SUBCHAPTER V:
CRAMDOWN DISCHARGES AND NONCONSENSUAL PLANS

(A) DO § 523(a) EXCEPTIONS APPLY TO A CORPORATE DEBTOR WHO RECEIVES A "CRAMDOWN" DISCHARGE?

AND

(B) CAN A DEBTOR ADMINISTRATIVELY CLOSE A CASE AND TERMINATE THE SERVICE OF THE SUBCHAPTER V TRUSTEE BEFORE ALL PAYMENTS HAVE BEEN MADE UNDER A NONCONSENSUAL PLAN?

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Enacted by the Small Business Reorganization Act ("SBRA"), 11 U.S.C. §§ 1181-1195, subchapter V of chapter 11 allows small businesses to file bankruptcy in a cost-effective and accelerated manner. Subchapter V imposes a shortened timeline to file a plan, eliminates the absolute priority rule for confirmation, and permits the confirmation of a plan without the acceptance of a class of creditors. 11 U.S.C. §§ 1189, 1191(a). Importantly, subchapter V treats debtors who confirm a consensual plan differently from debtors who confirm a nonconsensual or "cramdown" plan.

For example, a debtor who confirms a consensual plan receives a discharge immediately under § 1141(d)(1)A). That provision, however, does not apply upon confirmation of a cramdown plan. Instead, the debtor receives a discharge under § 1192, which occurs "as soon as practical" after the debtor completes all plan payments. Moreover, confirmation of a nonconsensual plan under § 1192 does not terminate the subchapter V trustee's services. 11 U.S.C. § 1183(b), (c). This paper addresses two issues arising in part from this difference in treatment. The first issue involves the scope of the cramdown discharge, and the second concerns the role of the subchapter V trustee after confirmation of a nonconsensual plan.

A. Do § 523(a) exceptions apply to a corporate debtor who receives a "cramdown" discharge?

An *individual* debtor who confirms a *consensual* plan and receives a discharge under § 1141(d)(2) is not discharged from any of the debts excepted under § 523(a). Unlike § 1141(d)(2), where the application of § 523(a) discharge exceptions after consensual confirmation is expressly limited to *individual* debtors, § 1192(2) does not limit the applicability of the § 523(a) exceptions after cramdown confirmation to either individual debtors or corporate debtors. Instead, § 1192(2) excepts debts from the cramdown discharge "of the kind specified in section 523(a)." This language, if read in isolation, indicates that the exceptions apply to both individuals and corporations.

If read in conjunction with the prefatory paragraph of § 523(a), however, the language leads to a different conclusion.

When Congress added subchapter V to chapter 11, it also amended the preamble to § 523(a), which now provides:

> A discharge under section 727, 1141, *1192*, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt – [defined in subsections (1) through (19) of § 523(a)].

11 U.S.C. § 523(a) (emphasis added). The SBRA added the italicized "1192" to the list of sections under which a discharge is granted in chapter 7, 11, 12, and 13 cases. Thus, as amended, § 523(a) provides, "A discharge under section . . . 1192 . . . does not discharge an *individual* debtor from any debt" listed in subsections (1) through (19). 11 U.S.C. § 523(a) (emphasis added). This introductory language suggests that § 1192(2)'s reference to debts "of the kind specified in section 523(a)" includes only those debts excepted under § 523(a), which are limited to the debts of individual debtors.

Most, if not all, bankruptcy courts that have considered the issue have concluded that although § 1192(2) states the discharge rule in a cramdown situation for all subchapter V debtors without regard to whether they are individuals or corporations, its reference to § 523(a) has no operative effect as to corporate debtors because § 523(a) itself applies only to individuals. In one of the earliest of these decisions, the bankruptcy court noted that because the scope of a corporate debtor's discharge in a chapter 11 case is generally all encompassing, applying § 523(a) to corporate debtors under § 1192(2) would be the equivalent of "Congress . . . hid[ing] elephants in mouseholes." *Cantwell-Cleary Co. v. Cleary Packaging, LLC (In re Cleary Packaging, LLC)*, 630 B.R. 466, 475 (Bankr. D. Md. 2021) (quoting *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 468 (2001)), *rev'd,* 36 F.4th 509 (4th Cir. 2022).

