Why Bankruptcy Law

• Individuals and corporations get into situations where their assets are exceeded by their liabilities.
  – What should happen then?

• It would be very foolish to argue that this should never be allowed to happen.

If it were never allowed to happen

• John Smith wants to buy a new house, costing $150,000, and only has $50,000 in cash and liquid assets. If he buys the house on a mortgage, and then home prices fall by half, he may well be bankrupt. There is no way, other than paying cash, to assure that this will never happen.

• John Smith wants neither to buy a house nor to start a business. But he has savings of $50,000 and must decide where to invest it. But potential borrowers are precluded from borrowing the money for they might go bankrupt.
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A market economy means that bankruptcies will arise. We must have some system of dealing with them.

American Bankruptcy

• The Constitution explicitly gives the federal government the authority to regulate bankruptcies.

• Congress has passed a series of bankruptcy laws, regulating the practice.

Bankruptcy Courts

• Judges are appointed for a limited period of time (15 years), and settle bankruptcy issues throughout their district.

• Two common types of bankruptcy:
  – Chapter 7 provides for dissolution of the assets.
  – Chapter 11 provides for a restructuring of the assets.

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Preserve the Going Concern Value
End

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