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Business Restructuring, Creditors' Rights & Bankruptcy Update

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FTX Joins Growing List of High-Profile and Intertwined Crypto-Related Chapter 11 Filings

Crypto investors were dealt another blow on November 11 when FTX, the world's second-largest cryptocurrency exchange, filed for chapter 11 bankruptcy relief in the District of Delaware, along with more than 130 related companies and affiliates. The bankruptcy was spawned by liquidity issues brought on by the sudden collapse in value of FTX's crypto assets. Starting on November 6, customers simultaneously attempted to withdraw their funds and assets from the exchange, causing a situation akin to a classic bank run that led to an estimated $32 billion in value quickly evaporating. FTX froze customer withdrawals on November 8, and criminal investigations may be coming.

In an apparent rush for bankruptcy relief with little advance warning, FTX's initial filings were stark, lacking the usual first-day motions. As of November 16 the docket in the designated lead case for FTX Trading Ltd. still had little more than a petition, a joint-administration motion, and various appearances of counsel. While the bankruptcy petition estimates more than 100,000 creditors, some media outlets report that up to a million customers are affected. FTX is also recovering from a cyberattack that took place just before the filing. These events leave stakeholders with more questions than answers.

Adding to the intrigue, information surfaced suggesting that over $450 million of the companies' assets were stolen and Sam Bankman-Fried, FTX's sensational founder and CEO who made the Forbes 400 list in 2021 and was touted as the world's richest 29-year-old at the time, stepped down immediately prior to the bankruptcy proceedings. The Department of Justice and SEC are looking into these incidents, which may involve illegal positions by Bankman-Fried's hedge fund, Alameda Research. Bankman-Fried's companies were already under investigation before the FTX collapse.

FTX is the latest in a string of high-profile bankruptcies involving cryptocurrency exchanges. Voyager Digital, which similarly declared bankruptcy on July 5 after suspending customer withdrawals, is another ongoing case involving thousands of creditors who are individual investors. According to an update sent to its creditors on October 21, Voyager had signed an asset purchase agreement with FTX, which was approved by the bankruptcy court. Pursuant to the agreement terms, FTX was to purchase substantially all of Voyager's assets for about $1.422 billion. Voyager also had submitted a disclosure statement and plan of reorganization that implemented the sale to FTX and proposed meaningful recovery for creditors, plans that are now upended.

On November 11 Voyager announced that it was reopening the bidding process in light of FTX's chapter 11 filing and its other problems. The no-shop provisions of the Voyager-FTX asset purchase agreement are no longer binding and Voyager hopes to find another buyer quickly. Fortunately, Voyager had not transferred assets to FTX prior to its filing, although disclosures show that Voyager maintained a balance of approximately $3 million in crypto assets at FTX.

In yet another ongoing crypto bankruptcy, Celsius Network filed a motion to extend its period of exclusivity to file a plan of reorganization on November 10. Like Voyager, Celsius declared bankruptcy in July and is facing numerous lawsuits and pending investigations into potential misconduct. Both the Voyager and Celsius bankruptcies were precipitated by a sudden collapse of the digital stablecoin LUNA in May. Celsius' creditors still await signs on the likely outcome of that case.

The flurry of crypto-related bankruptcies in 2022 raises questions about the administration of cryptocurrency assets in bankruptcy, the rights and burdens of stakeholders due to the fluctuation in the value of these assets, and the future of cryptocurrency with respect to regulation, the law and society in general. While current controversies appear to stem largely from bad actors, cryptocurrency and digital assets may still prove to have valid use cases. Observers must wait to see how these cases progress for answers.

FOR MORE INFORMATION

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