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The Application of 11 U.S.C. § 523(a) to Subchapter V Corporate Debtors Under 11 U.S.C. § 1192(2)

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Cite as: *The application of 11 U.S.C. § 523(a) to Subchapter V corporate debtors under 11 U.S.C. § 1192(2)*, 15 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 2 (2023).

Introduction

Under title 11 of the United States Code (the “Bankruptcy Code”), a debtor can receive a fresh start through a broad discharge of its debts. The general availability of a discharge is limited by section 523(a). Section 523(a) provides that certain types of debts of an individual are excepted from discharge. Section 1192 applies these exceptions in certain small business bankruptcy cases.

In 2019, Congress created Subchapter V of the Bankruptcy Code with the passing of the Small Business Reorganization Act (“SBRA”).¹ The SBRA added provisions to Chapter 11 which apply to small business debtors. Small business debtors, as defined by the Bankruptcy Code, include persons, partnerships, or corporations engaged in commercial or business activities who meet a specific debt limit. Since its addition to the Bankruptcy Code, courts have been tasked with interpreting how the dischargeability exceptions under section 523(a) apply to Subchapter V debtors.

This article explores whether the exceptions to dischargeability that were incorporated into section 1192(2) from section 523(a) apply only to individual debtors or if they also extend to

¹ Pub. L. No. 116-54, 133 Stat. 1079 (2019).

corporate debtors. Part I provides a textual analysis of statutory text governing dischargeability exceptions under Chapter 11, Subchapter V. Part II examines the two different interpretations courts have endorsed regarding (i) statutory construction, (ii) applicability of a Chapter 12 discharge exception analogy, and (iii) fairness and policy considerations, when deciding whether section 523(a) discharge exceptions extend to corporate debtors.

I. The Statutory Language of Section 523(a) and Section 1192(2) is Ambiguous.

Two statutes govern the discharge of debts for a Subchapter V debtor. If the debtor's plan is consensual under section 1181, then the discharge of debts is governed by section 1141(d). Section 1141(d)(2) provides "a discharge under this chapter does not discharge a debtor who is an individual from any debt excepted from discharge under section 523 of this title." However, if the debtor's plan is nonconsensual and confirmed via a cramdown under section 1191, then section 1192 governs the debtor's discharge. Section 1192 provides "... the court shall grant the debtor a discharge of all debts . . . except any debt (2) of the kind specified in section 523(a) of this title." Section 523(a) states that "a discharge under section 727, 1141, 1192, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor" from twenty-one specified kinds of debts, such as debts obtained by fraud, debts arising from government fines or penalties, and debts for willful and malicious injury by the debtor to another entity.

Missing from section 1192 but present in section 1141 is the explicit reference to "an individual." The absence creates uncertainty as to whether Congress intentionally drafted section 1192 to exclude corporate debtors from discharging section 523(a) debts if they confirm their plan via a cramdown. Moreover, it is unclear whether the cross-reference in section 1192(2) to section 523(a) was intended to solely refer to the types of debt without imposing section 523(a)'s restriction on individuals.

II. The Application of Section 523(a) to Subchapter V Corporate Debtors.

A. Statutory Construction of Section 1192(2) and Section 523(a)

Courts have come to contrasting conclusions regarding whether section 523(a)'s exceptions to discharge apply to Subchapter V corporate debtors. The first interpretation, adopted by the Fourth Circuit, supports that Subchapter V corporate debtors are subject to the exceptions to discharge listed in section 523(a) because section 1192(2)'s language governs over that of section 523(a).² The statutory language of section 1192(2) grants debtors a discharge of all debts, subject to the exceptions stated in section 523(a).³ Specifically, the language states “debts . . . of the kind in section 523(a) of this title.”⁴ The cross-reference to section 523(a) demonstrates a clear intent to the kind of debts dischargeable under section 523(a); not the “kind of debtor” set forth in section 523(a) (i.e., individuals).⁵ Courts have found that the reference to section 523(a) was a congressional shorthand to avoid listing out all twenty-one types of exceptions to the dischargeability of debt listed in 523(a).⁶ Further, as a matter of statutory interpretation, where two statutes conflict, the more specific provision governs.⁷ While section 523(a) generally only applies to individuals, there is also a more specific applicable statute – section 1192(2) of the Bankruptcy Code. Section 1192(2) specifically governs the applicable discharge for all Subchapter V debtors.⁸ In as much as a Subchapter V debtor can be either a

² See *Cantwell-Cleary Co. v. Cleary Packaging, LLC* (*In re Cleary Packaging, LLC*), 36 F.4th 509, 512 (4th Cir. 2022).

³ *Id.* at 514

⁴ 11 U.S.C. § 523(a).

