



## 2025 International Client Seminar

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*For the Love of Money - Proactive Steps to Take Now to Protect Yourself Before and After a Customer that Owes You Money Files for Bankruptcy*

*"For the Love of Money" (The O'Jays)*

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## From a creditor's perspective, there are universe of options when dealing with a distressed business.

### I. Creditors have “out-of-court” options when a company is in distress.

When dealing with a distressed business, there are numerous options available. Depending on the goals and circumstances, out-of-court solutions can be considered. These include workouts, negotiating forbearance agreements with the debtors, cooperative auctions or liquidation processes, ordinary course sale processes, or more structured options like an Article 9 sale, which involves surrendering to the secured lender and a simultaneous sale to a third-party buyer. Often, distressed situations can be resolved without court involvement, which can sometimes be the best approach.

The first question to ask is, “What kind of creditor am I”? If you are a secured creditor, it is crucial to ensure that you are properly secured. This means having a secured financing agreement with the debtor and filing a UCC-1 against the collateral, providing the most protection vis-à-vis the company. Perfected secured creditors must ensure both attachment and perfection. *See e.g., Appeal of Copeland*, 531 F.2d 1195, 1200 (3d Cir. 1976) (“Section 9—303 provides that a ‘security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken.’ Attachment occurs under s 9—204 when there is an agreement that the security interest attach, value is given, and the debtor has rights in the collateral. A security interest attaches immediately upon the happening of these events ‘unless explicit agreement postpones the time of attaching.’ s 9—204(1).”). Attachment involves having a proper grant of security interest from the correct party who owns the collateral. *See e.g., Wollenberg v. Phoenix Leasing Inc.*, 182 Ariz. 4, 9, 893 P.2d 4, 9 (Ct. App. 1994) (“Under section 9—203(1) and (2), a security interest attaches to collateral when the collateral is in the possession of the secured party pursuant to agreement or the debtor has signed a security agreement containing a description of the collateral, value has been given, and the debtor has rights in the collateral.”). Perfection requires different methods depending on the type of collateral, such as mortgages, UCC financing statements, and control agreements. *See e.g., R.C. §§ 1309.310(A)* (stating a security interest in an account (*i.e.*, a right to payment) and all proceeds thereof is perfected by filing a UCC-1 Financing Statement); 1309.502(A)(C); and 1309.104 (noting a depository account at a bank (*i.e.*, existing funds maintained at a bank) is perfected by control over the account). It is essential to ensure that the collateral described in UCC financing statements matches the description in the security agreement.

For unsecured creditors, there are ways to protect yourself. You can ask for collateral or personal guarantees, modify credit terms to cash on delivery, or explore reclamation rights. Additionally, it is important to protect yourself from preferences and fraudulent transfer litigation. If you suspect a company is in financial distress, certain actions can be taken to safeguard your interests. Ensure that any security agreements are properly filed, continue to receive payments from the distressed entity, and consider entering into settlement agreements that include preference release or similar language to represent that no fraudulent conveyance occurred.

Workouts and forbearance agreements offer opportunities to address potential issues. A workout agreement is a renegotiation between a lender and a delinquent borrower to modify the terms of a defaulted loan, often including waiving existing defaults and restructuring the loan's terms and covenants. *See e.g., Arakaki v. United States*, 71 Fed. Cl. 509, 516 (2006), *aff'd*, 228 F. App'x 1003 (Fed. Cir. 2007) (recognizing that a workout

agreement has been defined in certain contexts as a written agreement between the mortgagor and mortgagee acknowledging that the mortgagor's loan is in default, that the parties have agreed on steps to be taken to bring the loan current, and that the mortgagee will hold the loan in default and will not begin foreclosure proceedings as long as the mortgagee is complying with the terms agreed to in the workout). In contrast, a forbearance agreement temporarily halts foreclosure, providing the borrower with a short-term window to bring the loan current or refinance with another lender. *See e.g., Campbell v. Wells Fargo Bank*, No. 13-CV-12477, 2015 WL 1299811, at \*4 (E.D. Mich. Mar. 23, 2015) (“If references to ‘forbearance’ in the Forbearance Agreement mean something, they must, as the definition of forbearance makes plain, mean forgoing ‘a right, obligation, or debt.’”).

