

## ARTICLE

# Case Study: In Re Dynegy Holdings

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On March 9, 2012, Susheel Kirpalani, the court-appointed examiner for Dynegy Holdings LLC (Dynegy), concluded that the debtor's transfer of certain assets to its parent company, Dynegy Inc., prior to its bankruptcy filing may be recoverable as a fraudulent transfer. Kirpalani further determined that Dynegy's board of directors breached its fiduciary duty in approving the asset transfer. Dynegy Inc. vigorously disputes the examiner's findings.

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.

In the Dynegy case, the bondholders moved for the appointment of a bankruptcy examiner to investigate the alleged transfer of millions of dollars in assets related to coal-fired power plants to Dynegy's parent company approximately two months prior to the bankruptcy filing. The bondholders, who agreed to a proposed restructuring prior to the bankruptcy, 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.

Kirpalani agreed, finding serious problems with the prepetition asset transfer. The specifics of the transaction in question are somewhat unusual. As described by the examiner, in the months leading up to Dynegy's bankruptcy filing, Dynegy undertook a series of transactions designed to restructure corporate debt.

Specifically, in an effort to reduce Dynegy's unsecured debt while increasing value for Dynegy's stockholders, Dynegy transferred

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certain coal-related assets valued at \$1.25 billion to Dynegy Inc. in exchange for an unsecured "undertaking" obligating Dynegy Inc. to make certain payments in satisfaction of debt owed by Dynegy. According to the examiner, this transaction effectively "transferred hundreds of millions of dollars away from Dynegy's creditors in favor of its stockholders."

Further, the examiner concluded that the transfer was designed to force Dynegy's bondholders to agree to an exchange for bonds issued by Dynegy Inc. and backed by the transferred assets out of fear that they would not otherwise be paid. As a result, the examiner concluded that Dynegy transferred the assets with the actual intent to hinder and delay - but not necessarily to defraud - its creditors. Accordingly, the examiner's report suggests that the transfer may be recoverable under the Bankruptcy Code as an actual fraudulent transfer.

The examiner further concluded that the assets may be recovered as a constructively fraudulent transfer to the extent that the debtor was insolvent at the time of the conveyance. Pursuant to § 548(a)(1)(B) of the Bankruptcy Code, a bankruptcy trustee may avoid as constructively fraudulent those transfers made for "less than a reasonably equivalent value." The examiner assigned a present value of \$860 million to the undertaking - far less than the value received by Dynegy Inc. for the coal-related assets.

Two days after issuance of the examiner's report, the United States Trustee filed a motion alleging that the examiner's report "demonstrates gross mismanagement on the part of current management" and seeking the appointment of a bankruptcy trustee to serve as an independent fiduciary to manage the debtors' affairs. The United States Trustee argues that Dynegy's current management is conflicted from evaluating the validity of the examiner's conclusions.

According to the U.S. Trustee: "Only a chapter 11 trustee will be in a position to conduct the necessary evaluation of the Examiner's Report and to pursue the appropriate remedies in the best interests of creditors, including proposing a feasible plan of reorganization." While courts presiding over complex Chapter 11 cases generally prefer to allow the debtor's management to remain in control of its business operations and financial affairs, the conduct alleged by the examiner may be sufficient to warrant the appointment of a trustee for Dynegy's case.

On March 16, 2012, Dynegy Inc. responded with a 52-page pleading challenging the examiner's report and promising to aggressively defend against any claims that may be brought against it. Noting that it is "deeply troubled and disappointed" by the examiner's conclusions, Dynegy Inc. criticizes the examiner's report as failing to present a full statement of the facts and misapplying governing law. Promising to provide the court with the "full story" when appropriate in the case, Dynegy Inc. "implores readers of the Report not to confuse the examiner process with due process."

On April 4, 2012, Dynegy Inc. announced that it had reached an agreement with certain creditors of Dynegy that would resolve the dispute concerning the transfer of the coal-fired power plant assets. Pursuant to the proposed settlement, Dynegy's unsecured creditors would receive common stock representing a 99 percent

equity stake in the reorganized company. All potential claims between Dynegy and Dynegy Inc. would be settled and released as part of the settlement. While any such settlement will need court approval, such a resolution may allow Dynegy to avoid the appointment of a trustee.