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Christopher D. Hampson

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What Start-Up Lawyers Should Know About Bankruptcy



By Christopher D. Hampson March 12, 2026

Bankruptcy has long been regarded as a gloomy area of law, one that fits uneasily with the heady optimism usually associated with start-ups. At the same time, start-up lawyers need to understand how downside scenarios will play out, both inside and outside bankruptcy court, in order to advise their clients appropriately. That is especially true for social enterprises – where the decisions throughout a company’s life affect its ability to stick to its mission during times of financial distress. In a [forthcoming book chapter](#), I map out the various elements that start-up lawyers need to consider.

There’s a widespread concern that bankruptcy law may be an inhospitable restructuring strategy for social enterprises, at least in the United States, forcing the enterprise to choose between its business and its mission. That result may flow more from norms than law: Professor [Jonathan Brown](#) and I have published more optimistic assessments than scholars like professors Dana Brakman Reiser and Steven Dean (see their 2017 work, *Social Enterprise Law*). I have argued in subsequent work that some relevant areas of law, like fiduciary duties, are poorly understood and actually more flexible than we have previously appreciated. But I’m clear-eyed enough to recognize that I might be wrong about some or all of this, and so attorneys advising social enterprises at the start-up stage should not assume that a standard chapter 11 would enable their clients to stick to mission.

In the paper, I point out that, in law as in life, every decision comes with tradeoffs. Social enterprises can advance a variety of missions through a variety of corporate forms. Some missions are tightly integrated with the enterprise’s business activities and intellectual property, like [Dave’s Killer Bread](#), which employs individuals with criminal backgrounds while selling market-price bread. Others, like [Allbirds](#), [Bombas](#), and [Warby Parker](#), use a “donation model”: the business itself is relatively standard but the company donates some of its merchandise to a charitable cause. As for corporate forms, some solutions – like the nonprofit corporation – clearly elevate mission over money-making but may come with fundraising challenges. A regular corporate form allows maximum flexibility, but in a downturn, the case for preserving the founders’ mission is incredibly hard to make.

Later in the corporate life cycle, social enterprises might decide to raise money from social venture capital funds. Although those funds might have a “patient” investing strategy, they will still eventually push their borrowers toward a positive liquidity event, like an IPO or acquisition. Figuring out the growth strategy will be important, too. American bankruptcy law gives more flexibility to family farms and small businesses, so a social enterprise might have more resilience if it remains small.

Lastly, during financial distress, social enterprises cannot afford risky gambits if they want to preserve their mission during hard times. While a for-profit company might justify such an approach in the name of maximizing shareholder value, a business committed to mission (like a nonprofit or benefit corporation), has to avoid what Judge Michelle Harner and Jamie Marincic Griffin [call](#) the “ostrich syndrome.” A debtor who enters bankruptcy “hog-tied,” with all its assets pledged as collateral to a secured lender, will not have much of a say in the course of the bankruptcy case. The secured creditor sets the pace for the insolvency proceeding.

The framework listed in the book chapter – Mission, Form, Fundraising, Growth, and Downturn – can help “distress-proof” social enterprises, to various degrees, from losing their mission in a downturn. Still, the point is not to inoculate social enterprises from financial distress at any cost. Each decision has to be made in a business and financial context, and choices to make a social mission more “sticky” – whether through choice of corporate form or a borrowing decision – will have trade-offs, like raising the cost of capital or making it harder to find liquidity in a downturn. The only thing we know for sure is that start-up lawyers should be thinking about these dynamics at every stage of a company’s life cycle.

Finally, bankruptcy is an area of law to think about first, not last. It is not downstream from corporate governance but part of its inner workings, both in theory and in practice. The reason insolvency rules have such a profound impact on the fate of companies is not only because they govern in a downturn, but also because they operate as the backdrop for all sorts of negotiations during good times as well. As I write in the book chapter, all the “enduring questions” of corporate law – including ESG – “take on their hardest forms during financial distress.”

*Christopher D. Hampson is an associate professor at the University of Florida Levin College of Law. This post is based on his book chapter, “Distress-Proofing Social Enterprises,” available in draft form [here](#) and forthcoming in *Insolvency Law and Environmental, Social, and Corporate Governance* (Anthony J. Casey & Thilo Kuntz, eds.).*