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SOCIAL MEDIA ACCOUNTS AND SUBCHAPTER S ELECTION — ALL VITAL ASSETS

The use of social media accounts by companies is now commonplace and these social media accounts have themselves become valuable assets. In a recent bankruptcy case, the debtor company sought to sell substantially all of its assets, and the bankruptcy court had to analyze who owned the debtor's social media accounts, the debtor or the debtor's former CEO. The bankruptcy court also had to consider whether the debtor or the former CEO controlled the debtor's S corporation election, and therefore the ability to potentially shift millions of dollars of tax liability to the debtor. This article addresses the bankruptcy court's analysis and rulings as well as the significant impact these rulings may have on the financial services sector.

By Mark A. Salzberg and Michelle N. Saney *

Thirty years ago, John Owoc ("Mr. Owoc") — a self-professed avid fitness trainer, designer and producer of fitness supplements, weightlifter, motivational speaker, and writer — founded Vital Pharmaceuticals, Inc. ("Vital").[1] He served as the company's Chief Executive Officer and Chief Science Officer and his wife Megan served as Senior Vice President of Marketing until they both were terminated in March 2023.[2] Vital is a pioneer in the performance energy drink industry and is perhaps best known for its flagship product, Bang Energy, one of the top-selling energy drinks in the United States.[3] In October 2022, Vital filed for protection under Chapter 11 of the U.S. Bankruptcy Code. Instead of reorganizing, Vital utilized the bankruptcy process to effectuate a sale of substantially all of its assets to an affiliate of Monster Beverage Corporation ("Monster").[4]

The Vital bankruptcy case raised two issues of first impression in the Eleventh Circuit, both of which may impact the financial services sector by protecting creditor recoveries, including lender recoveries. *First*, the Vital case addressed who owns the rights to social media accounts created by Vital's former officers which had been used to promote Vital's products as well as for personal use.[5] *Second*, the case addressed whether Vital's Subchapter S election is property of the

[1] *In re Vital Pharm.*, 652 B.R. 392, 398 (Bankr. S.D. Fla. 2023) ("Vital I").

[2] *Id.* at 398-99.

[3] *Id.* at 399.

[4] *In re Vital Pharms.*, No. 22-17842-PDR, 2023 WL 6543190, at *2 (Bankr. S.D. Fla. Oct. 6, 2023) ("Vital II").

[5] Vital I at 396.

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bankruptcy estate.[6] Bankruptcy Judge Peter Russin of the U.S. Bankruptcy Court for the Southern District of Florida answered both questions in favor of Vital and held the Subchapter S election and the social media accounts at issue belonged to the bankruptcy estate, and not to Mr. Owoc.

VITAL I — OWNERSHIP OF THE SOCIAL MEDIA ACCOUNTS

Prior to its sale, Vital utilized social media to market its products and had more than 50 social media accounts which were used to promote Vital's products and increase sales.[7] After the Owocs were terminated, they refused to turn over the passwords to three social media accounts that Vital claimed belonged to the company — an Instagram account with the handle @bangenergy.ceo ("CEO Instagram Account"); a TikTok account with the handle @bangenergy.ceo ("CEO TikTok Account"); and a Twitter account with the handle @BangEnergyCEO ("CEO Twitter Account").[8] Like the other social media accounts utilized by Vital, these CEO Accounts contain "bang" or "bangenergy" in the account name.

In March 2023, Vital commenced an adversary proceeding against Mr. Owoc and filed a motion for summary judgment to determine that Vital owned the CEO Accounts and to force the Owocs to turn over the passwords to the accounts. Vital argued that the CEO Accounts were valuable assets that belonged to the Vital bankruptcy estate and should be included in the sale to Monster. The Owocs opposed the motion.