Secured creditors have several options for enforcing security interests under Article 9 of the UCC, including public disposition, private disposition, and strict foreclosure. Public disposition allows any party, including the enforcing secured party, to purchase the collateral, while private disposition generally restricts purchases to third parties. *Compare* 810 Ill. Comp. Stat. Ann. 5/9–610 n. 7 (2013) (providing “a ‘public disposition’ is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding. ‘Meaningful opportunity’ is meant to imply that some form of advertisement or public notice must precede the sale (or other disposition) and that the public must have access to the sale (disposition)”) *with Ford Motor Credit Co. v. Solway*, 825 F.2d 1213 (7th Cir.1987) (finding an auction in which only automobile dealers could participate a private sale and concluding that to term the auction a public sale would not conform with the usual meaning of the word public because the public consists of more than automobile dealers). Strict foreclosure requires the debtor's consent after default and no timely objections from other secured parties or lienholders. *In re CBGB Holdings, LLC*, 439 B.R. 551, 554–55 (Bankr. S.D.N.Y. 2010) (“Section 9–620 of the Uniform Commercial Code governs strict foreclosure—a procedure through which a secured creditor may retain its collateral in full or partial satisfaction of its claim. . . . The remedy is only available if the debtor consents to strict foreclosure after it has defaulted.”) (citations omitted).

## II. Creditors’ rights in bankruptcy proceedings.

Bankruptcy proceedings represent a complex intersection of debtor relief and creditors’ rights. The U.S. Bankruptcy Code provides different chapters to address various financial situations, each with distinct characteristics and implications for both debtors and creditors. Understanding these options and implementing appropriate strategies is essential for creditors to protect their interests and maximize recovery in bankruptcy proceedings.

### 1. The Bankruptcy Chapters.

#### *(a) Chapter 7: Liquidation Bankruptcy*

Chapter 7 represents the most straightforward form of bankruptcy, focusing on asset liquidation. This process involves:

- Complete liquidation of non-exempt assets
- Distribution of proceeds to creditors according to priority
- Oversight by a court-appointed trustee

- Relatively quick resolution compared to other chapters

*(b) Chapter 13: Individual Debt Restructuring*

Designed specifically for individuals with regular income, Chapter 13 offers:

- Structured repayment plans spanning 3-5 years
- Asset retention possibilities
- Debt adjustment opportunities
- Regular payment schedules
- Court supervision of the repayment process

*(c) Chapter 11: Business Reorganization*

Chapter 11 provides businesses with an opportunity to restructure while maintaining operations. Key features include:

- Debtor-in-possession status
- Ability to continue business operations
- Comprehensive debt restructuring
- Complex negotiation processes with multiple stakeholders
- Plan confirmation requirements

*(d) Chapter 12: Agricultural Bankruptcy*

This specialized chapter addresses the unique needs of family farmers and fishermen:

- Tailored reorganization options
- Seasonal payment schedules
- Specific debt limits and qualifications
- Modified plan confirmation standards

*(e) Subchapter V of Chapter 11: Small Business Reorganization*

A recent addition to bankruptcy law, Subchapter V provides:

- Streamlined reorganization process
- Reduced costs and complexity
- Expedited procedures
- Modified disclosure requirements
- Greater flexibility in plan confirmation

## 2. Strategic Considerations for Creditors in Bankruptcy Proceedings.

Success in maximizing recovery and protecting creditor interests requires a comprehensive understanding of available tools and strategic approaches. This section outlines key steps for creditors to consider when navigating bankruptcy proceedings.

### *(a) File a Proof of Claim.*

A proof of claim establishes a creditor's right to payment in bankruptcy proceedings. The filing must occur within strict deadlines - typically 70 days from filing in Chapter 11 cases. For 503(b)(9) claims, creditors must prove goods were received within 20 days before bankruptcy. Successful filings require detailed documentation including delivery confirmations, invoices, and payment histories. These administrative priority claims often receive better treatment than general unsecured claims, making accuracy in filing crucial. Common pitfalls include missing documentation, incorrect claim amounts, and failure to properly categorize claims. Smart creditors maintain real-time delivery records and payment histories to support potential 503(b)(9) claims.

### *(b) Secured creditors' protection.*

Secured creditors must take proactive steps to protect their collateral interests throughout the bankruptcy process. The first thirty days are crucial - requiring quick action on cash collateral and adequate protection motions.

