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ARTICLE

FTX'd: Conflicting Public and Private Interests in Chapter 11

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Abstract. Chapter 11 of the Bankruptcy Code is often justified by vague assertions that reorganizing troubled companies is in the "public interest." There has, however, been surprisingly little effort to consider seriously what this public interest is, how it should be operationalized, or who should pay for it.

Based on a case study of the controversial bankruptcy of crypto complex FTX, this Article develops a three-part typology of public interests at stake in chapter 11 and shows how they can conflict with one another and with private interests: (1) the paramount public interest in the integrity of the judicial process; (2) bankruptcy-specific public interests in maximizing value through efficient, consolidated proceedings; and (3) "other" public interests, such as the prosecution and defense of serious crimes.

We place FTX's counsel, Sullivan & Cromwell (S&C), at the center of this triptych. We present evidence indicating that S&C had undisclosed potential conflicts of interest due to apparent errors, omissions, and deceptions in their work for the company and its founder, Sam Bankman-Fried, before, at, and during the bankruptcy, thereby undermining the first-order public interest in procedural integrity. S&C's role as debtor's counsel has cast a

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troubling shadow over puzzling and costly decisions in the case, thereby undermining a second, bankruptcy-specific form of the public interest: maximizing an estate's value. S&C often justified its actions by reference to the third, "other" facet of the public interest. Namely, S&C touted that it supported the prosecution of disfavored insiders such as Bankman-Fried. But that pricey task—for which S&C billed millions of dollars—may have distorted the prosecutions without producing observable economic benefit to the bankruptcy estate.

FTX is a cautionary tale about the power that lawyers have to frame, control, and profit from claims about the public interest in chapter 11. An examiner appointed late in the case largely exonerated S&C, although he engaged little of the evidence we present. This is not surprising because S&C's resistance to that intervention left a narrow scope and little time for his investigation.

We situate our findings in a nascent body of literature exploring the public interest in bankruptcy. We suggest that the experience with S&C in FTX may reflect larger patterns in reorganization reminiscent of historical concerns about distorted incentives in restructuring processes. To ameliorate these concerns, we offer guidance to improve the functioning of the principal custodians of the public interest in chapter 11. Courts should more carefully police prebankruptcy connections of estate professionals and should use preliminary examinations more frequently. We further believe that the United States Trustee should have greater independence from other government actors so it can fulfill its watchdog mandate without compromise.

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Introduction

Congress, judges, and scholars sometimes advert to the "public interest" in corporate reorganization.[1] But they almost never define what that is, how it should be achieved, or—most difficult given financial distress—who should pay for it. We use the recent and controversial *FTX* bankruptcy as a case study to clarify and offer guidance on the public interests at stake in large-scale corporate reorganizations.

Discussions of the public interest in corporate reorganization are often nebulous because there are multiple versions of it in chapter 11, the reorganization provisions in current bankruptcy law.[2] We identify three:

- First, and most important, is the paramount interest in the integrity of the judicial process.[3]
- Second is the pursuit of bankruptcy- or insolvency-specific objectives, such as providing a collective judicial forum for resolving financial distress and maximizing the value of a debtor's assets in bankruptcy.[4]
- Third, and last, is the pursuit of non-bankruptcy public-interest objectives, such as the *Chrysler* bankruptcy's effort to develop energy-efficient cars[5] or *Purdue Pharma*'s effort to abate the opioid crisis.[6]

In *FTX*, the cryptocurrency exchange's bankruptcy attorneys and other professionals provided millions of dollars of assistance to the U.S. Attorney's office, in furtherance of the public interest in a robust fraud prosecution of

1. Congress sought to "protect the investing public, protect jobs, and help save troubled businesses." 124 CONG. REC. 32392 (1978) (statement of Rep. William Donlon Edwards); *see also* NLRB v. Bildisco & Bildisco, 465 U.S. 513, 517 n.1 (1984) (describing that Congress enacted chapter 11 "with the intention that business reorganizations should be quicker and more efficient and provide greater protection to the debtor, creditors, and the public interest"); Jay L. Westbrook, *Equity in Bankruptcy Courts: Public Priorities*, 94 AM. BANKR. L.J. 203, 222 (2020) ("I believe Congress should consider adopting a provision that would instruct the courts acting in Chapter 11 cases to take account of public interests that would be materially affected by a decision.").
2. 11 U.S.C. §§ 1101-1195.
3. In 1966, Judge Friendly famously admonished that "[t]he conduct of bankruptcy proceedings not only should be right but must seem right." *In re* Ira Haupt & Co., 361 F.2d 164, 168 (2d Cir. 1966). We discuss the preeminence of the public interest in judicial process integrity in Parts I.A and I.D below.
4. *See infra* Part I.B.
5. *See In re* Chrysler LLC, 405 B.R. 84, 106 (Bankr. S.D.N.Y. 2009). We discuss the pursuit of these objectives in *Chrysler* in Part VI.A below.
6. *See In re* Purdue Pharma L.P., 69 F.4th 45, 56 (2d Cir. 2023) ("OxyContin has been blamed for significantly contributing to one of the largest public health crises in this nation's history: the opioid epidemic."), *rev'd sub nom.* Harrington v. Purdue Pharma L.P., 144 S. Ct. 44 (2024).

founder and CEO Sam Bankman-Fried.[7] Although bankruptcy can be a crucial venue for the third category—non-bankruptcy-specific public interests—such objectives can undermine either or both of the other public interests, as well as private interests in maximizing recoveries. We argue that when the government or a party seeks to use bankruptcy to advance non-bankruptcy public interests, it is especially important to police judicial-process integrity and the bankruptcy objective of maximizing the value of the estate.

The modern pecking order of public-interest objectives is ironic in light of the history of such interests in reorganization. When large-scale corporate reorganization emerged in the nineteenth century as a device for restructuring the obligations of struggling railroads, the parties pursued the three forms of public interest in precisely the opposite order of importance.[8] Parties condoned sham sales and collusively obtained jurisdiction because the reorganizations served a non-bankruptcy public interest: keeping America's railroads running.[9] But by the 1930s, the Supreme Court had had enough. The Court signaled that it would tolerate the assault on judicial integrity in common-carrier cases due to the special public interest at stake, but would not with other types of corporate debtors.[10] Congress thereafter codified large-scale corporate reorganization in 1933 and 1934, removing the need for collusion and sham sales, while also achieving the bankruptcy-specific public interest of providing a collective proceeding to preserve value and efficiently resolve financial distress in a market economy.[11]

Even so, the New Deal Congress went too far, imposing a restrictive "disinterestedness" standard that made it impractical for major Wall Street lawyers and investment firms to continue their earlier restructuring practices.[12] Recognizing this, in 1978 Congress relaxed the definition of "disinterestedness" as part of a larger effort to make chapter 11 more appealing to corporate debtors and those who would represent them. Having represented a debtor before its distress was no longer per se disqualifying.[13] By this time,

7. *See infra* Part III.B.

8. *See infra* Part I.A.

9. *See infra* Part I.B.

10. *See infra* Part I.B.

11. *See infra* Part I.B.

12. The requirement applied to lawyers for the trustee that was appointed in large reorganization cases under the Chandler Act, and who ran the business in bankruptcy. Amendments to the Bankruptcy Act of 1898, Act of June 22, 1938, ch. 575, § 1(157), 52 Stat. 840, 888 (superseded by Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified as amended at 11 U.S.C. §§ 101-1532)).

13. 11 U.S.C. § 101(14) (excluding attorneys for investment bank but not attorneys for debtor from the term "disinterested person"); *see also* 11 U.S.C. § 327(e) (providing that the trustee "may employ, for a specified special purpose, other than to represent the

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however, a different norm had also taken hold: rather than relying on existing lawyers, large corporations typically hired a new law firm if they fell into financial distress.

As we shall see, the *FTX* bankruptcy is a stark departure from this pattern and a throwback to pre-New Deal norms. Sullivan & Cromwell (S&C), FTX's bankruptcy counsel, represented FTX well before its financial distress, during a period when FTX committed massive fraud.[14] During that time, S&C may well have known of, or missed red flags signaling, FTX's misconduct.[15] While this Article focuses on FTX, S&C's pre-distress involvement is only the most vivid and troubling example of what we fear is an emerging pattern across bankruptcy cases.

Prior to its fall, FTX was a multibillion-dollar enterprise that consisted of cryptocurrency exchanges and a hedge fund, all founded by Sam Bankman-Fried. During the height of the crypto frenzy in 2021 and early 2022, Bankman-Fried seemed to be the voice of trust and reason in the otherwise wild crypto world. He repeatedly promised customers that their accounts were safe, and that FTX would not use their assets for its own, or others', purposes.[16] Whereas the head of FTX's main competitor, Binance, positioned himself as a renegade who despised regulators, FTX sought credibility with investors, regulators, and even celebrities.[17] This credibility benefitted from the company's affiliation with S&C, an elite New York firm which represented the company in important regulatory efforts to legitimize and rationalize digital assets before bankruptcy.[18]

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trustee in conducting the case, an attorney that has represented the debtor, if in the best interests of the estate").

14. *See infra* Part II.B.

15. *See infra* Part II.B.

16. *See, e.g.*, Notice of Filing of Second Interim Report of John J. Ray III to the Independent Directors: The Commingling and Misuse of Customer Deposits at FTX.com at 7, Second Interim Report of John J. Ray III to the Independent Directors: The Commingling & Misuse of Customer Deposits at FTX.com, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. June 26, 2023), ECF No. 1704 ("The FTX Group represented to U.S. officials, the public and other third parties that it separated and protected exchange customer deposits, and it positioned itself as a vocal advocate of regulation requiring other crypto companies to do the same.").

17. *See* Tom Wilson & Angus Berwick, *How Binance CEO and Aides Plotted to Dodge Regulators in U.S. and UK*, REUTERS (Oct. 17, 2022, 11:00 AM GMT), https://perma.cc/AR7Z-TKF6. Tom Brady, Gisele Bündchen, and Larry David all appeared in FTX ads. *See* ZEKE FAUX, NUMBER GO UP: INSIDE CRYPTO'S WILD RISE AND STAGGERING FALL 89 (2023) (Brady); *id.* at 131 (Bündchen); *id.* at 90 (David). Fashion maven Anna Wintour invited Bankman-Fried to the Met Gala. *See* MICHAEL LEWIS, GOING INFINITE: THE RISE AND FALL OF A NEW TYCOON 15-18 (2023).

18. *See* Joshua Oliver & Sujeet Indap, *Sullivan & Cromwell's Role in FTX Bankruptcy Under Rising Scrutiny*, FIN. TIMES (Jan. 12, 2023), https://perma.cc/6XX9-YQYD (noting that

footnote continued on next page

FTX's claims of probity turned out to be false. After the digital asset crash in June 2022, it appears that un(der)-disclosed linkages between the profitable main exchange, FTX.com (FTX International), and the more precarious hedge fund, Alameda Research, had exposed billions of dollars of FTX customers' digital and fiat assets to loss.[19] Bankman-Fried was accused of creating these linkages and authorizing insiders at Alameda, including his sometime-girlfriend Caroline Ellison, to secretly filch funds that belonged to FTX customers.[20]

S&C dramatically intervened, persuading Bankman-Fried to give up control of FTX to insolvency expert John Ray in the early morning hours of November 11, 2022.[21] The company immediately filed for bankruptcy to impose controls and to recover assets for the benefit of FTX's customers. Bankman-Fried and the other founders were criminally charged. Bankman-Fried was convicted of fraud and sentenced to twenty-five years in prison for having used customer assets to purchase such things as a lavish compound in the Bahamas and to make generous political and philanthropic donations.[22]

Ray, and those he employed to handle the *FTX* bankruptcy—including S&C—have cast themselves as heroes to FTX's millions of stakeholders. S&C has "worked tirelessly and nonstop . . . to take control over what can only be described as a dumpster fire in order to stop assets from being depleted," Ray told *American Lawyer*.[23] Ray's team claims to have recovered billions of dollars

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"as FTX grew it shifted more work towards Sullivan, in particular on regulatory issues where the Wall Street firm has more expertise").

19. *See* Ian Allison, *Divisions in Sam Bankman-Fried's Crypto Empire Blur on His Trading Titan Alameda's Balance Sheet*, COINDESK (updated Aug. 16, 2023, 5:56 PM EDT), https://perma.cc/4QXA-6N87.

20. We discuss Bankman-Fried's criminal prosecution in Part III.B below.

21. We discuss the run up to bankruptcy in some detail in Part II below.

22. *See* Judgment in a Crim. Case at 3, United States v. Bankman-Fried, No. 1:22-CR-00673 (S.D.N.Y. Mar. 29, 2024), ECF No. 424; *see also* MacKenzie Sigalos, *Inside Sam Bankman-Fried's $35 Million Crypto Frat House in the Bahamas,* CNBC (Oct. 10, 2023, 8:00 AM EDT), https://perma.cc/AW78-N4WD ("A big part of Sam Bankman-Fried's journey to criminal court traces back to the $35 million Bahamian property he shared with nine people.").

23. *See* Patrick Smith, *No Playbook for What They Do: Sullivan & Cromwell Is the Financial Services Litigation Department of the Year Winner*, AM. LAW. (Dec. 7, 2023), https://perma.cc/V42D-VB4U. The "dumpster fire" image derives from testimony by FTX's turnaround CEO John Ray to Congress. Supplemental Declaration of John J. Ray III in Support of Debtors' Applications for Orders Authorizing the Retention and Employment of Sullivan & Cromwell LLP, Alix Partners LLP & Quinn Emanuel Urquhart & Sullivan LLP ¶ 9, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Jan. 17, 2023), ECF No. 511 [hereinafter Ray Supp. Retention Decl.].

in assets and proposed a plan of reorganization for FTX in which customers would be made whole.[24]

There is only one problem with this narrative: It may be as flawed as FTX's earlier claims of probity. We present evidence (some for the first time) which appears to indicate that:

- Through its significant prebankruptcy work for FTX, S&C knew, or was in a position to know, that FTX was commingling customer assets;[25]
- Despite this, S&C may have represented to U.S. regulatory authorities and to potential contract counterparties that FTX was "rock solid";[26]
- When FTX suffered a "run" on deposits in November 2022, S&C concluded for the first time that this commingling was problematic—perhaps a crime;[27]
- S&C may have violated ethical duties of confidentiality, candor, and loyalty by reporting these matters to prosecutors with inadequate client consent and by duping Bankman-Fried into giving control of FTX to Ray (whom S&C chose) with promises that Bankman-Fried would play a significant role in the reorganization—promises S&C likely knew were false.[28]

S&C has gone on to charge hundreds of millions of dollars in the bankruptcy, including to support the prosecution of Bankman-Fried and other

24. Steven Church & Jonathan Randles, *FTX Plans to Repay Customers in Full, Drop Exchange Relaunch*, BLOOMBERG (Jan. 31, 2024), https://perma.cc/DY3U-U9ET.
25. *See infra* Part II.B.
26. On November 7, in the *Voyager* bankruptcy, S&C attorney Andrew Dietderich sent an email to Darren Azman, an attorney at McDermott, Will & Emery, assuring him that concerns about FTX liquidity were "just Binance silliness" because FTX "is rock solid, doesn't use customer funds or take credit risk at all. It cannot have 'liquidity' issues because it doesn't lend." *See* Declaration of Joseph B. Evans in Support of the Objection of the Official Committee of Unsecured Creditors to Proofs of Claim Nos. 11206, 11209, & 11213 Exhibit 13, *In re* Voyager Digital Holdings, Inc., No. 22-10943 (Bankr. S.D.N.Y. Feb. 2, 2023), ECF No. 937 (quoting Email from Andrew G. Dietderich, Sullivan & Cromwell LLP, to Darren Azman, McDermott, Will & Emery LLP (Nov. 7, 2022) [hereinafter Rock Solid Email]). Yet on the same day, S&C opened a new file on restructuring FTX—not something one does for a "rock solid" client. *See* Supplemental Declaration of Andrew G. Dietderich in Support of Debtors' Application for an Order Authorizing the Retention & Employment of Sullivan & Cromwell LLP as Counsel to the Debtors & Debtors-in-Possession *Nunc Pro Tunc* to the Petition Date ¶ 54, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Jan. 17, 2023), ECF No. 510 [hereinafter Dietderich 1st Supp.]. The role of Binance in the collapse of FTX is discussed in Parts II.A.2 and V.C below.
27. *See infra* Part II.C.
28. *See infra* Part II.C.

insiders.[29] Doing so not only reduced stakeholder recoveries (professionals are paid off the top[30]), but S&C's work may have distorted the criminal justice process by giving prosecutors immediate and unfettered access to Bankman-Fried's company, its resources, and its data.

These are serious allegations, and we do not make them lightly.[31] Much of the evidence we present is public and comes from the Bankman-Fried prosecution and statements made by S&C, Ray, and others running the *FTX* chapter 11 bankruptcy. Some has been provided by third parties whom we consider reliable for these purposes. The full story may be more complex than we know. But the evidence is suggestive and warrants close examination. At minimum, it exposes serious flaws in chapter 11's architecture for defining and protecting the public interest, and for managing conflicts among public and private interests in large bankruptcy cases.

The Bankruptcy Code has rules and processes to guard against conflicts of interest.[32] But we argue that *FTX* demonstrates that these rules and processes are insufficient in their current form, because the very agents whose independence matters control those processes. Thus, those agents can evade the enforcement of conflicts rules.

Concerned about the public interest in *FTX,* the United States Trustee—an arm of the Department of Justice and the principal watchdog in bankruptcy[33]—initially objected to S&C's retention by FTX.[34] The U.S.

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29. *See infra* Part III.B; Fifteenth Monthly Fee Statement of Sullivan & Cromwell LLP as to the Debtors & Debtors-in-Possession for Compensation for Professional Services Rendered & Reimbursement of Expenses Incurred for the Period from January 1, 2024 Through & Including January 31, 2024 at 1-2, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Feb. 29, 2024), ECF No. 8306 [hereinafter Fifteenth S&C Fee Statement].

30. They are typically paid as first-priority expenses of administering the case. *See* 11 U.S.C. § 503(b)(1)(A)(j).

31. We are not the only ones with these concerns. In February 2024, plaintiffs filed a class-action lawsuit against S&C in the U.S. District Court for the Southern District of Florida, asserting claims for aiding and abetting FTX's misconduct and breach of fiduciary duty, among other claims. *See* Class Action Complaint & Demand for Jury Trial at 60-67, Garrison v. Sullivan & Cromwell, LLP, No. 24-cv-20630 (S.D. Fla. Feb. 16, 2024), ECF No. 1. That said, we have no grievance with S&C, per se. In our view, it generally is a first-rate firm. Indeed, S&C was recently recognized by the legal news service *Law360* as having one of the top bankruptcy groups of 2023. *See* Emily Lever, *Bankruptcy Group of the Year: Sullivan & Cromwell*, LAW360 (Mar. 6, 2023, 2:13 PM EST), https://perma.cc/6DQU-AKLL.

32. *See, e.g.*, 11 U.S.C. § 327 (outlining ethical standards for retention of estate professionals).

33. The role of the U.S. Trustee in bankruptcy is discussed in Part I.D below. *See* Lindsey D. Simon, *The Guardian Trustee in Bankruptcy Courts and Beyond*, 98 N.C. L. REV. 1297, 1310-11 (2020).

34. *See infra* Part III.A.

Trustee settled the objection in exchange for enhanced disclosures, made shortly before the hearing on the firm's retention.[35]

The U.S. Trustee also sought the appointment of an "examiner."[36] As written, Section 1104(c) of the Bankruptcy Code requires an examiner in large cases if an interested party requests one. But FTX, represented by Ray and S&C, resisted, and the bankruptcy judge denied the request. The U.S. Trustee appealed the examiner decision to the Third Circuit, which reversed.[37] The Third Circuit reasoned that, by saying "shall," Section 1104(c) makes appointment of an examiner mandatory,[38] and it noted that an examiner was especially appropriate in *FTX* given S&C's potential conflicts of interest.[39] Robert Cleary was appointed as examiner on March 20, 2024.[40] He released a report two months later finding that the bankruptcy court had made "no error" in its decision appointing S&C given the record that was before the judge at the time,[41] but he did not address critical evidence we discuss in Part II of this Article.

The absence of an examiner for well over a year after FTX filed for bankruptcy gave Ray and S&C latitude to marshal and manage conflicting claims about the public and private interests at stake as they saw fit. These

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35. *See infra* Part III.A.

36. *See infra* Parts IV.A-.B.

37. *In re* FTX Trading, Ltd., 91 F.4th 148, 150 (3d Cir. 2024).

38. *Id.* at 153 (quoting 11 U.S.C. § 1104(c)); *see also id.* ("The meaning of the word 'shall' is not ambiguous. It is a 'word of command' . . . ." (quoting *Shall*, BLACK'S LAW DICTIONARY 1233 (5th ed. 1979)).

39. *Id.* at 157 (explaining that a disinterested examiner "is particularly salient here, where issues of potential conflicts of interest arising from debtor's counsel serving as pre-petition advisors to FTX have been raised repeatedly").

40. Order Approving Appointment of Examiner, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Mar. 20, 2024), ECF No. 9882 [hereinafter Examiner Appointment Order]. The bankruptcy court entered a separate order defining the scope of the examination. *See* Order (I)(A) Establishing the Scope, Cost, Degree, & Duration of the Examination & (B) Granting Related Relief; & (II) Permitting the Filing of Certain Information Regarding Potential Parties in Interest Under Seal ¶ 4, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Mar. 20, 2024), ECF No. 9833 [hereinafter Examiner Phase I Order]. The scope of the examination was later expanded. *See* Order (I) Granting the Examiner Authority to Conduct Additional Investigations & (II) Establishing the Scope, Cost, Degree & Duration of the Second Phase of the Examination & Granting Related Relief ¶ 4, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. June 26, 2024), ECF No. 19061. [hereinafter Examiner Phase II Order].

