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Is It Time to Learn the “Canadian Two-Step”?

*By Benjamin Mintz and Justin Imperato**

In this article, the authors discuss a decision by a New York bankruptcy court recognizing and enforcing a reverse vesting order approved by a Canadian court in the debtors’ Canadian insolvency proceedings.

Reverse vesting orders (RVOs) have emerged in Canada as an important restructuring tool for debtors. Instead of a traditional sale, debtors’ *unwanted* liabilities and assets are reverse vested out of the debtor company into a newly created entity, “ResidualCo,” leaving the clean, viable business and its assets in the debtor company for the purchaser to acquire. RVOs have sparked fierce debate. Critics argue they can be used unfairly to shed pension obligations, environmental liabilities, and employee claims in ways that prejudice stakeholders, allowing purchasers to cherry-pick assets to the detriment of creditors.

In *In re Iovate Health Sciences International Inc.*,¹ one of the first published opinions to analyze the enforceability of Canadian RVOs in the U.S. under Chapter 15 of the U.S. Bankruptcy Code (the Bankruptcy Code), the U.S. Bankruptcy Court for the Southern District of New York (the Bankruptcy Court) granted Iovate Health Sciences International Inc.’s (in its capacity as the authorized foreign representative, the Foreign Representative) motion to recognize and enforce an RVO approved by the Ontario Superior Court of Justice (the Canadian Court) in the Iovate debtors’ Canadian insolvency proceedings.

The Bankruptcy Court did several notable things in *Iovate* when it enforced the Iovate RVO. First, it held that the Iovate RVO did not violate U.S. public policy and that creditor interests had been sufficiently protected in the Canadian insolvency proceedings. Second, it held that the Iovate RVO transaction did not necessitate review under Bankruptcy Code section 363(b),² although the Bankruptcy Court did grant section 363(m) good faith purchaser protections to the Purchaser (as defined below).³ Finally, it recognized

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¹ *In re Iovate Health Sciences International Inc.*, Case No.25-11958 (MG), ECF No. 108 (Bankr. S.D.N.Y. May 12, 2026) (*Iovate*).

² Bankruptcy Code section 363(b) provides, among other things, that court approval must be obtained before a debtor may sell assets outside of the ordinary course of business. See 11 U.S.C. § 363(b).

³ Bankruptcy Code section 363(m) provides that if a sale of estate property is authorized by the bankruptcy court, and that authorization is later reversed or modified on appeal, the reversal

nonconsensual third-party releases approved by the Canadian Court in the Iovate RVO, notwithstanding the Supreme Court's decision in *Harrington v. Purdue Pharma L.P.*⁴ which held that nonconsensual third-party releases in Chapter 11 plans are not permitted. These notable aspects from *Iovate* will be addressed below, along with a discussion on the implications of the decision. But first, this article discusses RVOs, generally, and provides background from the Iovate Canadian insolvency proceeding.

BACKGROUND ON REVERSE VESTING ORDERS AND *IOVATE*

Section 11 of the Canadian Companies' Creditors Arrangement Act (CCAA) confers broad authority on Canadian courts to "make any order that it considers appropriate in the circumstances."⁵ From CCAA section 11, RVOs have emerged in Canadian insolvency practice in the last decade. RVOs employ a reverse vesting structure whereby the debtor cancels all existing shares and issues new shares to a designated purchaser. The purchaser agrees to accept preferred assets and liabilities, while certain excluded assets and liabilities are vested into a newly formed ResidualCo. The purchased company, holding only the assumed assets and liabilities as desired by the purchaser, may then exit the Canadian insolvency proceeding with the ResidualCo being added as a debtor to the proceeding.

The Bankruptcy Code does not afford debtors and asset purchasers any parallel to RVOs. In cases under Chapter 11 of the Bankruptcy Code, the primary mechanism for asset sales is section 363, which works in the opposite direction from an RVO — the debtor transfers assets out to a purchaser free and clear of liens and claims, with liabilities (other than expressly assumed ones) staying behind in the estate. There's no statutory equivalent to the Canadian RVO structure where the liabilities are transferred out and the purchaser acquires the existing corporate shell with its licenses, tax attributes, and regulatory history intact. One could, theoretically, construct a plan that creates a ResidualCo entity, vests unwanted liabilities into it, and distributes the cleaned-up debtor's equity to a purchaser, thereby economically replicating the RVO structure. Nothing in the Bankruptcy Code expressly prohibits this approach, though engaging in the plan process would decrease the speed at which the sale may occur, potentially resulting in the depreciation of the entity and its assets.

or modification does not affect the validity of the sale to a good faith purchaser, unless the appellant obtained a stay of the sale pending appeal.