- *Adequate Protection Requests:*
  - Detailed analysis of collateral value and potential depreciation
  - Documentation of pre-petition security interests
  - Strategic timing of adequate protection motions
  - Negotiation of protection terms:
    - Replacement liens
    - Periodic cash payments
    - Insurance requirements
    - Reporting obligations
- *Cash Collateral Usage:*

- Immediate review of cash collateral motions
- Analysis of budget projections and assumptions
- Negotiation of usage restrictions
- Implementation of monitoring mechanisms:
  - Regular financial reporting requirements
  - Account segregation
  - Use limitations
  - Periodic reconciliation
- *Collateral Valuation Strategies:*
  - Independent appraisal considerations
  - Market analysis documentation
  - Expert witness preparation
  - Valuation methodology disputes
  - Timing of valuation determinations
- *Security Interest Protection:*
  - Perfection analysis and documentation
  - UCC continuation statement monitoring
  - Post-petition perfection actions when permitted
  - Defense against preference and fraudulent transfer actions
  - Protection of post-petition interests

***(c) Unsecured Creditors Committee Participation.***

An unsecured creditors committee (a “Committee”) appointed in a Chapter 11 case typically consists of the seven largest unsecured creditors willing to serve. Members gain significant advantages: direct access to debtor information, influence over major decisions, and shared professional resources. However, membership carries real responsibilities - regular meetings, document review, and strategic decision-making. The Committee can investigate the debtor's conduct, challenge transactions, and negotiate plan terms. Successful committees often establish clear protocols for information sharing and decision-making early in the case. Members must balance their individual interests with fiduciary duties to all unsecured creditors.

***(d) Executory Contract Management.***

The management of executory contracts in bankruptcy proceedings represents a critical juncture where business relationships, financial obligations, and operational necessities intersect. These contracts, which have ongoing obligations for both parties, require careful navigation through the bankruptcy process to protect creditor interests while maintaining valuable business relationships.

When a bankruptcy petition is filed, creditors with executory contracts find themselves at a unique crossroads. The debtor's right to assume or reject these contracts creates both opportunities and risks that must

be carefully managed. Understanding this landscape is crucial for creditors to protect their interests and maximize their position in the bankruptcy process.

The first critical step involves a thorough analysis of the contract's executory nature and its value to the bankruptcy estate. Creditors must evaluate whether their contract qualifies as truly executory – meaning both parties have material unperformed obligations – as this determination affects available rights and remedies. This analysis extends beyond the contract itself to consider its integration with other agreements and its impact on ongoing business operations.

Assumption of an executory contract brings both benefits and obligations. For creditors, assumption means the debtor must cure all existing defaults and provide adequate assurance of future performance. This creates an opportunity for creditors to recover pre-petition arrearages and secure stronger performance guarantees moving forward. However, creditors must be prepared to document and substantiate cure amounts, potentially negotiate cure payment terms, and evaluate the sufficiency of adequate assurance proposals.

Timeline management becomes particularly crucial in this context. The Bankruptcy Code provides specific deadlines for assumption or rejection decisions, but these can be extended with court approval. Creditors must actively monitor these deadlines and consider their strategic implications. For instance, forcing an early decision might be advantageous in some cases, while in others, allowing more time for negotiation might yield better results.

Performance obligations during the pre-assumption period require careful attention. Creditors must understand their obligations to continue performance and their rights to administrative expense claims for post-petition services. This period also presents opportunities for negotiating improved terms, particularly if the contract is valuable to the debtor's reorganization efforts.

Risk mitigation plays a vital role throughout this process. Creditors must maintain detailed documentation of performance, comply with notice requirements, and carefully track damages. When assignment is proposed, additional considerations arise, including the evaluation of proposed assignees and the enforceability of anti-assignment provisions.

The negotiation phase often presents opportunities for improving the creditor's position. This might involve modifying contract terms, structuring cure payments, establishing performance milestones, or creating security arrangements. Successful negotiations require understanding both the legal framework and the practical business considerations at play.

In cases involving shopping center leases or other specialized contracts, additional provisions and protections may apply. Creditors must understand these special rules and how they affect their strategic options. The intersection of these special provisions with general bankruptcy principles can create both opportunities and complications that require careful navigation.