41. Report of Robert J. Cleary, Examiner at 12, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. May 23, 2024), No. 15545 [hereinafter Examiner Report]. On September 25, 2024, the Examiner released a second report, which addresses matters largely beyond the scope of this Article. Phase II Report of Robert J. Cleary, Examiner, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Sept. 25, 2024), ECF No. 25679 [hereinafter Examiner Phase II Report].

conflicts appear to have reduced recoveries, even as they have enriched S&C.[42] For example, the debtors appear to have made little effort to maintain the exchanges as a going concern, although doing so may have been better for stakeholders.[43] The debtors also failed, until the very last minute, to pursue causes of action against some of those who may have hurt the company most, which problematically aligned with S&C's private interests. Notably, this occurred with Binance, which apparently took over $2 billion out of FTX prior to bankruptcy.[44]

FTX reveals the significant and underappreciated power that the debtor's counsel has to shape and arbitrate among the three types of public interest when they conflict. Moreover, it spotlights counsel's ability to privilege their own private interests, whether by avoiding scrutiny if they represented the debtor prior to its distress or by billing hundreds of millions of dollars in the process.[45]

In addition to revealing new information about the *FTX* bankruptcy, we connect growing awareness of the public interest in chapter 11 to the incentives of those who run the process. By reporting concerns about misconduct at FTX to prosecutors, S&C offered the government solutions to two persistent problems: (i) the need to show force in the face of an unregulated crypto market[46] and (ii) the interest in prosecuting individuals for organizational crimes, after failing to do so during the Great Recession.[47] In exchange, S&C would get to shield its reputation, charge millions of dollars, and return to a practice area—restructuring—that it initially helped invent but had abandoned after the New Deal. The *FTX* chapter 11 would be the nexus of, and engine for, these conflicting public and private interests.[48]

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42. We discuss notable examples of this in Parts V.A-.C below.

43. *See infra* Part V.A.

44. *See infra* Part V.C.

45. Through November 2023, S&C received over $200 million in fees. *See* Fifteenth S&C Fee Statement, *supra* note 29, at 1-2. For February 2024, S&C sought $8,870,398.88, reflecting 80% of the firm's billed time (consistent with common practice). *Id.* at 2.

46. *See* Yesha Yadav & Robert J. Stark, *The Bankruptcy Court as Crypto Market Regulator*, 96 S. CAL. L. REV. 1479, 1483 (2024) ("The crypto market has, through its evolution, lacked a systematic regulatory framework to constrain excessive risk-taking, interconnection, and propensities for predation against customers.").

47. *See, e.g.*, Memorandum from Lisa Monaco, Deputy Att'y Gen., U.S. Dep't of Just., on Corp. Crime Advisory Group and Initial Revisions to Corporate Criminal Enforcement Policies, to All U.S. Att'ys (Oct. 28, 2021), https://perma.cc/P7PD-B4BS; Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, N.Y. REV. (Jan. 9, 2014), https://perma.cc/RQ3P-CCYB.

48. See, for example, the discussions in Parts I.A (discussing S&C's historic role in reorganization practice) and V.A (discussing reasons why S&C might not want to restart exchanges).

The concerns we identify go beyond *FTX* or even digital assets. There is growing awareness that lawyers who run chapter 11 cases may have or represent parties with conflicting incentives, such as where the same firm represents both the debtor and its principal equity holder.[49] These appear to be modern versions of historic conflicts of interests in restructuring practice.

The Article proceeds as follows. Part I provides a brief historical overview, focusing on public-interest considerations that spurred Congress to create a large-scale reorganization framework and on the complications that ensued. It shows that conflicts of interest were a significant problem in the late nineteenth and early twentieth centuries in the receiverships that foreshadowed chapter 11.

The *FTX* case study is in Parts II through V. The case study shows how efforts to advance non-bankruptcy public interests can subvert higher-order interests in process integrity and maximizing recoveries. Part II describes S&C's prebankruptcy role at FTX, which may have exposed it to red flags of the company's wrongdoing. That Part also presents evidence that S&C misled Bankman-Fried in the tumultuous 72-hour period leading to the bankruptcy filings, raising questions about the ethics of its conduct.

Parts III and IV chronicle the contested hearings on the retention of S&C as FTX's bankruptcy counsel and on the U.S. Trustee's request for an examiner, as well as the prosecution of Sam Bankman-Fried taking place at the same time. S&C resisted the appointment of an examiner and seemed at times to act as an expensive back office for prosecutors in New York, advancing the firm's interests while distorting the criminal justice and reorganization processes. We also assess the Examiner's Report that was filed late in the bankruptcy.

Part V shows how the effects of S&C's potential conflicts, unchecked by the timely appointment of an examiner, permeated the case, including through problematic asset sales to insiders and the failure to sue Binance. Those failures may have eroded stakeholder recoveries and confidence in the judicial process. This Part also explains why stakeholders may have tolerated this.

Part VI shifts to larger implications and correctives, generalizing the lessons of *FTX* for analysis of competing public and private interests in bankruptcy and the role of the debtor's attorney, the examiner, and the U.S. Trustee.

I. The Roots of Bankruptcy's Public Interests

Corporate reorganization under chapter 11 of the Bankruptcy Code seems, and is often seen, to be a private system for restructuring financially distressed

49. *See, e.g.*, James Nani, *Vinson & Elkins Rejected Again as Enviva Bankruptcy Counsel (1)*, BLOOMBERG L. (updated July 2, 2024, 2:12 PM PDT), https://perma.cc/WNN7-YBGE.

corporations.[50] A creditors' committee is appointed early in the case to represent the interests of general creditors,[51] and the managers of a corporate debtor negotiate with senior creditors and the creditors' committee over the terms of a restructuring. A bankruptcy judge must confirm any proposed reorganization plan,[52] but the judge serves primarily as referee of a process run by the parties themselves, usually through their lawyers.

Yet American corporate reorganization has always had public dimensions, dating back to its origins in the nineteenth century. In this Part, we resurface three different forms of public interest as they emerged historically in American corporate reorganization. We conclude by briefly describing the problem of law firm conflicts of interest in chapter 11, which go to the heart of the first-order public interest in process integrity, and which will prove important when we turn to the *FTX* case in the parts that follow.

A. The Public Interest and the Railroad Receivership

The history of corporate reorganization in America is closely linked to the railroads, which became a crucial mode of transportation in the nineteenth century.[53] A bit like crypto, the railroads expanded rapidly and unevenly, with entrepreneurs trying to cobble together smaller railroads into interstate railroads that controlled important routes or fighting over a well-positioned existing railroad.[54] Railroad expansion was financed with debt, much as takeovers are today.[55] As a result, if the economy crashed, as it did with alarming regularity in the nineteenth century, many railroads would default.[56]

50. *See, e.g.*, Melissa B. Jacoby, *Corporate Bankruptcy Hybridity*, 166 U. PA. L. REV. 1715, 1721 (2018) (criticizing this tendency and stating that "[c]orporate bankruptcy's frequent characterization as private law, rather than public law or a hybrid, is curious and overdue for interrogation"); *see also* Jonathan C. Lipson & Christopher Fiore Marotta, *Examining Success*, 90 AM. BANKR. L.J. 1, 18 (2016) (highlighting that in bankruptcy, "public versus private is a false dichotomy: reorganization is a hybrid process, and will always require difficult alliances and compromises between 'public' and 'private' institutions").

51. 11 U.S.C. § 1102 (appointment of creditors' committee).

52. *Id.* § 1129.

53. *See* DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 48-69 (2001).

54. *See generally* David A. Skeel, Jr., *An Evolutionary Theory of Corporate Law and Corporate Bankruptcy*, 51 VAND. L. REV. 1323, 1356 (1998) (noting that railroads often had "a crazy quilt of security interests, made even more Byzantine by waves of mergers among the railroads").

55. Daniel A. Schiffman, *Determinants of Railroad Capital Structure, 1830-1885* (Bar-Ilan U., Working Paper No. 2001-15, 2001).

56. SKEEL, *supra* note 53, at 51-52.

After the 1893 Panic, 19% of all railroad track miles in America were in default.[57]

The financial distress of a railroad, like that of any complex network, created a conundrum. Every constituency was rooting for the railroad to survive—including the state and federal governments given the public interest in railroad transportation—but it was not clear there was constitutional authority to create a railroad reorganization law.[58] The dilemma was resolved by molding humble foreclosure law into the world's first large-scale reorganization framework.[59] In a process that became known as the equity receivership, one or more creditors would file a "creditors' bill" asking the court to appoint a receiver to take control of the assets of the corporation.[60] Another creditor would file a foreclosure bill, saying that the railroad had defaulted on the bonds and asking the court to commence a foreclosure sale.[61] But the parties would request that the court temporarily postpone the sale.[62] In the meantime, the Wall Street banks that had underwritten classes of stock or bonds would form committees to represent the stock or bondholders, and the bankers and lawyers representing the committees would negotiate with the managers of the railroad over the terms of a restructuring.[63] After agreeing on the terms, they would combine the committees into a single reorganization committee.[64] They would then invite the court to hold the foreclosure sale, at which exactly one bidder would appear: the reorganization committee,[65]

57. *Id.* at 53 (percentage in default in 1894, one year after the Panic).

58. If the problem arose today, Congress would point to the Bankruptcy Clause in Article I of the U.S. Constitution as authority. *Id.* at 52-56. But for the first half of the nineteenth century, lawmakers debated whether the Bankruptcy Clause extended to corporations. *Id.* at 52-54. Since the states incorporated and regulated railroads and corporations, some contended railroads and corporations must be outside Congress's authority under the Bankruptcy Clause. *Id.* The other potential source of authority, the Commerce Clause, was also construed very narrowly in the nineteenth century. *Id.* at 55. State lawmakers faced equally insuperable obstacles. A state could not regulate beyond the borders of the state, which would pose problems with an interstate railroad. *Id.* at 55-56. And the Contracts Clause in Article I of the Constitution forbids states from altering existing contracts, which is precisely the point of a reorganization framework. *See* U.S. CONST. art. I, § 10, cl. 1.

59. SKEEL, *supra* note 53, at 57-58.

60. *Id.* at 58-59 (describing the equity receivership process in detail).

61. *See, e.g.*, David A. Skeel, Jr., *The Past, Present and Future of Debtor-in-Possession Financing*, 25 CARD. L. REV. 1905, 1908 (2004).

62. *See id.*

63. *Id.*

64. *Id.* at 1909.

65. *Id.*

which would offer to exchange the old stock and bonds of the railroad for new stock and bonds containing the agreed upon terms.[66]

S&C played an important role in early equity receivership practice. Journalists Frank Lipsius and Nancy Lisagor describe S&C founder Oliver Nelson Cromwell as one of the pioneers of the practice.[67] In the 1893 Northern Pacific bankruptcy, they report that Cromwell "showed all ten lawyers then at Sullivan & Cromwell how to handle receiverships."[68] "He called his bankruptcy procedure the 'Cromwell Plan,' as though it were a patented product of Sullivan & Cromwell."[69] Cromwell's approach would "hold off creditors for as long as possible while awaiting an economic upturn,"[70] a strategy that foreshadows the rise in crypto prices during the *FTX* bankruptcy.[71]

The equity receivership worked remarkably well and achieved the public interest in fostering railroad transportation, but it relied on a variety of potentially problematic transactions. The receivership and foreclosure bills were often filed by friendly creditors—the product of collusion rather than an arms-length use of the legal system.[72] Transferring the railroad's assets to a receiver stymied most creditors (the outside creditors who were not in on the game) from exercising their remedies under state law, such as the right to sue and obtain a lien on the debtor's property.[73] And the terms of the restructuring often ignored basic payment priorities, allowing current shareholders to maintain a stake in the reorganized railroad while giving little or nothing to creditors who were not viewed as necessary to the future of the railroad.[74]

66. *Id.* Paul Cravath famously described the reorganizers' anxious wait to see if another bidder would emerge, and the reality that one never did, in Paul D. Cravath, The Reorganization of Corporations; Bondholders' and Stockholders' Protective Committees; Reorganization Committees; and the Voluntary Recapitalization of Corporations: A Lecture Delivered Before the Association of the Bar of the City of New York (1916), *in* SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION 153, 204-05 (1917).

67. NANCY LISAGOR & FRANK LIPSIUS, A LAW UNTO ITSELF: THE UNTOLD STORY OF THE LAW FIRM SULLIVAN & CROMWELL 31 (1988).

68. *Id.*

69. *Id.*

70. *Id.*

71. *See generally* Dietrich Knauth, *FTX Customers Feel Short-Changed by Company's Crypto Valuations*, REUTERS (Jan. 11, 2024, 12:45 PM PST), https://perma.cc/32HN-7ESP (describing the rise in crypto prices).

72. *See, e.g.*, Stephen J. Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 CORNELL L. REV. 1420, 1441-43 (2004) (describing self-interested receivers).

73. *See* Skeel, *supra* note 61, at 1908 (describing the benefit of putting the assets in the hands of a receiver).

74. *See, e.g.*, DOUGLAS G. BAIRD, THE UNWRITTEN LAW OF CORPORATE REORGANIZATIONS 40 (2022) (describing the view that if "those in control of the reorganization decided that, as a sound business matter, a particular stretch of track did not belong inside the

footnote continued on next page

In effect, judges held their noses when they approved the sham sale and other transactions at the heart of the equity receivership, due to the public interest in ensuring a robust system of railroads.[75] The equity receivership thus achieved one public objective—ensuring a viable transportation system—but threatened to undermine another: the fairness and integrity of the judicial system.

The extent of the incursion on the integrity of the legal system depended in part on how honestly and effectively the Wall Street bankers and law firms—including S&C—represented ordinary investors who had bought the stock or bonds. When a bank formed a protective committee, it asked the bondholders to "deposit" their bonds with the bank.[76] From this point on, the bank had almost complete authority to determine how the bond was treated in the restructuring.[77] With little role in the process and little visibility into the negotiations, bondholders were at the mercy of the bank that represented them. A faithful representative would negotiate the best possible treatment of the bonds and would ask only for reasonable fees; an unfaithful representative would not.

B. Stress-Tested by the Supreme Court in the 1930s

Once the receivership strategy was blessed by the courts, it migrated from railroads to other industries. By the early twentieth century, a substantial number of receiverships involved non-railroad corporations.[78] In a series of cases, the Supreme Court signaled that these receiverships needed to be more carefully scrutinized.[79] With railroads, the public interest in railroad transportation outweighed the public interest in a procedurally fair and evenhanded judicial system.[80] In other contexts, it might not.

[reorganized company] . . . . they did not have to give a seat at the bargaining table to those who invested in that track").

75. *See* Lubben, *supra* note 72, at 1441 ("[C]ourts routinely referred to railroads as 'utilities' that simply could not be allowed to fail.").

76. E. Merrick Dodd, Jr., *Reorganization Through Bankruptcy: A Remedy for What?*, 48 HARV. L. REV. 1100, 1104-06 (1935) (describing criticisms of the traditional process).

77. *See* Skeel, *supra* note 61, at 1909 (noting that a depositing bondholder retained the right to withdraw their bonds only if they disapproved of the plan).

78. *See* SKEEL, *supra* note 53, at 104-05.

79. *Id.* at 105.

80. Even with railroads, the Supreme Court did try to limit the extent of the unfairness, most famously in the *Boyd* decision in 1913. N. Pac. R.R. Co. v. Boyd, 228 U.S. 482, 503-08 (1913) (invalidating reorganization plan that prejudiced unsecured creditors, "even in the absence of fraud").

In *Harkin v. Brundage*, for example, the Daniel Boone Woolen Mills struggled after its president and treasurer were replaced for mismanagement.[81] On February 14, 1925, a shareholder filed a receivership bill in Illinois state court asking for the appointment of a receiver.[82] Five days later, a friendly creditor who was allied with the current managers filed a receivership bill in a federal district court.[83] To ensure the federal receivership motion was heard first, the company's lawyer secured a delay (apparently with misleading testimony) of the state-court proceeding.[84] After two lower courts blessed the federal receivership, the Supreme Court reversed.[85] Chief Justice (and former President) Howard Taft might have upheld it "if there had been no chicanery in the delay of the proceeding in the state court"—that is, if the company's lawyer had not misled both courts when he requested a delay.[86] But he refused to countenance this interference by a lawyer with the integrity of the legal system.[87]

Four years later, the Supreme Court again rejected a receivership on judicial-system integrity grounds. In *Shapiro v. Wilgus*, a lumber dealer who was operating in his individual capacity transferred the assets of a business to a newly created Delaware corporation for the purposes of having a receiver appointed.[88] The receiver would prevent creditors from seizing the assets of that business.[89] The lumber dealer predicted "a surplus of $100,000" if the business was "protected from the suits of creditors."[90] Although the debtor's motives were understandable, Justice Cardozo said the creation of a

81. 276 U.S. 36, 39 (1928).

82. *Id.* at 39-40.

83. *Id.* at 40, 49-51. The company immediately consented, *id.* at 41, which was essential because a general creditor ordinarily could not file a receivership bill until after the creditor obtained a lien. Courts often deemed this requirement waived if the company consented. *See, e.g.*, *id.* at 51 ("The Woolen Mills Corporation was advised that the creditor's bill to be filed could not be sustained because the nominal plaintiff was not a judgment creditor but was a simple nonjudgment creditor, and that that defect could only be remedied and immediate court action secured by an answer of the company admitting the averments of the bill and consenting to a receivership." (citation omitted)).

84. *Id.* at 56 ("What was done here in delaying the state court and inducing the federal court to act without a full disclosure of what had been done in the state court, was a fraud not only upon the state court but upon the federal court itself . . . .").

85. *Id.* at 58.

86. *Id.* at 56.

87. *See id.* at 56-57.

88. 287 U.S. 348, 352-53, 357 (1932).

89. *Id.* at 353.

90. *Id.*

receivership stymied the debtor's creditors.[91] That purpose "has been condemned in Anglo-American law since the Statute of Elizabeth."[92] As Justice Cardozo acknowledged:

> True indeed it is that receivers have at times been appointed even by federal courts at the suit of simple contract creditors . . . . This is done not infrequently where the defendant is a public service corporation and the unbroken performance of its services is in furtherance of the public good. It has been done at times, though the public good was not involved, where legitimate private interests might otherwise have suffered harm. We have given warning more than once, however, that the remedy in such circumstances is not to be granted loosely, but is to be watched with jealous eyes.[93]

Just what were the "legitimate private interests" justifying use of the receivership strategy in the two non-railroad cases Justice Cardozo cites?[94] In each case, a corporate debtor made a compelling showing that, unless a receiver were appointed, creditors' collection efforts and the "resulting forced sales of the property would cause great loss to the creditors."[95] Making a collective forum available to maximize the value of the debtor's assets serves the parties' private interests, but it also serves the public's interest in a functioning economy.[96] We characterize this as the second of three kinds of public interest in corporate reorganizations (the first being judicial-process integrity and the third being non-bankruptcy interests).

Congress codified large-scale railroad and non-railroad receivership for the first time in 1933 and 1934, respectively, incorporating both into the Bankruptcy Act.[97] The new rules eliminated the need to engage in collusive practices under equity receiverships, reflecting a renewed commitment to the

91. *See id.* at 354.

92. *Id.* at 354 ("A conveyance is illegal if made with an intent to defraud the creditors of the grantor, but equally it is illegal if made with an intent to hinder and delay them."). The Statute of Elizabeth is the earliest fraudulent conveyance statute, enacted in 1571. *See* Fraudulent Conveyances Act 1571, 13 Eliz. 1 c. 5 (Eng.).

93. *Id.* at 356 (citations omitted).

94. United States v. Butterworth-Judson Corp., 269 U.S. 504, 513 (1926); Michigan v. Mich. Tr. Co., 286 U.S. 334, 339-40 (1932).

95. *Butterworth-Judson Corp.*, 269 U.S. at 512-13; *see Mich. Tr. Co.*, 286 U.S. at 339-40.

96. As bankruptcy scholars recognize, this objective lies at the heart of the best-known normative theory of bankruptcy. *See* Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 866-67 (1982).

97. Bankruptcy Act of 1898 Amendments, ch. 204, 47 Stat. 1467 (1933) (superseded by Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified as amended at 11 U.S.C. §§ 101-1532)); Bankruptcy Act of 1898 Amendments, ch. 424, 48 Stat. 911 (1934) (superseded by Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified as amended at 11 U.S.C. §§ 101-1532)). The push for codification and the enactment of the two reforms are described in SKEEL, note 53 above, at 103-09.

public interest in judicial process integrity, the first and most basic public interest.[98] The reforms also regularized the second type of public interest—providing a collective forum—and continued to facilitate the specific objective of protecting and preserving the railroad system.[99]

C. The Public Responsibilities of Lawyers

Reformers of the New Deal era, several of whom were corporate-reorganization experts, concluded that the 1933-1934 codification was pathetically inadequate to assure the integrity of the system (the first public interest in our schema).[100] True, the reforms eliminated the need to use collusive techniques. But the New Deal reformers believed that the Wall Street bankers and lawyers who negotiated the transactions were more concerned with their own interests than with the ordinary investors they were ostensibly protecting.[101]

In 1934, Joseph Kennedy, the head of the newly created Securities and Exchange Commission (SEC), asked future Supreme Court Justice William Douglas, then a Yale law professor, to oversee a study of corporate reorganization practice that the Securities Exchange Act of 1934 instructed the SEC to undertake.[102] Douglas and his team eventually produced eight volumes of case studies and analyses of reorganization practice.[103] A recurring theme was that bankers would seize control of the reorganizations for their own purposes while the lawyers would fail to uphold the high standards of their profession.[104]

In addition to a concern about fees,[105] the report focused on conflicts of interest. "It is not unusual," the investigators wrote, "to find lawyers attempting to represent both senior and junior interests in a reorganization,"

98. SKEEL, *supra* note 53, at 103-09.

99. *Id.*

100. *See, e.g.*, *id.* at 108, 110-11 (describing early criticism of 1933-1934 reforms by E. Merrick Dodd and the subsequent, equally critical findings of the SEC study discussed below).

101. Thanks to *The Investor Pays*, a 1933 book by Max Lowenthal (a lawyer and, in later years, presidential advisor) the receivership of the Chicago, Milwaukee & St. Paul Railway Company was seen as emblematic of the problems of receivership practice. *Id.* at 103 (citing MAX LOWENTHAL, THE INVESTOR PAYS (1933)).

102. *Id.* at 109.

103. SEC, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES pts. I-VIII (1936-1940).

104. *Id.* pt. I, at 863, 867-68.

