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Not in My Court: Northern District of Texas Bankruptcy Court Dismisses NRA Bankruptcy Cases as Filed in Bad Faith

On May 11, 2021, Judge Harlin D. Hale, of the Bankruptcy Court for the Northern District of Texas (the “Court”) found that the bankruptcy cases of the National Rifle Association of America (“NRA”) and its subsidiary Sea Girt LLC (collectively, the “Debtors”)¹ were filed in bad faith to (i) gain an unfair litigation advantage, and (ii) avoid the regulatory scheme of the State of New York.² The Court dismissed the cases without prejudice but noted that if the NRA filed a new case, the Court would revisit its concerns regarding, among other things, disclosure, transparency, secrecy, and conflicts of interest, which could cause the appointment of a trustee to address the ability of the NRA, as a debtor in possession, to fulfill its fiduciary duties.

BACKGROUND:

The NRA is a 150-year-old not-for-profit New York corporation headquartered in Fairfax, Virginia. On August 6, 2020, the New York Attorney General (“NYAG”) filed a lawsuit in New York State Court against (i) the NRA (“NYAG Action”) and (ii) certain individual defendants, including the NRA’s Executive Vice President, Wayne LaPierre, for, among other things, breach of fiduciary duties, gross mismanagement, wrongful related-party transactions, self-dealing and unjust enrichment. As a remedy, the NYAG sought (i) dissolution of the NRA, (ii) restitution of funds, (iii) ban on certain officers from serving as fiduciaries of any New York charity, and (iv) voiding of certain transactions.³

On September 10, 2020, the NRA’s president created a Special Litigation Committee to oversee, among other things, the NYAG Action (as well as other lawsuits). Thereafter, on January 7, 2021, the NRA held a board meeting at which the board of directors adopted a resolution formalizing the Special Litigation Committee and approving a new employment agreement for Mr. LaPierre, which permitted Mr. LaPierre to “exercise corporate authority in furtherance of the mission and interests of the NRA,



including without limitation to reorganize or restructure the affairs of the Association for the purposes of cost-minimization, regulatory compliance or otherwise.”⁴ No discussion of bankruptcy or the possible reorganization of the NRA occurred at that meeting, nor were the board of directors informed that the language could authorize Mr. LaPierre to unilaterally authorize a bankruptcy petition.

On January 15, 2021, (i) the NRA and (ii) Sea Girt LLC, a Texas limited liability company wholly owned by the NRA, which was formed on November 24, 2020 (approximately two months prior to the bankruptcy filing),⁵ filed for chapter 11 bankruptcy. Through the filing, the Debtors sought to restructure as a Texas nonprofit and to “exit what it believes is a corrupt political and regulatory environment in New York” – effectively “dumping New York”. At the time of filing, the NRA claimed that it “is in its strongest financial condition in years,”⁶ and noted that it would propose a plan that pays creditors in full.

Thereafter, on February 10 and 12, respectively, (i) Ackerman McQueen, Inc.⁷ – the Debtors’ former advertising agency, largest unsecured creditor, and counterparty to a lawsuit currently pending in the U.S. District Court for the Northern District of Texas – and (ii) the NYAG,⁸ each filed motions to dismiss the Debtors’ bankruptcy cases and, alternatively, seek appointment of a chapter 11 trustee (collectively, the “*Dismissal Motions*”).⁹ Generally, the Dismissal Motions asserted (among other things) that the cases were filed in bad faith, solely as a litigation tactic (not to reorganize or respond to financial crises – as the Debtors are solvent) and, in light of misappropriation and lack of oversight, grounds existed to appoint a trustee (rather than allow the NRA to continue to manage their cases as debtors-in-possession). In support of their positions, the movants highlighted (i) the lack of board authorization for, and notice of, the bankruptcy filing, which was authorized solely by Mr. LaPierre relying on his employment agreement approved on January 7, 2021, and (ii) a post-filing attempt to retroactively ratify the bankruptcy filing.

DECISION:

After a 12-day trial that included 23 witnesses, the Court dismissed the bankruptcy cases for “cause” under Section 1112(b) of the Bankruptcy Code, finding that the cases were not filed in good faith and that the appointment of a trustee or an examiner was not in the best interests of creditors and the estates.¹⁰ In evaluating the Debtors’ “good faith,” the Court reviewed whether the bankruptcies were filed (i) for a valid bankruptcy purpose and (ii) merely to obtain a tactical litigation advantage.

Ultimately, the Court found that the purpose of the filings was to avoid the potential dissolution of the NRA in the NYAG Action. In reaching that finding, the Court focused on the testimony of Mr. LaPierre to establish that (i) the filing was not related to the NRA’s financial condition (as the NRA is financially healthy),¹¹ (ii) if the case were dismissed, the NRA would be able to pay its debts in full and meet its obligations and (iii) but for the NYAG Action, a bankruptcy filing by the NRA would not have been necessary.