Only one circuit court of appeals has addressed whether corporate subchapter V debtors can be denied a discharge of a debt excepted under § 523(a). The Fourth Circuit Court of Appeals in *Cantwell-Cleary Co. v. Cleary Packaging, LLC (In re Cleary Packaging, LLC)*, 36 F.4th 509 (4th Cir. 2022), held that corporate debtors in a subchapter V case may not discharge debts "of the kind specified in section 523(a)," reversing the bankruptcy court as well as overruling a different bankruptcy court in its jurisdiction. *See Cleary Packaging, LLC*, 630 B.R. at 466; *Gaske v. Satellite Rests. Inc. (In re Satellite Rests. Inc. Crabcake Factory USA)*, 626 B.R. 871 (Bankr. D. Md. 2021). Both bankruptcy courts had held that § 523(a) applies only to individual debtors. A circuit split may be forthcoming as the Fifth Circuit Court of Appeals recently accepted a direct appeal in *Avion Funding LLC v. GFS Industries LLC (In re GFS Industries LLC)*, 647 B.R. 337, 344 (Bankr. W.D. Tex. Nov. 10, 2022), in which a Texas bankruptcy court held that § 523(a) did not apply to corporate debtors.

Because of the Fourth Circuit's departure from the prevailing view among bankruptcy courts, its decision warrants discussion. In *Cleary Packaging, LLC*, a creditor commenced an adversary proceeding seeking to have its debt against the corporate debtor deemed nondischargeable under § 523(a)(2) and (a)(6). Looking past the restrictive language in § 523(a)'s preamble, the Fourth Circuit opined that § 1192(2)'s reference to debts *of the kind* specified in § 523(a) "indicates that Congress intended to reference only the *list of non-dischargeable debts* found in § 523(a)" and not the type of debtors to which § 523(a)'s discharge exceptions apply.

The Fourth Circuit claimed that its interpretation was consistent with that of virtually identical language under chapter 12. Similar to § 1192(2), § 1228(a)(2) provides chapter 12 debtors with a discharge of their debts except, in pertinent part, "any debt . . . of a kind specified in section

523(a)." According to the Fourth Circuit, if Congress did not intend for § 1192(2) to be interpreted the same as § 1228(a)(2), Congress would not have used nearly identical language.

The Fourth Circuit concluded that § 1192 provides discharges to debtors, whether they are individuals or corporations, except with respect to the nineteen kinds of debts listed in § 523(a). The Fourth Circuit seemingly based its opinion to a large degree on "fairness and equity."

The Eleventh Circuit Court of Appeals has not yet addressed the issue, but recently, a Florida bankruptcy court held that the § 523(a) exceptions do not apply to corporate debtors. In *Nutrien AG Solutions Inc. v. Hall (In re Hall),* No. 3:22-AP-00062-BAJ, 2023 WL 2927164 (Bankr. M.D. Fla. Apr. 13, 2023), Karen W. Hall ("Hall") and her business, Spuddog Farm Properties, LLC ("Spuddog"), filed separate bankruptcy petitions under subchapter V. Nutrien AG Solutions Inc. ("Nutrien") initiated an adversary proceeding against both Hall and Spuddog, alleging in each of the eleven counts of its complaint an exception to discharge under § 523(a). *Spuddog* moved to dismiss the complaint based on its argument that § 523(a) does not apply to a corporate debtor that receives a cramdown discharge pursuant to § 1192.

