



(REVIEW ARTICLE)



## Critical review of insolvency and bankruptcy laws

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### Abstract

Bankruptcy legislation plays a crucial role in ensuring economic stability by offering an institutional mechanism of handling financial distress. An effective insolvency framework provides confidence to investors and creditors. It is necessary for competitive credit costs, investment climate and economic growth. Insolvency laws provide solutions to distressed companies and help them turnaround to cash generating companies (Deb and Dubey,2020). However, complexities of regulation, high compliance costs and poor governance have often led to impediments in effective implementation of insolvency and bankruptcy laws (Finch, 1997). Efficiency of bankruptcy legislation varies significantly among economies, with resolution time being a key effectiveness driver. This paper critically examines bankruptcy legislation in major economies, comparing resolution time and overall performance. It offers a review of literature on existing research, conducts case studies, and examines the impact of variation in legal structures on economic recovery. Key parameters such as effectiveness of the judiciary, balance between creditor and debtor, economic impact, and regulatory flexibility are employed in measuring effectiveness.

**Keywords:** Insolvency Laws; Bankruptcy Laws; Legal Efficiency; Critical Evaluation; Economic Impact

### 1 Introduction

Insolvency laws primarily deal with situations where an individual or business cannot meet its financial obligations. Bankruptcy, often seen as the legal outcome of insolvency, is a process where a debtor is legally declared unable to pay their debts. In contrast, insolvency refers more broadly to the state of being unable to repay debts, regardless of whether formal bankruptcy proceedings occur.

- Insolvency laws are designed to fairly distribute an insolvent debtor's remaining assets among creditors, either through liquidation or reorganization.
- Bankruptcy laws provide a legal process for businesses or individuals to either discharge their debts or restructure them under a court-approved plan.

The main objectives of these laws are to balance the interests of creditors, debtors, and the economy while fostering economic stability and encouraging entrepreneurship.

#### 1.1 The Evolution of Insolvency and Bankruptcy Laws

Historically, bankruptcy laws were rooted in creditor protection, with debtors often facing severe punishments, including imprisonment. Over time, however, there has been a shift toward **debtor rehabilitation** rather than punishment. In the late 20th and early 21st centuries, the emphasis moved toward giving businesses a chance to restructure and recover rather than liquidating them.

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A review on **insolvency and bankruptcy laws** across the globe offers insight into how various countries approach financial distress, the protection of creditors, and the rehabilitation of businesses. It is essential to note that while insolvency and bankruptcy laws have common objectives, their implementation and philosophy vary significantly depending on legal, economic and cultural contexts. The motivation for this study stems from these prominent cases of bankruptcy:

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## 2 Lehman Brothers (US)

The 2008 bankruptcy of Lehman Brothers was one of the largest in history. The intricacy of the international operations of the financial institution resulted in drawn-out proceedings that lasted over a decade. While the U.S. Chapter 11 system provided a legal framework for the crisis management, the size and global nature of Lehman's business exposed shortcomings in U.S. bankruptcy laws for large financial institutions. The case posed questions of international cooperation in insolvency proceedings and triggered regulatory reforms like the Dodd-Frank Act.

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## 3 Jet Airways (India)

The insolvency case of Jet Airways exposed grave inefficiencies in India's bankruptcy resolution process. The airline was admitted to insolvency under the IBC in 2019 with a listed 330-day resolution period. The case, however, endured over four years due to litigation, multiple bidders withdrawing, and slow judicial proceedings. The case indicates that more stringent enforcement processes and a more formalized resolution process are necessary in India's bankruptcy law.

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## 4 Carillion (United Kingdom)

Carillion, one of the largest UK construction companies, failed in 2018 with over £7 billion of liabilities. In contrast to Lehman Brothers, Carillion's resolution was dealt with relatively quickly under UK insolvency regimes. The firm was wound up, and administrators were put in place to deal with asset distribution within two years. The UK's formal framework, with pre-pack administrations and transparent creditor priority rules, enabled a quicker resolution. This example illustrates the effectiveness of UK bankruptcy procedures in dealing with large company failures.