Throughout the process, creditors must balance competing considerations: maintaining business relationships, maximizing financial recovery, ensuring future performance, and protecting their legal rights. Success often requires a flexible approach that combines legal expertise with practical business judgment, always keeping sight of the creditor's long-term business objectives.

*(e) Critical Vendor Status.*

Critical vendor status is a tool in bankruptcy that protects the most essential suppliers to a business. It allows these key vendors to receive payment on pre-bankruptcy debts because their goods or services are deemed vital to the company's survival and successful reorganization.

To qualify, a vendor must be “irreplaceable” – meaning the debtor can't easily find another supplier or would face significant harm if they lost this particular vendor. Common examples include suppliers of proprietary parts, specialized service providers, or vendors with unique capabilities.

The benefits are straightforward: critical vendors get paid on old debts and maintain their business relationship with the debtor. In exchange, they typically must agree to continue supplying goods or services on established terms throughout the bankruptcy process.

The process requires clear documentation of the vendor's importance, careful monitoring of the ongoing relationship, and compliance with any agreed-upon terms. Both parties need to maintain their commitments – the debtor to make payments and the vendor to continue supply – for the arrangement to work.

Successfully navigating critical vendor status means balancing the immediate need for payment with the long-term value of the business relationship. When it works well, both the vendor and the debtor benefit from continued operations and a stable supply chain through the bankruptcy process.

*(f) Relief from Stay Considerations.*

The automatic stay halts most creditor actions, but relief is also available for cause. Common grounds include lack of adequate protection, no equity in property, and property unnecessary for reorganization. The burden of proof varies both by jurisdiction and grounds for relief. Courts often approve agreed relief from stay, making negotiation with the debtor worthwhile. Timing matters here because early motions may face stronger resistance than those filed after case developments reveal problems. Evidence of debtor misconduct or misuse of collateral strengthens relief motions.

*(g) Dismissal/Conversion Options.*

Motions to dismiss or convert can create significant leverage. Common grounds include continuing losses, gross mismanagement, and failure to maintain insurance or file reports. Obtaining a court's order to dismiss requires strong evidence and often support from other creditors (for example, through joinders). Courts typically give debtors reasonable opportunities to address problems before converting or dismissing. Some creditors use the threat of dismissal/conversion to negotiate improved treatment. Creditors should be urged here to comply with ethical rules of each jurisdiction. The strategy works best when supported by clear evidence of fundamental problems rather than minor defaults.

*(h) 363 Sales Participation.*

Section 363 sales provide quick asset sales with court protection. Creditors can influence sale procedures, bid requirements, and auction rules. Secured creditors often have credit bid rights up to their claim amount. Key issues include sale timing, marketing process, and treatment of liens and interests. Successful sales require adequate market exposure and competitive bidding. Many creditors negotiate specific sale provisions protecting their interests. The process moves quickly, requiring early preparation and clear objectives.

*(i) Plan Voting.*

Plan voting gives creditors direct say in reorganization terms. Claims are classified based on legal rights and treatment. Acceptance requires support from two-thirds in amount and majority in number of voting creditors in each class. Strategic considerations include treatment of similar claims, feasibility of proposed payments, and available alternatives. Many creditors form informal groups to increase voting leverage. Understanding plan releases and injunctions is crucial, as they may affect future rights.

*(j) Adversary Proceedings.*

Adversary proceedings function like separate lawsuits within the bankruptcy. Common issues include preference claims, fraudulent transfers, and lien validity. Preference defenses include ordinary course of business and new value. Success often requires extensive documentation of payment and business histories. Many creditors prepare preference defenses early, maintaining records of payment patterns and new credit extensions. Early assessment of exposure helps in negotiating resolutions.

*(k) Additional Creditor Tools.*

Beyond primary strategies, creditors have various other tools. Rule 2004 examinations allow broad discovery of debtor affairs. Involuntary bankruptcy requires careful coordination among creditors. Substantive consolidation objections protect against improper mixing of separate entities. Administrative expense claims provide priority for post-bankruptcy dealings. Many creditors use these tools selectively to address specific issues or create negotiating leverage. Success requires understanding each tool's requirements and strategic implications.