105. *Id.* pt. I, at 867 ("The vice is that the bar has been charging all that the traffic will bear. It has forsaken the tradition that its members are officers of the court and should request and expect only modest fees.").

often as "an aspect of the lawyer's representation of both the bondholders and the management or bankers."[106] The investigators also questioned whether it was appropriate for lawyers who had represented the company before bankruptcy or receivership to serve as counsel in a bankruptcy or receivership.[107] After all, "friendly alliances or prior professional connections" might discourage the lawyers from vigorously challenging problematic behavior by the debtor's managers or advisors—which we argue was echoed today in *FTX*.[108]

The New Deal reformers urged Congress to amend the Bankruptcy Act to forbid a debtor's prebankruptcy lawyers and bankers from continuing to represent the debtor in bankruptcy. They got their wish with the Chandler Act of 1938.[109] Chapter X of the 1938 reforms, which governed large corporate debtors, required that an independent trustee be appointed for any corporate debtor with more than $250,000 of liabilities and prohibited a banker or lawyer from representing the trustee in bankruptcy unless they were "disinterested."[110] The definitions of "disinterested" expressly excluded any banker who had recently underwritten securities for the debtor and any lawyer that had worked for the company prior to bankruptcy.[111] Major law firms like S&C left restructuring practice as a result of the Chandler Act reforms.[112]

Chapter X adopted a stringent vision for ensuring the fairness and integrity of the judicial process and legal system, putting far greater emphasis on this public-interest concern than either the equity receivership or the 1933-1934 codifications of large-scale reorganization had done. The lawyers at the heart of a large-scale reorganization were no longer lawyers who had represented the company or its underwriters prior to bankruptcy. They were lawyers the company would hire after it had fallen into financial distress.

Not surprisingly, the managers of troubled companies chafed at the prospect of being displaced by an independent trustee if the company filed for

106. *Id.* pt. II, at 526.

107. *Id.* pt. II, at 523. As discussed in Parts II.C and V.C, Ray and S&C appear to have attacked former insiders selectively, shielding those (such as former S&C partner Ryne Miller) whose "friendly alliance" and prior connections supported S&C's efforts to gain control of the debtor and its reorganization.

108. *Id.*

109. *See, e.g.*, SKEEL, *supra* note 53, at 113, 117-22 (describing the role of William Douglas and others in creating and lobbying on behalf of the new Chapter X).

110. Bankruptcy Act of 1898 Amendments, ch. 575, §§ 1(156-57), 52 Stat. 840, 888 (1938) (superseded by Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified as amended at 11 U.S.C. §§ 101-1532)).

111. *Id.* §§ 158(2)-(3).

112. *See, e.g.*, SKEEL, *supra* note 53, at 125.

bankruptcy. By the 1960s, an increasing number of large corporate debtors evaded Chapter X by filing under Chapter XI, which was intended for smaller corporate debtors.[113] This set the stage for the most recent overhaul of bankruptcy law in 1978.

D. The Public Interest and the 1978 Code

The 1978 Bankruptcy Code dramatically reformed the reorganization of large corporate debtors. Chapter 11, the reorganization chapter, assumes that a debtor's managers will continue to run the business,[114] rather than automatically replacing them with a trustee, as Chapter X had done. The debtor and its creditors negotiate the terms of a potential reorganization plan, the plan is voted on, and the bankruptcy court approves the plan if it meets a list of requirements set forth in Section 1129.[115]

The principal safeguards of the public interest in integrity and fairness in most cases are extensive disclosure obligations and ethical oversight conducted by an entity created under the 1978 Code called the Office of the United States Trustee.[116] The disclosure rules apply largely to the corporate debtor-in-possession and professionals retained by its estate. Debtors must, for example, file schedules of assets and liabilities;[117] a list of creditors;[118] and, in larger cases, monthly operating reports reflecting sources and uses of cash and other assets.[119] Professionals must disclose any "connections" to parties in interest, including potential conflicts of interest.[120] Every important matter in the case

113. *Id.* at 164-66.

114. 11 U.S.C. § 1107(a) (providing that a debtor-in-possession shall be vested with the rights a trustee would have).

115. 11 U.S.C. § 1129(a).

116. As discussed below, the United States Trustee is considered the "watchdog" of the Bankruptcy System, though one that is distinctly unpopular with both practitioners and judges. Pursuant to 28 U.S.C. § 586, the U.S. Trustee is generally charged with overseeing the administration of chapter 11 cases. *See* U.S. Tr. v. Colum. Gas Sys. Inc. (*In re* Columbia Gas Sys. Inc.), 33 F.3d 294, 296 (3d Cir. 1994) (stating that the U.S. Trustee has "public interest standing" under 11 U.S.C. § 307, which goes beyond mere pecuniary interest); Morgenstern v. Revco D.S., Inc. (*In re* Revco D.S., Inc.), 898 F.2d 498, 500 (6th Cir. 1990) (describing the United States Trustee as a "watchdog").

117. 11 U.S.C. § 521(a)(1)(B)(i).

118. *Id.* § 521(a)(1)(A).

119. 11 U.S.C. § 521; *see also id.* § 704(a)(3) (directing the trustee to ensure that the debtor will perform his intentions specified in § 521).

120. Per the Federal Rules of Bankruptcy Procedure, professional retention applications must describe "to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee." *See* FED. R. BANKR. P. 2014(a).

requires court approval which, in turn, requires public filings of pleadings and other documents.[121]

The U.S. Trustee, which is a branch of the Department of Justice, appoints (with some exceptions) the bankruptcy trustees in liquidation cases, the creditors' committee in reorganization cases, and examiners in the cases where they are appointed.[122] The U.S. Trustee may also challenge conflicts of interest and excessive fees charged by bankruptcy professionals.[123]

In addition to disclosure requirements and the U.S. Trustee, chapter 11 empowers creditors and other interested parties to replace problematic management with a bankruptcy trustee. For the vast majority of chapter 11 cases, no trustee is appointed.[124] Instead, chapter 11 authorizes the intermediate step of appointing an examiner if this is in the parties' interest or the company has more than $5 million of debt and a party asks for an examiner.[125] In cases of "great public interest" involving fraud or wrongdoing, the drafters of chapter 11 envisioned that an examiner would provide "special protection" by investigating and reporting on the causes and consequences of the debtor's failure while permitting current management to remain in control of the debtor.[126] Examiners have featured prominently in such notorious cases as *Enron* and *Lehman Brothers*.[127] The question whether to appoint an examiner would prove to be a pivotal issue in *FTX*.

E. The Lawyers' Role in Chapter 11

In the years between the 1938 Chandler Act and the passage of the 1978 Bankruptcy Code, large law firms like S&C exited corporate reorganization practice due to the prohibition on lawyers or bankers that had represented the debtor or its investment bank before bankruptcy serving as advisors in bankruptcy.[128] Because the new chapter 11 allowed the debtor's managers to

121. *See* 11 U.S.C. §§ 107(a) (requiring public access to court documents), 363(b) (requiring court approval of transactions that are not in the ordinary course of business).

122. 11 U.S.C. §§ 1104(d) (detailing appointment of trustee or examiner in chapter 11), 701-02 (detailing the same for a trustee in chapter 7).

123. *See, e.g.*, U.S. Trustee Program, *The U.S. Trustee's Role in Chapter 11 Bankruptcy Cases*, https://perma.cc/6LE7-RQJD (last updated Nov. 20, 2023) (describing challenges related to professional employment).

124. *See, e.g.*, DANIEL J. BUSSEL, DAVID A. SKEEL, JR. & MICHELLE M. HARNER, BANKRUPTCY 611 (11th ed. 2021) (noting that appointment of trustee in chapter 11 cases is "exceptional").

125. 11 U.S.C. § 1104(c).

126. 124 CONG. REC. 33990 (1978) (statement of Sen. Dennis DeConcini); *see In re* FTX Trading Ltd., 91 F.4th 148, 154-55 (3d Cir. 2024).

127. *See infra* Part IV.A.

128. *See* SKEEL, *supra* note 53, at 125.

run the business and relied on private negotiations among the parties, chapter 11 more closely resembled the equity receiverships that big law firms had helped to pioneer than the Chandler Act models.

After 1978, the big law firms quickly re-entered bankruptcy practice.[129] But they did not return to the model of the equity-receivership era. Large corporations that fell into financial distress did not use the lawyers that had previously represented the company as their bankruptcy lawyers. Instead, the company would hire new bankruptcy specialists. The new model avoided the conflicts of interest that had arisen in the receivership era, thus preserving this feature of the New Deal reformers' commitment to system integrity.

There were occasionally problematic exceptions. One involved Leslie Fay, a company whose bankruptcy was triggered by an accounting scandal.[130] Weil Gotshal had worked for Leslie Fay's audit committee before Leslie Fay filed for bankruptcy.[131] In its application for retention as the company's bankruptcy attorneys, Weil noted that it represented the audit committee but failed to disclose its substantial relationships with two Leslie Fay directors and an auditor who were potential subjects of the investigation.[132] Although the bankruptcy judge did not disqualify Weil Gotshal, given the potential disruption to the case, she ordered the firm to pay the costs incurred by an examiner and other direct and indirect costs of the undisclosed conflicts.[133]

Another exception involved a Wisconsin mining-tool manufacturer called Bucyrus-Erie that had gone through a leveraged buyout (LBO) and later filed for bankruptcy.[134] John Gellene, a young partner at Milbank Tweed, the debtor's bankruptcy lawyer, did not press to challenge the LBO as a fraudulent conveyance, contending that the statute of limitations had expired.[135] Late in the case, a creditor who was unhappy with the proposed reorganization discovered that Milbank had also represented the principal lender in other matters and that Gellene had failed to disclose that connection as required by the bankruptcy rules.[136] The creditor sought disgorgement of Milbank's fees

129. *See, e.g.*, Sherry R. Sontag, *Amid Bust, a Boom*, NAT'L L.J., Apr. 2, 1990, at 29 ("Ten years ago, before large corporate clients began to use the 1978 Bankruptcy Code as a way out of short-term financial problems, most large firms ignored the field altogether. Now they are scrambling to bolster and promote their insolvency practices.").

130. *In re* Leslie Fay Cos., 175 B.R. 525, 527 (Bankr. S.D.N.Y. 1994).

131. *Id.* at 529-30.

132. *Id.* at 530.

133. *Id.* at 539.

134. Mitt Regan wrote the definitive account of the case and the ethics scandal at the heart of it. MILTON C. REGAN, JR., EAT WHAT YOU KILL: THE FALL OF A WALL STREET LAWYER at ix, 1 (2004).

135. *Id.* at 1, 167.

136. *Id.* at 209-10.

and the U.S. Trustee contacted the U.S. Attorney's office.[137] Gellene was charged, tried, convicted, and sentenced to fifteen months in prison for lying to the court and failing to disclose the conflict of interest.[138] The fact that Gellene had succeeded in having the bankruptcy court confirm a plan that paid creditors 100% of their claims did not save him.[139] Nor did it matter that Milbank had previously represented a creditor in unrelated matters, rather than the debtor with respect to its financial distress.[140] The deeper structural problem of conflicting attorney incentives was the same.

As we shall see, like Weil Gotshal and Milbank Tweed before them, S&C—the *FTX* bankruptcy lawyers—had a substantial prebankruptcy relationship with FTX having nothing to do with the company's distress and which they perhaps incompletely disclosed.[141] This relationship would create the kinds of problems that worried the New Deal reformers in the equity-receivership era—and seems to have distorted both the prosecution of Sam Bankman-Fried and the chapter 11 reorganization itself.

II. Pushing FTX into Chapter 11

The story of FTX's rise and shocking collapse has been told in countless articles and books. Of the two most prominent accounts, the more flattering was written by best-selling author Michael Lewis (*Going Infinite*) and the less flattering by Zeke Faux (*Number Go Up*).[142] The *FTX* bankruptcy appears only at the very end of Lewis's book and even more briefly in Faux's.[143] Yet it is a crucial feature of the FTX story and of the fall of Sam Bankman-Fried. Indeed, a theme we draw from our case study is that the bankruptcy played a critical role in the prosecution and vice versa.

137. *Id.* at 210-11, 217 (motion asking for disgorgement for violating Rule 2014 disclosure requirements).

138. He was convicted of two counts of violating 18 U.S.C. § 152 by making a "false declaration," and one count of violating 18 U.S.C. § 1623 by submitting a document with "any false material declaration." *Id.* at 273, 287.

139. *See In re* B-E Holdings, Inc., 228 B.R. 414, 416 (Bankr. E.D. Wis. 1999) ("The debtors' Second Amended Joint Plan of Reorganization was confirmed on December 2, 1994. The plan of reorganization generally provides that creditors receive 100% of their allowed claims.").

140. *See* REGAN, *supra* note 134, at 209-10.

141. *See infra* Part II.B.

142. *See* LEWIS, *supra* note 17; FAUX, *supra* note 17.

143. *See* LEWIS, *supra* note 17, at 232-52; FAUX, *supra* note 17, at 217-19.

A. FTX and Crypto Credibility

FTX was a complex of over one hundred related entities which appear to have had three main lines of business: two cryptocurrency exchanges and a hedge fund. According to the company's chapter 11 disclosure statement, one of the two exchanges was based in the U.S. (FTX US), and the other conducted business internationally (FTX International, owned by FTX Trading, Ltd).[144] FTX US—by far the smaller of the two, but a basis for FTX's chapter 11 filing in the United States—was "an exchange for spot trading in digital assets and tokens"; FTX International was "a digital asset trading platform and exchange."[145]

FTX's exchanges "were among the world's largest digital asset exchanges, where millions of customers bought, sold and traded certain digital assets."[146] The exchanges "gained international prominence for their popularity among users, their high-profile acquisitions and celebrity endorsements, and the public image of Samuel Bankman-Fried, their co-founder and CEO, who was a vocal public figure in the cryptocurrency industry."[147]

The hedge fund, Alameda Research LLC ("Alameda")—a name Bankman-Fried chose because it did not conjure up images of risky trading[148]—predated the exchanges. It was Bankman-Fried's first foray into crypto. He and a band of fellow "effective altruists" (his preferred utilitarian philosophy[149]) sought to exploit mismatches in crypto prices around the world. Most of his early partners rebelled and left before the hedge fund surged into profitability.[150] As

144. The debtors filed several different disclosure statements, each bearing the same name. *See, e.g.*, Disclosure Statement for Debtors' Joint Chapter 11 Plan of Reorganization of FTX Trading Ltd. & Its Affiliated Debtors & Debtors-in-Possession at 12, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Dec. 16, 2023), ECF No. 4862 [hereinafter Original Disclosure Statement]; Disclosure Statement for Debtors' Joint Chapter 11 Plan of Reorganization of FTX Trading Ltd. & Its Affiliated Debtors & Debtors-in-Possession, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. May 7, 2024), ECF No. 14301 [hereinafter Approved Disclosure Statement]. While it is not uncommon to see different iterations of a disclosure statement in a large case, the failure to use readily distinguishable titles (e.g., "first amended disclosure statement") would make it harder to keep track of the development of the FTX plan.

145. Declaration of John J. Ray III in Support of Chapter 11 Petitions & First Day Pleadings ¶¶ 12, 33, *In re* FTX Trading Ltd., et al., No. 22-11068 (Bankr. D. Del. Nov. 17, 2022), ECF No. 24 [hereinafter Ray First Day Decl.].

146. *See* Original Disclosure Statement, *supra* note 144, at 12.

147. *Id.*

148. *See* LEWIS, *supra* note 17, at 110 (reporting that the "name itself had been chosen in part to hide the fact that the firm had anything to do with crypto").

149. *Id.* at 50.

150. A variety of factors contributed to their departure, including "a shared alarm at [Sam's] recklessness," which left the members of the management team "not perfectly unified in their opinions of Sam." LEWIS, *supra* note 17, at 96, 99-101.

the FTX empire grew, Alameda made investments on behalf of FTX in an array of assets, ranging from digital asset startups to artificial intelligence.[151] Author Lewis colorfully characterized this array of assets as a "dragon's lair," echoing Bankman-Fried's passion for computer games.[152]

Although he sold equity interests to investors, Bankman-Fried owned the majority of shares in most or all of the 100-plus entities in the group.[153] He was the CEO and appears to have been a director of many or all of them.[154] Caroline Ellison, his sometime-girlfriend and the star witness in the fraud trial against him, was the CEO of Alameda.[155]

As crypto grew in 2021-2022, it appeared that the earning capacity of FTX was virtually unlimited—it could generate, as Bankman-Fried fatefully said to author Michael Lewis, "infinity dollars."[156]

1. Becoming finite

All good things—apparently even infinite ones—come to an end. FTX's liquidity crisis was precipitated by two unappreciated, and un(der)-disclosed, linkages between FTX Trading, the international exchange, and Alameda, the hedge fund run by Ellison. One involved an account known as "info@"; the other involved an account known as "fiat@."[157] Together, these accounts

151. *Id.* at 7.

152. *Id.*

153. *See* Original Disclosure Statement, *supra* note 144, at 12 (noting "third-party equity investors, including investment funds, endowments, sovereign wealth funds and family offices").

154. The debtors recognized that Bankman-Fried continued to own most of the debtors' equity. Ray First Day Decl., *supra* note 145, ¶ 10 n.2. Ray declared at the beginning of the bankruptcy that:

> Mr. Bankman-Fried owns (a) directly, approximately 53% of the equity in Debtor West Realm Shires Inc.; (b) indirectly, approximately 75% of the equity in Debtor FTX Trading Ltd.; (c) directly, approximately 90% of the equity in Debtor Alameda Research LLC; and (d) directly, approximately 67% of the equity in Clifton Bay Investments LLC.

Id.

155. Hearing Transcript, Oct. 10, 2023, at 683, United States v. Bankman-Fried, No. 11-cr-00673 (S.D.N.Y. Dec. 12, 2023), ECF No. 358 [hereinafter Ellison Hearing Transcript 1] ("In 2021, I was appointed co-CEO. And in 2022, I became CEO when my co-CEO [Bankman-Fried] stepped down.").

156. *See* LEWIS, *supra* note 17, at xiv.

157. At Bankman-Fried's criminal trial, his defense counsel explained the accounts as follows:

> [I]nfo@Alameda was the trading account that Alameda had on the FTX exchange where it was trading for its own account. If you look at the visibility on the admin user dashboard at the bottom, when Sam was the CEO of FTX, no longer running Alameda, he would use that admin dashboard, as others would, to check accounts of all customers, including Alameda, and what he could see was what was in the info@Alameda account, the trading account. On the left-hand side is the FTX—fiat@FTX.com account. That was very different. It was a tracking

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created the means by which Bankman-Fried and other FTX insiders were able to misappropriate customer funds.[158]

According to Ellison's trial testimony, "info@" "was our main account for trading on FTX."[159] This was a ledger entry (not a bank account) through which assets held by Alameda could be traded through the FTX International exchange.[160] The account exempted Alameda from a rule on the exchange that required the automatic liquidation of any account that had a negative value.[161] Unlike other customers on the exchange, Alameda could effectively borrow billions of dollars from the exchange.[162]

This would not necessarily have been a problem, but for the fact that Alameda was actually borrowing billions of dollars in *customer* assets through the fiat@ account.[163] That account was, according to Bankman-Fried, created as a payment processor because Alameda (the hedge fund) could get a bank account but FTX International (the crypto exchange) could not.[164] Customers would send assets (fiat or digital) to fiat@ thinking those assets were going to

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> account. It was supposed to track FTX customer deposits and withdrawals of fiat or dollar, currency, so forth, via Alameda bank accounts, and it wasn't visible from the admin user dashboard.

Hearing Transcript, Nov. 1, 2023 at 3060, United States v. Bankman-Fried, No. 22-cr-00673 (S.D.N.Y. Dec. 12, 2023), ECF No. 382 [hereinafter SBF Closing Argument Transcript].

158. At the Bankman-Fried trial, Caroline Ellison testified as follows:

> Q. What are some of the ways that Alameda was able to steal customer money?
>
> A. We had access to an essentially unlimited line of credit on FTX, and we received FTX customer funds directly into our bank accounts as part of the FTX fiat deposit system.
>
> Q. And what was the defendant's role in taking that money and spending it on Alameda?
>
> A. He was the one who set up the systems that allowed Alameda to take the money, and he was the one who directed us to take customer money to repay our loans.

Ellison Hearing Transcript 1, *supra* note 155, at 644-45.

159. Hearing Transcript, Oct. 12, 2023 at 966, United States v. Bankman-Fried, No. 22-cr-00673 (S.D.N.Y Dec. 12, 2023), ECF No. 362 [hereinafter Ellison Hearing Transcript 2].

160. *Id.* at 965.

161. As the *Wall Street Journal* explained:

> Court filings have revealed a line buried deep in FTX's code that allowed Alameda to have a negative balance of as much as $65 billion on the exchange.
>
> Normal users couldn't go negative on FTX. They were subject to an automatic liquidation process, in which FTX sold off their assets if their balances fell below zero. But that didn't apply to Alameda.

Alexander Osipovich & Angus Berwick, *FTX Employees Found Alameda's Secret Backdoor Months Before Collapse*, WALL. ST. J. (Oct. 5, 2023), https://perma.cc/R5HU-EKS4.

162. Ellison testified that "once [Alameda] started borrowing in the billions of dollars, I knew that our borrowing exceeded the total amount of money that FTX had from its revenue and from its fundraising so I knew that some of what we were borrowing at least had to be customer funds." Ellison Hearing Transcript 1, *supra* note 155, at 662.

163. *See, e.g.*, LEWIS, *supra* note 17, at 219-20.