In assessing whether the CEO Accounts were property of the Vital bankruptcy estate, the bankruptcy court reviewed and analyzed the first case addressing ownership of social media accounts — *In re CTLI, LLC*, 528 B.R. 359 (Bankr. S.D. Tex. 2015). In *CTLI*, the Texas Bankruptcy Court held that a social media account handle using the name of the debtor business raises a presumption that the social media account in question belongs to the debtor.[9] That presumption was supported in the *CTLI* case because: (1) the social media account was linked back to the debtor's website; (2) the social media account was used to post status updates on the debtor's behalf; (3) the social media account was used to promote the debtor's business; (4) company employees and vendors had access to the social media account to post updates for marketing; and (5) a large number of posts were expressly business related and not personal in nature.[10] For these reasons, the *CTLI* court held that the evidence of some "personal" posts were simply insufficient to overcome the presumption that the social media account at issue belonged to the debtor. In its papers, Vital relied on *CTLI* for the proposition that social media accounts are property of the bankruptcy estate "when the content of the accounts is associated with the debtor's business and use of the accounts is 'clearly to generate revenues for the company.'"[11]

The bankruptcy court found that *CTLI* was distinguishable for a variety of reasons including that: (1) *CTLI* was issued more than eight years ago and does not account for the rapid changes in social media account usage since then; (2) *CTLI* did not consider the import of any agreement that established ownership or rights to social media accounts, such as terms of use; (3) in light of influencer culture, the presumption that an account bearing the name of a company belongs to the company gives far too much weight to a name or account handle; and (4) the framework established by the *CTLI* court failed to account for the countless social media influencers who cultivate a persona simply to market products.[12]

Based on these deficiencies, the bankruptcy court rejected the *CTLI* test and instead implemented its own framework, focusing on the existence of any documented or contracted property interest, control over access, and use of social media accounts.[13] Under this test, if a party has both a documented property interest and control over access to the account, the inquiry into ownership ends and that party owns the rights to the social media account.[14] However, where there is only a documented property interest or control over access (but not both), there is a rebuttable presumption of ownership that may be overcome by evidence of "use" of the social media account.[15] "Use" may be found through multiple factors, including: (1) the creation of the account; (2) whether the account handle is in the name of the business or the individual; (3) whether the account is

[6] Vital II at *1.

[7] Vital I at 399.

[8] *Id.* at 399-400. Together, the CEO Instagram Account, the CEO TikTok Account and CEO Twitter Account are referred to as the "CEO Accounts.".

[9] *Id.* at 405.

[10] *Id.*

[11] *Id.* at 404 (quoting *In re CTLI*, 528 B.R. at 368).

[12] *Id.* at 406-07.

[13] *Id.* at 407-08.

[14] *Id.* at 408.

[15] *Id.*

used exclusively to market a business or product owned by the company; (4) whether the account is used to promote multiple businesses or products; (5) whether the use of the account to promote products largely depends on the persona of the person marketing the product and who is paid for their promotion of the product; and (6) whether the social media account is used primarily to post personal content. Further, the bankruptcy court urged that additional factors should be considered as well, including: (1) whether the personal content posted on the account is subtle marketing of the promoted business or product; (2) whether the use of the account is to cultivate or promote a persona; (3) whether changes to the account would be required based on a determination of ownership; and (4) whether any required changes to the account would fundamentally change the nature of the account.[16]

Applying this new three-part rebuttable presumption test, the bankruptcy court held that neither party had established a "documented property interest" or "control over access," to the CEO Accounts.[17] However, the bankruptcy court held that the record evidence was indisputable that the CEO Accounts were pervasively used for marketing Vital products, finding that: (1) the accounts were created while the Owocs were employed by Vital; (2) Vital employees created the CEO TikTok Account upon the instruction of the Owocs, while the Owocs were employed by Vital; (3) each of the CEO Account handles include "bangenergy," and "ceo," in the account name; (4) Mr. Owoc served as CEO of Vital at the time the CEO Accounts were created and Vital continues to have a CEO position; (5) each CEO Account links back to Vital's website; and (6) the CEO Instagram Account is identified on the label of cans of Bang Energy drinks.[18] The bankruptcy court calculated that 33.5% of the most recent posts were pure marketing posts promoting Bang Energy drinks, 39.6% included a Bang hashtag or images of Bang products, Bang apparel, or the Bang logo, and 15% of recent posts were subtle marketing of Bang products which emphasized aspects of Mr. Owoc's persona in a way that was virtually indistinguishable from Vital's marketing strategies (*i.e.*, posts containing workout or nutritional advice consistent with attributes of Bang Energy drinks). Further, only 10% of the most recent posts were personal in nature and not business related.[19] The bankruptcy court held that the number of personal posts was not sufficient to rebut the presumption that the CEO Accounts belonged to Vital. For all these reasons, the bankruptcy court held that the CEO Accounts were "used" for Vital's business purposes and belonged to Vital and not the Owocs personally.