**III. Creditors have rights in state-court insolvency proceedings.**

**Assignments for the Benefit of Creditors.** Companies forced to wind down operations and liquidate their assets often choose a liquidation process known as an "ABC" (Assignment for the Benefit of Creditors). An ABC is usually

more streamlined, requires fewer public disclosures and less court involvement, and is significantly less expensive than other formal liquidation processes such as federal bankruptcy proceedings.

An ABC is a liquidation process governed by state law by which a company (referred to as the assignor or the debtor) assigns all of its assets to an assignee (typically, a professional firm specializing in ABCs) that will manage the liquidation process and distribute the assets' proceeds to the company's creditors in accordance with the priorities dictated by state law. The assignee serves as a neutral, independent fiduciary whose duty is to maximize value for the company's creditors and shareholders.

**A Delaware Perspective.** In Delaware, the statutes governing ABCs are relatively sparse and form the only subchapter of Delaware's insolvency laws not preempted by federal bankruptcy law. These provisions cover various aspects, including the assignee's filing of inventory, the court's appointment of appraisers, the bonding of the assignee, proceedings on the assignee's bond, the assignee's accounts and exceptions to those accounts, the removal of the assignee, and the voidance of preferential assignments. 10 DEL. CODE ANN. §§ 7381-7387.

ABCs in Delaware begin with the contractual assignment of the assignor's assets to an assignee in trust for the assignor's creditors. Within 30 days after executing the assignment, the assignee must file an inventory or schedule of the assigned assets with the office of the Register of Chancery in the county where the assignor's real and personal property is located. *Id.* § 7381. After making that filing, the assignee must provide periodic accounts of its trusteeship to the Register of Chancery of the proper county. *Id.* § 7385.

The Delaware Court of Chancery requires these, and other, robust public disclosures at the outset of an ABC proceeding regarding the company and the assignee, akin to disclosures that a company typically makes within the first few days of a federal bankruptcy case in an effort to bring "transparency and consistency" to the ABC proceedings. *See In re Theonys, Inc.*, C.A. No. 2023-0195-PAF, Letter (Del. Ch. May 22, 2023); *see also In re Glob. Safety Labs, Inc.*, 275 A.3d 1278, 1284 (Del. Del. Ch. 2022) ("What the Petition lacks, and what the court invariably needs, is context. The bankruptcy courts and their practitioners have developed a vehicle for providing that context through a submission known as a 'First-Day Declaration' or a 'First-Day Affidavit.' . . . This case calls out for a comparable declaration, tailored by skilled counsel to provide the information that the court needs to evaluate the Petition. . ."). Delaware court have recognized the importance of these disclosures because ABC cases are handled *ex parte* — i.e., without notice to all parties who may be affected by the relief. *Id.* at 1280 ("Many of these proceedings are handled *ex parte*, so the court never has the benefit of an interested party that can provide a different perspective or ask probing questions.").

Through a Delaware ABC, an assignee has plenary authority to administer the property of the ABC estate, subject to the terms of the assignment agreement, the duties imposed on the assignee by common law, and the requirements imposed by the ABC statute. Given this, creditors can expect the assignee to act as a fiduciary to the creditors' benefit. Creditors can expect the assignee to liquidate the company's assets and distribute the proceeds to the creditors according to their relative priorities, and creditors can expect the assignee to provide annual reports and a final report.

**State-Court Receiverships.** A receivership involves the court appointment of a receiver to oversee and, in most cases, operate or liquidate a business. A receiver is a neutral and independent third-party appointed to act on behalf, and for the benefit, of all interested parties. Receiverships can convey property free and clear of liens, and receivership courts commonly approve sale processes similar to bankruptcy courts.

**A Delaware Perspective.** Delaware's version of the general receivership is outlined in section 291 of the Delaware Code, where the receiver is court-appointed and steps in to operate and sell the debtor's entire business and all assets. In particular, that section provides that the Court of Chancery may appoint a receiver “[w]henever a corporation shall be insolvent, . . . on the application of any creditor or stockholder.” 8 DEL. CODE ANN. § 291.

