

May 26, 2021

Bankruptcy Court Orders Dismissal of NRA Chapter 11 Cases

On May 11, 2021, the United States Bankruptcy Court for the Northern District of Texas (“Court”) issued a decision¹ dismissing the chapter 11 cases of the National Rifle Association of America and its affiliate (“NRA”) for cause pursuant to section 1112(b) of the Bankruptcy Code. In so ruling, the Court found that the pending New York attorney general’s lawsuit seeking the NRA’s dissolution—which the NRA alleged was an “existential threat” to its existence—was not the type of threat that the Bankruptcy Code protects against. The Court further found that the NRA filed bankruptcy to gain an unfair litigation advantage and to avoid New York’s regulatory scheme, objectives that did not constitute good faith for bankruptcy filing purposes and which were cause to dismiss the cases.

Background

The NRA is a New York governed non-profit headquartered in Fairfax, Virginia.² Prior to the commencement of the chapter 11 cases, on August 6, 2020, the New York state attorney general (“NYAG”) filed a complaint in New York state court seeking, among other relief, dissolution of the NRA (“NY State Action”) under New York’s non-profit corporate law. New York law governing charitable organizations permits dissolution of charities in certain circumstances. These include (a) if a regulated entity’s misconduct injures the public;³ and (b) if directors or members in control of the regulated entity loot or waste its corporate assets, use the entity solely for their personal benefit, or otherwise act in an illegal, oppressive or fraudulent manner.⁴

On January 15, 2021 (“Petition Date”), the NRA filed for chapter 11 in the Northern District of Texas. At that time, the NY State Action had not reached trial and remained ongoing. In its “first day” papers, the NRA asserted that it “instituted this chapter 11 reorganization proceeding to establish a centralized, neutral forum in which it can streamline, resolve, and address all outstanding claims and preserve its ability to

¹ *Order Granting Motions to Dismiss* [Docket No. 740], *In re National Rifle Association of America and Sea Girt LLC*, Case No. 21-30085 (HDH) (Bankr. N.D. Tex. May 11, 2021) (“Order”).

² The other debtor in these cases was Sea Girt LLC, an entity governed by the laws of the state of Texas that was formed by the National Rifle Association of America in contemplation of commencing chapter 11 cases in Texas.

³ See N-PCL § 1101; Order, p. 28 (NYAG must show that the NRA “has produced, or tends to produce, injury to the public. The transgression must not be merely formal or incidental, but material and serious, and such as to harm or menace the public welfare.” *People v. Oliver Schools, Inc.*, 206 A.D.2d 143, 145 (4th Dep’t 1994) (interpreting BCL § 1101, from which N-PCL § 1101 is derived) (quoting *People v. North River Sugar Refining Co.*, 121 N.Y. 582, 609 (1890)).”).

⁴ See N-PCL § 1102.

pursue its constitutionally protected mission as a going concern” after noting that “the partisan attacks the NRA confronts in New York stand out as condemnable” and specifically citing the NY State Action.⁵ The NRA also stated that it would utilize the chapter 11 cases to “relocate to Texas” with respect to both its corporate domicile and principal place of business.⁶

Shortly following the Petition Date, the NYAG and various other parties in interest filed motions to dismiss the chapter 11 cases, among other forms of relief.⁷ The Court consolidated the motions and held a 12-day trial starting on April 5, 2021. Twenty-three witnesses testified, including Wayne LaPierre, the NRA’s executive vice president. LaPierre had also been named as a defendant in the pending NY State Action. Based on the evidence adduced at trial, the Court found that “the ultimate decision to file for bankruptcy was made solely by Mr. LaPierre.”⁸ Specifically, on January 7, 2021, the NRA held a board meeting where the board of directors, among other things, passed a resolution approving an employment agreement for LaPierre that contained language permitting LaPierre to unilaterally authorize the filing of a bankruptcy petition, although the board of directors was not informed that the NRA was considering filing for bankruptcy at all.⁹ The board of directors was never asked to vote on a bankruptcy filing prior to the filing of the petitions and the vast majority of the board was not even aware of the filing until after it happened. LaPierre also did not inform the NRA’s Chief Financial Officer or its General Counsel of the bankruptcy filing until after the cases were filed, all of which the Court found “shocking.”¹⁰

The Court’s Decision

The Court focused most of its opinion on findings regarding the NRA’s purpose for filing bankruptcy—which the Court determined based on the evidence was to avoid the potential dissolution for misconduct under New York’s regulatory scheme governing charities—and whether sanctuary from this threat constituted good faith for purposes of filing bankruptcy. Section 1112(b)(4) of the Bankruptcy Code sets forth a non-exclusive list of what constitutes “cause” for dismissal. In addition, most courts, including the Court of Appeals for the Fifth Circuit, have held that “cause” can include a finding that the debtor’s filing for

⁵ *Debtors’ Information Brief in Connection with Voluntary Chapter 11 Petitions* [Docket No. 31], January 20, 2021, ¶¶ 1–3.

⁶ *Id.* at ¶ 26.

⁷ On February 8, 2021, a director of the NRA filed a motion seeking appointment of an examiner to investigate the governance of the NRA and the action of its managers. On February 10, 2021, a vendor involved in prepetition litigation with the NRA filed a motion to dismiss the cases or, in the alternative, appoint a chapter 11 trustee. The NYAG and the attorney general for the District of Columbia each filed similar dismissal motions shortly thereafter.

⁸ Order, p. 18.

⁹ *Id.* at p. 8.