⁴ 603 U.S. 204 (2024).

⁵ R.S.C. 1985, c. C-36, § 11.

In recent years, some U.S. companies have tried to employ a similar process in advance of a bankruptcy filing, the so-called Texas two-step, which is a corporate restructuring maneuver that uses Texas’ divisive merger statute⁶ to shield solvent companies from mass tort liability. In the first step, a parent company uses a Texas divisive merger to split into two entities — one retaining the valuable assets and the other bearing the tort liabilities. In the second step, that liability-burdened entity commences a Chapter 11 bankruptcy case, which automatically stays all litigation against that liability-burdened spinoff.⁷ In addition, the debtor entity may be able to extend the stay to apply to all non-debtor affiliates.

Iovate Health Sciences International Inc. and its affiliated debtors commenced insolvency proceedings in Canada on September 5, 2025.⁸ The Canadian Court appointed KSV Restructuring Inc. (the Monitor) as independent monitor and approved a Sale and Investment Solicitation Process (SISP) conducted by the Monitor with the assistance of a sales agent. The SISP proceeded and later the Monitor selected the bid submitted by 1001542267 Ontario Inc. (the Purchaser), a newly formed entity, as the superior bid. The Purchaser’s winning bid was implemented through a Subscription Agreement (the Subscription Agreement), dated April 2, 2026, between the Purchaser and Xiwang Iovate Holdings Company Limited (the Purchased Company).

The parties structured the sale as a reverse vesting transaction whereby the Purchaser subscribed for and acquired 100 new common shares in the

⁶ See Tex. Bus. Orgs. Code §§ 10.001 et seq.

⁷ Bankruptcy courts have treated the Texas two-step with increasing skepticism, particularly after the Third Circuit’s rulings in the Johnson & Johnson (J&J) talc litigation. The Third Circuit held that J&J’s specially created subsidiary, LTL Management, was not eligible for bankruptcy protection because it was not in genuine financial distress — reasoning that good faith requires distress that is immediate, imminent, and apparent. After J&J refiled with an estimated \$61.5 billion settlement offer, the Bankruptcy Court for the District of New Jersey again dismissed the case as filed in bad faith, and the Bankruptcy Court for the Southern District of Texas subsequently rejected J&J’s third attempt as recently as March 2025, reaffirming that bankruptcy laws are for distressed businesses rather than a liability management tool for solvent corporations. By contrast, other users of the strategy — most notably Georgia-Pacific’s Bestwall entity, which offloaded asbestos liabilities in 2017 — have as yet survived in other circuits but have to date not achieved a successful confirmed plan. On the legislative front, a bipartisan group of lawmakers introduced the Ending Corporate Bankruptcy Abuse Act in July 2024, which was reintroduced in December 2024, and would instruct courts to presume bad faith in Texas two-step filings and prohibit extending the automatic stay to non-bankrupt affiliates — though the bill has yet to advance.

⁸ The insolvency proceedings were initially commenced under Canada’s Bankruptcy and Insolvency Act (BIA). The BIA proceedings were later converted to a CCAA proceeding by order of the Canadian Court on October 31, 2025.

Purchased Company, while all existing shares were cancelled for no consideration. Certain identified “Excluded Assets,” “Excluded Contracts,” and “Excluded Liabilities” (collectively, Excluded Property) were vested out to a newly formed ResidualCo, leaving the Purchased Company holding only the preferred assets and liabilities that the Purchaser wished to retain.

The reverse vesting structure was necessitated by the debtors’ possession of non-transferable regulatory licenses required to import goods and sell products in Canada, US\$114 million in non-capital losses eligible to be carried forward only if retained by the existing entity, and contracts that could be maintained more efficiently through the existing legal entity than through an asset sale. The Canadian Court approved the Iovate RVO on April 16, 2026, including the Subscription Agreement and third-party releases in it, finding that the structure satisfied all applicable CCAA requirements and produced an economic outcome at least as favorable as any available alternative.

The Foreign Representative filed a Chapter 15 petition in the Bankruptcy Court to prevent the Iovate debtors’ stakeholders and judgment creditors from commencing or proceeding with actions in the U.S. that would disrupt Iovate’s restructuring process. The Foreign Representative obtained recognition of the Canadian CCAA proceeding as a foreign main proceeding under Bankruptcy Code section 1517, and subsequently moved for an order that: (i) recognized and enforced the Iovate RVO under Bankruptcy Code sections 1522, 1521, and 1507; or, alternatively, (ii) authorized and approved the Iovate RVO under Bankruptcy Code sections 363, 1520, and 1521.