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## 5 Review of Bankruptcy Laws

Bankruptcy codes are designed to provide orderly resolution of financial distress, balancing creditor recovery and debtor protection. The duration of bankruptcy resolution, however, varies across the globe because of different legal systems, enforcement efficiency, and economic policies. This paper examines how these variations influence economic performance and firm survival rates. The study will critically analyze regimes of bankruptcy in terms of its comparison with significant parameters such as:

- **Judicial Efficiency:** The efficiency of the courts in expediting insolvency proceedings.
- **Creditor-Debtor Balance:** To what extent stakeholders are safeguarded by the law.
- **Economic Impact:** Economic recessions and their effect on investment, credit markets, and economic growth.
- **Regulatory Flexibility:** The ability of legislation to modify in response to economic needs.

### 5.1 Judicial Efficiency

Judicial efficiency matters in determining how quickly insolvency cases are adjudicated and concluded. Case backlog, procedural time, and whether there are specialist courts, affect the time taken significantly. In countries where there are specialist courts of bankruptcy, such as the UK and Germany, cases are handled better than in countries where there are general courts hearing insolvency cases, such as India and Italy, where delays are more frequent. -Judicial control also needs to be effective. In the US, for instance, Chapter 11 flexibility is a mechanism for reorganization of companies, but the protracted nature of some cases diminishes its effectiveness. In countries with good liquidation procedures, such as Canada and the UK, recovery and resolution of assets are quicker.

### 5.2 Creditor-Debtor Balance

Creditor-debtor protection provided varies widely between jurisdictions, affecting the extent to which business dynamics are influenced by bankruptcy law. Creditor-oriented systems in the UK and Germany allow creditors to recover a greater proportion of overdue debt. Still, these systems can deter entrepreneurship since the possibility of aggressive creditor action can discourage business risk-taking. Conversely, debtor-friendly systems such as the U.S.

Chapter 11 procedure focus on rehabilitation of business rather than liquidation. While this approach preserves employment and economic activity, it is likely to lead to lengthy court proceedings, which increase costs to all parties. An ideal balance such as in the economies of Canada provides fair representation of debtors and creditors.

### 5.3 Economic Impact

The efficiency of bankruptcy legislation has spillover effects on investment environments and credit markets. Investors will invest in jurisdictions with clear and speedy insolvency procedures. Countries with inefficient mechanisms, such as India before the Insolvency and Bankruptcy Code (IBC) of 2016, witnessed capital flight due to slow-moving bankruptcy procedures and poor recoveries by creditors. Efficient insolvency regimes also increase economic resilience. In times of financial crises, good resolutions prevent contagion of systemic risk. European Union harmonization under the EU Insolvency Regulation attempts to create a more predictable regime to increase economic stability.

### 5.4 Regulatory Adaptability

Bankruptcy legislation needs to adapt to respond to economic change, technology, and financial crises. Those jurisdictions that routinely revise their legislation fare better in insolvency management. The UK, for instance, enacted the Corporate Insolvency and Governance Act of 2020 to strengthen restructuring efforts in the context of the COVID-19 pandemic.

Conversely, China's restrictive regulatory framework and state intervention often deter the effectiveness of bankruptcy resolution, particularly in the case of large state-owned enterprises. Countries that fail to update their insolvency laws in line with economic conditions are likely to have longer resolution times and lower creditor recoveries.

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## 6 Discussion and Analysis of Bankruptcy Laws of major economies

### 6.1 Evaluation of Insolvency and Bankruptcy regime

This section provides a critical evaluation of insolvency and bankruptcy laws of 8 countries viz USA, UK, Japan, Canada, China, Germany, Italy and India.

#### 6.1.1 United States

The U.S. bankruptcy system is a model for many other countries, particularly with its robust procedures for corporate reorganization.

- **Chapter 11** allows businesses to continue operations while restructuring debts.
- **Chapter 7** focuses on liquidation, where assets are sold to pay off creditors.