The *Hall* court found compelling, and based its decision on, a cannon of statutory construction that requires courts to interpret statutes in a way that will "render every word operative, rather than one which may make some [words] idle and nugatory." *Hall*, 2023 WL 2927164, at *4 (quoting Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 69, 174 (2012)). The *Hall* court reasoned that if Congress had intended for § 523(a) exceptions to apply to corporations under § 1192, then it never would have amended § 523(a) to add a reference to § 1192. Any other interpretation would render the amendment to § 523(a) superfluous.

The *Hall* court acknowledged the Fourth Circuit's decision in *Cleary Packaging LLC*, but ultimately sided with other bankruptcy courts who had considered the dischargeability question

under § 523(a). The *Hall* court opined that the Fourth Circuit equated debts "of the kind specified in section 523(a)" to debts under § 523(a)(1)-(19) and disregarded the introductory language of § 523(a) that limits those discharge exceptions to individuals. It opted to follow in the footsteps of other bankruptcy courts addressing the issue and held that subchapter V corporate debtors that receive a cramdown discharge under § 1192 are not subject to § 523(a). *Hall*, 2023 WL 2927164, at *4.

The analysis in *Hall* is consistent with that of one of the first bankruptcy cases in the country, if not the very first, to address the applicability of § 523(a) to a non-individual debtor. In *Satellite Restaurants Inc.,* 626 B.R. at 871, the debtor was a restaurant business seeking relief under subchapter V of chapter 11. Nineteen alleged former employees of the debtor filed a complaint seeking a determination that the debts owed to them were non-dischargeable under § 523(a)(2)(A) because they arose from false pretenses, a false representation or actual fraud, or under § 523(a)(6) because they arose from a willful and malicious injury.

The *Satellite* court relied on the plain meaning of the statute and found that the language of § 523(a) was clear and unambiguous that it applied only to individual debtors. Moreover, it opined that the reference to § 1192 added to § 523(a) by the SBRA must be given meaning, and the only reasonable meaning was that Congress intended to continue to limit application of the § 523(a) exceptions in a subchapter V case to individuals.

The *Satellite* court further launched into a discussion regarding the pre-SBRA application of §523(a) and a legislative history of § 1192. It determined upon a review of the legislative history of § 1192 that nothing supported the conclusion that Congress intended to expand the application of § 523(a) to a non-individual. It also listed numerous cases from multiple circuits illustrating the historical view that §523(a) applied only to individual debtors.

Two other bankruptcy courts from Idaho and Texas have reached a similar conclusion. In *In re Rtech Fabrications, LLC*, 635 B.R. 559 (Bankr. D. Idaho 2021), the debtor, Retech Fabrications, LLC ("Rtech"), was an Idaho limited liability company specializing in custom vehicle builds and modifications. The creditors filed a state court action against Rtech alleging claims for breach of contract, fraud, and alter ego veil piercing. The adversary complaint sought to except the creditors' claims against Rtech from discharge pursuant to § 523(a) due to fraud, breach of contract, and violation of the Idaho Consumer Protection Act. Rtech's moved to dismiss the complaint for failure to state a claim upon which relief may be granted.

The Idaho bankruptcy court got in line with the reasoning set forth by the Maryland bankruptcy court in *Satellite*. It agreed with its use of statutory construction and came to the same conclusion that the plain language of § 523(a) and § 1192 dictates that only an individual is subject to the discharge exceptions listed in § 523(a). The *Rtech* court went further by discussing subchapter V's intertwinement with chapter 11 as a whole and the history of the scope of a corporate discharge. It opined that since subchapter V is part of chapter 11, its discharge provision must be interpreted consistent with chapter 11's overall statutory scheme.

