MORE COURT RULINGS DENYING THE APPLICABILITY OF THE EXCEPTIONS to Discharge to Corporate Subchapter V Debtors

SUBCHAPTER V HAS BEEN A HEAVILY UTILIZED VEHICLE FOR ELIGIBLE SMALL BUSINESSES SEEKING TO REORGANIZE OR CONDUCT AN ORDERLY LIQUIDATION. SUBCHAPTER V PROVIDES A MORE STREAMLINED CHAPTER 11 PROCESS THAT OFFERS LARGELY THE SAME BENEFITS OF A "TRADITIONAL" CHAPTER 11 CASE WHILE ELIMINATING MANY OF THE RISKS AND COSTS ASSOCIATED WITH CHAPTER 11—AT LEAST FROM THE DEBTOR'S PERSPECTIVE. THE CREDITORS OF A SUBCHAPTER V DEBTOR WILL NEED TO GRAPPLE WITH MOST OF THE SAME ISSUES THEY WOULD FACE IN A TRADITIONAL CHAPTER 11 PROCESS, WHILE ALSO DEALING WITH ASPECTS OF THE PROCESS THAT ARE SPECIFIC TO SUBCHAPTER V, SUCH AS THE ABSENCE OF A CREDITORS' COMMITTEE AND THE DEBTOR'S ABILITY TO DEFER PAYMENT OF ADMINISTRATIVE EXPENSE CLAIMS OVER THE DURATION OF ITS SUBCHAPTER V PLAN.

THE COURTS ARE SPLIT AS TO WHETHER **SECTION 523(A) APPLIES TO CORPORATE DEBTORS IN SMALL BUSINESS SUBCHAPTER V CASES.**

That said, creditors may have a significant collection tool in certain Subchapter V cases, in that they may be able to assert exceptions to discharge against corporate debtors that can only be asserted against individual debtors in traditional Chapter 11 cases. However, this collection tool is not available in all Subchapter V cases. As illustrated by a February 2025 opinion issued by a Georgia bankruptcy court, in *Halo Human Resources v. American Dental*, the exceptions to discharge do not apply to a corporate Subchapter V debtor that confirms a consensual plan—i.e., where all the debtor's voting classes accepted the debtor's Subchapter V plan.

In addition, a number of courts have held that the exceptions to discharge cannot be asserted against any corporate Subchapter V debtor, even where the debtor confirms a non-consensual Subchapter V plan. Granted, the courts are divided on this, as both circuit-level courts to address the issue have held that the exceptions to discharge may be asserted against corporate Subchapter V debtors where the plan is confirmed on a non-consensual basis. But a recent decision by the U.S. Bankruptcy Court for the Northern District of Florida, in *Spring v. Davidson*, has further solidified the opposing (and less creditor-friendly) view that creditors may pursue the exceptions to discharge only against individual Subchapter V debtors.

A PRIMER ON DISCHARGEABILITY IN SUBCHAPTER V CASES

The scope of a Chapter 11 debtor's discharge and the exceptions to discharge are generally governed by Section 1141(d) of the Bankruptcy Code. Section

THE FLORIDA BANKRUPTCY COURT'S DECISION IN SPRING V. DAVIDSON BREATHES NEW LIFE INTO THE SPLIT AMONG THE COURTS OVER WHETHER SECTION 523 APPLIES TO CORPORATE DEBTORS IN SUBCHAPTER V.

1141(d)(1)(A) broadly states that confirmation of a Chapter 11 plan "discharges the debtor from any debt that arose before such confirmation," except as otherwise provided in the plan or confirmation order, and except as otherwise limited by Section 1141(d).

Bankruptcy Code Section 523(a) lists numerous types of debt that may be excepted from the discharge usually granted to a debtor in bankruptcy. These debts include debts arising from a debtor's fraud, misrepresentation, materially false financial statements, defalcation in a fiduciary capacity, embezzlement or a debtor's willful and malicious injury to the creditor or its property. Section 523(a) specifically states that its discharge exceptions apply to "individual" debtors.

Section 1141(d) generally applies to Subchapter V where the debtor confirms a plan consensually under Section 1191(a) of the Bankruptcy Code—that is, where all of the impaired voting classes of creditors accept the plan. In addition, Section 1141(d)(2) states that the Section 1141 discharge does not discharge a debtor "who is an individual" from any debt excepted from discharge under Section 523. So individual debtors are subject to the exceptions to discharge, even where they confirm a consensual Subchapter V plan.

If a Subchapter V debtor is unable to confirm a consensual Subchapter V plan under Section 1191(a) because one or more impaired classes of claims or interests rejects the plan, the debtor could still confirm the plan as a nonconsensual plan under Section 1191(b). In that case, the discharge provisions of Section 1192 apply, rather than the discharge provisions of 1141(d). Section 1192 does not draw any distinction between individual and corporate debtors. Instead, Section 1192 states that where a nonconsensual plan is confirmed, "a debtor" is not entitled to a discharge of any debt "of the kind" specified in Section 523(a).

