US Bankruptcy Code

Title 11 of the United States Code

Written by CFI Team
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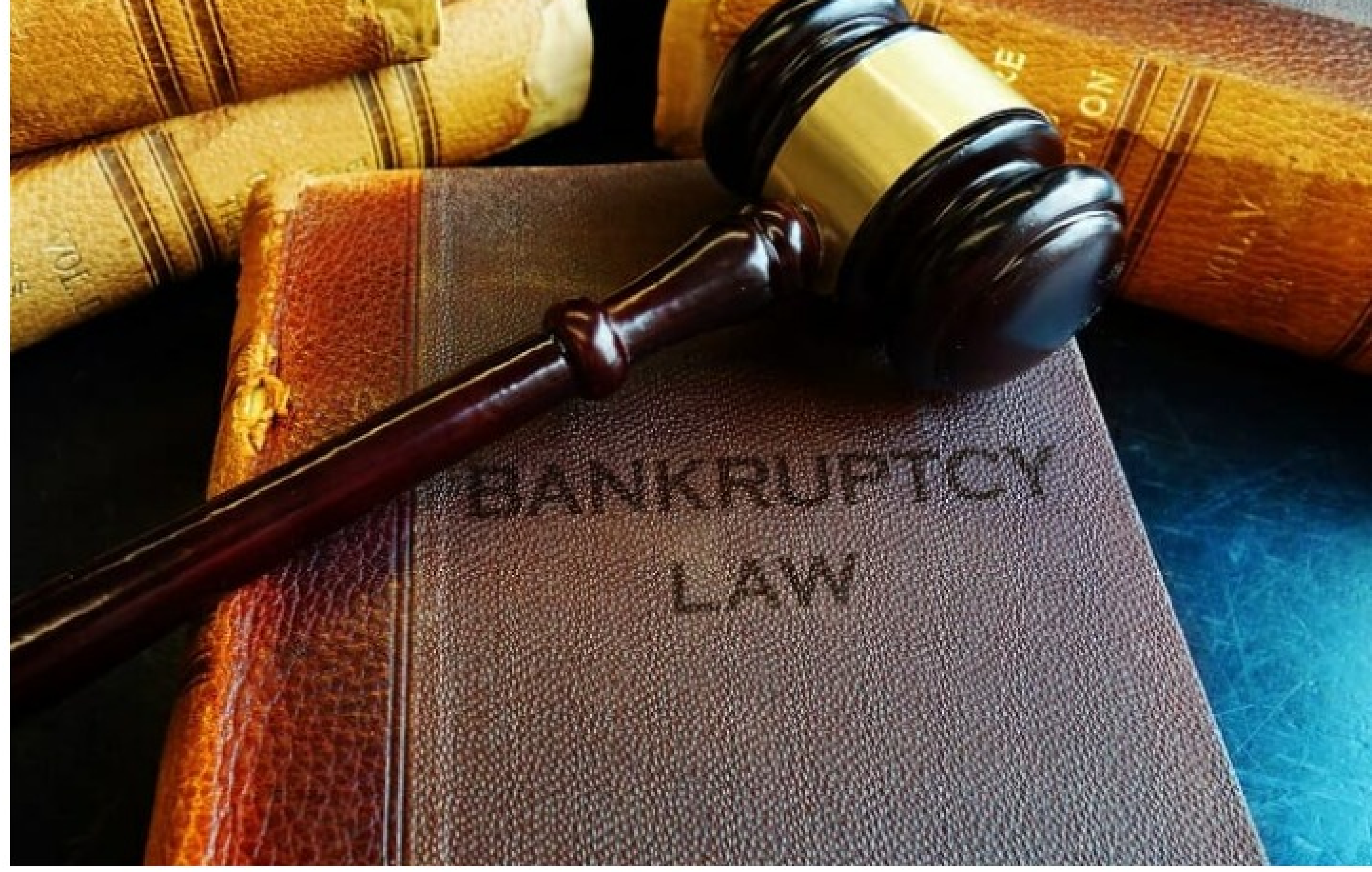
What is the US Bankruptcy Code?

The US Constitution gives the US Congress the authority to enact laws on the subject of bankruptcy for the country. In exercising this authority, legislators have passed several laws on the subject of bankruptcy, the most recent being the Bankruptcy Reform Act of 1978, which largely governs the country's current bankruptcy laws.



The US Bankruptcy Code is also referred to as Title 11 of the United States Code. It governs the procedures that businesses and individuals must follow when filing for bankruptcy in the United States Bankruptcy Court.

History of the US Bankruptcy Code

The first bankruptcy law in the United States came into being in 1800. This law was repealed in 1803 and was followed by the Act of 1841. The 1841 law was repealed in 1843 and was succeeded by the Act of 1867, which was amended in 1874 and was later repealed in 1878. The Nelson Act of 1898 became the first modern bankruptcy legislation in the country.

The next modern bankruptcy law was enacted in 1978 by the Bankruptcy Reform of 1978. The Bankruptcy Abuse Prevention and Consumer Protection Act (2005) is the most recent amendment to the 1978 law.