164. *See, e.g.*, *id.*

remain theirs to trade on FTX, which Bankman-Fried claims was what was supposed to happen. Legally, however, it did not. Instead, the assets were held and ultimately used by Alameda. According to a statement that Bankman-Fried shared with us during an interview:

> The fiat@ledger and Alameda's bank accounts at Silvergate Bank (hereinafter, jointly, the "fiat@ account") were created to serve as a payment processor for FTX, at a time when FTX could not obtain a bank account of its own, and hence could not process customers' fiat deposits and withdrawals directly. As a workaround until it could obtain its own bank account, FTX used Alameda's accounts at Silvergate to receive and disburse customers' fiat deposits and withdrawals. All of the transactions were tracked on the fiat@ledger, which automatically credited and debited customers' accounts on FTX to reflect the transfers of fiat.
>
> Once FTX obtained its own bank accounts in late 2021 and the spring of 2022, the portal on its website re-routed customers directly to its own accounts rather than the fiat@ account. There was, however, a serious problem with the fiat@ account having nothing to do with the "back door" or auto-liquidation, which was that FTX was not carefully tracking the balance in the account. As a result, management was unaware of large swings in the balance as they were happening. In the beginning of 2021, Alameda had a slight surplus in the fiat@ account—that is, *FTX* owed *Alameda* money. In the fall of 2021, Alameda had a negative balance of roughly $4 billion in the fiat@ account. As a result of the boom crypto market, the value of the fiat@ account doubled in the last quarter of 2021, reaching a high point of roughly $8 billion in the first two months of 2022. Even with the ballooning in the fiat@ debt, at the start of 2022, Alameda's net asset value was around $40 billion, which meant FTX faced no serious risk that Alameda would default on the loan at that point.[165]

Alameda also held a significant position in FTT, the FTX Group's "native token," which magnified the problem because the token appeared as an asset on Alameda's balance sheet but was effectively exposed to correlated risk.[166] FTT provided discounted access to the exchange and was a cross between a rewards program and equity that could be bought or sold, since holders were entitled to

165. *See* Telephone Interview with Sam Bankman-Fried (Jan. 27, 2025) (transcript on file with authors). Putting claims about Alameda's finanancial condition to one side, it appears that this is consistent with the government's version of the story. The SEC complaint against Bankman-Fried, for example, recites that "[t]his multi-billion-dollar liability was reflected in an internal account in the FTX database that was not tied to Alameda but was instead called 'fiat@ftx.com.' Characterizing the amount of customer funds sent to Alameda as an internal FTX account had the effect of concealing Alameda's liability in FTX's internal systems." *See* Complaint ¶ 37, SEC v. Bankman-Fried, No. 1:22-cv-10501 (S.D.N.Y. Dec. 23, 2022), ECF No. 1 [hereinafter SEC Complaint].

166. *See* Original Disclosure Statement, *supra* note 144, at 17; *see also* Examiner Report, *supra* note 41, at 86-87 ("[The] design of FTT . . . purported to tie the value of the FTT token to the success of the FTX.com exchange.").

one-third of the profits of FTX each year.[167] Alameda's stash was estimated at a value of approximately $4 billion as of June 2022, which represented over one-third of Alameda's total aggregate assets.[168]

On November 2, 2022, the cryptocurrency news site CoinDesk published an article revealing FTX's leverage and liquidity problems, driven in part by the linkages between FTX and Alameda and large FTT holdings.[169] Between November 2, 2022 and November 11, 2022, "customers attempted withdrawals of several billions of dollars."[170] Although many were able to do so, FTX froze withdrawals, amplifying the chaos customers experienced.[171]

2. The Binance problem (part 1)

While many things went wrong at FTX, it appears that the company's main crypto competitor, Binance, the largest centralized digital asset exchange, contributed significantly to its demise in three ways.

First, in July 2021, FTX repurchased from Binance 96 million shares of Series A Preferred Stock of FTX Trading for over $2 billion ($1.2 billion in cash, the balance in tokens).[172] It appears that some, if not all, of this purchase was made with customer assets held by Alameda.[173] While it appears that FTX was not insolvent or illiquid at the time, it may have left FTX undercapitalized.[174] The government would later point to this transaction as a main reason Bankman-Fried committed crimes.[175] As explained in Part V, it

167. *See, e.g.*, LEWIS, *supra* note 17, at 120.

168. *See* Allison, *supra* note 19 ("As of June 30, the company's assets amounted to $14.6 billion. Its single biggest asset: $3.66 billion of 'unlocked FTT.' The third-largest entry on the assets side of the accounting ledger? A $2.16 billion pile of 'FTT collateral.'").

169. *Id.*

170. Original Disclosure Statement, *supra* note 144, at 17.

171. Danny Nelson & Nikhilesh De, *FTX US Temporarily Froze Crypto Withdrawals, Adding to Chaos of Bankruptcy Proceedings*, COINDESK (updated May 8, 2023, 9:02 PM PDT), https://perma.cc/V2JV-7GNN.

172. *See* Share Transfer Agreement at 1, United States v. Bankman-Fried, No. 1:22-cr-00673 (S.D.N.Y. July 15, 2021) (on file with authors) [hereinafter Binance Repurchase Agreement].

173. At the Bankman-Fried criminal trial, the Government's expert, accounting professor Peter Easton, testified that Binance received "[o]ver a billion dollars . . . from customer funds from [the] FTX exchange." Shaurya Malwa, *FTX Used Billions in Customer Funds to Buy Back Binance Stake*, COINDESK (Oct. 19, 2023, 1:06 AM PDT), https://perma.cc/9RYF-5VC9.

174. *See infra* Part V.C.

175. *See* SBF Closing Argument Transcript, *supra* note 157, at 2950. In closing, prosecutor Nicolas Roos stated as follows:

> And so what we're going to do now is I'm going to talk about six moments in time. And here are the first three. But six moments in time in 2021 and 2022 where the defendant was

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may well have constituted an avoidable transfer that the FTX estate could recover to benefit stakeholders.

Second, on November 6, 2022—four days after CoinDesk had released the Alameda-FTX balance sheets—Changpeng Zhao (Binance's then-CEO, known as CZ) tweeted that "[d]ue to recent revelations that have [come] to light, we have decided to liquidate any remaining FTT on our books."[176] At Bankman-Fried's criminal trial, Ellison testified that this tweet was "both very bad news for the price of FTT and also suggest[ed] that Binance [was] aware of negative news about FTX and Alameda."[177] Ellison sought to prop up the price of these tokens because, she said, she believed that CZ's "real aim . . . was not to sell his FTT, but was to hurt FTX and Alameda."[178] CZ's tweet likely accelerated the run on the FTX exchanges.

Third, on November 8, 2022, Binance head-faked FTX, offering and then quickly and publicly withdrawing a potential lifeline. Initially, CZ announced that Binance had entered into a non-binding letter of intent to acquire FTX International.[179] The next day, however, CZ terminated the potential transaction, which "tipped Bankman-Fried's enterprise into full-blown crisis."[180] Since CZ was Bankman-Fried's principal competitor, CZ's motives were rather suspect.

In a very short time, FTX "went from a $32 billion valuation to bankruptcy as liquidity dried up, customers demanded withdrawals and rival exchange Binance ripped up its nonbinding agreement to buy the company."[181] Bankman-Fried admitted at the time that he "'f—ed up.'"[182]

In the early-morning hours of November 11, 2022, after significant pressure from S&C and their allies at FTX, Bankman-Fried docusigned an

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> presented with a choice about coming clean or doubling down and digging the hole deeper. And each time, he indisputably knew the financial situation at FTX and Alameda, and he knew that he would be spending customer money, and each of these times, he took the path of doing the wrong thing, he took the criminal path, and so that's what we're going to talk about.
>
> And No. 1, the first reason is the defendant's purchase, his buying back of stock from Binance using customer money in 2021.

Id.

176. Dan Milmo, *How Binance Played a Key Role as FTX Collapse Unfolded*, GUARDIAN (Nov. 11, 2022), https://perma.cc/SXR9-YMLF.

177. Hearing Transcript, Oct. 11, 2023 at 904, United States v. Bankman-Fried, No. 22-cr-00673 (S.D.N.Y Dec. 12, 2023), ECF No. 360.

178. *Id.* at 906.

179. Milmo, *supra* note 176.

180. *Id.*

181. MacKenzie Sigalos, *Sam Bankman-Fried Steps Down as FTX CEO as His Crypto Exchange Files for Bankruptcy*, CNBC (updated Mar. 28, 2024, 4:12 PM EDT), https://perma.cc/HEQ8-JUH9.

182. *Id.*

"Omnibus Corporate Authority" purporting to assign his corporate powers to bankruptcy specialist John Ray.[183] Ray had been selected by S&C and was presented as Bankman-Fried's only choice.[184] Ray is a well-known turnaround expert, so the choice in itself was not surprising but, as explained below, the process by which he gained control of the company was problematic. Three hours later, Ray began commencing chapter 11 bankruptcies for FTX Trading Ltd. and certain affiliated debtors in the United States Bankruptcy Court for the District of Delaware.[185] Among Ray's first actions was retaining S&C as general counsel for FTX in its bankruptcy.[186]

B. S&C's Prebankruptcy Work for FTX

S&C portrayed itself as having been asked by Can Sun, general counsel of FTX International, on November 8, 2022, to prepare for the chapter 11 filing that was made three days later.[187] S&C initially characterized the other work it had done for FTX before bankruptcy as "limited," focusing "chiefly with respect to acquisition transactions and specific regulatory inquiries."[188] Its initial disclosures had three sentences about this work.[189]

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183. Original Disclosure Statement, *supra* note 144, at 18. The Omnibus Corporate Authority (OCA) was annexed to the petition commencing the FTX bankruptcies. *See* Voluntary Petition for Non-Individuals Filing for Bankruptcy at 12, *In re* FTX Trading, Ltd., No. 22-bk-11068 (Bankr. D. Del. June 26, 2024), ECF No. 1 [hereinafter FTX Chapter 11 Voluntary Petition]. In other work, we hope to analyze the OCA, which may not have sufficed as a matter of corporate law to effect the change of control.

184. An email from S&C partner Andrew Dietderich to Bankman-Fried and others on November 11, 2022 at 12:58 AM lauded Ray's qualifications, telling Bankman-Fried that "John Ray is objective, experienced and fair. He is not proposed by anyone with an ax to grind, and will do a fair and objective job." *See* Email from Andrew G. Dietderich, Partner, Sullivan & Cromwell, to Ken Ziman, Partner, Paul Weiss, et al. (Nov. 11, 2022, 12:58 AM EST) [hereinafter November 11 Email] (on file with authors). This email appears as an exhibit to Samuel Bankman-Fried's Sentencing Submission. Exhibit E at 14, United States v. Bankman-Fried, 680 F. Supp. 3d 289 (S.D.N.Y. 2023) (No. 407-34), ECF No. 407 [hereinafter SBF Sentencing Memorandum]. The exhibits to the SBF Sentencing Memorandum, including much of the correspondence involving the days when FTX collapsed into bankruptcy, can be found on *United States v. Bankman-Fried* (1:22-cr-00673), COURTLISTENER, https://perma.cc/XNZ3-JXBU (last updated Dec. 15, 2023).

185. Original Disclosure Statement, *supra* note 144, at 18-19; Dieterich 1st Supp., *supra* note 26, ¶¶ 31-33. A discussion of S&C's role in inducing Bankman-Fried to convey the power to commence chapter 11 bankruptcies is described in Part II.C below.

186. Dieterich 1st Supp., *supra* note 26, ¶ 61 ("Mr. Ray confirmed his selection of S&C as proposed counsel to the Debtors for these Chapter 11 Cases promptly after filing.").

187. *Id.* ¶¶ 8, 10-11, 33.

188. *See* Declaration of Andrew G. Dietderich in Support of Debtors' Application for an Order Authorizing the Retention & Employment of Sullivan & Cromwell LLP as Counsel to the Debtors & Debtors-In-Possession *Nunc Pro Tunc* to the Petition Date

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Andrew Dietderich, the S&C partner leading the bankruptcy, later supplemented the firm's initial, miniscule disclosures shortly before the hearing on S&C's retention, to elaborate on the firm's prebankruptcy work for FTX.[190] Those later disclosures revealed that S&C had performed significant and critically sensitive tasks that brought the firm in close proximity to FTX's misconduct.[191]

1. FTX acquires LedgerX

S&C's connection to FTX began in July 2021, after Ryne Miller, an S&C partner, left the firm to become general counsel of FTX US, the U.S. exchange whose chapter 11 filing created a U.S. jurisdictional connection.[192] S&C's first assignment was the acquisition of a company known as LedgerX.[193] LedgerX was "the first exchange to offer cryptocurrency contracts in the U.S. using fractionalized portions of cryptocurrency."[194]

Starting with LedgerX, S&C went on to serve as counsel to FTX in about 20 prebankruptcy matters during the 16 months before filing, billing over $8.5 million for regulatory and transactional work.[195] It appears that S&C also

¶ 16, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. June 26, 2024), ECF No. 270 [hereinafter Dietderich Initial Declaration].

189. They were:

> S&C was engaged by the Debtors for a limited number of matters prior to the Petition Date, chiefly with respect to acquisition transactions and specific regulatory inquiries relating to certain U.S. business lines. The total amount of fees and expenses paid to S&C for all of these matters was $8,564,487.50, over the period from July 2021 to the Petition Date. S&C was not primary external counsel to any Debtor prior to the Petition Date.

Id.

190. *See* Dietderich 1st Supp., *supra* note 26, ¶¶ 47-50.

191. As discussed below, a principal example of such tasks was work performed by S&C on behalf of FTX Trading "in responding to information requests from the Commodity Futures Trading Commission ('CFTC') regarding the availability of FTX Trading's cryptocurrency exchange to persons in the United States and Know Your Customer policies and procedures." *See id.* ¶ 48.

192. Sujeet Indap & Joshua Oliver, *How a Prestigious Wall Street Law Firm Got Caught Up in FTX's Chaos*, FIN. TIMES (Jan. 25, 2023), https://perma.cc/V9FL-AQJF; *see supra* Part II.A.

193. Dieterich 1st Supp., *supra* note 26, ¶ 46.

194. *What Was FTX US Derivatives?*, INVESTOPEDIA (updated Dec. 20, 2023), https://perma.cc/3JQQ-F5QX.

195. Dieterich 1st Supp., *supra* note 26, ¶¶ 46-52. Of the other matters, the most economically significant was S&C's representation of FTX in the *Voyager* bankruptcy, where S&C assisted FTX and affiliates in an attempt to acquire assets out of that bankruptcy. *Id.* ¶ 48. S&C billed $3,128,000 for this work. *Id.* Of this amount, it appears that S&C billed $2,253,670.77 to Alameda. *See* Sullivan & Cromwell LLP, Invoice 0695071 to Alameda Research Ltd. (Oct. 18, 2022) (on file with authors). If Alameda paid these fees, then there is a good chance S&C was paid with customer assets. Although Dietderich disclosed the fact of this work, and the amount charged, he

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performed transactional work for Bankman-Fried personally, "arranged for and paid by Debtor Alameda Research Ltd. (total historical fees $195,000)."[196]

S&C promoted its role in the FTX acquisition of LedgerX as a "client highlight."[197] S&C characterized FTX US as "a leading U.S.-regulated cryptocurrency exchange," and explained that the LedgerX acquisition "provides FTX US with a CFTC-regulated Designated Contract Market, Swap Execution Facility and Derivatives Clearing Organization, which is expected to enable FTX to continue in its mission of creating products for retail and institutional traders while further developing a strong working relationship with the U.S. regulatory community."[198]

2. S&C as FTX's regulatory intermediary

S&C was a credible intermediary in fostering this "strong working relationship."[199] S&C is among the nation's premier banking and financial regulatory firms.[200] The firm was chosen by FTX, the *Financial Times* reported, "because of its regulatory expertise."[201]

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notably failed to indicate who paid S&C. *See* Dietderich 1st Supp., *supra* note 26, ¶ 48 ("Total fees and expenses received for this matter were approximately USD $3,128,000.").

196. *See* Dietderich Initial Declaration, *supra* note 188, at 37 n.2. It also appears that founder Nishad Singh "received a $543 million loan from Alameda, and [Alameda] paid lawyers at Sullivan & Cromwell to provide him with legal advice on tax matters and estate planning." David Yaffe-Bellany & Matthew Goldstein, *Third Top FTX Executive Pleads Guilty in Fraud Investigation,* N.Y. TIMES (Feb. 28, 2023), https://perma.cc/5WKH-R6H3; *see also* Dietderich 1st Supp., *supra* note 26, ¶ 51 ("S&C provided U.S. legal advice to Nishad Singh concerning U.S. tax matters and estate planning . . . . Total fees and expenses received for this matter were approximately $22,000.").

197. *S&C Advises FTX in Acquisition of Regulated Crypto Exchange LedgerX*, SULLIVAN & CROMWELL LLP (Nov. 1, 2021), https://perma.cc/DVH3-BAMJ.

198. *Id.*

199. *Id.*

200. Indap & Oliver, *supra* note 192 ("Its top practices are in banking, financial services and financial regulation and many of its senior partners are former regulators."). David Lat noted this reputation in a recent interview of Ryne Miller, former S&C partner and then general counsel of FTX US. *"Just Keep Going": Former FTX General Counsel Ryne Miller*, ORIGINAL JURISDICTION, at 09:56 (Aug. 7, 2024), https://perma.cc/ADF2-8M8U ("So let's talk about your time at S&C more generally. It has a great financial regulatory practice.").

201. Indap & Oliver, *supra* note 192 ("[S&C] assisted FTX with inquiries from regulators who wondered whether American users were improperly accessing the crypto exchange's international platform. And it helped craft FTX's groundbreaking proposal to US regulators to automate risk management in financial markets."). According to *Chambers,* S&C is "the leading global law firm on transactional, regulatory, enforcement and other matters affecting financial institutions." *See Sullivan & Cromwell*, CHAMBERS & PARTNERS, https://perma.cc/TU24-FJZC (archived Dec. 16, 2024).

Following the LedgerX acquisition, S&C advised FTX in seeking permission from the Commodity Futures Trading Commission (CFTC) to engage in certain regulated trading activites.[202] In December 2021, S&C apparently initially filed an application with the CFTC's Division of Clearing and Risk to "allow FTX to offer products that are not fully collateralized."[203] Although it appears (based on Dietderich's declaration) that S&C did a significant amount of work on this application for the next year, S&C withdrew the application the day that the debtors commenced the bankruptcy.[204] S&C received over $2 million for CFTC work before the bankruptcy.[205]

On July 12, 2022, S&C partner Colin Lloyd submitted a 400-plus page application on behalf of LedgerX to the CFTC.[206] Clark Hutchison, of the CFTC, responded to Lloyd confirming receipt and remarking that he was "sure you and FTX colleagues have worked hard" on it.[207] About a month later, on

202. *See* Letter from Colin D. Lloyd, Partner, Sullivan & Cromwell, to Clark Hutchison, Director, Commodity Futures Trading Commission, (Nov. 11, 2022) (on file with authors) [hereinafter CFTC Withdrawal Letter]. Dietderich's first supplement to the S&C retention application indicates that the firm's work in this regard was performed for West Realm Shires, Inc. ("WRS"). *See* Dietderich 1st Supp., *supra* note 26, ¶¶ 48-50. According to the Approved Disclosure Statement, it appears that WRS was the direct or indirect parent of LedgerX and the other entities in the FTX US group. *See* Approved Disclosure Statement, *supra* note 144, at 30. WRS was owned 78% by Bankman-Fried. *Id.* at 31 (showing organization chart).

203. CFTC Withdrawal Letter, *supra* note 202.

204. *Id.*; *see* FTX Chapter 11 Voluntary Petition, *supra* note 183. The authors have sought a copy of this application through various informal channels, but none were successful. Notably, Bankman-Fried reported to us that he had no such copy and had been shut out of FTX's systems shortly after the bankruptcy.

205. Examiner Report, *supra* note 41, at 28-29. The Examiner's Report provides as follows:

> S&C also represented WRS in its formal request to the CFTC to modify WRS' registration as a derivative clearing organization so it could offer margined products directly to participants. S&C was paid approximately $662,000 for this representation. And S&C advised the FTX Group in connection with other investigations and inquiries from the CFTC. One involved inquiries concerning third-party crypto businesses, for which S&C received approximately $220,000. There was one CFTC matter for which S&C received fees in excess of $1,000,000, which was in connection with the agency's investigation into the FTX Group's Know Your Customer policies and procedures, for which S&C received $1,405,000.

Id. (footnotes omitted).

206. *See* Email from Colin D. Lloyd, Partner, Sullivan & Cromwell, to Clark Hutchison, Director, Commodity Futures Trading Commission (July 12, 2022, 11:12 AM EST) (on file with authors) [hereinafter CFTC Transmittal Email]. This email was indexed in the Bankman-Fried criminal prosecution as FTX 001547691; SDNY 06_00785552. It is not clear whether this filing was a supplement to the initial application filed in December 2021 or a new application.

207. *See* Email from Clark Hutchison, Director, Commodity Futures Trading Commission, to Colin D. Lloyd, Partner, Sullivan & Cromwell (July 12, 2022, 12:34 PM EST) (on file with authors). This email was reproduced in the CFTC Transmittal Email, note 206 above.

August 10, 2022, Scott Sloan, of the CFTC, emailed Lloyd to ask that he and FTX answer a series of queries, the first of which was: "Please explain FTX's and Sam Bankman-Fried's relationship with Alameda Research."[208] Lloyd responded that evening, "[w]e and FTX will review and come back shortly."[209]

At some point thereafter, it appears that a lengthy response was sent to the CFTC. Part of this response stated that Alameda "has no . . . special or unique access to the exchange, to exchange data, or to any other feature of either exchange [international or U.S.], versus that which is available to any other professional trading participant."[210]

This statement was false. The info@ and fiat@ accounts *did* give Alameda special access to the FTX exchange, which was a key factor in the Bankman-Fried prosecution.[211]

S&C's connection to the statement is not clear. It appears, based on documents produced in Bankman-Fried's criminal trial, that discussions with the CFTC occurred through S&C partner Lloyd,[212] but it is not known who prepared or sent this statement. Thus, it is possible that S&C did not know of it or play a role in writing it, as S&C lawyers would later assert.[213]

That seems improbable, however. Lloyd had told the CFTC that "[w]e and FTX will review and come back shortly."[214] "We" almost surely meant S&C. Moreover, given S&C's reputation for excellence in regulatory practice and the fact that the firm billed $2 million for this work, it seems more likely that the firm would, or should, have engaged in some verification of the facts underlying the statement.

Nevertheless, the appointed bankruptcy Examiner later accepted S&C's assertions that they did not verify the statement.[215] As explained in Part IV.E,

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208. *See* SBF Sentencing Memorandum, *supra* note 184, Exhibit J, at 2 (reproducing Email from Scott Sloan, Special Counsel, Commodity Futures Trading Commission, to Colin D. Lloyd, Partner, Sullivan & Cromwell, et al. (Aug. 10, 2022, 6:02 PM EST) [hereinafter Sloan-Lloyd Email]).

