASES UNDER THE INSOLVENCY AND BANKRUPTCY CODE, 2016

- A. Swiss Ribbons Pvt. Ltd. v. Union of India AIR (2019) 4 SCC 17:** This case affirmed the constitutional validity⁸ of the IBC, with the Supreme Court highlighting its intention to prioritize the revival of financially distressed companies. The Court emphasized the IBC's role in safeguarding the interests of various stakeholders, including creditors, workers, and the broader economy. This decision underscores the IBC's fundamental aim to balance stakeholders.
- B. Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta & Ors AIR 2019 SC 1494:** The case definitively clarified the distribution of assets in a resolution plan, with the Supreme Court emphatically upholding the primacy of the CoC in decision-making. Furthermore, it resolutely emphasized the crucial need for equitable distribution of assets among creditors.
- C. ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta, (2019) 2 SCC 1:** This case focused on Section 29A of the IBC, which prohibits willful defaulters from bidding for distressed assets. The Supreme Court ruled that promoters

⁸ Mrunalini Sohani & Aditi Malkar, IBC, 2016: A Revolution in Bankruptcy Laws, 2 JUS CORPUS L.J. 1149 (2022).

of defaulting companies are not eligible to participate in the resolution process.

D. SBI v. V. Ramakrishnan, (2018) 17 SCC 394: The case revolved around the extent of the moratorium under Section 14 of the IBC and whether it is applicable to personal guarantors. The Supreme Court ruled that the moratorium under Section 14, which prohibits legal actions against the debtor during the insolvency resolution process, does not cover personal guarantors. This means that creditors can still take legal action against personal guarantors even while the insolvency proceedings of the corporate debtor are ongoing.

E. Phoenix ARC Pvt. Ltd. v. Spade Financial Services Ltd. & Ors, (2021) 3 SCC 475: The case addressed the classification of related-party financial creditors and their involvement in the resolution process. The Supreme Court's ruling stated that related-party creditors of a corporate debtor cannot participate in the Committee of Creditors (CoC) to prevent conflicts of interest. This decision aims to prevent related-party creditors from exerting influence over the resolution process for their own benefit.

F. UP Power Transmission Corporation Ltd. and Anr. v. CG Power & Industrial Solutions Ltd. & Anr., (2021) 6 SCC 15: The case centered on a dispute regarding whether a breach of contract claim for damages could initiate corporate insolvency resolution proceedings (CIRP) under the Insolvency and Bankruptcy Code (IBC), 2016. The Supreme Court ruled in favor of CG Power, affirming that damages resulting from a breach of contract do not inherently qualify as a "debt" under the IBC.

G. Gujarat Urja Vikas Nigam Ltd. v. Amit Gupta, (2021) 7 SCC 209: The central issue in this case revolved around whether the National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) were empowered to adjudicate disputes concerning the termination of contracts, specifically a Power Purchase Agreement (PPA), during the corporate insolvency resolution process (CIRP) under the IBC, 2016. The Supreme Court of India affirmed that NCLT and NCLAT indeed have the jurisdiction to address disputes related to the termination of contracts such as PPAs during insolvency proceedings, particularly when such termination impacts the ability of the corporate debtor to continue its operations.

H. Jet Airways (India) Ltd v. State Bank of India, 2019 SCC

Online NCLAT 1216: The central issue in this case revolved around the cross-border⁹ insolvency proceedings concerning Jet Airways and the management of insolvency procedures across multiple jurisdictions under the IBC, 2016. Sections 234 and 235 of the IBC are key provisions pertaining to cross-border insolvency.

Jet Airways, a prominent Indian airline, was undergoing insolvency proceedings in India while simultaneously grappling with bankruptcy proceedings in the Netherlands. The Dutch court had appointed a bankruptcy administrator for Jet Airways' operations in the Netherlands. In India, the National Company Law Tribunal (NCLT) had initiated Corporate Insolvency Resolution Process (CIRP) proceedings following an application from Jet Airways' financial creditors, led by State Bank of India (SBI). The National Company Law Appellate Tribunal (NCLAT) ruled in its judgment that the insolvency process in India would take precedence over the proceedings in the Netherlands. The Dutch administrator and the Indian resolution professional were both urged to coordinate and collaborate to ensure the equitable handling of Jet Airways' assets and creditors across jurisdictions.

CHALLENGES AND CRITICISMS OF THE INSOLVENCY AND BANKRUPTCY CODE (IBC), 2016

The Insolvency and Bankruptcy Code¹⁰ (IBC) has brought significant reform to India's insolvency framework. However, it has encountered several challenges and criticisms, primarily stemming from the practical implementation of the Code, judicial bottlenecks, and concerns raised by various stakeholders, including operational creditors, financial creditors, and other market participants. Here are some of the major challenges and criticisms associated with the IBC:

1) Delay in Resolution Process: Despite the IBC's mandate for time-bound resolution, delays in the Corporate Insolvency Resolution Process (CIRP) have become a significant challenge.