⁵ *In re Cleary Packaging, LLC*, 36 F.4th at 515.

⁶ *Id.*

⁷ See, e.g., *In re Breezy Ridge Farms, Inc.*, 2009 WL 1514671 at *2 (Bankr. M.D. Ga. May 29, 2009); *Universal Am. Mort. Co. v. Bateman* (*In re Bateman*), 331 F.3d 821, 825 (11th Cir. 2003).

⁸ *In re Cleary Packaging LLC*, 36 F.4th at 515.

corporation or individual, Section 1192(2) and its reference to section 523(a) must apply to all Subchapter V debtors.⁹

Other courts, opposing section 523(a)'s application to Subchapter V corporate debtors, have found that the governing statutory language leads to a different conclusion in that the language of section 523(a) clearly limits the dischargeability exceptions to individual debtors only. Section 523(a) "unequivocally applies" only to individuals, and the language of section 1192(2) does not empower the cross-reference to reach beyond what the language of section 523(a) permits.¹⁰ Making section 523(a) applicable to Subchapter V corporations would be a deviation from the common understanding of the Bankruptcy Code as a whole.¹¹ There are "innumerable" cases predating the SBRA which dictate that section 523(a) only applies to individual debtors based on the first sentence of the provision.¹² If Congress intended to only refer to the "kinds of debt" listed in section 523, this could have easily been accomplished by refining the reference in section 1192(2) to section 523(a)(1)-(19), which would not include the limiting language about individual debtors.¹³ Since section 1192(2) refers to all of section 523(a), the statute must be interpreted to mean the exceptions only apply to an individual debtor.¹⁴

B. Applicability of Chapter 12 Discharge Exception Interpretations

When there is no controlling guidance on how to interpret a specific provision, courts may look to other sections of the Bankruptcy Code to inform their analysis and reach a reasonable interpretation.¹⁵ Indeed, some courts have recognized that several aspects of

⁹ *Id.*

¹⁰ *See In re GFS Indus., LLC*, 647 B.R. 337, 342 (Bankr. W.D. Tex. 2022).

¹¹ *Id.* at 349.

¹² *In re Lapeer Aviation, Inc.*, 2022 WL 1110072 at *2 (Bankr. E.D. Mich. April 13, 2022).

¹³ *In re RTECH Fabrications, LLC*, 635 B.R. 559, 565 (Bankr. D. Idaho 2021).

¹⁴ *Id.*

¹⁵ *See, e.g., Cohen v. de la Cruz*, 523 U.S. 213, 219-20 (1998) (construing a provision of section 523(a) in light of other discharge exception provisions of the Bankruptcy Code).

Subchapter V are premised on provisions of Chapter 12.¹⁶ Yet, courts have opposing views as to whether interpretations of Chapter 12 provisions are appropriate to extend and apply in the Chapter 11, Subchapter V context. The first view, endorsed by the Fourth Circuit, supports that Subchapter V corporate debtors are subject to section 523(a)'s discharge exceptions because interpretations of Chapter 12 discharge exceptions must rationally extend to Chapter 11, Subchapter V.¹⁷ The language of Subchapter V is virtually identical to that of Chapter 12.¹⁸ Chapter 12 provides that “the court shall grant the debtor a discharge of all debts provided for by the plan . . . except any debt . . . of a kind specified in section 523(a) of this title.”¹⁹ The language of section 1228(a) largely mirrors the language included in section 1192(2)²⁰ and courts have interpreted section 1228(a)'s discharge exception to apply to both individual debtors and corporate debtors.²¹ Accordingly, it would “ignore . . . rationality” to give different interpretations to identical language within the Bankruptcy Code.²²

On the other hand, some courts have found that interpretations of section 523(a)'s discharge exceptions in the Chapter 12 context should not be extended to the Chapter 11 context.²³ In so finding, these courts have found that section 1192 should be read solely within the framework of Chapter 11 cases without any analogy to Chapter 12.²⁴ Although the phrases found in section 1228(a) and section 1192(2) are similar, a critical distinction exists due to

¹⁶ See, e.g., *In re Trepetin*, 617 B.R. 841, 848 (Bankr. D. Md. 2020).

¹⁷ *In re Cleary Packaging, LLC*, 36 F.4th 509, 517 (4th Cir. 2022).

¹⁸ *Id.* at 516.

¹⁹ 11 U.S.C. § 1228(a).

²⁰ *In re Cleary Packaging, LLC*, 36 F.4th at 516.

²¹ See, e.g., *In re JRB Consol., Inc.*, 188 B.R. 373 (Bankr. WD Tex. 1995); *In re Breezy Ridge Farms, Inc.*, 2009 WL 1514671 at *2 (Bankr. M.D. Ga. May 29, 2009).