209. *Id.*

210. *See id.* at 16.

211. *See infra* notes 157-65 and accompanying text.

212. *See, e.g.*, Sloan-Lloyd Email, *supra* note 208; CFTC Withdrawal Letter, *supra* note 202.

213. Examiner Report, *supra* note 41, at 55. S&C lawyers would assert that they neither knew, nor had reason to know, of the fraud at FTX because:

> (1) the work they performed did not entail verifying the factual accuracy of statements made by the FTX Group; (2) at the time, they had no reason to question the veracity of the information they received from the Debtors; and (3) they relied upon the accuracy of these representations in rendering their legal advice.

Id. (footnote omitted).

214. *See* Sloan-Lloyd Email, *supra* note 208, at 2.

215. Examiner Report, *supra* note 41, at 55-56 (concluding that there was "no evidence to suggest that S&C attorneys knew that any of the Debtors' submissions to regulators

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there are reasons to question the Examiner's conclusion on this issue. Among other limitations, he relied heavily on an investigation of S&C by S&C's co-counsel in the bankruptcy, Quinn Emanuel Urquhart and Sullivan (Quinn Emanuel), who, in turn, apparently confined their investigation to reviewing documents and interviewing S&C partners.[216] The contents of those investigations were not revealed by the Examiner.

3. Discovering the linkages and missing red flags?

Two incidents that occurred shortly after the CFTC application was filed are further reason to believe that S&C's prebankruptcy work exposed it to the underlying misconduct or created grounds to make further inquiry.

First, it appears that evidence of asset commingling was discovered by LedgerX employees in May 2022.[217] According to a *Wall Street Journal* report, Julie Schoening, the Chief Risk Officer for LedgerX, "raised concerns about her team's discoveries with her boss, LedgerX head Zach Dexter."[218] Then, in early August 2022, Schoening was fired.[219] According to the *Wall Street Journal,* "[t]he termination came after some FTX executives circulated a document containing what were purported to be screenshots of inappropriate messages she had sent to other employees."[220] Although Schoening's lawyer could not comment due to a settlement agreement with FTX, some at LedgerX said "the messages were doctored or taken out of context, and suggested that Schoening irritated her bosses by identifying problems with FTX's risk management."[221]

Second, the next month, in September 2022, LedgerX affiliate FTX US fired its auditor.[222] That auditor (identified in the Examiner's Report as "Auditor-1") had, according to the Examiner, provided "clean audit opinions" for the fiscal year ending December 31, 2021.[223] But the auditor was fired after submitting draft reports identifying FTX US's "lack of internal controls as 'Material Weaknesses' and 'Significant Deficiencies.'"[224]

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contained false or misleading statements" and that "S&C was not made aware of any facts that would have revealed to it the fraud at the FTX Group").

216. *See* Examiner Report, *supra* note 41, at 36-37. These limitations in the Examiner's Report are discussed in Part IV.E below.

217. Osipovich & Berwick, *supra* note 161 ("The LedgerX team unearthed several problematic practices with how FTX managed risk and handled liquidations . . . .").

218. *Id.*

219. *Id.*

220. *Id.*

221. *Id.*

222. Examiner Report, *supra* note 41, at 136.

223. *Id.* at 135.

224. *Id.* at 136.

Terminating a chief risk officer or an auditor is a significant event.[225] Terminating both in the space of two months would seem to be even more serious. If S&C knew of these events, the firm would have been on inquiry notice that there were problems at FTX.

It is possible that FTX hid these events from S&C. Here, however, that seems unlikely because internal counsel for these FTX entities was Ryne Miller—the former S&C partner.[226] It appears more likely that, as general counsel, Miller knew of these events and, given his relationship to S&C, shared the information with S&C.

If S&C knew of either event, there is no evidence that S&C took any action in response. It is, however, notable that on November 11, 2022—the same day FTX commenced its bankruptcy—S&C withdrew FTX's CFTC licensure application.[227] As of this writing, that application is not publicly available, so it is not known what it stated about FTX or what role S&C played in its preparation. The Examiner's report does not discuss the application or reveal its contents.

C. Wresting Control from Sam Bankman-Fried

We are here to help . . . however we can.

During the bankruptcy case, S&C would characterize Sam Bankman-Fried as a liar and indicted intermeddler for tweeting criticisms of how Ray and S&C were handling the case.[228] But that is not how they treated him when crisis

225. *See, e.g.,* Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233, 1237 (2002) (discussing the importance of auditor independence).

226. Examiner Report, *supra* note 41, at 25-26, 39-40 (referring to Miller as general counsel of FTX US). In addition, former S&C attorney Tim Wilson was general counsel of FTX Ventures, Ltd. *Id.* at 26. Interestingly, the Examiner Phase II Report paints a picture of a highly dysfunctional FTX US, in which "FTX.US did not always clearly delineate corporate and customer crypto assets," and instead "maintained a single set of crypto wallets for all crypto assets of FTX.US." Examiner Phase II Report, *supra* note 41, at 99. It is not clear how this state of affairs could have escaped the attention of Miller or S&C in preparing the CFTC licensure application.

227. S&C withdrew the application and filed the bankruptcy petitions on the same day, November 11, 2022. CFTC Withdrawal Letter, *supra* note 202. As indicated above, the voluntary petition commencing the case was likewise filed November 11, 2022. FTX Chapter 11 Voluntary Petition, *supra* note 183.

228. At a hearing in the bankruptcy court in April 2023—well before Bankman-Fried's trial had commenced in early October—S&C partner Andrew Dietderich stated that "Mr. Bankman-Fried repeatedly, pervasively, and often persuasively, lied to stakeholders and the customers and creditors in order to maintain the digital con game." Hearing Transcript, Apr. 12, 2023, at 9, *In re* FTX Trading, Ltd., No. 22-50513 (Bankr. D. Del. May 2, 2024), ECF No. 33. S&C was quick to impugn Bankman-Fried's efforts to influence the reorganization. At the hearing on the firm's retention early in the case, S&C partner James Bromley criticized Bankman-Fried's "very long and rambling

footnote continued on next page

struck and S&C urged Bankman-Fried to transfer control of the companies to Ray to commence the bankruptcy.[229] Indeed, they assured Bankman-Fried that bankruptcy could save the companies—and that he would play an important role in that process. Based on available information, and as discussed in this Subpart, S&C did not inform Bankman-Fried that he or other insiders had criminal exposure—or that S&C may have played a role in triggering or accelerating that exposure. Quite the opposite: S&C attorneys offered to help Bankman-Fried "avoid[] legal pitfalls."[230] Based on these assurances, Bankman-Fried gave up control of FTX to John Ray, who would later use the company's significant resources to support Bankman-Fried's prosecution.[231]

1. Reassuring Sam and "reporting out"

On November 9, 2022, in the wake of Binance's decision not to acquire FTX, S&C partner Andrew Dietderich sent Bankman-Fried an email at around 9:30 PM, describing steps needed to "rescue" FTX. We refer to this as the "November 9 Email."[232] There, Dietderich presented a "short list" of items needed for a "safety net" in order to have "the option" of chapter 11 ready "in case you need it."[233] Preparation was important, Dietderich said, because "it usually takes two weeks to be ready in an organized manner."[234] Although S&C had "that process underway," it was important to do a "few more things."[235] "Ideally," Bankman-Fried would:

> appoint a CRO [chief restructuring officer] to be on stand-by as the manager of the company in a possible chapter 11. We recommend Sam stay as a director. The manager is there because of conflicts. We have considered candidates and suggest John Ray. Resume attached. The CRO works by the hour and can be terminated

tweets." Hearing Transcript, Jan. 20, 2023, at 13, In re *FTX Trading*, No. 22-11068 (Bankr. D. Del. Jan. 23, 2023), ECF No. 558 [hereinafter S&C Retention Transcript].

229. *See infra* Parts II.C.1-.2.

230. In an email dated November 10, 2022, S&C Partner Mitchell Eitel encouraged Bankman-Fried (and his father, Joseph Bankman, who was advising his son) to "reach out if we can be helpful in thinking through the structuring of any transaction that you are looking at. Particularly around minimizing execution risk and avoiding legal pitfalls." *See* Email from Mitchell S. Eitel to Andrew G. Dietderich, Joe Bankman & Sam Bankman-Fried (Nov. 10, 2022, 12:37 PM), *in* SBF Sentencing Memorandum, *supra* note 184, Exhibit E, at 8 [hereinafter Eitel Email].

231. *See infra* Part IV.D.

232. *See* Email from Andrew Dietderich to Sam Bankman-Fried & Ryne Miller, Re: Preparation Steps (Nov. 9, 2022, 9:32 PM), *in* SBF Sentencing Memorandum, *supra* note 184, Exhibit E, at 8-9 [hereinafter November 9 Email].

233. *Id.* at 9.

234. *Id.* at 8-9.

235. *Id.*

> anytime. We can set up [sic] so he does nothing before a decision to file if you prefer.[236]

Three things are notable about Dietderich's November 9 Email. First, Dietderich did not recommend that Ray be appointed as *chief executive officer* (CEO), but instead as *chief restructuring officer* (CRO), terminable at will.[237] A CRO is someone who works alongside the CEO, and exerts significant influence, but who does not displace the CEO.[238] This implied that Bankman-Fried would remain CEO, and Dietderich specified that Bankman-Fried would remain a director. This made sense, since Bankman-Fried was "focused on rescue alternatives," which would include raising new funds to address the liquidity crisis presented by the run on deposits.[239] Months later, Ray and S&C claimed that Bankman-Fried "resign[ed]," but there is no public evidence that he resigned from any of his positions at the company.[240] The absence of

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236. *Id.* The November 9 Email reads in full as follows:

> Sam and Ryne,
>
> I know company focused [sic] on rescue alternatives at this time and we are here to help support that however we can. On the safety net, there is a short list we need your decision on to keep making progress and have the option ready in case you need it. Even if we go full speed, it usually takes two weeks to be ready in an organized manner. We have that process underway but think it's important to do a few more things:
>
> 1. Identify someone at FTX.com that can be our point person for information requests. Is that Ryne or is Ryne only in US? There is a lot of information to get ready to pay employees etc. without disruption upon filing.
>
> 2. Appoint Alvarez & Mars[a]l to help us on the accounting for case prep. They work on an hourly basis and take a retainer. We have documentation to send you to sign if you are okay.
>
> 3. Ideally, appoint a CRO [chief restructuring officer] to be on stand-by as the manager of the company in a possible chapter 11. We recommend Sam stay as a director. The manager is there because of conflicts. We have considered candidates and suggest John Ray. Resume attached. The CRO works by the hour and can be terminated anytime. We can set up [sic] so he does nothing before a decision to file if you prefer.
>
> 4. Identify a chapter 11 communications team, which should be external. They also can be completely on stand-by for now, but we should know who they are and have them ready to go in case the decision is made.
>
> Those are the immediate priorities. We'd like to do more, of course, but that's the core of it for now. Again, no decision is made to file—this is only prep at this time.
>
> Andy

Id. at 8-9.

237. *Id.* at 9.

238. "With the advent of the chief restructuring officer (CRO) role during the 1990s," one observer explains, "the industry developed a point of view that management should focus intently on running the business during the restructuring process and let outside professionals, a CRO or advisers, handle the specialized aspects of the turnaround and legal processes." Martha E.M. Kopacz, *The Missing Link to Successful Company Turnarounds: Balance Sheet Management Is Only Part of the Story*, AM. BANKR. INST. J., Mar. 2014, at 32, 32.

239. November 9 Email, *supra* note 232, at 8.

240. Original Disclosure Statement, *supra* note 144, at 18.

contemporaneous evidence that Bankman-Fried resigned supports an inference that Bankman-Fried was assured he would not have to do so.

Second, Bankman-Fried later claimed that he sought to rescind the appointment of Ray less than ten minutes after executing it.[241] If, in fact, Ray was to be terminable at will, then he should have been terminated if that was communicated to Ray and S&C.[242]

Third, and most important, is timing. "Even if we go full speed," Dietderich explained to Bankman-Fried via the November 9 Email, "it usually takes two weeks to be ready in an organized manner."[243] Yet according to Dietderich's sworn declaration submitted in support of S&C's retention, at 8:44 AM on November 8, 2022—one day before the reassuring November 9 Email—Dietderich received an invitation to a meeting that suggested a very different timeline.[244] Can Sun, the general counsel for FTX International, asked that Dietderich join a videoconference with him and Miller, as general counsel for FTX US.[245] As Dietderich wrote:

> In that videoconference I was informed by Mr. Sun that he had learned FTX International could not cover customer liabilities. Mr. Sun and Mr. Miller were visibly distressed and appeared surprised and upset by these developments. After a discussion, Mr. Sun engaged S&C and Mr. Sun instructed S&C to take steps to begin to prepare FTX International for chapter 11 in the event that a rescue financing or other transaction was not forthcoming or, if forthcoming, could not be consummated without court supervision.[246]

This apparently means that Dietderich knew on November 8—one day *before* his reassuring email to Bankman-Fried—that FTX was in potentially serious trouble. It was, he declared, an "exigent situation."[247] Yet his email to Bankman-Fried the next day conveyed none of this exigency and, instead, assured Bankman-Fried that a bankruptcy filing was likely two weeks away.[248]

S&C may have been telling a different story to government officials, however. Dietderich declared in the bankruptcy that, on November 9, 2022—the same day he was assuring Bankman-Fried of his continuing role at FTX—FTX US general counsel (and former S&C partner) Ryne Miller had "informed

241. Steven Ehrlich, *Exclusive Transcript: The Full Testimony Bankman-Fried Planned to Give to Congress*, FORBES: DIGITAL ASSETS (updated Dec. 13, 2022, 12:42 PM EST), https://perma.cc/53CF-QKLA.

242. Dietderich later claimed that it was not communicated to him. Dietderich 1st Supp., *supra* note 26, ¶ 38.

243. November 9 Email, *supra* note 232, at 8.

244. Dietderich 1st Supp., *supra* note 26, ¶ 10.

245. *Id.*

246. *Id.*

247. *Id.* ¶ 13.

248. November 9 Email, *supra* note 232, at 8.

state regulators of prudential problems reconciling entitlements and digital assets on the FTX US exchange."[249] S&C apparently took part in the reporting:

> On November 9, 2022 . . . S&C attorneys in our Criminal Defense & Investigations Group, in consultation with Mr. Miller, reported the concern to federal authorities, including the United States Attorney's Office for the Southern District of New York, the Securities and Exchange Commission and the Commodity Futures Trading Commission.[250]

It is, as a preliminary matter, not clear whether Miller or S&C had the authority to report their concerns. While attorneys for an organization such as FTX have some discretion in deciding how to proceed when they believe there has been serious misconduct, they must, "if warranted by the seriousness of the matter, refer[] to the highest authority that can act in behalf of the organization as determined by applicable law."[251]

Bankman-Fried was the highest authority at FTX, which is presumably why Dietderich sought his approval, and not Miller's, to proceed with preparation for the chapter 11 filing.[252] As such, the New York Rules of Professional Conduct would have had Miller and S&C refer their concerns to Bankman-Fried.[253] Bankman-Fried maintains that he was not informed on November 9 (or any time until after he had given control to Ray) that Miller and S&C had gone to prosecutors.[254]

Legal ethics expert Stephen Gillers has observed that reporting out concerns about organizational misconduct to authorities is a "knotty problem[]," especially when there is a worry that the highest authority in the organization may be the culprit.[255]

The organization's attorney may bypass that highest authority, and report out, if "despite the lawyer's efforts . . . the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, that is clearly in violation of law and is likely to result in a substantial injury to the organization."[256]

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249. Dietderich 1st Supp., *supra* note 26, ¶ 16.

250. *Id.*

251. N.Y. RULES OF PRO. CONDUCT § 1.13(b)(3).

252. Miller recognized this in an email the next day, November 10, in which he said he was "exploring ways to change control." Email from Ryne Miller, FTX, to Michael Bacina & Piper Alderman (Nov. 10, 2022, 2:37:23 PM), *in* SBF Sentencing Memorandum *supra* note 184, Exhibit E, at 12 [hereinafter FTX Australia Email].

253. N.Y. RULES OF PRO. CONDUCT § 1.13(b)(3).

254. *See* Email from Barbara Fried to Jonathan C. Lipson (Aug. 2, 2024, 3:08 PM) (on file with author).

255. Stephen Gillers, *Model Rule 1.13(c) Gives the Wrong Answer to the Question of Corporate Counsel Disclosure*, 1 GEO. J. LEGAL ETHICS 289, 293-96 (1987).

256. N.Y. RULES OF PRO. CONDUCT § 1.13(c).

An influential report from the American Bar Association has stated that the decision to "report out" should be limited to "circumstances where the wrongdoing is clear, the injury to the client organization is substantial, and disclosure would clearly be in the interest of the entity client."[257] The lawyer who reports out "must have a heightened level of certainty as to the violation of law, and the actual or threatened violation must be 'clear.'"[258]

Given the exigent circumstances at the time, it is unclear how Miller or S&C could have known with "certainty" (heightened or otherwise) that Bankman-Fried or other senior officers at FTX were "insist[ing] upon action" that was both illegal and "likely to result in substantial injury" to FTX, as required by New York's rules of professional conduct.[259] Recall that only two days earlier, on November 7, Dietderich had stated that FTX was "rock solid."[260] In hindsight, the criminal verdict against Bankman-Fried evidences that Bankman-Fried violated law in ways that hurt FTX and its customers. But, in the moment, S&C could not have known this outcome and, as discussed below, S&C and FTX appear to have played an important role in supporting, and possibly distorting, that prosecution.[261]

Because they knew that Bankman-Fried was the highest authority at FTX, Miller and S&C may have worried that telling him they reported out would further harm FTX, if they believed he was the culprit. Miller and S&C reported their concerns to prosecutors on November 9, 2022.[262] Dietderich's November 9 Email was sent around 9:30 PM that evening, which would seem to be after the concerns had been reported.[263] To have reported out, Miller and S&C would have to have known with certainty that there was serious misconduct at FTX.

If so, however, it is unclear how Dietderich could then assure Bankman-Fried later that evening that he would have a continuing role in the rescue of FTX. That is, it is unclear how S&C could know with requisite certainty that FTX, under Bankman-Fried, was engaged in serious misconduct, yet also reassure Bankman-Fried that he would remain central to the company's rescue, as both a director and (by inference) its CEO. In the moment, both could not be true.

257. *See* James H. Cheek, III et al., *Report of the American Bar Association Task Force on Corporate Responsibility*, 59 BUS. LAW. 145, 175-76 (2003).

258. *Id.* at 176.

259. *Id.*; N.Y. RULES OF PRO. CONDUCT §§ 1.13(b)-(c).

260. Rock Solid Email, *supra* note 26.

261. *See infra* Parts IV.C-.D.

262. Dietderich 1st Supp., *supra* note 26, ¶ 16.

263. *See* November 9 Email, *supra* note 232, at 8.

S&C did more than just report its concerns that day. It appears that on the same day, they also caused FTX to enter into an agreement with prosecutors to voluntarily produce documents, seemingly again without telling Bankman-Fried.[264] Indeed, S&C's transmittal letter did not copy Bankman-Fried.[265] The initial production occurred by November 15, 2022 and included financial statements, general ledgers, and employee contact information; S&C also caused FTX to agree to voluntarily disclose confidential information on a "rolling basis."[266]

Yet S&C continued to reassure Bankman-Fried that they were there to help, and that Bankman-Fried would play a role in the reorganization. Around 12:30 PM on November 10, shortly before the first bankruptcy petitions were filed, S&C attorney Mitchell Eitel invited Sam to "reach out if we can be helpful in thinking through the structuring of any transaction you are looking at."[267] As late as November 13, 2022, S&C partner James McDonald wrote to attorney Martin Flumenbaum at Paul Weiss, who was briefly Bankman-Fried's individual counsel, to say that "[w]e'd be happy to discuss with you any ideas Sam might have."[268] Since McDonald was also the S&C white-collar defense lawyer—and former Southern District of New York prosecutor—who had just committed FTX to cooperating with prosecutors, it is not clear what "ideas" of Bankman-Fried's he would have been "happy to discuss."[269]

It is important to be clear that there may be more to the story than we know. Although Bankman-Fried asserts that he did not know that Miller and S&C had reported to prosecutors,[270] he may in fact have been told and forgotten in the chaos of the moment. Or, S&C may have informed lawyers at the Paul Weiss firm who, by this time, were acting as Bankman-Fried's

264. Letter from James M. McDonald, Partner, Sullivan & Cromwell, to Nicolas Roos & Danielle Sassoon, Assistant U.S. Att'ys, U.S. Att'y's Off., S.D.N.Y. (Nov. 15, 2022), *in* SBF Sentencing Memorandum *supra* note 184, Exhibit E, at 30-33 [hereinafter McDonald Letter]. This letter is dated November 15, 2022, but references a November 9, 2022 document request. *Id.*

265. *Id.*

266. *Id.* at 1-2; 30-33.

267. Eitel Email, *supra* note 230.

268. Email from James M. McDonald, Partner, Sullivan & Cromwell, to Martin Flumenbaum, Of Counsel, Paul Weiss et al. (Nov. 13, 2022, 11:19 PM) [hereinafter McDonald Email] (on file with authors). This email was provided by Bankman-Fried.

269. *Id.*; *see* McDonald Letter, *supra* note 264. McDonald was an Assistant United States Attorney in the Southern District of New York, where he investigated and prosecuted white-collar crimes. *See James M. McDonald*, SULLIVAN & CROMWELL, https://perma.cc/GLC4-M4EQ (archived Jan. 22, 2024).

270. Email from Barbara Fried to Jonathan C. Lipson, *supra* note 254.

personal counsel.[271] If Paul Weiss knew that prosecutors had been contacted, they could have counseled Bankman-Fried to better protect himself.