Section 291 empowers the Court to appoint a receiver for an insolvent corporation “to take charge of its assets, estate, effects, business and affairs, and . . . to do all other acts which might be done by the corporation and which may be necessary or proper.” “[T]he appointment of a receiver does not follow automatically.” *Keystone Fuel Oil, Inc. v. Del-Way Petroleum, Co.*, 1977 WL 2572, at \*2 (Del. Ch. June 16, 1977). Rather, “the appointment of a receiver lies within the sole discretion of the Court.” *Banet v. Fonds de Regulation et de Controle Café Cacao*, 2009 WL 529207, at \*3 (Del.Ch. Feb. 18, 2009). In that regard, this Court has held that “[t]he appointment of a receiver is appropriate only if the company is insolvent and there exist ‘special circumstances’ where ‘some real beneficial purpose will be served.’ Accordingly, the court will appoint a receiver only if the company is insolvent and exigent circumstances warrant such relief.” *Pope Invs. LLC v. Benda Pharm., Inc.*, 2010 WL 5233015, at \*6 (Del. Ch. Dec. 15, 2010) (footnotes omitted) (quoting *Banet*, 2009 WL 529207, at \*3). Stated differently, the plaintiff must demonstrate that appointment of a receiver is necessary to protect the insolvent corporation’s creditors or shareholders by showing “some benefit that such an appointment would produce or some harm it could avoid.” *Id.* at \*8.

“Even [where] exigent circumstances . . . exist, the appointment of a receiver is only justified if it would serve a ‘beneficial purpose.’” *Pope Invs. LLC v. Benda Pharm., Inc.*, 2010 WL 5233015, at \*13 (Del. Ch. Dec. 15, 2010) (quoting *Banet v. Fonds de Regulation et de Controle Café Cacao*, 2009 WL 529207, at \*3 (Del. Ch. Feb. 18, 2009)). In that regard, the potential benefits must outweigh any potential harm that appointment of a receiver could cause.

If a receiver is appointed, the court will issue an assignment with which to charge him or her. Under 8 Del. C. § 291, “[t]he powers of the receivers shall be such and shall continue so long as the Court shall deem necessary.”

**A Wisconsin Perspective.** Wisconsin Statutes Chapter 128 provides a state-law alternative to federal bankruptcy proceedings through assignments for the benefit of creditors (ABCs). Chapter 128 was established in 1937, modeled on the federal Bankruptcy Act of 1898. While the federal Bankruptcy Code has been substantially modernized since then, Wisconsin's Chapter 128 has remained largely unchanged, with only minor revisions since 1977. This creates unique challenges for practitioners who must navigate between outdated statutory language and modern commercial realities. That said, Chapter 128 proceedings are very popular in Wisconsin, especially as a remedy for secured creditors.

A Chapter 128 receivership in Wisconsin typically begins in one of two ways: through voluntary assignment by the debtor or through an involuntary petition filed by a creditor. Each path sets in motion a complex process that requires careful attention to detail and strategic planning.

In a voluntary assignment, the debtor makes the conscious decision to place its assets in the hands of a receiver for orderly liquidation and distribution to creditors. This process begins with the debtor's careful assessment of its financial situation and the preparation of detailed schedules listing all assets and liabilities. The debtor selects a proposed receiver – often an experienced insolvency professional – and prepares the necessary assignment documents. These documents must comprehensively detail the transfer of the debtor's property to the receiver

in trust for the benefit of creditors.

Involuntary proceedings present a different dynamic. Here, a secured creditor – unlike in federal bankruptcy where multiple unsecured creditors are typically required – can initiate the proceeding by filing a verified petition. The petition must demonstrate proper grounds, such as an unsatisfied execution or the debtor's insolvency. The creditor often combines this with other causes of action, such as replevin or foreclosure, creating a multi-faceted approach to protecting their interests.

Upon appointment, the receiver starts acting swiftly to take control of the debtor's assets. This involves physical securing of property, taking control of bank accounts, verifying insurance coverage, and conducting a thorough inventory. The receiver must also quickly establish communication with key stakeholders – employees, customers, vendors, and creditors – to minimize disruption and maintain value.

The sale process itself varies depending on the nature of the assets and the circumstances of the case. For ongoing businesses, the receiver might seek to sell the enterprise as a going concern to preserve jobs and maximize value. For others, a piecemeal liquidation might yield better results. In either case, the process typically involves court approval of sale procedures, notice to creditors, an opportunity for competing bids, and final sale approval.