

NRA Fires Off Bankruptcy Petition, Raising Questions about Good Faith and Venue

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The January 15, 2021 bankruptcy petition filed by the National Rifle Association of America (NRA) in the Northern District of Texas poses important tests of the rules for determining proper venue in a bankruptcy case and the standard for determining whether a bankruptcy petition has been filed in good faith.

By filing in Texas, the NRA, a New York entity with its principal place of business in Virginia, is relying on the fact that its subsidiary Sea Girt LLC was formed under Texas' limited liability company law. Typically, a company may file for bankruptcy in any venue that would be available to any one of its affiliates, and the NRA is relying on its Sea Girt affiliate's presence in Texas in this case. But the complicating factor for the NRA's choice of venue is that Sea Girt does not appear to have been formed until November 24, 2020^[1] – less than two months before the bankruptcy filing. Thus, opponents of the NRA's filing have strong arguments that the subsidiary was created for the sole purpose of paving the way to a bankruptcy filing in Texas, and that the NRA's corporate relationship to Texas is simply too attenuated to serve as a proper basis for venue there.

Leading venue decisions in the Patriot Coal and Winn-Dixie bankruptcy cases should be instructive. In the early stages of the Patriot Coal bankruptcy case, numerous stakeholders battled over the question of the proper venue for the proceeding. The Patriot Coal case had initially been filed by the debtor in the Southern District of New York, a choice that was challenged by the mine workers' union, among others, who sought to transfer the case to the Southern District of West Virginia where Patriot Coal had its headquarters and operations. In Patriot Coal, a mirror image of the NRA venue issue, the company's selection of the New York venue was tied to its formation of a New York subsidiary shortly before the bankruptcy filing for the strategic purpose of being able to establish bankruptcy venue in New York. Unlike the NRA case, Patriot Coal was trying to find its way into the New York venue, not escape from it.

In transferring venue to West Virginia, the bankruptcy court in the Patriot Coal case emphasized that the transfer-of-venue statute (28 U.S.C. 1412) focuses on the "interest of justice," among other considerations, and ruled that justice was better served by having the proceeding go forward in West Virginia. As Judge Chapman observed in her transfer-of-venue decision: "Whether one characterizes the creation of venue [in New York] as exploiting a loophole or as simply not fair, one thing is clear: it is not the thing which the statute intended."^[2] Similarly, in the Winn-Dixie bankruptcy

case, the New York bankruptcy court transferred venue to Florida in the interest of justice, relying in large part on the fact that the only basis for New York venue was the presence of a New York affiliate that had been formed shortly before the bankruptcy for the sole purpose of creating venue in New York.^[3]

It is worth noting that in both the Patriot Coal and Winn-Dixie decisions, even though the court transferred venue, it did not find that the debtors had acted in bad faith in initially filing the cases in New York. In the NRA case, there is reason to question the good faith of the filing, which should lead the Texas bankruptcy court to be even more skeptical of the NRA's Texas strategy and choice of venue.

The NRA has bluntly and publicly stated that its chief purpose in filing the bankruptcy petition is to evade New York's "regulatory environment," which the NRA calls "corrupt." Specifically, it appears that the NRA is seeking to use the bankruptcy process to obtain an advantage in battling against a lawsuit filed by the New York Attorney General's Office (NYAG), in which the NYAG seeks dissolution of the NRA on the basis that the NRA and its officers, including Executive Vice President Wayne LaPierre, have failed to properly manage the NRA's funds and have used funds for their personal benefit, have failed to comply with state and local laws, and have deviated from the NRA's own bylaws.

The NRA has described the NYAG's lawsuit as a political vendetta. Notably, the NRA's public statements do not assert that the bankruptcy filing was prompted by financial distress, boasting that the "NRA is in its strongest financial condition in years." Indeed, the NRA's early filings report assets of \$203 million and liabilities of \$153 million, implying net assets of approximately \$50 million. According to the NRA, the objective of the filing is to provide a "mechanism for adjudicating and/or resolving the claims of the NYAG" before the bankruptcy court in Texas. Of course, New York courts are perfectly capable of adjudicating disputes between the NYAG's office and New York entities under its regulatory oversight.

Section 1112 of the Bankruptcy Code permits a court to dismiss a bankruptcy case "for cause." Although there is no enumerated Bankruptcy Code requirement that a petition be filed in good faith, courts have consistently interpreted Section 1112 to allow for dismissal of a bankruptcy case due to "the lack of good faith in its filing."^[4] Courts do not apply a bright-line test in determining good faith, but rather consider the totality of circumstances, with a focus on preventing the "abuse of the bankruptcy process" and protecting the "jurisdictional integrity of the bankruptcy courts."^[5] Here, if the NRA cannot supply a genuine reason for the filing that is rooted in financial distress and a legitimate need for restructuring, then there is a strong case for the rare step of dismissing the filing for lack of good faith. At a minimum, the NRA's apparent attempt to escape the NYAG's regulatory oversight should cause the court in Texas to cast a skeptical eye upon the choice of Texas as the venue for this case.

Even if the NRA's decision to file for bankruptcy in Texas is upheld, that does not necessarily mean that the NRA will be able to use the automatic stay to protect itself from the NYAG's lawsuit. Beyond procedural wrangling over the NRA's eligibility to file for bankruptcy in Texas lies the important substantive question of whether the NYAG's lawsuit is an exercise of the state's regulatory and police powers exempt from being subject to the bankruptcy stay.

In the Patriot Coal decision, Judge Chapman observed that "nothing in our jurisprudence requires the Court to condone every strategy devised by clever lawyers to outsmart statutory purpose and language." While the NRA might be expected to belatedly soften its rhetoric to portray its Texas filing as driven by economics, its statements to date make its strategy and objective fairly plain. The

NYAG has not yet taken a position on the case before the Texas court, and it is yet to be determined whether the bankruptcy court in Texas will permit the NRA to pursue its bankruptcy case there.

[1] 'Bad Faith' Questions May Overshadow The NRA's Ch. 11 Case (last accessed on January 20, 2021).

[2] *In re Patriot Coal Corp.* 482 B.R. 718, 745 (Bankr. S.D.N.Y. 2012).

[3] *In re Winn–Dixie Stores, Inc.*, Case No. 05–11063(RDD) (Bankr. S.D.N.Y. April 12, 2005) (hearing transcript).

[4] See, e.g., *In re Humble Place Joint Venture*, 936 F.2d 814, 816-17 (5th Cir. 1991).

[5] *In re Little Creek Develop. Co.*, 779 F.2d 1068, 1071-72 (5th Cir. 1986).

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