The *Rtech* court noted that corporate discharge under chapter 11 has been "strenuously protected." Although the Bankruptcy Act of 1898 included exceptions to discharge for certain corporate debtors[2], Congress rejected the historic approach and provided a more expansive discharge to corporate debtors in 1978 when it enacted the Bankruptcy Code. This represented "an intentional and decisive change by Congress with respect to the scope of a corporate debtor's

[2] Section 17 of the Bankruptcy Act of 1898 allowed certain types of provable debts to be deemed nondischargeable. These included: taxes levied by the United States, or any State, county, district, or municipality; obtaining money or property by false pretenses or false representations; willful and malicious injuries to person or property of another; alimony and domestic support obligations; seduction of an unmarried female, breach of promise of marriage accompanied by seduction and criminal conversation; debts which had not been duly scheduled, unless such creditor had timely notice or actual knowledge of the proceedings in bankruptcy; fiduciary misconduct; wages earned withing 3 months prior to bankruptcy.

discharge." The *Rtech* court found that by passing the SBRA, Congress expressed no intention to further limit the scope of a non-individual's discharge in enacting § 1192. The *Rtech* court determined that when considering the priority placed on the corporate discharge and the difficulty Congress faced with passing even a limited exception, "the suggestion that Congress incorporated 19 new exceptions to discharge for small corporations in a bill that was introduced in April 2019, and signed into law by the President in April 2019, seems not only improbable but also contradicts years of bankruptcy law and policy." *Rtech Fabrications, LLC*, 635 B.R. at 559 (quoting *Cleary Packaging, LLC*, 630 B.R. at 475).

The *Rtech* court, in considering the plain language of § 523(a) and § 1192, as well as the history of the corporate discharge and overall statutory scheme of chapter 11, held that § 523(a)'s discharge exceptions only apply to an individual debtor and § 1192(2)'s reference to § 523(a) does not expand its applicability to entity debtors.

The Texas bankruptcy court's decision in *GFS Industries, LLC*, 647 B.R. at 339, is currently on appeal before the Fifth Circuit. There, the debtor, GFS Industries, LLC ("GFS"), provided cleaning and environmental services to commercial tenants. As a result of the COVID pandemic, GFS anticipated that the increased demand for sanitation and cleaning services would enable its business to grow. GFS attempted to expand its business to meet the forecasted demand. With the burden of increased administrative costs, GFS resorted to seeking funding through Merchant Cash Advances ("MCA"). Because MCAs require factoring of future account receivables at a discount, GFS was unable to service its operations without sufficient cash flow. GFS filed bankruptcy under subchapter V.

The adversary proceeding was filed by one of GFS's MCA lenders, Avion Funding, LLC ("Avion"), who alleged that GFS made material misrepresentations concerning whether a

bankruptcy filing was imminent and failed to disclose the existence of other, more senior, MCA lenders from which GFS obtained funding. As a result of these misrepresentations and nondisclosures, Avion claimed that it had been harmed and sought relief in the form of a declaration that the debt GFS owed to Avion was nondischargeable.

The Texas bankruptcy court started its analysis by examining § 1192. It noted that § 1192 "does not contain a carve-out provision for non-individual debtors like § 727(a)(1), which explicitly excludes non-individual debtors from discharge under Chapter 7." The court pointed out that § 1192 provides for "a discharge of all debts provided in section 1141(d)(1)(A)" and excepts from discharge those debts that are "of the kind specified in section 523(a) of this title." The court determined that, although § 1192(2) on its face seeks to incorporate the list of debts that are deemed nondischargeable found in § 523(a), without regard to the character of the debtor, the preamble to § 523(a) contains overriding limiting language.

The Texas bankruptcy court opined that the language in § 1141(d)(2) and § 1141(d)(6) is evidence that Congress knew, when it drafted § 1192(2), how to distinguish dischargeability based on the type of debtor. Both of these sections distinguish between corporate and individual debtors, and Congress did not make any kind of similar distinction in § 1192(2). Thus, that Congress added § 1192 into § 523 demonstrates that Congress intended § 1192(2) to limit the § 523 exceptions to individuals only.