VITAL II — OWNERSHIP OF THE SUBCHAPTER S ELECTION

Mr. Owoc founded Vital Pharmaceuticals in 1993 and was its sole officer and director. At the time of the company's formation, Mr. Owoc elected and consented, as its sole shareholder, that the company be treated as an S corporation.[20] As was the intended result, Vital avoided tax liability by passing its income, losses, deductions, and credits to Mr. Owoc who only paid taxes at the shareholder level. Thus, for approximately 30 years, Mr. Owoc benefitted from the Subchapter S election and avoided double taxation on all distributions from Vital at the corporate level.[21]

Shortly after commencing the Chapter 11 case, Vital reconstituted its board of directors to add a majority of independent directors who then removed Mr. Owoc as an officer and director. Following this corporate shakeup, Vital was governed by John DiDonato, who served as Chief Technology Officer and acting CEO, and a five-member board of directors.[22]

In January 2023, Vital sought approval to conduct a competitive sale and auction process.[23] Vital eventually contracted to sell its assets to Blast Asset Acquisition LLC, a subsidiary of Monster for $370 million, $362 million of which was paid in cash. After satisfying the secured debt, the sale would generate between $9.2 million and $11.6 million in proceeds for unsecured creditors, and Mr. Owoc, as a shareholder, would receive no distribution. However, because Vital is an S corporation as opposed to a C corporation, all the taxable income from the sale would flow through to Mr. Owoc, making him personally liable for the resulting taxes.[24] To avoid the tax liability, Mr. Owoc sought a determination that Vital's Subchapter S election is not property of the estate and that the automatic stay would not prevent him from terminating the election and

[16] *Id.* at 410-11.

[17] *Id.* at 412.

[18] *Id.*

[19] *Id.* at 413.

[20] Vital II at * 1.

[21] *Id.*

[22] *Id.*

[23] *Id.* at *2.

[24] *Id.*

shifting the tax liability from himself to Vital.[25] Driving Mr. Owoc was his concern with personal tax liability that his expert witness testified could be as much as $197 million.[26]

The bankruptcy court denied Mr. Owoc's motion and held that Vital's Subchapter S election belongs to the company and is property of the bankruptcy estate. Thus, Mr. Owoc could not reverse or nullify the Subchapter S election without violating the automatic stay.

In so ruling, the bankruptcy court analyzed and rejected the Third Circuit Court of Appeal's decision, *In re The Majestic Star Casino, LLC*, 716 F.3d 736 (3d Cir. 2013) ("*Majestic Star*"), in which the appellate court reversed the bankruptcy court and held that a corporation's Subchapter S election was not an asset of the bankruptcy estate and was therefore not protected by the automatic stay.[27] The bankruptcy court noted that the Third Circuit's logic in *Majestic Star* was flawed for a variety of reasons. In its simplest terms, the bankruptcy court reduced the Third Circuit's flawed reasoning as follows:

> NOLs are property
>
> An S election is not an NOL
>
> Therefore, an s election is not property.[28]

While the term "property" is included in the major premise and conclusion, it is not in the minor premise. So, the fact that a Subchapter S election may not be an NOL does not mean that a Subchapter S election is not property. Put simply, applying the Third Circuit's logic above to a simple premise — all dogs are animals. No cats are dogs. Therefore, no cats are animals. This is simply not true. Here, "animal" in the major premise is distributed to the conclusion but not the minor premise.[29]

After concluding that a Subchapter S election is not property of the estate, the Third Circuit reasoned that a "S-Corp debtor is merely a 'conduit' for tax benefits that flow through to shareholders" and so "the corporation retains no real benefit from its tax-free status" because all of its pre-tax income is passed on to its shareholders.[30] The bankruptcy court disagreed with the Third Circuit and held that the Subchapter S election provides a valued right — the right of not having to pay taxes — and there was no basis provided to suggest that this right is any less a property right than property that produces income.[31]

