AMERICAN BANKRUPTCY INSTITUTE

2022 Annual Spring Meeting

Examining Venue, Ethics and Bad-Faith Issues in 2020/2021 Bankruptcy Filings

Hosted by the Business Reorganization, Commercial Fraud & Ethics/Professional Compensation Committees

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CONCURRENT SESSION

2022

Examining Venue, Ethics and Bad Faith Issues in 2019-2021 Bankruptcy Filings
Saturday, April 30, 2022
10:00 – 11:15 AM ET

Program Description
Recent large bankruptcies like NRA, Boy Scouts of America, Roman Catholic Archdiocese, Purdue Pharma and J&J have invigorated debate over the longstanding issues of venue and bad faith in bankruptcy. Join our panel of experts as they explore the issues of venue and bad faith filings, related ethics considerations, and the newest wave of reform initiatives.

Learning objectives
- Participants will be able to identify issues related to venue in chapter 11 bankruptcy
- Participants will be able to identify issues related to chapter 11 good faith requirements and assertions of bad faith filings and defenses thereto, including obtaining an overview of relevant case law
- Participants will be able to identify certain ethics considerations that should be considered in connection with filing for chapter 11
- Participants will be able to identify current initiatives / legislation to reform bankruptcy to address these issues

I. Introductions

a.) Joshua Lesser – I am an associate with the Financial Services practice group of Adams and Reese LLP, in Houston, Texas. I have served as a judicial law clerk to Magistrate Judge Sam S. Sheldon for the U.S. District Court for the Southern District of Texas. I was selected as a Thompson Reuters 2022 Texas Rising Star, recognized in my practice of Banking. I earned my J.D. from Tulane University Law School.

b.) **Our first distinguished panelist is Judge Meredith S. Grabill**: The Honorable Meredith S. Grabill currently serves in the United States Bankruptcy Court for the Eastern District of Louisiana. Prior to taking the bench in September 2019, she practiced primarily in the areas of bankruptcy, commercial, and oil-and-gas litigation in New York and Louisiana. In her practice, she served on bankruptcy teams representing publicly traded, closely held, and individual chapter 11 debtors; official unsecured creditors' committees; and corporate creditors. Outside of bankruptcy court, she has represented large and multinational corporations in antitrust proceedings, labor and contract disputes, and insurance and reinsurance disputes. Judge Grabill served as a judicial clerk to The Honorable Edith Brown Clement in the United States Court of Appeals for the Fifth Circuit, The Honorable Martin L.C. Feldman in the United States District Court for the Eastern District of Louisiana, and The Honorable Martin Glenn in

the United States Bankruptcy Court for the Southern District of New York. She earned her J.D. from Tulane Law School, where she served as Editor in Chief of the *Tulane Law Review*, and received a B.A. from The Evergreen State College in Olympia, Washington. Prior to earning her law degree, Judge Grabill worked for years in the juvenile justice field in Washington State, providing direct treatment services and administering programs for offenders with mental health issues, chemical dependency issues, and developmental delays

c.) **Our second distinguished panelist is Professor Anthony J. Casey**: Professor Casey is a Deputy Dean, the Donald M. Ephraim Professor of Law and Economics, and a Faculty Director for the Center on Law and Finance at the University of Chicago School of Law. Professor Casey' research, examining the intersection of finance and law, has been published in the Yale Law Journal, the Columbia Law Review, the Supreme Court Review, and the University of Chicago Law Review. Before entering academics, Professor Casey was a partner at Kirkland and Ellis, LLP and an associate at Watchtell, Lipton, Rosen & Katz, where his practice focused on corporate bankruptcy, merger litigation, white-collar investigations, litigation, and complex class actions. Prior thereto, Professor Casey served as a judicial law clerk for Chief Judge Joel M. Flaum of the United States Court of Appeals for the Seventh Circuit. Professor Casey received his JD with High Honors from the University of Chicago Law School, and was also awarded John M. Olin Prize for the outstanding student of law and economics.