²² *In re Cleary Packaging, LLC*, 36 F.4th at 517.

²³ *Gaske v. Satellite Restaurants Inc. Crabcake Factory USA (In re Satellite Restaurants Inc. Crabcake Factory USA)*, 626 B.R. 871, 877 (Bankr. D. Md. 2021).

²⁴ See *id.*

Chapter 12 being a unique scheme of the Bankruptcy Code.²⁵ Chapter 12 is only available to a small, specific subset of farmer or fisherman debtors.²⁶ Due to the unique nature of Chapter 12 debtors, courts do not have to extend the same interpretation regarding section 523(a) exceptions to Subchapter V debtors.²⁷ Therefore, although similar language exists in section 1228(a) and section 1192(2), the same meanings do not necessarily apply.²⁸

C. Policy Considerations

Where the statutory text is ambiguous, bankruptcy courts can exercise their broad equitable powers to contemplate policy considerations.²⁹ Some courts have held that distinguishing between individual and corporate debtors undermines fairness and equity incentives and that individual and corporate debtors should be subject to the same discharge restrictions.³⁰ Subchapter V departed from the absolute priority rule traditionally applicable in regular Chapter 11 proceedings.³¹ That departure heavily benefits debtors, and as such Congress recognized the need to provide additional protections for creditors in the realm of discharges.³² Thus, inconsistent application of exceptions for debt dischargeability would unnecessarily harm creditors if section 523(a) did not apply equally to both individuals and corporations.³³ Moreover, if section 523(a) only applied to individuals, then small business corporate debtors would be essentially rewarded through the discharge of debts for fraud, willful and malicious injury, or other tortious conduct which goes against public policy.³⁴

²⁵ *In re GFS Indus., LLC*, 647 B.R. 337, 345 (Bankr. W.D. Tex. 2022).

²⁶ 11 U.S.C. § 109(f).

²⁷ *In re GFS Indus., LLC*, 647 B.R. at 345–346.

²⁸ *Id.*

²⁹ *See* 11 U.S.C. § 105(a); *Pioneer Inv. Serv. Co. v. Brunswick Assoc. Ltd. P'ship*, 507 U.S. 380, 389 (1993).

³⁰ *See In re Cleary Packaging, LLC*, 36 F.4th 509, 517 (4th Cir. 2022).

³¹ *See id.* at 514.

³² *Id.* at 517.

³³ *Id.*

³⁴ *Id.* at 518.

Alternatively, when deciding whether section 523(a) applies to both corporate and individual debtors some courts have held that fairness and policy arguments are not relevant because the plain language of section 523(a) is dispositive of this issue.³⁵ For example, the Court in *In re Lapeer Aviation, Inc.* granted a motion to dismiss based solely on the first sentence of section 523(a).³⁶ Only the bankruptcy court in *In re GFS Indus., LLC* even addresses the viability of a fairness argument in supporting a statutory interpretation.³⁷ Unsecured creditors in a Subchapter V corporate case actually benefit from a debtor being able to discharge debts.³⁸ Debtors with non-dischargeable debts may convert to a Chapter 7 liquidation, under which unsecured creditors generally receive less money than under a reorganization plan.³⁹ Thus, no generally accepted standard or argument proves an unfair advantage exists for either the creditor or the debtor. Instead, the textual analysis should govern because when the statute’s language is plain and clear, the sole function of the courts is to “enforce it according to its terms.”⁴⁰ Therefore, the plain language of section 523(a) is dispositive.⁴¹

Conclusion

Courts disagree as to whether the exceptions to dischargeability under section 523(a) apply only to individual debtors or also extend to corporate debtors. The Fourth Circuit found that the exceptions to discharge found in section 523(a), which ordinarily apply exclusively to individual debtors, also apply to small business corporate debtors in Chapter 11 bankruptcy under Subchapter V if the debtor confirms a cramdown plan. Alternatively, several bankruptcy

³⁵ See *In re GFS Indus., LLC*, 647 B.R. 337, 346 (Bankr. W.D. Tex. 2022).

³⁶ See *In re Lapeer Aviation, Inc.*, 2022 WL 1110072 at *4 (Bankr. E.D. Mich. April 13, 2022).

³⁷ *In re GFS Indus., LLC*, 647 B.R. at 350.

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ See *In re Satellite Restaurants Inc. Crabcake Factory USA*, 626 B.R. 871, 876–877 (Bankr. D. Md. 2021).

⁴¹ See *id.*; *In re GFS Indus., LLC*, 647 B.R. at 345–346.

courts have concluded the opposite, ruling that the statutory construction requires that the exceptions to discharge in section 523(a) apply only to individual debtors.