THE *IOVATE* DECISION

Bankruptcy Code section 1521(a)(7) gives courts broad discretion to provide to foreign representatives “any appropriate relief that would further the purposes of chapter 15 and protect the debtor’s assets and the interests of creditors,”⁹ including relief that would not be available in a Chapter 11 case, “provided that such assistance is consistent with the principles of comity and satisfies fairness considerations set forth in Section 1507(b).”¹⁰ This broad grant is constrained only by the requirement in Bankruptcy Code section 1522(a) that creditor interests be “sufficiently protected,” and that the relief not violate U.S. public policy pursuant to Bankruptcy Code section 1506.¹¹

⁹ In re Asbestos Corp. Ltd., 674 B.R. 855, 868 (Bankr. S.D.N.Y. 2025); see 11 U.S.C. § 1521(a)(7).

¹⁰ In re Rede Energia S.A., 515 B.R. 69, 90 (Bankr. S.D.N.Y. 2014).

¹¹ In re Cozumel Caribe S.A. de C.V., 482 B.R. 96, 113 (Bankr. S.D.N.Y. 2012).

Many U.S. bankruptcy courts have, without objection, enforced Canadian RVOs without accompanying opinions explaining the court’s reasoning.¹² In one notable instance, though, the Delaware bankruptcy court published a decision that recognized a Canadian RVO that was presented without objection for enforcement, and cautioned against applying the decision as precedent, citing uncertainty in how the court would, in the face of an objection, view an RVO that redeems and cancels existing equity for no consideration and vests out to a ResidualCo the debtor’s liabilities.¹³

The Bankruptcy Court enforced the Iovate RVO pursuant to Bankruptcy Code sections 1522 and 1521.¹⁴ Applying Bankruptcy Code section 1522, the Bankruptcy Court held that creditor interests were sufficiently protected for two reasons. First, the Canadian Court had specifically found that no stakeholder was worse off under the Iovate RVO structure than under any available alternative. Second, the Monitor, an independent officer with court-appointed oversight authority, had conducted the SISF, ensuring objective and fair administration of the process. Critically, the Bankruptcy Court emphasized that the Iovate RVO did not extinguish any creditor’s claim; all such claims would survive against either the reorganized principal entities or ResidualCo, with the same nature and priority as before the Iovate RVO.

The Bankruptcy Court further held that recognition and enforcement of the Iovate RVO did not violate the public policy exception of Bankruptcy Code section 1506, which the Bankruptcy Court held should be construed narrowly

¹² See, e.g., *In re Votur Analytics Corp.*, No. 25 11996 (JKS) (Bankr. D. Del. Feb. 13, 2026); *In re The Lion Elec. Co.*, No. 24-18898 (DDC) (Bankr. N.D. Ill. June 26, 2025); *In re Chesswood Grp.*, No. 24-12454 (CTG) (Bankr. D. Del. Mar. 24, 2025); *In re 9139249 Canada Inc.*, No. 24-19627 (VZ) (Bankr. C.D. Cal. Jan. 10, 2025); *In re Elevation Gold Mining Corp.*, No. 24-06359 (Bankr. D. Ariz. Dec. 30, 2024); *In re Endoceutics Inc.*, No. 22-11641 (Bankr. D. Mass. Oct. 12, 2023); *In re Just Energy Grp.*, No. 21-30823 (Bankr. S.D. Tex., Dec. 1, 2022).

¹³ *In re Goli Nutrition Inc.*, Case No. 10438, 2024 WL 1748460, at * 2 (Bankr. D. Del. Apr. 23, 2024) (Goli Nutrition) (“I stated that I would enforce the order as there were no objections to the transaction as a whole or its structure. Notice was provided to all parties, including shareholders whose stock is being redeemed and cancelled for no consideration, and those who may hold liabilities that are being vested out to Residual Co. I must emphasize, however, that I do not know how I would rule on a similar reverse vesting transaction if there were objections. So, I cannot stress enough that the order I enter should not be cited in future motions for the proposition that U.S. courts have unconditionally approved such transactions.”).

¹⁴ In Iovate, one of the debtors’ creditors, TSI Group Co., Ltd., filed a limited objection to the Foreign Representative’s motion to enforce the RVO, citing Iovate’s failure to confirm that it would assume existing contractual agreements with TSI or pay the cure amounts owed to TSI. TSI, however, subsequently withdrew its limited objection.

to apply only to actions contrary to the “most fundamental policies of the United States.”¹⁵ The Bankruptcy Court reasoned that, if even the denial of a jury trial right in a foreign proceeding does not offend U.S. public policy when a fair and impartial proceeding is offered,¹⁶ then a reverse vesting structure that preserves creditor claims certainly does not rise to that level. Given its findings under Bankruptcy Code sections 1522 and 1521, the Bankruptcy Court did not determine whether recognition was also warranted under section 1507.