d.) **Our third distinguished panelist is Gerrit Pronske**: Mr. Pronske is a Partner with the Bankruptcy, Restructuring, and Creditor's Rights practice group of Spencer Fane, in Plano, Texas. Mr. Ponske is the author of "Pronske's Texas Bankruptcy, Annotated," an eleven-hundred-page textbook that provides insights and guidance by bankruptcy practitioners throughout Texas, and which is currently in its 21st edition published by the Texas Lawyer. Recently, Mr. Pronske represented the New York Attorney General's Office in the landmark case of In re NRA of America. Prior to practice, Mr. Pronske served as a judicial law clerk to the Honorable Robert C. McGuire, former Chief United States Bankruptcy Judge for the U.S. Bankruptcy Court, Northern District of Texas.

II: Explanation / Overview of the Issues

A. Today's panel will focus on the facts and issues underlying "bad faith" in bankruptcy proceedings, including a discussion of recent landmark bad-faith rulings, commonplace bad-faith fact patterns, and touching on the corresponding policy implications. The panelists will also discuss the ethics considerations for lawyers when faced with fact scenarios that may implicate bad faith and the newest wave of reform initiatives from critics, commentators, and capitol hill. The panel will conclude with time for questions from you. On behalf of our distinguished panelists and myself, thank you for being here.

III. Good Faith in Filing

B. What is the Requirement?

a. 28 U.S.C. § 1112(b), (b)(4)

b. Every Circuit in the country has a good faith filing requirement - Fifth Circuit case of Matter of Little Creek Development Co. 779 F.2d 1068 (5th Cir. 1986) - "every bankruptcy statute since 1898 has incorporated literally, or by judicial interpretation, a standard of good faith for the commencement, prosecution, and confirmation of bankruptcy proceedings"

C. Reasons to File

1. Core idea is that you need a bankruptcy purpose

a. Good faith filing rules are very flexible

b. No insolvency requirement

2. NRA Case Study

a. Grounds to Determine Filing of NRA not filed in Good Faith:

i. NRA and Sea Girt cases were improperly filed for purely a litigation strategy purpose: in the words of the NRA, to "Dump New York"

ii. NRA clearly and undisputedly had no financial reasons for filing bankruptcy.

iii. Venue of the bankruptcy Filings in Texas of the NRA and Sea Girt were clearly and cavalierly the result of Impermissible Forum Shopping.

iv. Filed without Board approval, and also by intentionally deceiving the Board.

b. Litigation Strategy Purpose of Filing

i. Bankruptcy filing purely as a Litigation Strategy is a Bad Faith Filing, necessitating dismissal.

ii. *Investors Group, LLC v. Pottorff*, 518 B.R. 380 (N.D. Tex. 2014) "When a bankruptcy court finds a party pursues bankruptcy for the purpose of securing litigation advantage in another forum, such intent is dispositive: it establishes bad faith and necessitates dismissal."

iii. Testimony relevant to the reasons that the NRA filed bankruptcy showed case was filed for purposes of legal strategy

iv. Attempting to side-step police and regulatory power is not an appropriate basis for bankruptcy filing.

c. No Financial Reasons for Filing

i. Federal Courts, including Bankruptcy Courts are courts of limited jurisdiction – bankruptcy courts purpose is to solve debt issues.

ii. A major indicia of bad faith and abuse of the bankruptcy court and process was that the NRA had no debt problems.

iii. Evidence in NRA clearly showed no debt problems: (a) Plenty of cash on-hand; (b) Failed to pay creditors to artificially create reason for bankruptcy filing; (c) $20 million in equity in the NRA building; (d) The assets of the NRA greatly exceeded its Liabilities; (e) NRA vastly solvent.

d. Venue Artificially Created Forum Shopping.

i. Sea Girt LLC was formed as a Texas LLC on November 24, 2020 as an NRA affiliate.

ii. A bankruptcy paradigm from the Boy Scouts bankruptcy case. In that case, the Boy Scouts had no nexus to Delaware for bankruptcy filing. In order to forum shop the BS case to Delaware, the BS set up an entity to boot-strap the real BS case into Delaware. The NRA followed the BS paradigm precisely to the letter, with 100% similarity.