We think it is unlikely, however, that Miller or S&C informed Bankman-Fried or his counsel when they reported their concerns to prosecutors.[272] If evidence of such disclosure existed, S&C had good reason to share it with the Examiner, because that would support their authority to report out and would allay concerns about this question. The Examiner reports no such evidence, implying that it does not exist. Indeed, as discussed below, S&C's initial resistance to the Examiner's appointment suggests that they may have sought to suppress evidence about their conduct before and at the commencement of the case.[273]

It is equally important to note that, even if Miller and S&C hid the reporting from Bankman-Fried and his lawyers, they may have caused no harm in doing so. Prosecutors may already have commenced an investigation into FTX and Bankman-Fried by November 9, 2022, in which case S&C's actions may have done little damage to him and may have helped to prevent greater harm to the company.[274]

Unfortunately, the Examiner's Report engaged none of the evidence above. Instead, the Examiner noted that he "has not seen any email or other document in which S&C expressly disclosed a crime to prosecutors or regulators prepetition."[275] This may be true, but it is inconsequential. The important question was not what was *documented*, but what Miller and S&C *told*

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271. *See* Examiner Report, *supra* note 41, at 52. The authors sought an interview with Paul Weiss attorneys Ken Ziman and Martin Flumenbaum. They never responded to the request.

272. The closest we have seen is a message dated November 9, 2022 from Ryne Miller—not S&C—to a group including Bankman-Fried saying:

> Based on what we are learning . . . and based on advice of Sullivan & Cromwell, our recommendation and instruction (I am GC of FTX US so saying what I can) is to *turn off trading and halt activity* on both FTX US and FTX.com. And then identify a control/decision person to work with outside counsel on next steps. For US purposes, we will be informing the CFTC, SEC, and Department of Justice that *this recommendation has been made*.

Joshua Oliver, *'Sam? Are you there?!' The Bizarre and Brutal Final Hours of FTX*, FIN. TIMES (Feb. 9, 2023), https://perma.cc/LZX4-6PS2 (emphasis added). This indicates nothing about potential criminal exposure—only that the Department of Justice would be informed of the halt in trading.

273. *See infra* Part IV.B.1.

274. It is, for example, well-known that the Department of Justice encourages early cooperation by corporations. *See, e.g.*, Memorandum from Sally Quillian Yates, Deputy Att'y Gen., U.S. Dep't of Just., Individual Accountability for Corporate Wrongdoing 3 (Sept. 9, 2015), https://perma.cc/YS8Q-VT35 (stating that the government will deny cooperation credit to companies that fail "to provide the Department with complete factual information about individual wrongdoers," or "declines to learn of such" information, regardless of any other cooperation that the company may provide).

275. Examiner Report, *supra* note 41, at 39.

prosecutors. The Examiner apparently interviewed prosecutors but reported neither what he asked nor what they said.[276]

The Examiner seemed to think that Miller authorized whatever reporting occurred, and this made the reporting permissible.[277] But that begs the question whether Miller had authority to make such an authorization. As explained above, he was not the highest authority in the organization, or even the top-level general counsel (that was chief legal officer Dan Friedberg).[278] Instead, Miller was general counsel for FTX US. As a fallback, the Examiner excused S&C on grounds that Bankman-Fried had his own counsel by this point.[279] But that is irrelevant to the question of authority and, if they did not know that S&C and Miller had gone to prosecutors, then they would have been as duped as Bankman-Fried claims to have been.[280] As further explained in Part IV.E, this is one of several unfortunate limitations in the examination that ultimately occurred.

276. *Id.* at 8.

277. *Id.* at 39-40 ("The Examiner has seen communications disclosing to the government that FTX.US had discovered an anomaly on its balance sheet—that there were not enough assets to cover liabilities. Those disclosures do not conclude that the anomaly amounted to, or was the result of, a crime. Notably, these prepetition disclosures were made either by Miller himself or by S&C at the direction of Miller while he was still acting as General Counsel to FTX.US." (footnotes omitted)).

278. *See* Declaration of Daniel Friedberg in Support of Amended Objection of Warren Winter to Debtors' Application for an Order Authorizing the Retention & Employment of Sullivan & Cromwell LLP as Counsel to the Debtors & Debtors-in-Possession *Nunc Pro Tunc* to the Petition Date ¶¶ 2, 11, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Jan. 19, 2023), ECF No. 530 [hereinafter Friedberg Decl.].

279. Examiner Report, *supra* note 41, at 40 ("Significantly, Bankman-Fried was then separately represented by sophisticated, experienced counsel."). The Examiner criticized an earlier draft of this paper for "conflat[ing]" "a corporate client and its principals." *Id.* To be clear, we never stated that S&C was acting as Bankman-Fried's counsel for these purposes. We recognized then, and now, that Bankman-Fried had his own counsel, but we think that is not relevant if they were as uninformed about this as Bankman-Fried. In any case, FTX appears not to have observed corporate formalities, so it is unclear why this formal distinction would have mattered as the company collapsed into bankruptcy. The Examiner's Phase II Report later indicated that S&C itself ignored corporate formalities when it represented both Bankman-Fried and FTX, though it seemed to think it irrelevant to questions of S&C's professional responsibilities. *See* Examiner Phase II Report, *supra* note 41, at 16 ("[S&C] knew that the FTX Group was largely owned by Bankman-Fried, and that it is common for wealthy individuals to rely on their corporate employees in this manner.").

280. A more useful question the Examiner might have asked was: Why did Bankman-Fried not object to S&C's retention or, at minimum, file an ethics grievance with appropriate bar authorities? When we asked that question, a representative said that it was because of "everything else going on," which we interpret to mean Bankman-Fried's focus on defending the criminal prosecution. *See* Email from Barbara Fried to Jonathan C. Lipson (June 1, 2024, 8:06 AM) (on file with authors).

2. "Urging" Sam

The problem was not simply that S&C failed to tell Bankman-Fried and his lawyers that they had gone to prosecutors. S&C also substantially changed Bankman-Fried's role in FTX at the last minute, so that he would give up all control to Ray—not simply appoint him as CRO.

On November 10, 2022, the crisis at FTX took a new turn when involuntary insolvency proceedings were commenced against the Australian subsidiary.[281] When he learned of this, Miller advised that the exchanges should be "halted immediately," and that he was "exploring ways to change control in order to authorize a proper insolvency process."[282] This was because "the founding team is not currently in a cooperative posture."[283]

At around 8:00 PM that day, it appears that Dietderich sent to Bankman-Fried's personal counsel, Paul Weiss (but not Bankman-Fried), a draft document titled "Omnibus Corporate Authority" (OCA).[284] It is not clear what that version of the OCA said. Initially, Dietderich agreed that Paul Weiss should hold the OCA in escrow after Bankman-Fried executed it.[285] Although Dietderich recognized that a "more fulsome approach" might be needed later, "this at least sets up what we need in an emergency."[286]

That emergency was only hours away. At around 12:30 AM that night, Paul Weiss attorney Martin Flumenbaum (acting as Bankman-Fried's personal counsel) responded to Dietderich's email with the OCA by saying that Bankman-Fried "would prefer . . . to sign the document without Ray's name in it for us to hold in escrow" because they wanted to "check with a couple more contacts concerning Ray" as well as "other potential restructuring

281. Amitoj Singh, *FTX Australia Calls in the Administrators: Report,* COINDESK (updated May 9, 2023, 4:02 AM UTC), https://perma.cc/KP9U-7NY5.

282. *See* FTX Australia Email, *supra* note 252.

283. *Id.* It is not clear what this means. As discussed in Part V, Bankman-Fried was at this time apparently acting on Dietderich's advice in the November 9 Email regarding rescue financing, and indeed claims to have obtained it. *See infra* Part V.A. Rescuing the company would seem to have been an important form of cooperation in the company's interest if the commingling had stopped and withdrawals could resume.

284. *See* Email from Andrew G. Dietderich, Partner, Sullivan & Cromwell, to Ken Ziman, Partner, Paul Weiss (Nov. 10, 2022, 8:05 PM) ("Ken, as discussed, this is an omnibus authority to have ready to go.") *in* SBF Sentencing Memorandum, *supra* note 184, Exhibit E, at 16 [hereinafter OCA Transmittal Email].

285. *Id.* ("We recommend Sam sign and deliver to you asap to hold in escrow until he is ready to release.").

286. *Id.*

executives."[287] Flumenbaum asked that Dietderich revise the OCA to remove Ray's name.[288]

Dietderich responded forcefully about a half hour later, at 1:00 AM on November 11 (the "November 11 Email").[289] "We don't have time," Dietderich told Flumenbaum and Bankman-Fried, who had now been added to the thread.[290] Holding the OCA in escrow or considering other individuals "does not work":[291]

> Sam is copied as the current CEO of our client. [But t]he *new* CEO needs to sign the petitions to file, have an engagement letter and arrangements in place, etc. Changing the identity of the new CEO at this late date would preclude filing tonight, likely result in loss of value around the world through government action that can be avoided by acting now, [sic] delay this substantially, and be subject to scrutiny.[292]

Dietderich was "amazed by the suggestion that we are not filing tonight. This is way behind current events and is likely to result in substantial investor losses."[293] "It is," he said, "our strongest possible recommendation that Sam sign this now to avoid imminent losses."[294]

It is unclear why Dietderich changed his tone, or why Ray's position changed from CRO to CEO.[295] It is even less clear why Bankman-Fried could

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287. Email from Martin Flumenbaum, Of Counsel (Litigation), Paul, Weiss, to Andrew G. Dietderich, Partner, Sullivan & Cromwell (Nov. 11, 2022, 12:32 AM), *in* SBF Sentencing Memorandum, *supra* note 184, Exhibit E, at 15.

288. *See id.*

289. *See* November 11 Email, *supra* note 184. Dietderich's November 11 email states in full:

> We don't have time. That does not work. Sam is copied as the current CEO of our client. The *new* CEO needs to sign the petitions to file, have an engagement letter and arrangements in place, etc. Changing the identity of the new CEO at this late date would preclude filing tonight, likely result in loss of value around the world through government action that can be avoided by acting now, [sic] delay this substantially, and be subject to scrutiny.
>
> John Ray is objective, experienced and fair. He is not proposed by anyone with an ax to grind, and will do a fair and objective job. The inquiry should be limited to that. He is available to discuss now.
>
> I also am amazed by the suggestion that we are not filing tonight. This is way behind current events and is likely to result in substantial investor losses.
>
> It is our strongest possible recommendation that Sam sign this now to avoid imminent losses.

Id.

290. *Id.*

291. *Id.*

292. *Id.*

293. *Id.*

294. *Id.*

295. This is a puzzle the Examiner expressly does not solve. *See* Examiner Report, *supra* note 41, at 51 ("Ray was initially proposed to serve as the Debtors' CRO. It is not clear why Ray was appointed CEO instead of CRO as originally planned, and it is not apparent who made that decision or why.").

not have signed the chapter 11 petition as CEO, as Dietderich's earlier November 9 email implied would be the case. Nothing would have precluded him from doing so as a legal matter, and Dietderich's email failed to explain the change. Nor is it apparent from this email what had changed to create this new sense of urgency. It may have been concern that foreign insolvency proceedings would be commenced. This might have led to multiple simultaneous proceedings around the world, but it is not clear how or why that would "result in substantial investor losses," as Dietderich wrote.[296]

Later, Bankman-Fried would claim that he was "put under extreme pressure to file for Chapter 11" by S&C and its alumnus, Miller, to sign the OCA.[297] Despite the "URGENT" subject line, Dietderich later categorically denied doing so.[298]

At around 4:30 AM, Bankman-Fried executed the OCA that S&C had prepared.[299] Under it he would:

> authorize, instruct and consent to . . . the appointment of John J. Ray III (the "CEO") as Chief Executive Officer with plenary authority to exercise all powers and authority capable of delegation to an officer under applicable law, including without limitation in connection with a voluntary filing for protection from creditors under Title 11 of the United States Code.[300]

For all practical purposes, it gave Ray control of FTX, its data and its billions of dollars in assets, all of which Ray could use in his discretion, including to support the Bankman-Fried prosecution. It sealed Bankman-Fried's fate.

III. Foxes and Henhouses: S&C's Retention and the Bankman-Fried Trial

In most bankruptcy cases, the choice of bankruptcy attorneys is uncontroversial. But the retention hearing in FTX was contested, due to S&C's extensive involvement with FTX before FTX fell into financial distress.[301] Troubling though they are, however, few of the material facts in the preceding

296. November 11 Email, *supra* note 184.

297. *See* Ehrlich, *supra* note 241.

298. Dietderich 1st Supp., *supra* note 26, ¶ 5; *see* November 11 Email, *supra* note 184.

299. Dietderich 1st Supp., *supra* note 26, ¶¶ 31-33.

300. The OCA was annexed to the petition commencing the FTX bankruptcies. *See* FTX Chapter 11 Voluntary Petition, *supra* note 183, at 12.

301. *See, e.g.*, Objection of the United States Trustee to Debtors' Application for an Order Authorizing the Retention & Employment of Sullivan & Cromwell LLP as Counselor To the Debtors & Debtors-in-Possession *Nunc Pro Tunc* to the Petition Date at 2, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Jan. 13, 2023), ECF No. 496 [hereinafter UST S&C Objection].

discussion—red flags regarding misconduct, reporting to prosecutors with uncertain authority, and deceiving Bankman-Fried—appear to have been before the bankruptcy court when it approved S&C's retention.

A. The Retention of S&C as FTX's Bankruptcy Lawyers

As noted earlier, chapter 11 counsel ordinarily has little or no significant history with the corporate debtor.[302] This is due in part to special ethics rules imposed by the Bankruptcy Code. Section 327(a) of the Bankruptcy Code authorizes the debtor-in-possession, with court approval, to employ professionals, including lawyers, if the professionals (1) "do not hold or represent an interest adverse to the estate" and are (2) "disinterested persons."[303] The latter are defined, in relevant part, as those who do "not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason."[304]

A claim that the bankruptcy estate has against the lawyers would be an "adverse interest."[305] Assessing the work of prebankruptcy gatekeepers, to determine whether malpractice contributed to the debtor's collapse, is a key function of the debtor's bankruptcy lawyers. Assurance that the bankruptcy lawyers had no role in prebankruptcy misbehavior is especially important if the likelihood of misbehavior is high, as in cases where fraud contributed to the company's failure. In *Enron*, for example, prebankruptcy counsel were not

302. *See supra* Part I.E.

303. 11 U.S.C. § 327(a); *see In re* BH&P Inc., 949 F.2d 1300, 1314 (3d Cir. 1991). In addition to Section 327(a), Section 327(e) can be read as a blanket prohibition against pre-distress counsel serving as the debtor's principal bankruptcy counsel, but this interpretation is unsettled. *See* 11 U.S.C. § 327(e) ("The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debt or, if in the best interest of the estate, and if such attorney does not represent or hold any in terest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.").

304. 11 U.S.C. § 101(14)(C).

305. *See, e.g.*, *BH&P*, 949 F.2d at 1308 (noting that the definition of "disinterested person" under § 327(a) "has been held 'broad enough to include anyone who in the slightest degree might have some interest or relationship that would even faintly color the independence and impartial attitude required by the Code and the Bankruptcy Rules.'" (quoting *In re* BH&P, Inc., 119 B.R. 35, 42 (D.N.J. 1990))). The logic seems to be that the malpractice cause of action is property of the estate, which the trustee can pursue against the negligent lawyer. This is at minimum consistent with the more general view that causes of action can become property of the bankruptcy estate. *See* Polis v. Getaways, Inc. (*In re* Polis), 217 F.3d 899, 901 (7th Cir. 2000).

retained in the bankruptcy.[306] Nor should they have been, as it turned out the estate had malpractice claims against some of the prebankruptcy lawyers, given their role in Enron's misconduct.[307]

In *FTX,* S&C's original retention application had only three sentences on its prebankruptcy work.[308] It did not describe the type of regulatory and transactional work that S&C had performed for FTX. Nor did it disclose that a former S&C partner, Ryne Miller, was the general counsel at FTX US, and that other S&C alumni also worked at FTX.[309] Nor that S&C had also worked for certain FTX founders (e.g., Bankman-Fried) personally. A judge or other observer who read quickly might easily imagine that S&C's role was similar to the prebankruptcy role that lawyers play in other major cases, helping to prepare for the bankruptcy but having no earlier involvement.

Were it not for S&C's earlier involvement, the firm would be highly qualified to represent the FTX debtors. As John Ray put it in his affidavit, S&C had expertise in "all of the key practice areas" likely to matter in the case, including financial services regulation, civil and criminal investigations, cybercrime, international money laundering, and sanctions compliance.[310] Notably, in the list of services S&C would perform, Dietderich listed as second (behind advising the debtors on their powers and duties in that capacity) "advising the Debtors with respect to responses and discussions with local and

306. Disclosure Statement for Fifth Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code at 234, *In re* Enron Corp., No. 01-16034 (Bankr. S.D.N.Y. Jan. 9, 2004), ECF No. 15414.

307. This resulted in a settlement of $30 million for the benefit of creditors. *See* Associated Press, *Ex-Enron Law Firm to Pay $30 Million,* N.Y. TIMES (June 2, 2006), https://perma.cc/7KAD-RFHK. One of us was an expert witness retained by the creditors committee in *Enron* to assess and potentially litigate against Enron's former lawyers, Vinson & Elkins and Andrews Kurth. Interestingly, Ray would later claim that he led the prosecution of Enron's lawyers. Transcript of Hearing, Feb. 6, 2023 at 68, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Feb. 7, 2023), ECF No. 632 ("I [led] the prosecution of . . . accounting malpractice, legal malpractice, breach of fiduciary duty, crime.") [hereinafter Examiner Hearing Transcript].

308. *See* Dietderich Initial Declaration, *supra* note 188, ¶ 16.

309. *Id.*; *see* Dietderich 1st Supp., *supra* note 26, ¶ 62 ("Ryne Miller, the General Counsel of FTX US, was a partner of S&C from January 2019 through July 2021 and an associate for several years before being elected partner.") He was not alone. Tim Wilson was a member of the FTX Trading legal team and a former associate of S&C from September 2019 to April 2021. *Id.* ¶ 63. T'Shae Cooper, a former member of the Alameda legal team, was a former associate of S&C from September 2015 to June 2018. *Id.* ¶ 64. Kelly Yamashita, a former Alameda employee in Hong Kong, was an associate of S&C from September 2015 to September 2018. *Id.* ¶ 65.

310. *See* Declaration of John J. Ray III in Support of Debtors' Application for an Order Authorizing the Retention & Employment of Sullivan & Cromwell LLP as Counsel to the Debtors & Debtors-in-Possession *Nunc Pro Tunc* to the Petition Date ¶ 3, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Dec. 21, 2022), ECF No. 270.

federal governmental authorities and regulators."[311] This list was an early indication of the role that S&C expected to play in defining and controlling the public interest in the *FTX* chapter 11 case.

The U.S. Trustee and certain customers objected to S&C's retention. The U.S. Trustee asserted two overarching concerns. First, S&C had failed to adequately disclose its connections to FTX and its prebankruptcy insiders, as required by the Bankruptcy Code.[312] This mattered because "publicly available information thus far raises the specter that S&C may have a conflict or not be disinterested given that an S&C partner of eight years became general counsel for certain of the Debtors approximately 14 months before the petition date."[313]

Second, S&C sought to oversee the internal investigation into the debtor's collapse which, the U.S. Trustee argued, was forbidden by the Bankruptcy Code.[314] Under the Code, "only bankruptcy trustees and examiners . . . , not debtors-in-possession, have authority to investigate 'the acts, conduct, assets, liabilities, and financial condition of the debtor.'"[315] Section 1107(a) permits debtors-in-possession to exercise most trustee powers—but not that one. This was, according to the U.S. Trustee, "intentional" to preserve the integrity of the reorganization process.[316]

S&C apparently settled the Trustee's objections and cured some of the disclosure failures shortly before the hearing on their retention by filing supplemental affidavits, discussed further below.[317] On January 17, 2023, less than seventy-two hours before the hearing on S&C's retention, Dietderich submitted the first of two supplemental declarations in support of S&C's retention.[318] That declaration set out thirty-four pages of additional disclosures and exhibits relating to S&C's connections with the debtors, revealing for the first time virtually everything publicly known about S&C's connections to FTX before bankruptcy.[319]

311. Dietderich Initial Declaration, *supra* note 188, ¶ 2.

312. *See* UST S&C Objection, *supra* note 301, ¶ 3 ("First, S&C's disclosures as filed are wholly insufficient to evaluate whether S&C satisfies the Bankruptcy Code's conflict-free and disinterestedness standards. The incomplete disclosures are a sufficient and independent reason to deny the application.").

313. *Id.*

314. *Id.*

315. 11 U.S.C. §§ 1106(a)(3), 1107(a).

316. UST S&C Objection, *supra* note 301, ¶ 6 (quoting 11 U.S.C. § 1106(a)(3)).

317. S&C Retention Transcript, *supra* note 228, at 5-6.

318. Dieterich 1st Supp., *supra* note 26 (showing it was filed on January 17, 2023).

319. *Id.* Other objectors argued that "this chronology shows gamesmanship" on the part of S&C. *See* S&C Retention Transcript, *supra* note 228, at 17. Marshal Hoda, on behalf of customers Warren Winter and Richard Brummond, stated that "[t]here is no excuse

footnote continued on next page

S&C's interactions with the U.S. Trustee reflect a delay tactic they would deploy elsewhere in the case.[320] An affidavit submitted by S&C partner Alexa Kranzley on the same date Dietderich submitted his supplemental affidavit showed that the U.S. Trustee struggled to get S&C to provide additional disclosures about the nature and scope of its work for several weeks before ultimately filing its objection.[321] By the time Dietderich's supplemental affidavit was filed, few observers would have had the time or sophistication to ask further questions about the nature of S&C's work or how Ray came to be CEO.

Nevertheless, customers continued to challenge FTX's request to retain the firm. One customer, Warren Winter, argued that S&C's retention was "the most flagrant attempt by a fox to guard a henhouse in recent memory."[322] S&C was, Winter argued, "not only an inappropriate candidate for appointment as the FTX Group's bankruptcy counsel—it is a target for investigation with its own potential liability. Its appointment as counsel would endanger the estate and create a rigged game, undermining creditors' and the public's faith in the bankruptcy process."[323] But this objection offered few specifics.

