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Potential or Problem? The Prospect of Reverse Vesting Under Chapter 11

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Over the last five years, the "reverse-vesting order" (RVO) has emerged in Canada as the preferred means of implementing a transaction for insolvent companies. While still described as an "unusual and extraordinary measure" (the granting of which should "involve close scrutiny"[1]), the RVO has become ubiquitous in Canadian insolvency proceedings. It has been utilized in a variety of scenarios, ranging from restructurings under the Companies' Creditors Arrangement Act (CCAA)[2] and Bankruptcy and Insolvency Act (BIA),[3] to liquidations by court-appointed receivers under the BIA, to corporate arrangements under the Canada Business Corporations Act (CBCA).[4]

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The utility of the RVO in Canadian restructuring proceedings begs several questions: Could an RVO be implemented in the context of a proceeding under chapter 11 of the Bankruptcy Code, and what would the adoption of this mechanism add to the toolkit currently available to U.S. debtor companies? Responses to these questions must grapple with the criticism of RVOs in Canada, the existing chapter 11 tools that achieve similar outcomes, and the prevailing wariness in the U.S. toward mechanisms that allow for segmentation of corporate liabilities.

Despite these challenges, an RVO-style option could deliver efficient, less costly restructurings. To gauge whether that promise can translate to chapter 11 practice, this article explores the ongoing debate over RVOs in Canada and the efficiencies they have nonetheless produced, considers the incremental benefits such a device might bring to U.S. restructurings, and highlights the legal and policy hurdles that may restrict its adoption.

What Is an RVO?

Unlike a traditional vesting order, an RVO does not provide for the sale of assets. It instead provides for "reverse vesting," whereby certain excluded assets and liabilities are vested into a newly formed company, or "ResidualCo." Following this cleanse of unwanted assets and liabilities, the purchaser becomes the sole shareholder of the existing debtor corporation. RVOs are often used to facilitate restructurings whereby the debtor company possesses desirable attributes, such as nontransferable government licenses or permits, or valuable tax losses. RVOs are particularly useful for companies in highly regulated industries.

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RVOs also offer practical advantages. Prior to the prevalent use of RVOs, if a purchaser wanted to avoid challenges associated with an asset sale and acquire a debtor company following a cleansing of its liabilities, the transaction was implemented by way of a plan of compromise or arrangement under the CCAA. As is the case in chapter 11 proceedings, plans under the CCAA are subject to a creditor vote[5] and court approval. Unlike chapter 11, the CCAA does not incorporate cross-class cramdowns. Creditors that may not be getting a recovery under a plan must still support its implementation. The RVO allows a debtor company to effect the same result as a plan without the requirement of a creditor vote, eliminating any need to incentivize creditors who are "out of the money" to support the plan.

Notably, unlike a plan or a traditional vesting order, the availability of an RVO in Canada — and the requirements that must be met for its use — are not statutorily enshrined. In the context of CCAA proceedings, Canadian courts found the discretion to grant RVOs in § 11 of the CCAA, which grants a supervising court broad authority to make any order it considers appropriate.[6] Similar discretion

1 *Harte Gold Corp. (Re)*, 2022 ONSC 653 at ¶ 38.
2 R.S.C., 1985, c. C-36.
3 R.S.C., 1985, c. B-3.
4 R.S.C., 1985, c. C-44.
5 A CCAA plan must be approved by a majority of creditors in number, representing 66 percent and two-thirds of the voting claims in each class of affected creditors. *See* CCAA, *supra* n.2, § 6(1).
6 CCAA, *supra* n.2, § 11.

has been found in the context of proposal proceedings under the BIA,[7] in receivership proceedings under the BIA,[8] and in the context of a corporate arrangement under the CBCA.[9]

Perspectives on RVOs in Canada

Despite its widespread adoption and use, RVOs continue to be scrutinized and viewed as "extraordinary relief." This is partly because of the traditional procedures that an RVO circumvents. Creditors have challenged RVOs (albeit, unsuccessfully) on the basis that the mechanism is specifically designed to deprive creditors of their rights of participation in the plan-of-arrangement process.[10] Some have argued that the RVO's availability must be judicially enshrined to mitigate against any potential inequitable treatment of stakeholders.[11] To date, in considering RVO requests, Canadian courts have relied on the responses put forth by debtor companies to the following questions to determine whether an RVO meets the requirements of fairness and furthers the remedial objectives of the CCAA:

1. Why is the RVO necessary in this case?
2. Does the RVO structure produce an economic result at least as favorable as any viable alternative?
3. Is any stakeholder worse off under the RVO structure than they would have been under any other viable alternative?
4. Does the consideration being paid for the debtor's business reflect the importance and value of the assets (*i.e.*, licenses, permits, tax losses) being preserved under the RVO structure?[12]

Debtors that can answer these questions persuasively now obtain RVOs with regularity.