1. Both entities created LLC's where their forum shopping took them

2. Both entities put the same amount of $50,000 into a bank account of LLC in the forum-shopped state to create an asset in the filing venue (NRA transferred money back out after bankruptcy with no court approval)

3. Both LLC's carried on no business

4. Both LLC's had no employees

5. Both LLC's were pure corporate shells

6. Both LLC's had no financial problems, no creditors and no reasons to file bankruptcy

7. This paradigm was not challenged in BSA case

8. Adam Levitin, Professor of Bankruptcy Law at Georgetown Law School wrote an article, entitled Boy Scouts of America: Venue DeMerit Badge, saying "It's hard to conceive of a more blatant abuse of the venue statute. . . ." and a "Gaming of the Bankruptcy Venue statute."

e. No Board Approval for Filing

i. Board Approval needed under NRA By-Laws.

ii. General Counsel of the NRA, and Board Members did not know that bankruptcy was going to be filed until after the filing.

iii. NRA Management attempted to obtain Board approval by sneaking Language into an Employment Contract to fool the Board of Directors into approving the bankruptcy filing – the language, in the Duties Section of the Employment Contract, gave Wayne LaPierre the duty "to reorganize or restructure the affairs of the Association for purposes of cost-minimization, regulatory compliance or otherwise."

iv. No discussion or mention of bankruptcy at the Board Meeting to the Board Members - Management wanted to get Board approval but decided that they needed to get that Board approval in a way that the Board didn't know that it was giving approving to file a bankruptcy – Court found this "shocking"

v. NRA attempted to ratify the bankruptcy filing at a post-bankruptcy Board meeting - admission of the failure to properly obtain Board approval prior to filing. Ratification resolution not only authorized, but directed the Officers of the NRA to refile bankruptcy if dismissed.

3. NRA is an extreme case—in some sense it is the exception that proves the how flexible the rule is. The opinion in Johnson & Johnson on good faith filing is also helpful in laying out the rules.

a. Worth comparing NRA and J&J:

i. NRA cases is an obvious example of a filing without a bankruptcy purpose. Indeed, it is not clear that bankruptcy could provide anything other than a stalling tactic

ii. J&J (and similar tort bankruptcies), on the other hand, turns on the question of whether the bankruptcy process is a proper tool for resolving mass torts.

1. *In re LTL Management, LLC*, No. 21-30589 (MBK), 2022 WL 596617 (Bankr. D.N.J. Feb. 25, 2022). In addition to whether there was "cause" to convert or dismiss under 11 USC § 1112(b) ((1) whether the petition served a valid bankruptcy purpose; and (2) whether the petition was filed merely to gain a tactical litigation advantage), Judge Michael B. Kaplan (Bankr. D.N.J.) framed the critical issue as one of policy, as follows.

2. In evaluating the legitimacy of Debtor's bankruptcy filing, this Court must also examine a far more significant issue: which judicial system—the state/federal court trial system, or a trust vehicle established under a chapter 11 reorganization plan structured and approved by the United States Bankruptcy Court—serves best the interests of this bankruptcy estate, comprised primarily of present and future tort claimants with serious financial and physical injuries.

3. This policy consideration was a central touchstone throughout Judge Kaplan's opinion, and the cornerstone to his ultimate conclusion that "the filing of a chapter 11 case with the expressed aim of addressing the present and future liabilities associated with ongoing global personal injury claims to preserve corporate value is unquestionably a proper purpose under the Bankruptcy Code."

4. For example, Judge Kaplan, in addressing this "far more significant issue" of mass-tort redress, considered the alternatives. Class actions were not viable because the Supreme Court has disallowed the use of class actions in a product-liability case and in a limited-fund case. And MDL is just a pre-trial procedure, which would still "necessarily return nearly 40,000 cases to federal courts across the country to await pre-trial proceedings and eventual trials and appeals."

5. Ultimately, Judge Kaplan considered the exposure stemming from the 38,000+ cases then-currently pending and reasoned that it was in "financial distress" sufficient to justify the filing—that a debtor "need not have waited

until its viable business operations were threatened past the breaking point" to file bankruptcy.

