Promised payment at t = 2
F
F_{high}
F_{low}
Bankruptcy cost
45°
z
0
1
Cash flow at t = 2
Default $z < F_{low}$
Repayment of F_{low}
Default $z < F_{high}$
Repayment of F_{high}

F
1
1/2
With frictions
$1 + i_{high}$
Without frictions
$1 + i_{low}$
q'
1/4
1/2
Borrowing q at t = 1