The Existing Chapter 11 Toolkit

Chapter 11 affords distressed companies two principal pathways for transferring a business as a going concern: (1) a court-approved sale of assets under § 363 of the U.S. Bankruptcy Code; and (2) a reorganization plan. Both paths come with strengths and weaknesses, but none expressly contemplates the liability-cleansed share transfer that characterizes the Canadian RVO.

For example, a fully marketed sale under § 363 can close within roughly 30-90 days and enjoys the twin advantages conferred by § 363(f) and (m): the ability to convey assets "free and clear" of claims, interests and encumbrances, and the appellate-mootness protection accorded to a good-faith purchaser.[13] However, state and federal licenses could be lost unless regulators consent, and tax attributes could be stranded once the corporate shell is severed from the operating assets.

By contrast, a confirmed plan can surgically allocate assets and liabilities while preserving licenses and net operating loss carryforwards, yet the creditor solicitation and plan-confirmation process for a traditional (non-prepackaged or prearranged) chapter 11 plan seldom finishes in less than six months, with the commensurate erosion of going-concern value. Accordingly, none of these mechanisms precisely replicates the Canadian RVO.

Texas Two-Step: A Superficial Analogue to an RVO

At first glance, the Texas Two-Step appears to be a close analogue to an RVO, and the comparison between the two tools is foreseeable. Such a comparison is, however, superficial.

In recent years, the Texas Two-Step has been the subject of heightened scrutiny and judicial criticism. The Texas Two-Step employs § 10.901 of the Texas Business Organizations Code to effect a "divisive merger" that allocates assets and liabilities between successor corporations, typically resulting in desirable assets flowing to one entity and unwanted liabilities to the other.[14] The Texas Two-Step has been used in the context of mass tort litigation to allow a solvent corporation to transfer legacy mass tort claims into a ResidualCo funded by the solvent corporation for the purposes of resolving the mass tort claims.[15]

However, the Texas Two-Step has been criticized as a paradigmatic bad-faith bankruptcy maneuver.[16] This criticism culminated in the Third Circuit's decision in the chapter 11 proceeding of *LTL Management*, where the proceedings were ultimately dismissed on the basis that LTL lacked the "degree of financial distress" necessary for chapter 11 relief.[17]

In contrast, the timing, transparency, judicial oversight and creditor involvement in the implementation of an RVO substantially differs. While the Texas Two-Step implements a liability shuffle pre-petition, leaving creditors to challenge it after the fact, an RVO is implemented following commencement of a CCAA proceeding while the company remains under court supervision. Creditors receive notice prior to an RVO's implementation, and, as reflected in the factors considered by Canadian courts, the interests of stakeholders are at the forefront of the court's decision to authorize an RVO. This inversion of sequence explains much of the judicial comfort with RVOs in Canada and suggests that the RVO might be viewed as a more transparent alternative to a pre-petition divisive merger.

Challenges to a U.S. RVO

If adopted in the U.S. under chapter 11, an RVO could potentially add a tool to effect more efficient, less costly restructurings, as has been the case in Canada. Furthermore, it is unlikely that an RVO would be met in the U.S. with similar concerns regarding creditor approval, as has been the case in Canada, given the availability and widespread use of cross-class cramdown in chapter 11

7 *See, e.g., Re PaySlate Inc.*, 2023 BCSC 608 at ¶¶ 84-86; § 183(1) of the BIA, *supra* n.3.
8 *See, e.g., British Columbia v. Peakhill Capital Inc.*, 2024 BCCA 246 at ¶ 22 (leave to appeal refused 2025 CanLii 38366 (SCC)); § 243(1)(c) of the BIA, *supra* n.3.
9 *See Xplore Inc. (Re)*, 2024 ONSC 5250 at ¶ 55; § 192 of the CBCA, *supra* n.4.
10 *See S. Star Devs. Ltd. v. Quest Univ. Canada*, 2020 BCCA 364 at ¶ 13.
11 *See, e.g.*, Victor Olusegun, "The Journey of Reverse Vesting Orders from 'Extraordinary' to Ordinary: Is it Time for Parliamentary Intervention?," 2024 22 *Annual Review of Insolvency Law*, 2024 CanLIIDocs 3053, canlii.ca/t/7njx4 (unless otherwise specified, all links in this article were last visited on June 27, 2025).
12 *Harte Golde Corp. (Re)*, *supra* n.1, ¶ 38.
13 11 U.S.C. §§ 363(f), 363(m).
14 Tex. Bus. Orgs. Code Ann. § 10.901.
15 *See, e.g., In re Bestwall LLC*, 605 B.R. 43 (Bankr. W.D.N.C. 2019); *In re DBMP LLC*, 2021 WL 3552350 (Bankr. W.D.N.C. Aug. 11, 2021); *In re Aldrich Pump LLC*, 2023 WL 2711675 (Bankr. W.D.N.C. March 31, 2023); *In re LTL Mgmt. LLC*, 64 F.4th 84 (3d Cir. 2023).
16 Michael A. Francus, "Texas Two-Stepping Out of Bankruptcy," 120 *Mich. L. Rev. Online* 38 (2023), repository.law.umich.edu/mlr_online/vol120/iss1/3.
17 *In re LTL Mgmt.*, *supra* n.16 at 102-04.