6. Finally – fun quote: With regard to the movants' argument that permitting LTL's Texas Two-Step would "'open the floodgates' to similar machinations and chapter 11 filings[,]" Judge Kaplan did not flinch; given his view that § 524(g) "offers a preferred approach to best serve the interests of injured tort claimants and their families, maybe the gates indeed should be opened." (Emphasis added.) Otherwise stated, "the tort system produces an uneven, slow-paced race to the courthouse, with winners and losers" and "[p]resent and future talc claimants should not have to bear the sluggish pace and substantial risk if there exists another viable option."

iii. Key Quotes from the court

1. "Let's be clear, the filing of a chapter 11 case with the expressed aim of addressing present and future liabilities associated with ongoing global personal injury claims to preserve corporate value is unquestionably a proper purpose under the Bankruptcy Code"

2. "What the court regards as folly is the contention that the tort system offers the only fair and just pathway."

3. "Bankruptcy court is an optimal venue for redressing the harms of both present and future talc claimants—ensuring a meaningful, timely, and equitable recovery"

D. Other Cases Worth Discussing

a. *In re Green*, 422 B.R. 469, 474 (Bankr. S.D.N.Y. 2010) (Imposing sanctions on debtor's attorney under both Section 1927 and the court's inherent authority where the attorney knowingly failed to disclose in the debtor's petition that the debtor's landlord had obtained a judgment of possession, and failed to move promptly to correct the omission, rejecting the attorney's plea that it was a "mistake," reasoning that the court could see "no colorable reason for [the attorney] to omit disclosure of the judgment of possession" from the petition and "no reason, other than delay, why [the attorney] failed to list the ... judgment of possession in the bankruptcy petition.").

b. *In re Artho,* No. 15-20046-RLJ-12, 2018 WL 4631761 (Bankr. N.D. Tex. Sept. 24, 2018). There, the court awarded sanctions against the adversary plaintiff/debtor's attorney under Rule 9011 for signing the adversary complaint (and motion for reconsideration of dismissal) that the

attorney "knew after [his client's] deposition and, with reasonably inquiry, would have known . . . well prior to the deposition . . . had not factual support and were not warranted under law." Id. at *8. Those claim included fraud, civil conspiracy to commit fraud, civil conspiracy to commit duress, civil conspiracy to violate 18 USC § 152 (criminal bankruptcy fraud), and civil conspiracy to violate 18 U.S.C. § 1962 (RICO). Id. at *3. "Essentially, the amended complaint alleged that [the] Defendants conspired to acquire [the debtor's] assets at prices way below their actual values." Id. In awarding sanctions against the attorney, the court reasoned that "[a]lthough the attorney's role in this litigation was limited to bankruptcy issues alone, his signature on the pleadings merits an award of sanctions as well" and "[b]y signing pleadings, counsel cannot turn a blind-eye to the allegations made." Id. at *9.

IV. View From the Bench / § 1112(B) Motions

A. Burden of Proof

a. Need for Evidence: Who, What, When, Where, and How?

1. Does the burden fall to the debtor to show that its petition was filed in good faith?

a. *In re Energy Future Holdings Corp*., 561 B.R. 630, 639 (Bankr. D. Del. 2016) (citing *In re 15375 Mem'l Corp. v. Bepco, L.P.*, 589 F.3d 605, 918 (3d Cir. 2009))

2. Or does the burden shift back to the debtor only after the movant has made an initial showing of a lack of good faith in filing the petition?

a. *In re Nat'l Rifle Assoc. of Am*., 628 B.R. 262, 270 (Bankr. N.D. Tex. 2021)

b. *In re The Roman Catholic Church of the Archdiocese of New Orleans,* 632 B.R. 593, 600–01 (Bankr. E.D. La. 2021)

c. *In re Forest Hill Funeral Home & Memorial Park*, 364 B.R. 808, 819 (Bankr. E.D. Okla. 2007)

d. *In re Fraternal Composite Serv., Inc*., 315 B.R. 247, 249 (Bankr. N.D.N.Y. 2003)