The courts are split as to whether Section 523(a) applies to corporate debtors in small business Subchapter V cases. Several courts—including the Ninth Circuit's Bankruptcy Appellate Panel and courts in Florida, Idaho, Maryland, and Michigan—have held that the Section 523 exceptions to discharge apply only to individual debtors and not corporate debtors in Subchapter V. On the other hand, the only Circuit-level courts to address the issue—the U.S. Courts of Appeals for the Fourth Circuit (in *Cantwell-Cleary Co., Inc. v. Cleary Packaging, LLC*) and the Fifth Circuit (in *Avion Funding LLC v. GFS Industries LLC*)—have held that Section 523's exceptions apply to all debtors in Subchapter V, including corporate debtors. It seemed the latter view was trending after the Fourth Circuit was joined by the Fifth Circuit in August 2024, particularly when the U.S. District Court for the Northern District of Illinois adopted the same view in an opinion issued in November 2024, in *In re R & W Clark Construction, Inc.* However, the recent Florida bankruptcy court decision of *Spring v. Davidson* bucked that trend, in holding that Section 523's exceptions to discharge just apply to individual debtors in Subchapter V.

HALO HUMAN RESOURCES V. AMERICAN DENTAL ON SUBCHAPTER V DISCHARGEABILITY

American Dental of LaGrange, LLC (American Dental) and two of its affiliates filed Subchapter V cases on May 24, 2024, in the Middle District of Georgia. On September 25, 2024, Halo Human Resources, LLC (HHR) filed a complaint against American Dental in which HHR opposed the discharge of outstanding amounts owed by American Dental to HHR under a services agreement the parties had executed in 2017. HHR's complaint alleged that certain of Section 523's exceptions to discharge applied because the debt arose from misrepresentations, misstatements, and other wrongful conduct by American Dental. Specifically, HHR alleged that American Dental made intentionally false representations to HHR regarding American Dental's wherewithal to pay HHR for amounts owed by American Dental under the parties' agreement.

On October 30, 2024, the bankruptcy court confirmed American Dental's consensual Subchapter V plan under Section 1191(a). On that same day, American Dental filed a motion to dismiss HHR's adversary complaint for three primary reasons:

1. The exceptions to discharge under Section 523, which HHR asserted via Section 1192, are inapplicable. Section 1192 governs dischargeability only where a nonconsensual plan is confirmed under Section 1191(b). That was not the case here, where American Dental's plan was confirmed consensually. As such, Section 1191(a) applied; dischargeability under its plan is governed by Section 1141 and Section 523's exceptions to discharge do not apply.
2. Even if American Dental's plan was confirmed under Section 1191(b) and Section 1192 therefore, applied, Section 523's exceptions to discharge apply only to individual debtors and, therefore, do not apply to American Dental, a limited liability company.

3. In any event, the exceptions to discharge are irrelevant because American Dental had confirmed a liquidating plan and the applicable discharge provision, Section 1141(d)(3), states that no discharge is granted to liquidating debtors.

On February 3, 2025, the bankruptcy court granted the motion to dismiss HHR's complaint. The bankruptcy court agreed that where a Subchapter V Plan is confirmed consensually, discharge is governed by Section 1141 rather than Section 1192. As a result, Section 523's exceptions to discharge, which are made applicable to Subchapter V via Section 1192, do not apply. Having decided the complaint must be dismissed on that basis in any event, the bankruptcy court held it was unnecessary to address whether Section 523's exceptions to discharge apply to corporate debtors in Subchapter V cases involving nonconsensual plans. The bankruptcy court also held it had insufficient information to determine whether Section 1141(d)(3)'s exception to discharge applied to American Dental.

SPRING V. DAVIDSON ON THE APPLICABILITY OF SECTION 523 EXCEPTIONS

While the Georgia bankruptcy court did not address the question of Section 523's applicability to corporate Subchapter V debtors in the *Halo Human Resources* decision, that question was squarely at issue in the recent *Spring v. Davidson* decision by the U.S. Bankruptcy Court for the Northern District of Florida. In that case, a group of creditors filed an adversary complaint against Subchapter V debtors Karen Davidson and Blok Industries, Inc. (the Debtors). The creditors asserted that their claims should be excepted from discharge under Section 523(a) because they were the result of the Debtors' false representations and fraud, and because the Debtors caused willful and malicious injury to the creditors. The Debtors sought to dismiss the complaint for a variety of reasons, including that Section 523's exceptions were inapplicable to the corporate debtor, Blok Industries, Inc.

The bankruptcy court agreed, and dismissed the claims for non-dischargeability against Blok Industries, Inc.[1] The bankruptcy court noted that the Fourth Circuit and Fifth Circuit decisions disregarded that Section 523 itself states that it applies only to "individual" debtors. The bankruptcy court refused to read anything into Section 1192's failure to explicitly restate Section 523's limitation to individual debtors, relying on the legislative history behind the relevant Bankruptcy Code provisions and the restriction on Section 523's applicability to corporate debtors. Echoing the Ninth Circuit's Bankruptcy Appellate Panel's opinion issued in 2023 in *In re Off-Spec Sols,* the bankruptcy court concluded that "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."

The Florida bankruptcy court's decision in *Spring v. Davidson* breathes new life into the split among the courts over whether Section 523 applies to corporate debtors in Subchapter V. The court's ruling in *Spring v. Davidson* has not been appealed and, therefore, will not directly result in an opportunity for the Eleventh Circuit Court of Appeals to weigh in on the opinions issued by the Fourth and Fifth Circuits that the Section 523 exceptions to discharge apply to corporate debtors. Nonetheless, the *Spring v. Davidson* decision shows that courts outside of the Fourth and Fifth Circuits may still hold that Section 523's exceptions do not apply to a corporate debtor and only apply to individual debtors, even where the debtor confirms a nonconsensual plan—limiting the collection tools available to creditors depending on where a Subchapter V case is filed. BC

1. The bankruptcy court denied the Debtors' motion to dismiss the non-dischargeability claims against the individual debtor, Karen Davidson.

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