Further the Texas bankruptcy court determined that the overarching chapter 11 scheme and historical use of the corporate discharge in chapter 11 required a finding that § 523(a) only applied to individual debtors. For Congress to suddenly depart from this well-established principle when it enacted subchapter V defied reason. According to the bankruptcy court, it was much more likely,

as evidenced by the language in subchapter V, that Congress intended to expand, not discontinue, the principle that Chapter 11 corporate debtors are not subject to § 523(a) complaints.

The court's opinion went on to discuss the Fourth Circuit's opinion in *Cleary Packaging, LLC* and its own previous opinion in a chapter 12 case, but ultimately concluded that § 523(a) applied only to individual debtors under subchapter V.

B. Can a Debtor Administratively Close a Case and Terminate the Service of the Subchapter V Trustee Before All Payments Have Been Made Under a Nonconsensual Plan?

Subchapter V has a few "carrots" by which to attempt to facilitate consensual plans. One of these is termination of oversight by the subchapter V trustee when a consensual plan is confirmed. In general, the role of the trustee is to supervise and monitor the case and to participate in the development and confirmation of a consensual plan. In subchapter V cases, under § 1183(c) the service of the subchapter V trustee terminates when a consensual plan confirmed under § 1191(a) has been substantially consummated. However, for a cramdown plan confirmed under § 1191(b), § 1194(b) requires the subchapter V trustee to make plan payments unless the plan or confirmation order provides otherwise. Section 1183 is silent as to whether discharge of the trustee is allowed after the confirmation of a cramdown plan, but § 1194(b) appears to have some room for interpretation in that respect, as it allows the plan payments to be made by a party other than the subchapter V trustee if provided for in the plan or in the order confirming the plan. Notably, in the *Handbook for Small Business Chapter 11 Subchapter V Trustees*, the U.S. Department of Justice takes the position that when a nonconsensual plan is confirmed under § 1191(b), "instead of being terminated, the trustee will remain in place for the life of the plan, regardless of whether the trustee or the debtor make the plan payments." U.S. Dep't of Justice, Executive Office for U.S.

Trustees, *Handbook for Small Business Chapter 11 Subchapter V Trustees* 3-15 (last updated February 2022).

Administrative closure and the termination of the service of the subchapter V trustee are mutually exclusive. If the parties agree, the trustee's service can be terminated through the plan based on § 1194 if the debtor can make the plan payments. Even so, the case cannot be administratively closed under § 350 but would need to remain open while the debtor makes the payments instead of the trustee. In any event, the trustee can be reappointed at any time. Relevant statutes are listed below.

Section 1183(c)(1) - If the plan of the debtor is confirmed under section 1191(a) of this title, the service of the trustee in the case shall terminate when the plan has been substantially consummated, except that the United States trustee may reappoint a trustee as needed for performance of duties under subsection (b)(3)(C) of this section and section 1185(a) of this title.

Section 1194(b) - If a plan is confirmed under section 1191(b) of this title*, except as otherwise provided in the plan or in the order confirming the plan*, the trustee shall make payments to creditors under the plan.

Section 1191(b) – This is the subchapter V nonconsensual plan confirmation provision.

As of the preparation of this paper, the only reported case that has directly addressed whether a subchapter V case can be administratively closed and the subchapter V trustee terminated is *In re Gui-Mer-Fe, Inc*., 2022 WL 1216270 (Bankr. D.P.R. Apr. 25, 2022). There, the debtor requested that a final decree be entered given "that the Plan is effective, and that the estate has been fully administered," thus administratively closing the case pursuant to § 350(a). The bankruptcy court then ordered the debtor, the subchapter V trustee, the U.S. Trustee, and any party in interest who so wished, to further clarify within twenty-one days why a final decree could be

entered at that juncture. The debtor filed a Motion in Compliance of Order and in Request of Administrative Closing of the Case withdrawing its request for entry of final decree and clarifying that its request was for the "administrative closing of the case" as it is customarily done in chapter 11 cases and, thus, would be to the benefit of the estate saving the debtor from having to incur additional expenses for post-confirmation professional services. The U.S. Trustee opposed the entry of an order closing the case at the time because there is no distinction between an order entering a final decree and an order directing the "administrative closing of the case." The U.S. Trustee also argued that the entry of an order closing the case was premature, given that the Subchapter V trustee had not been discharged from her duties. Importantly, pursuant to the bankruptcy court's Confirmation Order, the trustee was not to be discharged until after the debtor completed all plan payments.