B. Hallmarks of a Good-Faith Filings (or Lack Thereof)

1. Does the debtor's petition serve a valid reorganizational purpose?

a. *Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 No. LaSalle St. P'ship*, 526 U.S. 434, 453 (1999) (identifying "preserving going concerns" and

"maximizing property available to satisfy creditors" as valid bankruptcy purposes)

b. *In re Mirant Corp*., No. 03-46590, 2005 WL 2148362, at *6 (Bankr. N.D. Tex. Jan. 26, 2005)

c. *In re Costa Bonita Beach Resort Inc*., 479 B.R. 14, 39–40 (Bankr. D.P.R. 2012) (citing *Fields Station LLC v. Capitol Food Corp. (In re Capitol Food Corp.)*, 490 F.3d 21, 25 (1st Cir. 2007))

2. Or is the purpose of filing a petition to obtain a tactical litigation advantage?

a. *In re SGL Carbon Corp*., 200 F.3d 154, 163–66 (3d Cir. 1999)

b. *Marsch v. Marsch (In re Marsch)*, 36 F.3d 825, 829 (9th Cir. 1994)

c. *In re 15375 Mem'l Corp*., 400 B.R. 420, 427 (D.Del. 2009) (citing *In re Integrated Telecom Express, Inc*., 384 F.3d 108, 128 (3d Cir. 2004))

3. Was the debtor experiencing "financial distress: at the time of filing?

a. *In re Dixie Broad., Inc*., 871 F.2d 1023, 1027 (11th Cir. 1989) (defining "financial distress" as the opposite of financial health)

b. *In re Rent-A-Wreck of Am., Inc*., 580 B.R. 364, 375–76 (Bankr. D. Del. 2018) (listing factors to be considered when identifying financial distress to include solvency; cash reserves; recent financial performance and profitability; the proportion of debt owed to insiders; realistic estimates of actual or likely liability; the threat of litigation; whether a debt is fixed, substantial, and imminent; current cash position or current liquidity; ability to raise capital; and overdue debts or the ability to pay debts as they become due)

V: Venue

A. Current Rules

a. 28 U.S.C. §§ 1408

i. "a case under title 11 may be commenced in the district court for the district—

(1) in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the person or entity that is the subject of such case have been located for the one hundred and eighty days immediately preceding such commencement, or for a longer portion of such one-hundred-and-

eighty-day period than the domicile, residence, or principal place of business, in the United States, or principal assets in the United States, of such person were located in any other district; or

in which there is pending a case under title 11 concerning such person's affiliate, general partner, or partnership."

b. 28 U.S.C. § 1412

i. "A district court may transfer a case or proceeding under title 11 to a district court for another district, in the interest of justice or for the convenience of the parties."

c. Flexibility of filing across district

d. Ease of changing on eve of filing

e. Ability to choose your judge within district

i. Recent moves by courts to limit this

f. Recent Cases

i. J&J venue transfer from W.D.N.C. to D.N.J.

ii. Criticisms about Purdue filing

iii. NRA

B. Proposed Legislation / Reform

a. Recent legislative proposal

i. "(2) in which the **principal place of business or principal assets** in the United States of an entity, other than an individual, that is the subject of the case have been located—…

(3) in which there is pending a case under title 11 concerning an **affiliate that directly or indirectly owns, controls, or holds 50 percent or more of the outstanding voting securities of, or is the general partner of**, the entity that is the subject of the later filed case, but only if the pending case was properly filed in that district in accordance with this section."

b. Academic proposals

i. Anthony J. Casey & Joshua C. Macey, Bankruptcy Shopping: Domestic Venue Races and Global Forum Wars, 37 Emory Bankruptcy Developments Journal, 463 (2021).