As such, the Court found that “[t]he NRA is a solvent and growing organization using bankruptcy as a tool to win its dissolution lawsuit, and that is not an appropriate use of bankruptcy.”¹² The Court distinguished the present case from the more typical case, where a debtor files a bankruptcy to avoid a potential monetary judgment posing an existential threat. Here, in contrast, the NRA sought to deprive the NYAG of the statutory remedy of dissolution (if the NYAG could meet certain high thresholds),¹³ and the Court found that the “Bankruptcy Code does not provide sanctuary from this kind of threat.”¹⁴ Furthermore, using the bankruptcy process to avoid dissolution deprived the state of New York of the ability to regulate its not-for-profit corporations in accordance with its laws. As such, the Court found that the bankruptcy filings sought to (i) obtain a litigation advantage and (ii) avoid a regulatory scheme, each of which equates to bad faith for purposes of section 1112(b).

The Court next considered whether appointment of a trustee or examiner was in the best interest of creditors and the estates, but found that such relief was not warranted. Specifically, the Court was concerned with “lingering issues of



secrecy and a lack of transparency," and, in particular, the "surreptitious manner" in which Mr. LaPierre obtained, and exercised, authority to file bankruptcy for the NRA.¹⁵ The Court noted that "[e]xcluding so many people from the process of deciding to file for bankruptcy, including the vast majority of the board of directors, the chief financial officer, and the general counsel, is nothing less than shocking."¹⁶ However, the Court also noted, among other things, that the NRA was financially healthy and, outside of bankruptcy, could pay its creditors, continue to fulfill its mission and improve its governance and internal controls and contest dissolution in the NYAG Action. As such, the Court believed such factors weighed in favor of dismissal, rather than keeping the cases in bankruptcy.

CONCLUSION:

The NRA bankruptcy cases are a unique situation given, among other things, their high-profile nature, the ongoing litigation with the NYAG and the nature of the allegations against the NRA and Mr. LaPierre. Nonetheless, the cases offer valuable lessons and considerations regarding the scope of bankruptcy protections and filing rationales. Moreover, the cases highlight the (i) importance, and need, for corporate formalities and process and (ii) care and thoughtfulness that should go into planning, and implementing, a cohesive, justifiable, and feasible restructuring.

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¹ The cases were jointly administered under case number 21-30085-hbh-11. Citations to “[ECF No. ____]” shall refer to documents filed on the docket in the case captioned *In re National Rifle Association of America and Sea Girt LLC*, No. 21-30085 (HDH) (Bankr. N.D. Tex. May 11, 2021).

² Order Granting Motions to Dismiss, *In re National Rifle Association of America and Sea Girt LLC*, No. 21-30085 (HDH) (Bankr. N.D. Tex. May 11, 2021), ECF No. 740 (the “Dismissal Order”).

³ The suit, which remains pending, has spawned related litigation, additional federal suits and motion practice, including motions to dismiss and to transfer venue.

⁴ See Dismissal Order, at 8.

⁵ NRA Dumps New York to Reincorporate in Texas, Announces New Strategic Plan, NRA, Jan. 15, 2021, <https://www.nraila.org/articles/20210115/nra-dumps-new-york-to-reincorporate-in-texas-announces-new-strategic-plan>.

⁶ *Id.*

⁷ See Motion to Dismiss the Chapter 11 Bankruptcy Petition, or, in the Alternative, Motion for the Appointment of a Chapter 11 Trustee and Brief in Support [ECF No. 131].

⁸ See Motion to Dismiss, or, in the Alternative, to Appoint a Chapter 11 Trustee [ECF Nos. 155 and 156].

⁹ Subsequently, among other things, (i) the District of Columbia filed motions in support of the NYAG’s motion to appoint a trustee [ECF No. 214] and dismiss the cases [ECF Nos. 423 and 429], (ii) Christopher Cox, a former executive director of the NRA Institute for Legislative Action, joined the NYAG’s motion [ECF No. 172], (iii) the United States Trustee, in closing arguments, took the position that the evidence supported dismissal, the appointment of a trustee, or the appointment of an examiner, (iv) sixteen other States sought leave to submit a brief as *amici curiae* in support of the Debtors [ECF No. 439], which the Court granted on March 31, 2021 [ECF No. 439] and (v) the Official Committee of Unsecured Creditors appointed in the cases also opposed the relief sought in the Dismissal Motions, contending, among other things that a bankruptcy proceeding was in the best interests of creditors (but suggested a trustee with limited powers to the extent that the Court were inclined to appoint a chapter 11 trustee) [ECF No. 369].

¹⁰ Section 1112(b) of the Bankruptcy Code provides “the Court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate.” 11 U.S.C. § 1112(b).

¹¹ Dismissal Order, at 28.

¹² *Id.* at 32.

¹³ See N-PCL §§ 1101 and 1102; see also Dismissal Order, at 28.

¹⁴ Dismissal Order, at 28.

¹⁵ *Id.* at 34.

¹⁶ *Id.*