The **U.S. Bankruptcy Code** has a significant emphasis on reorganization and debtor-in-possession financing, offering companies a second chance at survival. The U.S. bankruptcy system, administered primarily through Chapter 7 (liquidation) and Chapter 11 (reorganization), is structured to reconcile creditors' repayment and debtors' rehabilitation. While Chapter 11 offers corporations the opportunity to restructure and continue operating, its lengthy proceedings make it inefficient and costly. Excessively high legal fees and complex negotiations tend to extend resolution periods, making it less efficient for small and medium-sized enterprises. Nevertheless, the formal process enables companies with good recovery plans to emerge stronger, preventing large-scale unemployment and economic dislocation.

Critics argue that Chapter 11 can favor large corporations, providing them with opportunities for a more extended reorganization process, potentially disadvantaging smaller creditors and stakeholders.

#### 6.1.2 United Kingdom

The UK follows a **debtor-friendly** approach, allowing for corporate rescue through **administration**, a procedure designed to save a business as a going concern.

The **Insolvency Act 1986** governs both liquidation and administration procedures. The UK also introduced the **Corporate Insolvency and Governance Act 2020**, which introduced provisions to allow businesses to seek temporary relief from creditors during COVID-19 and beyond, as well as a **moratorium** for companies facing financial distress. The UK's creditor-based insolvency regime focuses on maximizing recovery of assets. The formal procedures of

administration, liquidation, and pre-packaged insolvencies provide solutions for insolvent businesses. The efficiency of UK bankruptcy law is evident in the Carillion case, in which an accelerated process cut economic damage. The UK Insolvency Act 1986 and the more recent Corporate Insolvency and Governance Act 2020 have introduced modern restructuring tools, and the system has become responsive to the dynamics of the economy.

The UK has a strong emphasis on **voluntary arrangements** for individuals and businesses, which provide a way to avoid formal insolvency proceedings while paying off debts over time.

### 6.1.3 Germany

Germany's **Insolvency Code (InsO)**, which came into effect in 1999, represents a robust framework for both liquidation and corporate reorganization.

Germany has a strong creditor protection system but also promotes restructuring through insolvency proceedings. The Restructuring Framework (StaRUG) was introduced in 2021 to allow businesses to restructure outside of formal insolvency processes, offering greater flexibility. Germany places importance on preventative restructuring, requiring early intervention before a firm becomes insolvent, an approach also seen in Austria and some Scandinavian countries. Germany's insolvency regime, regulated by the Insolvency Code (Insolvenzordnung), is creditor-protective but enables companies to restructure successfully. The enactment of the StaRUG (Act on the Stabilization and Restructuring Framework for Enterprises) in 2021 further enhanced Germany's insolvency regime, which became more flexible. German courts are extremely efficient in dealing with insolvency cases, willing to resolve them quicker than in most other European countries. The country's structured approach ensures that companies with recovery potential are provided with a second chance, balancing liquidation and rehabilitation.

### 6.1.4 Japan

- Japan's insolvency laws are a blend of civil law traditions and modern bankruptcy procedures.
- The Civil Rehabilitation Law allows businesses to reorganize while continuing to operate.
- Bankruptcy liquidation process

Unlike the U.S. or UK, Japan has relatively strict creditor approval mechanisms in the restructuring process, often complicating efforts for a company to exit bankruptcy.

### 6.1.5 Canada

Canada's bankruptcy laws, as enshrined in the Bankruptcy and Insolvency Act (BIA) and Companies' Creditors Arrangement Act (CCAA), balance liquidation and reorganization smoothly. The Canadian insolvency regime is certain and timely. The presence of specialized bankruptcy courts ensures that cases are disposed of in a timely manner, leading to higher recovery rates for creditors. Canada's hybrid model, which takes the best elements of the U.S. model and the UK model, makes it one of the world's finest insolvency systems.

### 6.1.6 China

China's insolvency laws have undergone significant reforms over the last few decades as part of its transition to a market economy.

The **Enterprise Bankruptcy Law (2006)** governs corporate insolvency, and its enactment marked a shift toward debtor rehabilitation.