ii. Robert K. Rasmussen & Randal S. Thomas, Timing Matters: Promoting Forum Shopping by Insolvent Corporations, 94 NW. U. L. REV. 1357, 1357–63 (2000);

iii. David A. Skeel, Jr., Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware, 1 DEL. L. REV. 1, 1–5 (1998)

c. Questions about how this interacts with international forum shopping

VI. Ethics Issues in Bad Faith Filings / Venue & Forum Shopping

VIII. Questions & Answers – Audience/Panel

Faculty

Prof. Anthony J. Casey is deputy dean and Donald M. Ephraim Professor of Law and Economics at The University of Chicago Law School in Chicago. He is also the faculty director of the Law School's Center on Law and Finance. His research examines the intersection of finance and law, with a focus on corporate bankruptcy. He has written about asset valuation, creditor priority, the constitutionality of bankruptcy courts and intercreditor agreements, among other topics. His broader projects explore business organization, civil procedure and complex business disputes. Before entering academics, Prof. Casey was a partner at Kirkland & Ellis LLP, where his legal practice focused on corporate bankruptcy, merger litigation, white-collar investigations and securities litigation. He was recognized in 2017 as one of ABI's inaugural "40 Under 40" honorees. Prof. Casey received his J.D. with high honors from The University of Chicago Law School, where he was awarded the John M. Olin Prize for outstanding student of law and economics. After law school, Prof. Casey clerked for Chief Judge Joel M. Flaum of the U.S. Court of Appeals for the Seventh Circuit.

Hon. Meredith S. Grabill is a U.S. Bankruptcy Judge for the Eastern District of Louisiana in New Orleans. Prior to taking the bench in September 2019, she practiced primarily in the areas of bankruptcy, commercial, and oil and gas litigation, serving on bankruptcy teams representing publicly traded, closely held, and individual chapter 11 debtors; official unsecured creditors' committees; and corporate creditors. Outside of bankruptcy court, Judge Grabill has represented large and multinational corporations in antitrust proceedings, labor and contract disputes, and insurance and reinsurance disputes. She previously clerked for Hon. Edith Brown Clement in the U.S. Court of Appeals for the Fifth Circuit, Hon. Martin L.C. Feldman in the U.S. District Court for the Eastern District of Louisiana, and Hon. Martin Glenn in the U.S. Bankruptcy Court for the Southern District of New York. Judge Grabill received her B.A. from The Evergreen State College in Olympia, Wash., and her J.D. from Tulane Law School, where she served as editor-in-chief of the *Tulane Law Review*.

Joshua A. Lesser is an associate with the Financial Services practice group of Adams and Reese LLP in Houston, where his practice focuses on bankruptcy, finance and complex commercial litigation. He represents institutional banks, commercial and individual clients in litigation and transactional matters, as well as corporate debtors, secured and unsecured creditors, and committees at all stages of debt restructurings, sales and liquidations. Prior to joining Adams and Reese LLP, Mr. Lesser clerked for Magistrate Judge Samuel S. Sheldon in the U.S. District Court for the Southern District of Texas. He also practiced at a global AM15 law firm, where he worked on large, complex bankruptcy cases and workouts across the U.S. Mr. Lesser received his B.A. in 2013 from the University of California at Los Angeles and his J.D. *cum laude* in 2016 from Tulane University Law School.

Gerrit Pronske is a partner with Spencer Fane LLP in Plano, Texas, and practices in all areas of bankruptcy, business law, commercial litigation and real estate. He has also served as a trained mediator specializing in cases involving bankruptcy, insolvency and commercial disputes. Mr. Pronske's practice focuses on chapter 11 proceedings and bankruptcy mediations. He also has a unique understanding of individual cases involving homestead law, which refers to exempting homesteads from being sold to settle an outstanding debt or seized for such purposes. As the author of *Pronske's*

Texas Bankruptcy, Annotated, Mr. Pronske shares insights and guidance in the 1,100-page textbook used by bankruptcy practitioners throughout Texas, currently in its 21st edition and published by Texas Lawyer. He formerly served as editor of *Texas Bankruptcy Decisions*, a bimonthly case report summarizing all bankruptcy decisions of the Fifth Circuit Court of Appeals and all bankruptcy and federal district courts within the state of Texas. Mr. Pronske previously clerked for Hon. Robert C. McGuire, former Chief U.S. Bankruptcy Judge for the Northern District of Texas's Dallas Division He received his B.A. *magna cum laude* in 1980 from Texas Tech University and his J.D. in 1983 from Texas Tech University School of Law.