proceedings. Nevertheless, the statutory structure of chapter 11 provides barriers to the adoption of the RVO in chapter 11 proceedings.

Even before the widespread adoption of RVOs, a sale of a debtor's shares outside of a plan was a recognized approach in Canada to the restructuring of a distressed business.[18] As a result, the adoption of the RVO was not a substantial departure from existing mechanisms available under the CCAA.

In contrast, the ability of a U.S. debtor to sell its own shares is primarily accomplished through confirmation of a reorganization plan under §§ 1123 and 1129 of the Bankruptcy Code. The bankruptcy estate that is created upon the filing of a chapter 11 petition captures only the debtor's legal or equitable interests, not the debtor's separate legal identity or the outstanding equity that embodies that identity.[19]

Hon. **Laurie Selber Silverstein** of the U.S. Bankruptcy Court for the District of Delaware underscored this point in her April 18, 2024, bench ruling in the chapter 15 proceeding of *Goli Nutrition Inc*. She granted comity to the Quebec court's RVO but declined to layer on the "bells and whistles" of a U.S. sale order, explaining that "the issuance of stock in a debtor company is not a sale transaction under section 363."[20] A sale of shares by a debtor company outside of a confirmed plan would, therefore, represent a marked departure from the mechanisms expressly authorized by the Bankruptcy Code that would need to be confronted and overcome.

A second and related concern is structural. The CCAA and BIA provide a supervising court with the broad discretion to grant any relief appropriate in the circumstances.[21] The jurisdiction to craft novel remedies is therefore readily available. By contrast, chapter 11 allocates power through explicit provisions, and its equitable catch-all under § 105(a) of the Bankruptcy Code supplements those grants but cannot displace them.[22] Implementation of an RVO-style share transfer into the U.S. cases would likely require adjustments to the existing chapter 11 framework.

This goal could potentially be met through congressional amendment of § 363 of the Bankruptcy Code or by adding a new section that directly codifies the RVO concept. In theory, such an amendment could be drafted in a page and would leave the Code's distributional priorities untouched. In practice, bankruptcy legislation moves only when a political consensus emerges, and the recent fate of even modest chapter 11 reform bills suggests that such consensus is elusive. Unless this hurdle is cleared, U.S. courts are likely to remain limited to the traditional triad of asset sale, confirmed plan and priority-respecting structured dismissal — none of which directly replicates the "speed plus continuity" promise that has made RVOs popular north of the border.

Conclusion

Canada's experience shows that an RVO can deliver regulatory continuity and transaction speed without sacrificing judicial oversight. The same benefits would be welcome in complex U.S. restructurings, but importing the device will require thoughtful adjustments to chapter 11, which Congress is unlikely to undertake for now.

As practitioners, academics, judges and policymakers continue to consider the idea, the conversation itself will refine our understanding of how best to balance efficiency, creditor protections and statutory fidelity. The RVO could well join the U.S. toolkit one day, but getting there will depend on sustained discussion and incremental development of both the legal framework and market's appetite for innovation. abi

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18 *See, e.g., In the Matter of the Plan of Compromise or Arrangement of Toys "R" US (Canada) Ltd. Toys "R" US (Canada) Ltee* (CV-17-00582960-00CL), Canadian Equity Sale Order (April 27, 2018).

19 11 U.S.C. § 541(a)(1) (defining "property of the estate" as all legal and equitable interests of debtor in property as of commencement of case).

20 *In re Goli Nutrition Inc.*, Case No. 24-10438 (Bankr. D. Del. April 18, 2024), Bench Ruling at 5-6.

21 CCAA, *supra* n.2, section 11; BIA, *supra* n.3, §§ 183 and 243(1)(c).

22 11 U.S.C. § 105(a) (authorizing orders "necessary or appropriate to carry out the provisions of this title" but not granting independent substantive powers); *Nw. Bank Worthington v. Ahlers*, 485 U.S. 197, 206-07 (1988) (ruling that § 105 "does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable").