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Seeking Appointment of Bankruptcy Examiners

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In late 2011, bondholders in the bankruptcy case of power company Dynegy Holdings, LLC (Dynegy) moved for the appointment of a bankruptcy examiner to investigate certain transactions that occurred immediately prior to the filing of Dynegy's bankruptcy petition. The transactions at issue involve the alleged transfer of millions of dollars in assets to Dynegy's parent company (a non-debtor) approximately two months prior to the bankruptcy filing. The bondholders, who agreed to a proposed restructuring prior to the bankruptcy but will likely receive nothing following the reorganization, have alleged that the transfers were part of a "closed and secretive process" undertaken without notice to Dynegy's creditors or the use of a third-party marketing process. At a hearing held in December 2011, the court approved the bondholders' request and ordered the appointment of an examiner to investigate Dynegy's alleged improper transfers, as well as whether the debtor is capable of confirming a chapter 11 plan. The Dynegy examiner was appointed on January 12, 2012, and has 60 days to complete his investigation (additional time may be permitted with court approval) and issue a written report concerning his findings. The examiner has been given the authority to issue subpoenas for documents and testimony as part of his investigation.

The Dynegy bondholders are the latest in a series of creditors seeking to take advantage of a Bankruptcy Code provision allowing for the appointment of an examiner to investigate alleged fraud, misconduct or mismanagement. Particularly in light of recent high-profile cases involving accounting fraud and corporate misconduct, requests for the appointment of bankruptcy examiners seem to be

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more frequent or at least garnering more attention. Pursuant to § 1104 of the United States Bankruptcy Code, the court may appoint a bankruptcy examiner to investigate the debtor with respect to allegations of fraud, dishonesty, incompetence, misconduct or mismanagement. A qualified examiner, with a clearly defined mission, can drastically affect the success of the bankruptcy case and directly impact the return to creditors.

Typically, in chapter 11 cases where a bankruptcy trustee has not been appointed, the court will order the appointment of an examiner upon the request of any affected party in the case upon a determination that such appointment is in the best interests of the creditors or the estate. Further, the Bankruptcy Code provides for the appointment of an examiner if "the debtor's . . . unsecured debts, . . . exceed $5,000,000."

The type of misconduct alleged by the Dynegy bondholders, i.e., improper asset transfers, is just one example of the fraud or mismanagement that prompts creditors to seek the appointment of an examiner. In September 2011, House Judiciary Committee Chairman Lamar Smith (R-TX), requested that Attorney General Eric Holder direct the United States Trustee (U.S. Trustee), the arm of the Justice Department that monitors bankruptcy cases, to appoint an examiner to investigate alleged mismanagement and the circumstances leading to the bankruptcy filing of Solyndra, the solar company that filed for bankruptcy after receiving a $535 million loan guarantee from the Department of Energy.

While no motion for appointment of an examiner was filed, shortly after Representative Smith's letter, the U.S. trustee did in fact file a motion seeking the appointment of a bankruptcy trustee. According to the U.S. trustee, the appointment of a trustee was necessary because of the refusal of Solyndra's officers to answer certain questions about the debtor's business affairs. In contrast to an examiner, whose powers and duties are limited and defined by the order of appointment, a chapter 11 trustee replaces the debtor's management for virtually all purposes. The appointment of a bankruptcy trustee in a complex chapter 11 case is uncommon. Courts typically prefer to allow the debtor's management to remain in control of its business operations and financial affairs. Consistent with this view, in an order entered on October 24, 2011, the United States Bankruptcy Court for the District of Delaware denied the U.S. Trustee's request for appointment of a trustee.

Rather than pursue the appointment of a trustee-undoubtedly a more drastic remedy-the parties in the Solyndra case might have had greater success in seeking the appointment of an examiner. The appointment of an examiner allows the court to balance the competing interests of allowing an independent investigation of the debtor's affairs in cases where wrongdoing or mismanagement is suspected, while nonetheless retaining the debtor's pre-petition management unless or until it is shown to be in the creditors' best interests to remove pre-petition management. In addition, courts often view the appointment of an examiner for a discrete purpose as more economical than the appointment of a trustee for the entire case. Thus, creditors and interested parties often succeed in convincing a court that the appointment of an examiner is warranted even in cases where the court remains unwilling to divest the debtor-in-possession of control of the business operations.

For the Dynegy bondholders, the results of the examiner's investigation remain to be seen. To the extent that the examiner concludes that Dynegy improperly transferred its assets shortly before filing its bankruptcy petition, the Bankruptcy Code's fraudulent transfer provisions may permit recovery of the assets for the benefit

of the estate and its creditors.