Originally, the IBC set a 180-day resolution period, extendable by 90 days, for a total of 270 days. However, many cases exceed this timeframe in practice. One of the main reasons for these delays is the overloaded National

⁹ Avin Tiwari, Cross Border Mergers in India in the IBC Era: A Legal Inquiry, 11 INDIAN J.L. & JUST. 286 (2020).

¹⁰ Darshan Shah, Revitalizing the Indian Economy - Assessing the Impacts of the Bankruptcy and Insolvency, 4.1 JCLJ 1 (2023).

Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT). Both tribunals are understaffed and struggling to handle the high volume of cases, leading to backlogs.

To address these issues, the resolution period was extended to 330 days through amendments. Despite this, prominent cases like the Essar Steel and Jaypee Infratech insolvencies have taken years to resolve, contradicting the goal of a swift resolution process.

2) Unequal Treatment of Creditors: The Insolvency and Bankruptcy Code (IBC) has faced criticism for its unequal treatment of operational creditors (OCs) - like suppliers and employees - compared to financial creditors (FCs), such as banks and financial institutions. Under the IBC, financial creditors hold the majority of voting power in the Committee of Creditors (CoC), which frequently results in operational creditors receiving a smaller portion of their claims in resolution plans.

However, judicial intervention has aimed to address this disparity. A notable instance is the Supreme Court's decision in the case of Essar Steel India Ltd. v. Satish Kumar Gupta (2019), where the court ruled that the CoC cannot discriminate between operational and financial creditors, mandating fair treatment for all. Despite this ruling, operational creditors often continue to recover significantly less compared to their financial counterparts in practical outcomes.

3) Low Recovery Rates: Although the Insolvency and Bankruptcy Code (IBC) initially led to improved recovery rates for creditors, recent years have seen a decline in these recovery percentages. Reports from the Insolvency and Bankruptcy Board of India (IBBI) indicate that the recovery rate has decreased from approximately 45% in the early years of the IBC to less than 30% in some of the more recent cases.

Furthermore, there appears to be a tendency towards liquidation over resolution in many instances, making liquidation the more common outcome. This trend results in creditors often receiving lower recoveries than they might have obtained through a successful resolution plan.

4) Misuse of the Insolvency Process by Debtors and

Creditors¹¹: Some companies have allegedly used the insolvency process to avoid paying debts, delay payments, or maintain control of the business by having insiders bid for the company during the resolution process.

There have been cases where operational creditors filed for insolvency for very small claims, sometimes as low as ₹1 lakh. This has led to the insolvency process being used more for debt collection than genuine insolvency resolution, which clogs the system and diverts resources from larger insolvencies.

5) Challenges for MSMEs (Micro, Small, and Medium Enterprises): The absence of dedicated provisions for Micro, Small, and Medium Enterprises (MSMEs) within the insolvency process presents a significant challenge. Given their comparatively limited scale and diminished negotiating power, MSMEs consistently realize reduced returns during the Corporate Insolvency Resolution Process (CIRP).

Furthermore, the susceptibility of MSMEs, serving as operational creditors, to the repercussions of substantial corporate payment defaults is a matter of particular concern, as these payments constitute a fundamental component of their operational funds.

6) Complexity in Cross-Border Insolvency: The Insolvency and Bankruptcy Code (IBC) includes provisions for cross-border insolvency under Sections 234 and 235; however, India currently lacks a comprehensive framework to address cross-border insolvency cases. The existing provisions rely on bilateral treaties with other countries, which are not fully developed.

The impact of this absence is particularly significant in the context of global business. With the increasing globalization, many Indian companies hold substantial assets abroad, and foreign creditors may have claims against these entities. The lack of a robust cross-border insolvency framework introduces uncertainties in such cases, which can have implications for global business operations.

CONCLUSION

¹¹ Ritu Singh & Aditya Bhandari, *Challenges in Implementing the IBC: Delays, Legal Interpretations, and Tribunal Bottlenecks*, 15 INDIAN J. CORP. L. REV. 12 (2021).

The Insolvency and Bankruptcy Code (IBC), enacted in 2016, has significantly transformed India's approach to insolvency and bankruptcy. This groundbreaking legislation has unified previously scattered laws, introduced a time-bound resolution mechanism, and enhanced creditors' rights, thereby profoundly influencing the Indian economic landscape. Despite facing challenges, notably in terms of delays and recovery rates, the IBC has established a foundation for a more streamlined and transparent insolvency system. Continuous reforms and judicial interpretations are expected to further shape the IBC's trajectory, securing its ongoing importance in promoting economic development and stability.