The Foreign Representative had alternatively sought approval of the RVO transaction under Bankruptcy Code section 363, which applies by operation of section 1520(a)(2) to transfers of U.S.-sited property in a recognized foreign main proceeding. The Bankruptcy Court declined to conduct a section 363 analysis on two grounds.

First, following *Goli Nutrition*, the Bankruptcy Court held that the issuance of new shares to the Purchaser is not a “sale” of property within the meaning of section 363. Unlike a stock sale, in which a debtor sells already-issued shares, the reverse vesting structure involves the issuance of newly created shares; no existing estate property is transferred to the Purchaser.

Second, with respect to the transfer of Excluded Property to ResidualCo — which could potentially implicate section 363 — the Foreign Representative represented on May 6, 2026, at a hearing, that no physical assets currently located in the U.S. would constitute Excluded Property. Accordingly, no transfer of property within the territorial jurisdiction of the U.S. would occur, and Bankruptcy Code section 1520(a)(2) was not triggered. Notably, notwithstanding its declination to review the RVO transaction under section 363(b), the Bankruptcy Court held that the Purchaser was entitled to the good faith protections of section 363(m) where the Monitor confirmed that the Purchaser was unrelated to the debtors under section 36 of the CCAA, the SISP produced broad market canvassing, and there was no evidence of fraud or collusion in the bidding process.

Finally, the Bankruptcy Court recognized nonconsensual third-party releases approved by the Canadian Court, notwithstanding the Supreme Court’s decision in *Purdue*, which held that nonconsensual third-party releases in Chapter 11 plans are not permitted. Relying on *In re Credito Real, S.A.B. de C.V.*¹⁷ and *In re Odebrecht Engenharia e Construção S.A.*,¹⁸ the Bankruptcy

¹⁵ *In re Ephedra Prods. Liab. Lit.*, 349 B.R. 333, 336 (S.D.N.Y. 2006) (citing H.R. Rep. No. 109–31(I), at 109, as reprinted in 2005 U.S.C.C.A.N. 88, 172).

¹⁶ See *id.*

¹⁷ 670 B.R. 150 (Bankr. D. Del. 2025) (*Credito Real*).

Court held that *Purdue*’s holding is limited to Chapter 11 cases. According to the Bankruptcy Court, the releases here were permissible because they were narrowly tailored and limited to claims arising from or relating to the Subscription Agreement, the RVO, and the transactions contemplated by the RVO and Subscription Agreement and expressly excluded claims for fraud or willful misconduct. This scope, according to the Bankruptcy Court, was consistent with releases approved in *Odebrecht*, and the Bankruptcy Court found them properly balanced against stakeholder interests. The Bankruptcy Court also notably observed that failing to enforce the releases in the U.S. would create an unequal playing field, giving U.S.-based creditors rights that Canadian creditors did not have, thereby undermining the comity-based framework of Chapter 15.

CONCLUSION

The *Iovate* decision is significant in two respects.

First, it is among the first published decisions to provide a full legal analysis of a reverse vesting order, building on the sparse precedent from the Delaware bankruptcy court in *Goli Nutrition* and the broader body of unpublished RVO recognition orders from courts around the country. The Bankruptcy Court’s detailed treatment of the RVO mechanism, including its Canadian statutory basis, the approval factors, and the distinction from the Texas two-step, provides a framework that future courts and practitioners can draw upon.

Second, the decision reinforces the post-*Purdue* consensus that is emerging in Chapter 15 cases: the Supreme Court’s prohibition on nonconsensual third-party releases in Chapter 11 plans does not extend to Chapter 15 recognition proceedings, where the broader statutory grants in Bankruptcy Code sections 1521 and 1507 permit courts to enforce such releases when creditor interests are sufficiently protected.

While *Iovate*’s holding is consistent with *Credito Real* and *Odebrecht* and reflects a growing judicial consensus that *Purdue*’s reasoning does not curtail the distinctly broader tools available in ancillary cross-border proceedings, we expect *Purdue*’s applicability to Chapter 15 proceedings to be a continuing source of debate. We also expect to see, where obtaining third-party releases are critical to the success of a company’s efforts to reorganize, more companies pursue foreign restructurings in Canada, the United Kingdom, and other locales where nonconsensual third-party releases are enforceable, with such companies thereafter attempting to obtain recognition in the U.S. under Chapter 15 to enforce those third-party releases.

¹⁸ 669 B.R. 457 (Bankr. S.D.N.Y. 2025) (*Odebrecht*).