BANKRUPTCY LAW ALERT
April 25, 2023
By: Michael S. Amato, Esq.
Briana Enck-Smith, Esq.

RMF
RuskinMoscouFaltischek P.C.
Smart Counsel. Straight Talk.

Texas Bankruptcy Court Declines to Revoke Subchapter V Status for Related Company After Alex Jones Files Bankruptcy

On February 19, 2020, the Small Business Reorganization Act ("SBRA") went into effect to assist small businesses with a simpler, more efficient and cheaper bankruptcy option pursuant to Chapter 11 of the Bankruptcy Code ("Subchapter V"). In order to elect to proceed under Subchapter V, a small-business debtor must meet the eligibility requirements of Section 1182(1) of the Bankruptcy Code. Those eligibility requirements include, among other things, a $7.5 million cap on the "aggregate noncontingent liquidated secured and unsecured debts" a debtor may have "as of the date of the filing of the petition", and a $7.5 million cap on "aggregate noncontingent liquidated secured and unsecured debts" of "a member of a group of affiliated debtors."

In the recent Order entered on March 31, 2023 (the "Order") in the Southern District of Texas *In re: Free Speech Systems, LLC* [1], Bankruptcy Judge Christopher Lopez held that a subsequent Chapter 11 filing by Alex Jones did not render a related debtor that previously elected to proceed under Subchapter V ineligible to continue as a Subchapter V debtor.

The debtor, Free Speech Systems LLC, is owned by radio show host Alex Jones, who gained notoriety for making numerous public statements that the Sandy Hook school massacre was a hoax. As a result of these statements, the families of the murdered students filed defamation suits in Connecticut and Texas state courts against Alex Jones and his companies. The defendants defaulted, and default judgments were entered. In July 2022, Free Speech Systems LLC filed for bankruptcy protection, and elected to proceed under Subchapter V. Judge Lopez modified the automatic stay in the case to allow the state court suits to proceed. In October 2022, a Connecticut jury awarded approximately $1.5 billion in damages. The Texas suit resulted in a judgment of approximately $50 million.

In December 2022, Alex Jones individually filed a Chapter 11 petition. The magnitude of the judgments rendered him ineligible for Subchapter V treatment. In February 2023, the plaintiffs filed a motion to revoke Free Speech Systems LLC's Subchapter V status pursuant to Section 1182(1)(A) and 1182(1)(B)(i), arguing that Free Speech Systems lost eligibility for Subchapter V treatment when Alex Jones filed his own Chapter 11 petition.

Section 1182(1)(A) provides that the debtor may have "not more than $7,500,000" in "aggregate noncontingent liquidated secured and unsecured debts" on the "date of the order for relief." Section 1182(1)(B)(i) bars a debtor from Subchapter V status if a "member of a group of affiliated debtors under this title that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than $7,500,000."

[1] *In re: Free Speech Systems, LLC*, 2023 WL 2732943 (Bankr. S.D. Tex. Mar. 31, 2023)

Plaintiffs argued that Section 1182(1)(B)(i) does not include the phrase "as of the date of the filing of the petition," and is a continuing obligation. Thus, if an affiliate of a debtor later files a bankruptcy case with debts exceeding the cap, it renders the first debtor ineligible under Subchapter V.

Judge Lopez held that Alex Jones' subsequent Chapter 11 bankruptcy filing did not render Free Speech Systems LLC ineligible to continue as a Subchapter V debtor.

Judge Lopez noted that Bankruptcy Rule 1020(a) requires a debtor to state in a voluntary petition if it elects to proceed under Subchapter V, including an affirmative statement that "[t]he debtor is a debtor as defined in 11 U.S.C. § 1182(1), its aggregate non-contingent liquidated debts (excluding debts owed to insiders or affiliates) are less than $7,500,000, and it chooses to proceed under Subchapter V of Chapter 11." [2]

Next, the Court reasoned that Section 1182(1)(A) provides that it is "subject to subparagraph B" and a debtor must satisfy both Sections 1182(1)(A) and (B)(i) on the petition date, stating, "[s]ubparagraph B is a petition date check on the filing debtor to make sure there isn't already an affiliate in bankruptcy with debts exceeding the cap, and a check that the debtor isn't part of a group of affiliated debtors filing on the same day."[3]

Additionally, Judge Lopez held that plaintiffs' position contradicted the text and purpose of Subchapter V, which is a streamlined chapter 11 process for an expeditious resolution of the case. If post-petition affiliate filings could result in ineligibility and revocation of Subchapter V status, then, a debtor could "float in and out of Subchapter V at any time", which would render the purpose of Subchapter V meaningless. Judge Lopez continued that plaintiffs' position would result in "[a] roaming eligibility trap" that "could also punish an innocent Subchapter V debtor." For example, one member of a corporate group, with its own, independent board, could file a petition under Subchapter V, to be undone by a subsequent filing by another member of the group with a different board, "perhaps with unrelated debts." Therefore, Judge Lopez found the "better reasoned" approach is to allow the first case to proceed under Subchapter V, and prohibit the second case from doing so. [4]

Judge Lopez also noted that Bankruptcy Rule 1020(a) provides that a bankruptcy case proceeds in accordance with the debtor's statement of election in the petition "unless and until the court enters an order finding that the debtor's statement is incorrect." Bankruptcy Rule 1020(b) allows parties to challenge the debtor's statement of election no later than 30 days after the meeting of creditors held under Section 341(a) of the Bankruptcy Code, or within 30 days after any amendment to the statement, whichever is later. [5] Therefore, the Plaintiff's motion was untimely. (However, Judge Lopez said the relief requested would still be denied for the reasons stated above, even if it was timely.)

---

[2] 2023 WL 2732943, at *2
[3] *Id*.
[4] 2023 WL 2732943, at *3
[5] *Id.*

The Texas Bankruptcy Court's decision in the Alex Jones bankruptcy case has significant implications for debtors with related entities that may have substantial liabilities. It is unclear whether future debtors could exploit the Subchapter V process, by filing smaller entities first, and larger cases after the objection period. Small businesses considering electing Subchapter V must contemplate both: (i) whether any of its affiliates would affect the small businesses' eligibility for Subchapter V on the petition date, and (ii) potential future actions of its affiliates that could render the small business ineligible after the petition date.

For more information, please contact:

Michael S. Amato, Esq.
(516) 663-6517
mamato@rmfpc.com

Briana Enck-Smith, Esq.
(516) 663-6683
benck@rmfpc.com