In further support of its holding, the bankruptcy court noted that *only the corporation can revoke its Subchapter S election*, and that it cannot do so without the consent of the majority of shareholders.[32] While there are some instances where a shareholder can take action which can result in the termination of the Subchapter S election, *i.e.*, by selling shares to a partnership or a foreign citizen, this was irrelevant to the determination of whether the Subchapter S election is property of the estate. This is because Section 541 of the Bankruptcy Code does not, by its express terms, limit property of the estate in any way to property interests that are noncontingent and the bankruptcy court refused to read any limitation into Section 541 which was not written by Congress. Thus, the bankruptcy court concluded that Vital has a property interest in its Subchapter S election because, once elected, that status gives Vital the right to avoid paying taxes.[33]

The bankruptcy court also ruled that Mr. Owoc failed to demonstrate "cause" to lift the stay and therefore Mr. Owoc did not have the right to revoke Vital's Subchapter S election.[34] In so doing, the bankruptcy court recognized that the harm of Mr. Owoc's ultimate tax bill is outweighed by the harm that would be caused in permitting Mr. Owoc relief from stay to terminate Vital's Subchapter S election. Specifically, the bankruptcy court noted that despite the tax bill, Mr. Owoc would receive certain benefits from the sale, including that he would be able to carry forward $49 million in net capital losses and $23 million in net operating losses, thus yielding $19 million in tax benefits in future years. The bankruptcy court also noted that Mr. Owoc has benefited from avoiding double taxation on his distributions from the company for 30 years. Further, the bankruptcy court noted that the rights of shareholders of an insolvent corporation are subordinate to the rights of the corporation's creditors,

[25] *Id.* at *1.

[26] Vital disagreed over the potential tax bill and their expert estimated the sum to be closer to $3.4 million. *Id.* at *11.

[27] *Id.* at *7.

[28] *Id.* at *8.

[29] *Id.*

[30] *Id.* at *9.

[31] *Id.* at *10.

[32] *Id.* at *8.

[33] *Id.*

[34] *Id.* at *11-12.

and applying that principle here and granting relief from stay will result in administrative creditors not being paid in full and unsecured creditors losing anywhere from $9.2 million to $11.6 million.[35]

For these reasons, the bankruptcy court held that Vital's Subchapter S election is property of the estate and could not be revoked by Mr. Owoc.

IMPLICATIONS OF VITAL I AND VITAL II

Both of the bankruptcy court's opinions in the Vital bankruptcy case are sure to have significant implications on sales effectuated under Section 363 of the Bankruptcy Code and on creditor recoveries, including lender recoveries.

As recognized in Vital I, social media accounts are assets, which can be a significant contributor to a company's enterprise value. Social media marketing is oftentimes the central component of a company's success. Companies can also monetize their social media accounts through advertising, and the data generated by the social media accounts can be utilized by the company to increase the return on investment on marketing spends and can be itself sold to third parties. Social media can drive brand identity and loyalty. Accordingly, any attempts made by a company's principals to take ownership of social media accounts previously utilized by the company threaten to decrease the value of the company and reduce expected sale price to the detriment of creditors.

The test enunciated in Vital I provides a more detailed framework than utilized before for determining ownership of social media accounts. The court's three-part rebuttable presumption test allows for more certainty as to ownership of the social media accounts and enterprise value of the company. The first prong of the test, specifically whether there is a documented property interest, may incentivize companies to adopt written policies in advance that would delineate rights to social media accounts and avoid ownership challenges in the first place. In sum, the new test set forth in Vital I may help to facilitate Section 363 sales and prevent the type of last-minute challenges as brought by Mr. Owoc which threatened not only the sale itself but conversion to a Chapter 7 liquidation and loss of significant enterprise value to the detriment of all creditors.

The bankruptcy court's decision in Vital II similarly allows value maximization for the benefit of creditors. Permitting shareholders to cause a debtor corporation to revoke its Subchapter S election would destroy value for creditors by shifting tax liabilities upon the bankruptcy estate, even though the shareholders may have for years avoided personal taxes by the Subchapter S election. Allowing revocation of the debtor corporation's Subchapter S election would inject uncertainty into the bankruptcy case since the amount of administrative claims would be uncertain at all points throughout the case while the possibility of revocation is left hanging. Section 363 sales would be made more challenging, as the parties would be required to structure the sale without knowing whether, and when, the Subchapter S election would be revoked. In sum, the specter of administrative insolvency would constantly be present, and numerous constituencies would be faced with great, and potentially insurmountable, uncertainties in structuring sales, thus leading to loss of value and creditor recoveries. ■

[35] *Id.* at *12.

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