Section 350(a) provides that "[a]fter an estate is fully administered and the court has discharged the trustee, the court shall close the case." The bankruptcy court in *Gui-Mer-Fe, Inc*. noted the distinction between a fully administered estate under section 350(a) and substantial consummation pursuant to § 1101(2). Bankruptcy Rule 3022 provides that the court on its own motion or a party in interest may seek a final decree. Ordinarily that party will be the trustee or the debtor, but the U.S. Trustee also may move for a final decree. A final decree is required in every chapter 11 case. Until entry of a final decree, a case is active. If a final decree has been entered, the case may be reopened. 9 COLLIER ON BANKRUPTCY ¶ 3022.01(16th ed. 2022). Importantly, § 350 requires both full administration of the case and discharge of the trustee. In this case, the plan confirmation order stated that the trustee was not to be discharged until all plan payments were made. Thus, early discharge of the trustee would be premature in light of § 350 as the plan term was not over.

The bankruptcy court did not buy the debtor's reasoning for wanting to administratively close the case which it claimed was based on reducing the costs of the administration of the estate. It explained that subchapter V has some built-in features to save money and subchapter V debtors are specifically exempted under 28 U.S.C. § 1930(a)(6)(A) & (B) from having to pay quarterly fees to the U.S. Trustee. Additionally, subchapter V debtors' obligation to file monthly operating reports terminated on the effective date of the plan pursuant to Bankruptcy Rule 2015(6). Further, plan confirmation under § 1191(b) does not terminate the subchapter V trustee's services pursuant to § 1183(b) and (c)(2).

The bankruptcy court ultimately concluded that in this case the debtor was not allowed to administratively close the case early, and because the plan required the trustee to remain in place until the plan payments were finished, the subchapter V trustee could not be discharged prematurely.

There are other considerations regarding the early discharge of a subchapter V trustee under § 1194(b). Two cases from Texas, both written by the same Bankruptcy Judge have seemingly considered terminating the trustee in a nonconsensual plan under § 1191(b). They use the same language when addressing the issue, and they are mentioned here to show that the issue is receiving some thought. The language from each case is quoted in its entirety below.

1. *In re Pearl Resources LLC*, 622 B.R. 236, 247 (Bankr. S.D. Tex. 2020), the Texas bankruptcy court stated that

> [c]onversely, in a non-consensual plan such as the one before the Court, § 1194(b) provides for the subchapter V trustee to make payments to creditors under the plan, after confirmation, unless the plan or the order confirming it provides otherwise. Because the subchapter V trustee must make payments under a non-consensual plan, the trustee's service does not terminate upon its substantial consummation but continues, at a minimum, until the trustee has made the required disbursements. Although Debtors' original Plan contemplated Debtors making payments to creditors, the Court, given the objections raised by creditors discussed more fully infra,

> found it appropriate to require Debtors to submit all or such portion of the future earnings or other future income of Debtors to the supervision and control of the subchapter V trustee as is necessary for the execution of the plan.

2. For the same reason set forth in *Pearl Resources*, the Court *In re Samurai Martial Sports, Inc.*, 644 B.R. 667, 690 (Bankr. S.D. Tex. 2022) held that the trustees services did not terminate upon substantial consummation, but continued, at a minimum, until the trustee had made all required disbursements. Notably, in this case the debtor's plan modification provided for the trustee to act as the plan dispersing agent anyway, but the Court did contemplate allowing the debtor to make payments itself.