The bankruptcy court held a hearing on the retention application on January 20, 2023.[324] Winter sought to delay the hearing on the firm's retention because, shortly before the hearing, Dan Friedberg, FTX's former general counsel, filed a statement which contained allegations that were "as relevant as

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for a firm, with the resources available to Sullivan & Cromwell, to wait until less then [sic] 72 hours before the hearing on its application to make any substantive disclosures about its prepetition work for the debtors, and crucial disclosures concerning its own former partner's employment as one of the top legal officers of the FTX Group." *Id.*

320. S&C's appeal of the request for an examiner meant that none was appointed until sixteen months into the case. *See* Examiner Appointment Order, *supra* note 40.

321. Declaration of Alexa J. Kranzley in Support of Debtors' Reply in Support of Debtors' Application for an Order Authorizing the Retention & Employment of Sullivan & Cromwell LLP as Counsel to the Debtors & Debtors-in-Possession *Nunc Pro Tunc* to the Petition Date Exhibits 1-4, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Jan. 17, 2023), ECF No. 512 (email chains over three weeks between S&C and Trustee regarding disclosures).

322. Amended Objection to Debtor's Application for an Order Authorizing the Retention & Employment of Sullivan & Cromwell LLP as Counsel to the Debtors & Debtors-in-Possession *Nunc Pro Tunc* to the Petition Date at 2, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Jan. 10, 2023), ECF No. 459 [hereinafter Winter Amended Objection].

323. *Id.*

324. *See* S&C Retention Transcript, *supra* note 228, at 1.

they are explosive," the objectors argued.[325] Friedberg oversaw compliance and other legal issues from early 2020 to November 8, 2022, when he resigned.[326]

Friedberg's declaration outlined several claims that he believed the bankruptcy estate had against S&C, including for overcharging and poor advice due to potential conflicts of interest.[327] Friedberg declared that he would testify competently to the facts in his declaration if given the opportunity.[328] But his objection said nothing about the missed red flags or efforts to mislead Bankman-Fried, perhaps because he knew of neither (he had not been directly involved in FTX US, whose general counsel was Miller).

James Bromley, an S&C partner, questioned Friedberg's motives, insinuating that Friedberg's real concern was his own potential culpability. Mr. Friedberg, Bromley said, "has got a checkered past. It takes a lot of guts for him to put something in writing that says I was the chief compliance officer at FTX."[329] The individuals "who were at, and running, and making the decisions that have brought this company to its knees are rightly concerned that the information that is being provided to authorities could lead back to their doorstep."[330] Insiders such as Friedberg, Bromley argued, "can't throw stones at the U.S. Attorney's Office, but they can throw stones at debtor's counsel that is providing information to the prosecutors and the regulators; that is exactly what is happening."[331] Bromley's suggestion that S&C was a vital resource for the prosecutors who had indicted Sam Bankman-Fried, and that the firm was furthering the public interest in policing fraud, would become a theme in the *FTX* bankruptcy. Friedberg would later be one of the few lawyers FTX sued for malpractice.[332]

The court concluded that it would pay no attention to the Friedberg statement, acquiescing to S&C's argument that "it's a rambling declaration," and that "Mr. Frie[d]berg is not here" in the courtroom.[333]

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325. *Id.* at 17-18. Debtors' counsel, S&C, seemed to share this view, characterizing it as an "incendiary device." *Id.* at 22.

326. *See* Friedberg Decl., *supra* note 278, ¶¶ 9, 11, 26, 32.

327. *Id.* ¶¶ 48-63. As to the latter, the Examiner concluded that "because S&C had limited involvement in this transaction, and S&C was not acting as legal counsel to either party to the transaction, this fact likely would *not* have impacted the Court's ruling on S&C's disinterestedness." Examiner Report, *supra* note 41, at 50.

328. Friedberg Decl., *supra* note 278, ¶ 81.

329. S&C Retention Transcript, *supra* note 228, at 22.

330. *Id.* at 21.

331. *Id.*

332. *See* First Amended Complaint at 1-2, Alameda Research, LLC v. Friedberg, No. 23-50419 (Bankr. D. Del. Jan. 1, 2024), ECF No. 32.

333. S&C Retention Transcript, *supra* note 228, at 22-24.

In addition to questioning Friedberg's motives, Bromley alleged that Friedberg was acting on behalf of Sam Bankman-Fried, who is "behind all of this."[334]

> So what we have here, Your Honor, is a gentleman who ran this company into the ground, Mr. Bankman-Fried, sitting in his parent[s'] home in Palo Alto, California with an ankle bracelet on, extradited from the Bahamas, and charged with multiple crimes by the Southern District of New York U.S. Attorney[']s Office.[335]

Bromley's consternation was understandable. At the time, Bankman-Fried was waging "assault by Twitter," said Bromley.[336] Bromley acknowledged that Dietderich's original, three-sentence description was inadequate,[337] but insisted that "the mere fact that Sullivan & Cromwell had done work" for FTX and its insiders before bankruptcy was "irrelevant."[338] "The question," he said, "is whether or not any of that work goes to any of the issues that we're facing and if so, how would it go to those issues. Is there anything about the work that we have done in the past or the relationships that we have that would be disqualifying, and the answer to that is no."[339]

We now submit that the answer is "yes": S&C's LedgerX work before the CFTC did "go[] to . . . the issues that we're facing" because the relationship between Alameda and FTX was central to the debtors' fraud.[340]

Bromley assured the Court that, if there were any questions about S&C's role, co-counsel would handle those issues:

> Now, to the extent that anything comes out that there's a transaction that we may have been involved in might have an issue that needs to be investigated, we of course will not be involved in that. The Quinn firm [special counsel to the

334. *Id.* at 22.

335. *Id.* at 21.

336. *Id.* at 11 ("One of the things that the debtors have been facing, generally in these cases, is assault by Twitter. It is very difficult, Your Honor, to cross-examine a tweet, particularly tweets that are being issued by individuals who are under criminal indictment and whose travel is restricted so to speak."); *see also* Joshua Oliver, Sujeet Indap & Joe Miller, *FTX Lawyers Accuse Sam Bankman-Fried of 'Assault by Twitter'*, FIN. TIMES (Jan. 20, 2023), https://perma.cc/3F84-PPRU.

337. S&C Retention Transcript, *supra* note 228, at 8 ("[I]n retrospect, Your Honor, we should have gone further in the original declaration . . . .").

338. *Id.* at 29-30. There was, he argued, "nothing in the record that indicates that Sullivan & Cromwell holds an interest adverse to the estate." *Id.* at 34. That would be true only because Judge Dorsey declined to take the Friedberg Declaration into evidence or to permit him to testify. *See id.* 24-25.

339. *Id.* at 30. This was because "[w]e did not have anything to do with the creation of these entities, we didn't structure them, we didn't incorporate them, we didn't act as secretary on board meetings; we were not general outside counsel with respect to those entities." *Id.* at 32.

340. *Id.* at 30; *see infra* Part V.B.

debtors] is here, the Landis firm [local counsel to the debtors] is here, and Paul Hastings [counsel to the creditors' committee] is here.[341]

Unfortunately, the Examiner's Report revealed that S&C failed to fully honor this commitment. While co-counsel (Quinn Emanuel) did interview certain S&C attorneys, they did not interview Miller or Tim Wilson, another former S&C attorney who had become a subsidiary general counsel at FTX. Instead, S&C conducted those interviews as part of its investigation.[342] To us, S&C interviewing its own alumni violates that commitment. The bankruptcy court approved the retention of S&C based on the record before it.[343] "As a preliminary matter," Judge Dorsey explained, "there's nothing in the record before me to indicate that any of the—any investigation would be required of those transactions with which Sullivan & Cromwell might have been involved."[344] But that finding was possible because Judge Dorsey had no information about red flags at FTX US or S&C's problematic tactics in wresting control of the company from Bankman-Fried.

It is hard to imagine a bankruptcy judge would have found S&C disinterested, as required by Section 327 of the Bankruptcy Code, were the judge fully informed at the time about the nature of S&C's involvement before and at the commencement of the bankruptcy.[345] The Examiner concluded that

341. S&C Retention Transcript, *supra* note 228, at 33. The "Quinn Firm" is Quinn, Emanuel, Urquhart & Sullivan as special counsel to the debtors; Landis, Rath & Cobb were local counsel for the debtors; and Paul Hastings was counsel to the Official Committee of Unsecured Creditors (UCC). Paul Hastings' Kris Hansen stated that the UCC:

> Intends to do the job that it's authorized to do under Section 1103(c)(2) of the [Bankruptcy C]ode, which is to investigate all of the financial affairs of the debtors, including all of the fraudulent allegations, and that also includes the evaluation of all professionals who were involved with the debtors on a prepetition basis, but that investigation doesn't need to preclude the retention of Sullivan & Cromwell here today.

Id. at 37. Section 1103 of the Bankruptcy Code, which governs the duties of creditors' committees, does not contemplate writing a report about any investigation they may conduct. Not surprisingly, Hansen made no offer to write a report on behalf of the UCC.

342. The Examiner Report cites to confidential notes from interviews that S&C conducted with Miller and Wilson. Examiner Report, *supra* note 41, at 54 n. 213. These interviews covered Miller's realization that there might be a hole in the FTX US balance sheet and a conversation with Bankman-Fried regarding that hole. *Id.* This stands in contrast to other interviews, which were performed by Quinn. *Id.* at 73 ("Quinn Emanuel interviewed nine employees from the legal and compliance departments, the majority of whom were attorneys.").

343. Order Authorizing the Retention & Employment of Sullivan & Cromwell LLP as Counsel to the Debtors & Debtors-In-Possession *Nunc Pro Tunc* to the Petition Date at 2, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Jan. 20, 2023), ECF No. 553.

344. *See* S&C Retention Transcript, *supra* note 228, at 48.

345. As discussed in Part I.E above, the failures of Milbank Tweed and Weil Gotshal in earlier times to make adequate disclosure of potentially adverse interests had serious consequences for those firms.

the bankruptcy court had made "no error" in approving S&C's retention "[i]n light of the record before the Court" and the "wide discretion afforded to the [bankruptcy court] in determining whether disqualifying conflicts exist."[346] Technically, this may be correct. But the Examiner's report did not engage the evidence we presented and carefully avoided affirmatively finding that S&C was, in fact, disinterested.

B. S&C and the Criminal Prosecution of Bankman-Fried

Ray and S&C have taken much credit for the prosecution of Sam Bankman-Fried and other insiders, and deservedly so.[347] By aiding the prosecution, these bankruptcy insiders claimed to satisfy the public interest. But these efforts were funded by the FTX estate and altered the dynamics of the Bankman-Fried trial. It is important to understand the complications this created.

The indictment, prosecution, and trial of Bankman-Fried all took place in less than a year, which one expert described as "the prosecutorial equivalent of breaking the sound barrier."[348] It began on December 9, 2022, with an eight-count indictment, which alleged "a wide-ranging fraud on FTX's customers and investors and on Alameda's lenders"[349] and ended with a jury verdict against him less than a year later, on November 2, 2023.[350]

The swift verdict reflected the overwhelming evidence that prosecutors marshaled against Bankman-Fried, including "4.3 terabytes of data [and] more than 1.4 million documents."[351] It appears that much of this material came from FTX, courtesy of CEO John Ray and the work of S&C.[352] Bankman-Fried had alleged in his criminal prosecution that "[t]he Government has effectively deputized Mr. Ray, the FTX Debtors, and their counsel as federal agents to

346. Examiner Report, *supra* note 41, at 35.

347. "Through the efforts and cooperation supplied to Federal prosecutors," Ray stated in an affidavit early in the case "which is ongoing, two individuals have plead[ed] guilty and another has been charged." *See* Ray Supp. Retention Decl., *supra* note 23, ¶ 9.

348. Ankush Khardori, *The Indictment of SBF Is a Bombshell*, N.Y. MAG. (Dec. 13, 2022), https://perma.cc/JD8S-BYSV ("We are not just talking about a swift arrest. This is more like the prosecutorial equivalent of breaking the sound barrier.").

349. United States v. Bankman-Fried, 680 F. Supp. 3d 289, 297 (S.D.N.Y. 2023).

350. *See* Allison Morrow, *Sam Bankman-Fried Found Guilty of Seven Counts of Fraud in Stunning Fall for Former Crypto Billionaire*, CNN (updated Nov. 3, 2023, 7:04 AM EDT), https://perma.cc/3FZQ-P9ER.

351. Approved Disclosure Statement, *supra* note 144, at 64.

352. Ray Supp. Retention Decl., *supra* note 23, ¶ 9.

review and synthesize the evidence for them."[353] Ray made no secret of the debtors' close alignment with prosecutors.[354]

Bankman-Fried's criminal defense counsel documented hundreds of hours of attorney-time on calls, correspondence, and "collecting, reviewing, and analyzing documents" costing the estate "tens of millions of dollars."[355] They asserted (unsuccessfully) that the government used FTX and S&C to evade *Brady* duties to produce exculpatory evidence, allowing FTX and S&C to "deflect blame from themselves."[356] A preliminary review of S&C's first fee application in *FTX* shows twenty-two S&C attorney time entries involving communications with prosecutors Danielle Sassoon and Nicholas Roos in the first 18 days of the case (from November 12 to November 30, 2022).[357]

Notably, although Ray was eager to cooperate with prosecutors, he was less enthusiastic about cooperating with an examiner. As discussed below, at a hearing to consider a request for an examiner, Ray testified that he would cooperate with any court order—but not necessarily with an examiner.[358]

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353. Memorandum of Law in Support of Samuel Bankman-Fried's Motion for Discovery on the Basis That FTX Is a Member of the Prosecution Team, at 1, United States v. Bankman-Fried, No. 22-cr-00673 (S.D.N.Y. May 8, 2023), ECF No. 143 [hereinafter Discovery Brief].

354. Indeed, at one point he conflated them. In his supplemental affidavit supporting S&C's retention, for example, Ray stated "[t]he Debtors, through . . . most importantly, the tireless work of *Federal prosecutors* . . . have made it quite clear exactly what transpired, how it occurred, who was principally involved and the results of their actions." Ray Supp. Retention Decl., *supra* note 23, ¶ 9 (emphasis added).

355. *See* Discovery Brief *supra* note 353, at 2, 6.

356. *See id.* at 12. In 1963, the Supreme Court held in *Brady v. Maryland* that "the suppression by the prosecution of evidence favorable to an accused upon request violates due process where the evidence is material either to guilt or to punishment, irrespective of the good faith or bad faith of the prosecution." *See* Brady v. Maryland, 373 U.S. 83, 87 (1963). *Brady* creates a "constitutional duty to disclose favorable evidence to the accused where such evidence is 'material' either to guilt or to punishment." *See* United States v. Coppa, 267 F.3d 132, 139 (2d Cir. 2001) (quoting *Brady*, 373 U.S. at 87).

357. On November 28, 2022, for example, S&C white collar defense partner Steve Peikin billed 1.2 hours for a call with U.S. attorneys Nicholas Roos and Danielle Sassoon "re: Delaware issues." *See* First Monthly Fee Statement of Sullivan & Cromwell LLP as Counsel to the Debtors & Debtors-in-Possession for Compensation for Professional Services Rendered & Reimbursement of Expenses Incurred for the Period from November 12, 2022 Through and Including November 30, 2022 at 207, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Feb. 7, 2023), ECF No. 648 [hereinafter First S&C Fee Application].

358. Attorney Juliet Sarkessian, of the United States Trustee's office, queried Ray as follows:

> Q. If an examiner is appointed, if the Court appoints an examiner in this case, would you cooperate with that examiner?
>
> A. I will follow whatever orders are issued by this Court.
>
> Q. Assuming that you were directed to cooperate with the examiner would you do so?
>
> A. Can you explain what you mean by "cooperation?"

footnote continued on next page

IV. The Battle Over an Examiner

The most obvious corrective to the distortions created by S&C's role as FTX's bankruptcy lawyers would have been to appoint an examiner at the outset of the case. An examiner who did not have ties to S&C or their designee, Ray, could identify and objectively assess the severity of any conflicts of interest and whether the estate should take action. That an examiner was not appointed for nearly a year and a half in *FTX*—and produced a problematic report—shows how important it is that an examiner be appointed early, especially in large freefall cases like *FTX*.

A. Chapter 11 Examiners

Section 1104(c) of the Bankruptcy Code provides that the bankruptcy court "shall order" the appointment of an examiner "to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor."[359] It authorizes that appointment in two circumstances: where "(1) such appointment is in the interests of creditors, any equity security holders, and other interests of the estate; or (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes," exceed $5 million.[360]

Despite the statutory language—"shall" usually means "must," as the Third Circuit later said[361]—judges bridle at being told they must appoint an examiner when they question the value.[362] Thus, some do not, despite the statute.[363]

> Q. If the examiner needs documents, for example, that the debtors have would you provide those documents to the examiner?
>
> A. I think there might be some caveats to that but, yes.
>
> Q. Are there other things that you would not provide to the examiner if he or she asked?

Examiner Hearing Transcript, *supra* note 307, at 71-72. At this point, S&C attorney James Bromley objected on grounds that this asked Ray to speculate, and so he did not answer. *Id.* at 72.

359. 11 U.S.C. § 1104(c).

360. *Id.*

361. *In re* FTX Trading Ltd., 91 F.4th 148, 153 (3d Cir. 2024) ("The meaning of the word "shall" is not ambiguous. It is a 'word of command,' . . . that 'normally creates an obligation impervious to judicial discretion' . . . .") (first quoting *Shall*, BLACK'S LAW DICTIONARY (5th ed. 1979); and then quoting Lexecon Inc. v. Milberg Weiss Bershad Hynes & Lerach, 523 U.S. 26, 35 (1998)).

362. *See, e.g.*, *In re* Residential Cap., LLC, 474 B.R. 112, 120-21 (Bankr. S.D.N.Y. 2012). Judge Robert Gerber, the well-respected bankruptcy judge who oversaw, among others, the *General Motors* bankruptcy, stated in the *Lyondell Chemical* case that:

> mandatory appointment [of examiners] is terrible bankruptcy policy, and that the Code should be amended, forthwith, to delete section 1104(c)(2), and to give bankruptcy judges

footnote continued on next page

Even though Congress apparently expected examiners to be common (indeed, mandatory) features of large cases,[364] an empirical study found that they were "vanishingly rare" for two basic reasons.[365]

First, parties rarely sought them. In a sample of 1,225 cases from 1991 to 2010, examiners "were sought in only 104 (8.5% of) cases, and appointed in 48, fewer than half of cases where requested, and less than 4% of the sample."[366] Even in the 661 large cases in the sample—where appointment would likely have been mandatory given the $5 million threshold—"they were sought in only ninety-three (14% of) cases, and appointed less than half the time sought, in forty-three (or 6.5% of) large cases."[367]

Second, courts and parties worry about cost. The examiners in *Enron* famously cost about $100 million, mostly in legal fees paid as a first-priority expense of administration.[368] The cost of an examiner can be difficult to justify when a company has limited cash flow and the parties view themselves as capable of performing the same functions as an examiner.[369]

Although creditors chiefly bear these costs, estate professionals may also resist examiner appointments to avoid losing work. Creditors' committee counsel may believe that they have the duty and the opportunity "to do the sort of an investigation that an examiner might undertake," and want to

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> (subject to appellate review, of course) the discretion to determine when an examiner is necessary and appropriate, and whether a request for an examiner is merely a litigation or negotiating ploy.

Transcript of Hearing Before the Honorable Robert E. Gerber, October 26, 2009, at 35, *In re* Lyondell Chemical Co. (No. 09-10023) (Bankr. S.D.N.Y. Oct. 26, 2009).

363. Jonathan C. Lipson, *Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies*, 84 AM. BANKR. L.J. 1, 4 (2010) (finding in an empirical study that requests for examiners were granted in "less than half of cases where sought, and about 6.7% percent of *all* cases in the sample").

364. *See* 124 CONG. REC. 33990 (daily ed. Oct. 6, 1978) (statement of Sen. Dennis DeConcini) ("There will be automatically appointed an examiner in [large cases], but not a trustee . . . I am convinced that debtor and creditor interests, as well as the public interest, will be preserved and enhanced by these provisions.").

365. *See* Lipson & Marotta, *supra* note 50, at 5, 7.

366. *Id.* at 4; *see also id.* app. 1 (listing cases in which examiners were appointed, along with the district and year the case was commenced).

367. *Id.* at 4. "A case is 'large' (n=661) if it has publicly traded securities and assets in excess of $100 million in 1980 dollars; otherwise (n=564) it is 'small.'" *Id.* at 4 n.6.

368. Lipson, *supra* note 363, at 53.

369. *Id.* at 5 ("Holding other things equal, a request for an examiner was three times more likely in a case with a debtor having at least $100 million in net assets."). A company in chapter 11 is more likely to have unencumbered cash if the value of its assets exceeds liens or other security interests (that is, the assets are net positive).

protect that turf.[370] Creditors' committees do in fact often object to the appointment of an examiner.[371]

The parties also may worry that an examiner is an outsider who will insert herself "into disputes in ways that may not be constructive, acting as 'ombudsman' to address 'problems' that do not concern the parties."[372] The examiner represents no party, and instead answers only to the court.[373] But the cost of the examiner is borne by the bankruptcy estate.[374] Although bankruptcy examinations may constitute a public good, private creditors foot the bill.

Examiners have nevertheless featured prominently in some of the nation's largest and most controversial chapter 11 cases, in particular *Enron* and *Lehman Brothers* which, like *FTX*, were massive free-fall cases precipitated by allegations of serious misconduct.[375] *FTX* seemed to be an obvious case for appointing an examiner.

And yet, it almost wasn't.

B. The FTX Examiner Motion

1. The bankruptcy court proceeding

The U.S. Trustee sought the appointment of an examiner in *FTX* by motion December 1, 2022, about three weeks after the *FTX* case was commenced.[376] The U.S. Trustee did so for two basic reasons. First, the U.S. Trustee has long taken the position that the Bankruptcy Code's examiner provisions are mandatory.[377] Second, the public had an inherent interest in

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370. *See id.* at 51.

371. *Id.* (finding the official committee of unsecured creditors to be the second most likely party to object to an examiner request, "objecting in twenty-four cases, or 40% of cases in which an objection was filed").

372. *Id.* at 53.

373. *In re* Big Rivers Elec. Corp., 355 F.3d 415, 431-32 (6th Cir. 2004) (finding the examiner "'answers solely to the Court.'" (quoting *In re* Baldwin United Corp., 46 B.R. 314, 316 (Bankr. S.D. Ohio 1985))).