¹⁰ *Id.* at p. 34.

bankruptcy relief is not in good faith,¹¹ and that a chapter 11 petition “is not filed in good faith unless it serves a valid bankruptcy purpose.”¹² The question of “whether the petition is filed merely to obtain a tactical litigation advantage” is “particularly relevant to the question of good faith.”¹³

Relying primarily on LaPierre’s testimony, which the Court found to be “the most compelling evidence for why the NRA filed for bankruptcy,”¹⁴ the Court found that “the primary purpose of the bankruptcy filing was to avoid potential dissolution” in the NY State Action.¹⁵ The Court then examined whether filing for chapter 11 to avoid dissolution in the NY State Action was a “valid purpose for bankruptcy such that the bankruptcy was filed in good faith.”¹⁶ The Court ultimately concluded that the petitions were not filed in good faith “but instead filed as an effort to gain an unfair litigation advantage in the NYAG [State] Action and as an effort to avoid a regulatory scheme,” neither of which were valid purposes for bankruptcy.¹⁷

In so holding, the Court distinguished “traditional bankruptcy case[s] in which a debtor is faced with financial difficulties or a judgment that it cannot satisfy” from the NRA’s circumstances, where “the attorney general of a state is specifically seeking dissolution of a debtor under the state’s laws and therefore required to satisfy standards and requirements that specifically justify dissolution.”¹⁸ The Court found that the purpose of the bankruptcy was to “deprive the NYAG of the remedy of dissolution, which is a distinct litigation advantage” and the “NRA’s goal [was] to avoid dissolution and subvert the remedy provided for under New York law entirely through this Chapter 11 case.”¹⁹ The Court rejected the NRA’s argument that the Bankruptcy Code could be used to avoid a state’s regulatory authority to govern a charitable organization’s alleged misconduct under applicable state law: “The NRA is a solvent and growing

¹¹ See, e.g., *In re Little Creek Dev. Co.*, 779 F.2d 1068 (5th Cir. 1986); *In re Humble Place Joint Venture*, 936 F.2d 814 (5th Cir. 1991).

¹² Order, p. 12 (citing *Off. Comm. Of Unsecured Creditors v. Nucor Corp. (In re SGL Carbon Corp.)*, 200 F. 3d 154, 165 (3d Cir. 1999)).

¹³ *Id.* at p. 27.

¹⁴ *Id.* at p. 18.

¹⁵ *Id.* at p. 26. The Court based its conclusion on (a) LaPierre’s testimony that the NRA filed for chapter 11 “because the New York state attorney general is seeking dissolution of the NRA and [seizure of] its assets,” (b) the fact that neither receivership nor dissolution were imminent, (c) the NRA was solvent, in its strongest financial condition in years, and able to pay its ongoing litigation costs, and (d) reincorporation in Texas could have been accomplished entirely outside of the bankruptcy process, calling into question the NRA’s use of the bankruptcy forum to achieve such ends given the timing of the chapter 11 filing with respect to the commencement of the NY State Action.

¹⁶ *Id.* at p. 27.

¹⁷ *Id.* at p. 33.

¹⁸ *Id.* at pp. 27–29.

¹⁹ *Id.* at p. 29.

organization using this bankruptcy as a tool to win its dissolution lawsuit, and that is not an appropriate use of bankruptcy.”²⁰ In so holding, the Court emphasized that it was not announcing a *per se* rule that a pending state law dissolution action renders an entity ineligible for bankruptcy. Rather, whether an entity filed for bankruptcy in good faith depends on the totality of the facts and circumstances of a specific case.²¹

Conclusion

While the NRA facts are unusual, the ruling is a useful reminder that a bankruptcy case filed solely for the purpose of obtaining an unfair litigation advantage risks being dismissed as not filed in good faith.²² The Bankruptcy Code remains a powerful tool for corporate reorganizations and to respond to financial pressures—including litigation judgments. However, bankruptcy filings must be supported by sound corporate governance processes and a valid purpose for seeking bankruptcy relief.

* * *

²⁰ *Id.* at p. 32.

²¹ *Id.*

²² Without issuing an opinion, the Delaware bankruptcy court in an oral ruling also recently affirmed this principle when it dismissed the chapter 11 case of Stream TV Networks, Inc. for lack of good faith—one week after the NRA decision was issued—finding that the debtor had filed for chapter 11 protection in an attempt to interfere with a Delaware Chancery Court order to enforce a prepetition asset transfer agreement whereby the debtor had agreed to transfer all of its assets to its secured creditors in lieu of foreclosure. *See Order Dismissing Debtor’s Chapter 11 Case* [Docket No. 198], *In re Stream TV Networks, Inc.*, Case No. 21-10433 (KBO) (Bankr. D. Del. May 17, 2021).

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Jacob A. Adlerstein
+1-212-373-3142
jadlerstein@paulweiss.com

Paul M. Basta
+1-212-373-3023
pbasta@paulweiss.com

Brian Bolin
+1-212-373-3262
bbolin@paulweiss.com

Robert Britton
+1-212-373-3615
rbritton@paulweiss.com

Kelley A. Cornish
+1-212-373-3493
kcornish@paulweiss.com

Alice Belisle Eaton
+1-212-373-3125
aeaton@paulweiss.com

Brian S. Hermann
+1-212-373-3545
bhermann@paulweiss.com

Kyle J. Kimpler
+1-212-373-3253
kkimpler@paulweiss.com

Alan W. Kornberg
+1-212-373-3209
akornberg@paulweiss.com

Elizabeth R. McColm
+1-212-373-3524
emccolm@paulweiss.com

Andrew M. Parlen
+1-212-373-3141
aparlen@paulweiss.com

Andrew N. Rosenberg
+1-212-373-3158
arosenberg@paulweiss.com

Jeffrey D. Saferstein
+1-212-373-3347
jsaferstein@paulweiss.com

John Weber
+1-212-373-3656
jweber@paulweiss.com

Associate Alice Nofzinger contributed to this client memorandum.