Contents of the US Bankruptcy Code (Title 11)

Businesses and individuals seeking relief under the US Bankruptcy Code are allowed to file a petition under the Bankruptcy Code chapters 7, 9, 11, 12, 13, and 15.

Chapter 7 – Liquidation

Chapter 7 of the Bankruptcy Code is the most common form of bankruptcy in the United States, and it covers the process of liquidation. It involves the appointment of a trustee by the bankruptcy court to collect the non-exempt assets of the debtor. The trustee is tasked with selling the assets and distributing the proceeds to creditors in order of preference. Businesses and individuals in the United States can file for bankruptcy under Chapter 7.

In the case of businesses, a troubled company may file or be forced by creditors to file for bankruptcy. After the petition is filed, the business ceases to exist unless the court-appointed trustee decides to continue operations. In the case of a large company, the trustee may decide to sell an entire division to another company to raise funds to pay the creditors. Secured creditors are usually paid first because the company's assets act as collateral for the credit advanced to the liquidating company.

Individuals who own property, run a business, or reside in the United States may file for liquidation in a federal court under Chapter 7. These individuals may be allowed to keep certain exempt properties, but the value of properties that may be classified as exempt varies from one state to another. Other assets are sold by the trustee to repay creditors.

While the court may discharge certain unsecured debts, other forms of debts are exempted from the discharge. These debts may include tax arrears for the last three years, child support, property taxes, student loans, and fines imposed by a court of law.

An amendment was made to the bankruptcy law in 2005 with the passing of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005. The amendment was intended to limit consumer debtors from filing bankruptcy in general. Supporters of the amendment claimed that the change would protect certain creditors such as credit card companies from losses resulting from bankrupt customers.

Chapter 9 – Reorganization of Municipalities

Chapter 9 of the Bankruptcy Code deals exclusively with municipalities and how to help them in the restructuring of their debts. A municipality, in this case, refers to a political subdivision or a public agency of a state. The US Bankruptcy Code requires that, for a municipality to be a debtor in a Chapter 9 bankruptcy, it must be authorized to be a debtor by state law, a government officer, or an organization allowed by state law to give such authorizations. Only 12 states specifically authorize bankruptcy, while 12 others approve Chapter 9 bankruptcy after the municipalities have met certain stringent rules.

Before the Chapter 9 bankruptcy came into being, the only remedy for troubled municipalities was for the creditors to pursue an action of mandamus to force the municipality to raise taxes. An amendment to the Bankruptcy Act in 1934 extended the bankruptcy code to include municipalities (the law was declared unconstitutional by a US court in 1935 but a similar law was passed by the US Congress in 1937).

The 2008 financial crisis eventually led to many municipal bankruptcies, six in 2010, 13 in 2011, and 12 in 2012. The largest municipality to file for bankruptcy was Detroit, Michigan on July 18, 2013. Other large municipalities that have filed for Chapter 9 bankruptcy include Jefferson County (Alabama) in 2011 and Stockton (California) in 2012.

Chapters 11, 12, and 13 – Reorganization

Unlike Chapter 7 that deals with the process of liquidation, Chapters 11, 12, and 13 deal with the reorganization of the debtor's assets. Usually, the bankruptcy court will allow the debtor to keep some or all of their assets and use them to pay debts owed to creditors.

Chapter 11 bankruptcy is available to businesses, whether a sole proprietorship, partnership, or corporation. Individuals can also file for Chapter 11, but it is most popular among corporate entities. The debtor remains in charge of the business as a debtor in possession but under the oversight of the bankruptcy court.

Chapter 12 of the Bankruptcy Code is only applicable to family farmers and fishermen. It provides additional benefits such as higher debt ceilings that are not provided by Chapters 11 and 13. Chapter 12 was added to the bankruptcy code in 1986 by the Family Farmer Bankruptcy Act of 1986 that came as a response to the tightening of agricultural credit.

Chapter 13 provides a reorganization plan to individuals who do not want to go through a Chapter 7 bankruptcy. Individuals get an opportunity to reorganize their financial affairs while under the protection of the bankruptcy court. Chapter 13 plans are typically for three to four years, but may not exceed five years.

Chapter 15 – Cross-Border Insolvency

Chapter 15 of the bankruptcy code allows for the cooperation between United States courts, foreign courts, and other authorities involved in cross-border insolvency cases. During certain bankruptcy proceedings in foreign countries, a business or individual may have a connection to assets located in more than one country. Cross-border insolvency focuses on the choice of law rules, jurisdiction rules, and the enforcement of judgment rules.

More Resources

CFI is the official provider of the Commercial Banking & Credit Analyst (CBCA)™ certification program, designed to transform anyone into a world-class financial analyst.

In order to help you become a world-class financial analyst and advance your career to your fullest potential, these additional resources will be very helpful:

- Corporate Structure
- Insolvency
- Tax-Free Reorganization
- Section 368