However, challenges remain in enforcement, transparency, and the handling of state-owned enterprises (SOEs) in distress, where political considerations may influence outcomes. Chinese insolvency law is evolving, with ongoing efforts to streamline and modernize procedures, particularly in addressing corporate debt defaults. China's bankruptcy system is controlled by state intervention, and particularly in the case of major state-owned enterprises (SOEs). The 2007 Enterprise Bankruptcy Law (EBL) was designed to encourage a market-oriented insolvency system, but political interests override legal process in practice. Troubled firms are more likely to be rescued by the government than to be put through regular insolvency processes. Judicial autonomy and creditor protection are absent, and China's bankruptcy system is thus less effective in resolution time and monetary recovery.

### 6.1.7 Italy

Italy's insolvency framework has long been marred by bureaucratic inefficiencies, which have caused unacceptably long resolution times. The 2003 collapse of Parmalat exposed glaring deficiencies in Italy's insolvency framework, and reforms were implemented as a consequence. The introduction of the New Insolvency Code in 2019 was designed to streamline procedures, enhance the protection of creditors, and restrict backlogs on cases. While efforts have been made, achievement with these reforms is still in the process of being made, with resolution times still longer than those in Germany and the UK.

### 6.1.8 India

India's **Insolvency and Bankruptcy Code (IBC, 2016)** is a relatively new but influential framework aimed at providing faster resolution for companies facing insolvency.

The IBC consolidates previous laws and introduces a time-bound process for the resolution of insolvency cases. It encourages creditor participation in the resolution process and focuses on restructuring rather than liquidation. The National Company Law Tribunal (NCLT) adjudicates insolvency cases in India, and the Insolvency and Bankruptcy Board of India (IBBI) regulates the process. Despite its innovations, the Indian insolvency regime has faced challenges related to delays, judicial backlogs, and difficulties in the actual implementation of corporate reorganization plans. India's insolvency law has been revamped in its entirety with the enactment of the Insolvency and Bankruptcy Code (IBC) in 2016. Bankruptcy resolutions were otherwise a futile exercise that would take years. The IBC brought time-bound processes with the intent of resolving cases in 330 days. Nevertheless, judicial delay and implementation issues continue to stifle resolution timelines. Although the IBC has enhanced creditor confidence and business revival, more is needed to make judicial efficiency and enforcement mechanisms more effective.

## 6.2 Common Challenges

- **Cross-border insolvency:** Countries are increasingly grappling with insolvency cases that involve international creditors or assets, which complicates the legal proceedings. International agreements like the UNCITRAL Model Law on Cross-Border Insolvency (1997) aim to provide a framework for handling such cases.
- **Corporate rescue versus liquidation:** The trend is shifting toward rescuing viable businesses rather than liquidation. However, balancing the interests of creditors, shareholders, and employees remains complex, and some systems are criticized for giving too much power to large creditors.
- **Financial distress in the COVID-19 era:** The pandemic has led to an uptick in insolvency filings globally, prompting many countries to introduce temporary relief measures. The Global Financial Crisis of 2008 also brought forward challenges that continue to shape insolvency laws today.

## 7 Conclusion and Policy Recommendations

A critical analysis of cross-border bankruptcy law reveals that efficiency is a function of judicial capacity, debtor-creditor balance, and regulatory responsiveness. The optimal systems (UK, Canada, Germany) enjoy an acceptable balance between these, while others (U.S., India, China, Italy) are plagued by high cost, delay, or state intervention. Insolvency and bankruptcy laws around the world reflect a delicate balance between offering relief to distressed businesses and protecting the rights of creditors. While there is a global shift toward debtor rehabilitation, the actual mechanisms and philosophies of insolvency differ significantly across jurisdictions. Insolvency laws continue to evolve, with a particular focus on harmonization, creditor-debtor relations, and international cooperation. Some policy recommendations are:

- **Enhance Judicial Efficiency:** Dedicated bankruptcy courts can reduce delay and accelerate case disposition.
- **Streamline Out-of-Court Settlements:** Alternative means of dispute resolution can accelerate cases and reduce the burden on the court.
- **Enhance Cross-Border Cooperation:** Cross-border insolvency law harmonization can improve cross-border financial stability.
- **Update Laws Periodically** Keeping bankruptcy laws in sync with economic development and technological innovation is a way to keep legal infrastructures up-to-date.
- **Longer term studies** would examine the integration of AI and case management, and experimental studies on the long-term effects of varying regimes of insolvency.

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