374. 11 U.S.C. § 503(b)(1).

375. *See, e.g.*, Steve Mollman, *'A Lot of People Have Compared This to Lehman. I Would Compare It to Enron': Larry Summers Has Some Choice Words for Sam Bankman-Fried and FTX*, FORBES (Nov. 11, 2022, 10:32 AM PST), https://perma.cc/G8DL-XLG6.

376. Motion of the United States Trustee for Entry of an Order Directing the Appointment of an Examiner at 23, *In re* FTX Trading Ltd., No. 22-11068 (Bankr. D. Del. Dec. 1, 2022), ECF No. 176 [hereinafter Examiner Motion].

377. *In re* FTX Trading Ltd., 91 F.4th 148, 151 (3d Cir. 2024) ("Of greater significance for the purposes of this appeal, the U.S. Trustee argued that the Code mandates the Bankruptcy Court to grant their motion and order the appointment of an examiner.").

knowing how and why FTX collapsed.[378] A "public report of the examiner's findings could reveal the 'wider implications' that FTX's unprecedented collapse had for the cryptocurrency industry."[379] Unlike an internal investigation that CEO John Ray might conduct, an examiner's report would be "public and transparent" and thus educate the investing public about the implications FTX's collapse may have for the crypto industry.[380] One of those implications was public confidence that, in the case of "such a precipitous and devastating failure . . . affecting stakeholders worldwide, any investigation here must not only be legitimate and independent but also must be seen as beyond reproach by stakeholders and the public."[381]

John Ray and S&C (representing the debtors) and the Official Committee of Unsecured Creditors (UCC) forcefully resisted. They argued that every request for an examiner is discretionary because the scope of an examination should be "as is appropriate."[382] Here, they contended, Judge Dorsey should exercise this discretion to deny the request. "In our view," the debtors argued, "an examiner is not appropriate. In our view, a report is not appropriate."[383]

The UCC asserted that creditors should not have to bear the costs of satisfying the public's interest in understanding this failure.[384] Concern about the cost of an examiner is understandable, but UCC counsel Ken Pasquale also hinted at the turf-battle lying just below the surface: "There's no denying that the work that we're doing is, you know, that there's a significant cost to that work, but it's necessary work and . . . an examiner's investigation would just be over and above what is already being done and those costs that are being incurred."[385] In other words, counsel to the UCC would rather it be paid for the investigation than an examiner.

Judge Dorsey agreed with the debtors and UCC and denied the request. He reasoned that Ray was the equivalent of an examiner because, although appointed by Bankman-Fried on the eve of bankruptcy, he was independent of

378. *Id.* at 151.

379. *Id.*

380. *See* Examiner Motion, *supra* note 376, at 3.

381. *Id.* at 21.

382. *See In re FTX Trading*, 91 F.4th at 152 ("The opposing parties argued the phrase 'as is appropriate' in Section 1104(c) renders the appointment of an examiner subject to the Bankruptcy Court's discretion.").

383. Examiner Hearing Transcript, *supra* note 307, at 117. The debtors added that it would be "entirely inappropriate for an examiner to be appointed . . . for the purpose of issuing a report that satisfies some public interest outside of these cases for the very simple reason, as [Debtors' counsel] mentioned: the cost of an examiner will come out of the unsecured creditors' recoveries." *Id.* at 121.

384. *Id.*

385. *Id.* at 121-22.

him.[386] Judge Dorsey also took seriously concerns about cost, stating that "if an examiner was appointed here the cost of the examination, given the scope suggested by the [U.S.] Trustee at the hearing, would be in the tens of millions of dollars and would likely exceed $100 million."[387] There were, he reasoned, "already multiple investigations underway by incredibly competent and independent parties."[388]

Absent concerns about S&C's role and incentives, this might be correct. But as we explained in Part II, S&C's work before, at, and after the bankruptcy filing created questions about S&C's incentives. If S&C wanted to shield information about its actions, and S&C for all practical matters hired Ray, it is unclear how Ray could be the equivalent of an examiner. He may well be a seasoned bankruptcy professional who was independent from Bankman-Fried. But his incentives would be different from those of an examiner. In principle, he should focus on maximizing creditor recoveries.[389] But he might also have an interest in shielding S&C from investigation—after all, they recruited him.[390] Even in the absence of such problems, neither S&C nor Ray would ordinarily ever get to select the examiner. That would be the job of the U.S. Trustee, if an appointment were approved.[391]

2. The appeal

After Judge Dorsey denied the request, the U.S. Trustee took a direct appeal to the Third Circuit.[392] The arguments before the Third Circuit panel were lopsided. The panel viewed the lower court's decision not to appoint an examiner as clearly mistaken, for two reasons.

386. Hearing Transcript, Feb. 15, 2023 at 9, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Feb. 16, 2023), ECF No. 737 ("There is no question that an examiner or a Chapter 11 Trustee, for that matter, appointed pursuant to Section 1104 would have the same attributes as Mr. Ray and the independent directors.") [hereinafter Examiner Ruling Transcript].

387. *Id.* at 9.

388. *Id.* at 10.

389. As we discuss in Parts IV.D and V, below, there is considerable evidence that Ray has failed to maximize value, including by his resistance to early financing proposals that might have restarted the exchanges, problematic asset sales, and of course the significant "burn rate" in professional fees incurred in the case.

390. *See supra* Part II.C.

391. 11 U.S.C. § 1104(d) ("[T]he United States trustee, after consultation with parties in interest, shall appoint, subject to the court's approval, one disinterested person other than the United States trustee to serve as trustee or examiner, as the case may be, in the case.").

392. *In re* FTX Trading, Ltd., 91 F.4th 148, 152 (3d Cir. 2024) (citing 28 U.S.C. § 158(d)(2)).

First, the statute obviously requires an examiner; it was a matter of "straightforward" statutory interpretation.[393] Second, the mandatory nature of the appointment reflected Congressional intent to protect the public interest. The Third Circuit focused on the importance of investigation by a person who is independent and objective. Congress "forbade the examiner from acting as or representing a trustee in the bankruptcy and required that the investigation remain separate from the reorganization process."[394] Moreover, the examiner could not later act as trustee or counsel to the trustee "in order to ensure that examiners may not profit from the results of their work."[395] Such "independence distinguishes examiners from other participants in the chapter 11 bankruptcies who may investigate wrongdoing but who also seek to benefit financially from the reorganization plan."[396]

Although the Third Circuit held that an examiner appointment is mandatory if the statutory criteria are satisfied, it did not prescribe the scope of the examination. It did, however, offer some hints. Perhaps foremost was concern about potential conflicts "arising from debtor's counsel serving as pre-petition advisors to FTX," which "have been raised repeatedly."[397]

C. Conflicts of Public Interests and the FTX Examiner Appointment: The Watchdog That Did Not Bark

Although the Court of Appeals said that S&C's potential conflicts had been raised repeatedly, they had not been raised by the appellant, the U.S. Trustee. This was curious, because the mission of the U.S. Trustee is to preserve the integrity of the system. Indeed, one of the U.S. Trustee's key roles is "to police the bankruptcy system for conflicts of interest by professionals (lawyers), 'cronyism,' or debtor misconduct."[398]

The U.S. Trustee's approach in *FTX* was more tentative. He initially objected to the S&C retention, noting that "publicly available information thus far raises the specter that S&C may have a conflict or not be disinterested given that an S&C partner of eight years became general counsel for certain of the Debtors approximately 14 months before the petition date."[399] But the U.S.

393. *Id.* at 150 ("Sometimes highly complex cases give rise to straightforward issues on appeal. Such is the case here."); *see also id.* at 153 ("The Bankruptcy Court erred in denying the U.S. Trustee's motion to appoint an examiner to investigate FTX Group.").

394. *Id.* at 155.

395. *Id.* at 155 n.6 (quoting *In re* Big Rivers Elec. Corp., 355 F.3d 415, 430 (6th Cir. 2004)).

396. *Id.* (citing 11 U.S.C. § 1102(b)(1)).

397. *Id.* at 157.

398. Jonathan C. Lipson, *The Shadow Bankruptcy System*, 89 B.U. L. REV. 1609, 1628 (2009).

399. *See* UST S&C Objection, *supra* note 301, ¶ 3.

Trustee quickly agreed to settle and withdraw the objection in return for additional disclosure by S&C, which they made at the last minute.[400]

The U.S. Trustee's decision to stand down proved consequential. S&C often said that it was qualified to lead the investigation because it had been found to be disinterested by Judge Dorsey, a finding the Examiner did not disavow.[401] In the examiner appeal, the issue of S&C's potential conflict was asserted not by the Trustee, but instead by a group of law professors (including one of us), who submitted a brief and argued as amici curiae that the appearance of S&C's potential conflicts, coupled with an unusual degree of secrecy in the case, presented significant problems for the chapter 11 case and the integrity of the process itself.[402]

Surely, the U.S. Trustee understood this. The appearance of S&C's potential conflicts, coupled with their control of the bankruptcy, would be strong grounds for the appointment of an examiner. That would have enabled the Trustee to seek a more targeted examination, focused on that cluster of questions, rather than the broader ranging, and potentially more expensive and duplicative examination, that Judge Dorsey had rejected. Why not make the argument?

We don't know for sure, but the Trustee's reticence may have reflected a different conflict of interests—between that office and other government actors, who might not have wanted an independent examiner.[403] Evidence from S&C fee applications suggests that S&C discussed its response to the

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400. *See supra* Part III.A.

401. At oral argument before the Third Circuit, James Bromley of S&C said flatly "the conflict of interest does not exist":

> Judge Dorsey held an evidentiary hearing with respect to the retention of my law firm . . . . Based on that factual determination, Judge Dorsey found that we did not have any issues and all of the things that the learned professor just mentioned are res judicata in favor of the estate and in favor of my firm. There is not an issue before this Court to look at whether or not there was a conflict of interest, because it has been judicially determined with evidence already.

Transcript of Oral Argument, FTX Trading, Ltd. v. Vara at 26-27, No. 23-2297 (3d Cir. Nov. 28. 2023), ECF No. 65. S&C made a similar assertion in defense of an FTX investor lawsuit against them. *See* Defendant Sullivan & Cromwell LLP's Motion to Dismiss & Incorporated Memorandum of Law at 2, *In re* FTX Cryptocurrency Exchange Collapse Litigation, No. 24-cv-20630 (S.D. Fla. May 13, 2024), ECF No. 8 ("[T]he United States Bankruptcy Court for the District of Delaware (the 'Bankruptcy Court') held that S&C was 'disinterested' pursuant to Section 327(a) of the Bankruptcy Code.").

402. *See* Brief of Amici Curiae Law Professors in Support of Appellant on the Role of Bankruptcy Examiners in Chapter 11 Reorganization, FTX Trading v. Vara, Ltd., No. 23-2297 (3d Cir. Sept. 8, 2023), ECF No. 27.

403. For similar concerns that the U.S. Trustee may be influenced by other actors within the Department of Justice, see Simon, note 33 above, at 1310-11.

Examiner motion with prosecutors.[404] If, as the evidence suggests, FTX and S&C supported the Bankman-Fried prosecution, an independent examination might interfere with that prosecution by raising questions about why S&C was doing so.

Thus, the U.S. Trustee and the U.S. Attorney would represent different, and potentially conflicting, facets of the public interest in chapter 11. Here, the Trustee may have wanted to vindicate the first—judicial-process integrity—whereas prosecutors sought to advance an important, but different, public interest in prosecuting crimes (the third form of public interest identified in this Article—non-bankruptcy objectives). S&C's unique position enabled it to arbitrate between these interests, and to cast itself as the vindicator of the version it preferred.

It is not clear how conflicts of this sort within the Department of Justice are resolved. We speculate that it may have been the subject of a compromise between the Trustee and prosecutors: The U.S. Trustee could (and did) seek an examiner, but could not do so in a way that directly threatened the prosecution of the prebankruptcy insiders. To accommodate the prosecution, the U.S. Trustee would have to refrain from saying anything specifically about S&C's prebankruptcy history with the company, as that might lead to inquiries about S&C.

The compromise we posit would in all likelihood accomplish two important goals. First, it would give prosecutors the time and resources to aggressively pursue the FTX insiders, as they did. Second, it would give the Trustee a clean ruling from a highly-regarded appellate court on a key issue—the mandatory nature of examiner appointments. But in the time it would take to appeal—the Third Circuit's decision did not issue until fifteen months after the case was commenced—the U.S. Attorney's Office would continue its high-speed prosecution of Bankman-Fried.

The U.S. Trustee is the "watchdog" of the bankruptcy system. Its failure to assert S&C's potential conflicts as grounds for an examiner, and its potential tensions with other government actors, suggest that in *FTX* it may have been

404. On November 28, 2022, for example, S&C white collar defense partner Steve Peikin billed 8/10ths of an hour for time spent with other S&C attorneys "re: SDNY examiner issues." *See* First S&C Fee Application, *supra* note 357, at 345. Since a request for an examiner was made by the U.S. Trustee two days later, and it seems likely that the U.S. Trustee had already informally raised the possibility of an examiner with S&C, it would appear that S&C was discussing the implications of an examiner for prosecutors in the Southern District of New York. That same day, white collar partner James McDonald, who had initially caused FTX to cooperate with prosecutors, see McDonald Letter, note 264 above, at 30-33, billed half an hour for a call with other S&C litigators "re: SDNY examiner issues" and 7/10ths of an hour for a "call with S. Peikin and SDNY and review of materials re: same," First S&C Fee Application, note 357 above, at 346.

the "watchdog" that did not bark.[405] We do not fault the U.S. Trustee, however. Assuming our speculations are correct, we imagine that the Trustee had uncertain leverage within the Department of Justice, especially given the magnititude of the underlying allegations and the public interest in prosecuting serious crimes. We discuss the problematic implications of these public versus public conflicts in corporate reorganization in Part VI.

D. The Public Interest and Bankruptcy Examinations

Although Congress thought that examiners would vindicate the public interest in chapter 11, they did not specify that interest, much less say how or who should pay for it. In *FTX,* the debtors exploited this uncertainty by offering conflicting claims about the public interest in the FTX reorganization. On one hand, they argued in response to the examiner request that there was none at all. "Section 1104 does not," they argued, "authorize the use of substantial estate assets to satisfy an undefined public interest or for a 'true neutral,' however that may be defined, to conduct an investigation that benefits potential defendants or wrongdoers."[406]

On the other hand, they argued, if there were a public interest, they would address it by assisting public actors, such as prosecutors. "Given the investigation's [sic] already going on by the congressional committees, CFTC, SEC, the prosecutors," the UCC argued, "the public interest is being well-served in all of those ways."[407] The creditors, "who are just going to want to get their fiat currency and crypto back," should not "be forced to bear the cost of an examination that's only going to tell them the who, what, when, where, and why they lost money, but not actually give the money back."[408]

But of course, creditors and other stakeholders would be forced to bear this cost, since the debtors' advisors billed the estate for their work supporting the U.S. Attorneys' office.[409] The only difference was that their money would go to S&C, Ray, and other case insiders, rather than to an examiner and their professionals.

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405. The allusion is, of course, to the famous story in which a dog's failure to bark alerted Sherlock Holmes that the dog knew the perpetrator of the crime. ARTHUR CONAN DOYLE, *Silver Blaze*, *in* THE MEMOIRS OF SHERLOCK HOLMES 4, 48 (Floating Press 2009) (1894).

406. Debtors' Objection to Motion of the United States Trustee for Entry of an Order Directing the Appointment of an Examiner at 4, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Jan. 25, 2023), ECF No. 573 [hereinafter DIP Examiner Objection].

407. Examiner Hearing Transcript, *supra* note 307, at 122.

408. *Id.* at 130.

409. *See supra* Part III.B.

Indeed, Ray had no qualms about forcing creditors to bear the cost of his and FTX's advisors' cooperation with prosecutors and other governmental officials. In opposing the request for an examiner, he testified extensively about the work that he, FTX, and S&C had done to support public actors—support that would, he argued, satisfy any public interest in the case: "I made it very, very clear from the beginning of my taking control . . . that we would do whatever the Government request[ed] relative to cooperation."[410]

> We believe that, ultimately, not only is that, you know, required but we believe that, you know, it's in the best interest of creditors to allow these regulatory authorities to get full access to the information on a real time basis as we're learning about what happened in the company. They're virtually getting information, again, real time, and we believe that was sort of fundamental to our, you know, mission here which is to maximize value for the creditors.[411]

Although FTX was prudent to cooperate with prosecutors under these conditions, it is hard to see how "real time" cooperation with government actors would "maximize value for creditors."[412] Wouldn't he and S&C have to evaluate the information before deciding whether divulging was in the interests of the estate? Still, he continued:

> As you can see, we've collected ten terabytes of data, over twenty-seven million documents. We've provided an analysis of several hundred thousand documents. We've interviewed and received proffers of 24 current and former employees. And then, we've also provided an analysis relative to the transactions inside the companies [sic] databases.[413]

S&C wasn't cheap. At the hearing on the examiner motion, S&C's James Bromley conceded that the debtors were spending "tens of millions of dollars"—at least some on legal fees—to vindicate their preferred version of the public interest, supporting prosecutors:

> When we talk about the debtors furthering public policy, we have spent, literally, tens of millions of dollars, complying with public policy by reporting to the Congress, to the House, to the Senate, to the U.S. Attorney's Office in the Southern District of New York and three other Districts.[414]

The "burn rate" in *FTX*—the costs of professionals such as lawyers and accountants—was astronomical, perhaps the highest ever, and estimated to be $1.5 million *per day*.[415] Some cooperation was no doubt prudent, but here S&C

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410. Examiner Hearing Transcript, *supra* note 307, at 51-52.

411. *Id.* at 52.

412. *See id.*

413. *Id.* at 53.

414. *Id.* at 113.

415. *See* Rick Archer, *FTX [Fee] Examiner Report OKs $111M in Professional Fees*, LAW360 (Sept. 6, 2023, 7:39 PM EDT), https://perma.cc/JKU5-QWQC (noting that "$320 million of the estate's funds have been spent on professional fees so far, with the burn

footnote continued on next page

is saying that Ray was spending tens of millions of dollars to support its preferred vision of the public interest (prosecution) in order to defeat the U.S. Trustee's (process integrity).

E. Limitations in the Examination That Did Occur

Although S&C made much of concerns about the cost of an examiner, the examination ultimately ordered would cost the estate approximately $6 million[416]—less than one percent of the estimated professional fees in the case.[417] In part, this reflects the limited scope and time the Examiner had to undertake his investigation.

The order approving Robert Cleary's appointment as examiner gave him two months to investigate and report on three things, the most relevant here being "whether there are potential conflicts of interest involving S&C which were not adequately addressed by the Court's hearing and ruling on the Employment Application."[418] On May 23, 2024, he reported that there was "no error" in the bankruptcy court's decision to appoint S&C given the information before it and the broad discretion afforded to bankruptcy courts.[419] Strictly speaking, this seems correct, but unfortunately the problems

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continuing at $1.5 million a day"); Justin Wise, *Sullivan & Cromwell Wins in FTX, Silicon Valley Bank Wrecks (1)*, BLOOMBERG L. (Jan. 19, 2024, 2:00 AM PST), https://perma.cc/TQU6-9VWX ("When combined with other advisers working on the case, approved fees for the first nine months eclipsed $300 million, making FTX 'one of the highest, if not the highest,' burn rates for any bankruptcy, said Nancy Rapoport, a University of Nevada Las Vegas law professor.").

416. The initial order appointing the Examiner contemplated about $1.6 million in legal fees. *See* Examiner Phase I Order, *supra* note 40, ¶ 4. The fees were later increased to $3.3 million. *See* Examiner's Motion to Amend the Cost of Phase I of Examination ¶ 19, *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. July 12, 2024), ECF No. 20342. After filing his report, the Examiner sought to continue the investigation for a second phase at a cost of an additional $3 million. *See* Examiner Phase II Order, *supra* note 40, ¶ 4.

417. If, as noted, the estate spends $1.5 million/day, and the case is in bankruptcy for two years, then by November 11, 2024, it will have cost $900 million. *See* Archer, *supra* note 415. According to an email provided by Katherine Stadler, the Court-appointed fee examiner in FTX (a fee examiner performs a different role than statutory examiners, and focuses only on professional fees), professionals had been paid over $500 million as of June 2024. *See* Email from Katherine Stadler, Godfrey & Kahn, to Jonathan C. Lipson (Oct. 3, 2024, 10:48 AM) (on file with authors). Precise and current numbers are difficult to obtain, but it is not hard to see that, by any measure, $6 million for the Examiner is likely to cost less than 1% of the total cost of professionals for the case.

418. *See* Examiner Phase I Order, *supra* note 40, ¶ 3(a).

419. Examiner Report, *supra* note 41, at 35 ("In light of the record before the Court, the Court's analysis of each of the objectors' arguments, and the wide discretion afforded to the Court in determining whether disqualifying conflicts exist, the Examiner has concluded that there was no error in the Court's decision concerning the Debtors' retention of S&C.").

that concern us were not before the court.[420] Thus, in the first instance, the question was whether these matters *should* have been disclosed.[421] We think so; the Examiner, like S&C, apparently thought not.

It is important to recognize both the strengths and limitations of the Report. On one hand, it contained a significant amount of information that was not previously public, including as to the role that professionals other than S&C played in the rise and fall of FTX. It also explained the investigative processes that Ray, S&C, and others undertook, and provided insight into how FTX was able to manipulate the value of its token, FTT.[422]

On the other hand, the Examiner conceded "significant" limitations in his report. He relied heavily on an investigation conducted by "conflicts counsel," Quinn Emanuel.[423] Quinn Emanuel's mandate was to investigate whether S&C attorneys knew of the commingling of customer deposits/funds with the corporate assets of Alameda.[424]

"Significantly," the Examiner noted, "Quinn Emanuel's investigative mandate had certain limitations."[425] First, "Quinn Emanuel was not asked to consider and, hence, did not investigate, the broader question of whether S&C had any conflicts of interest that might have disqualified it from serving as counsel under Bankruptcy Code section 327."[426] Quinn Emanuel did not do so "because S&C's retention had already been approved by the bankruptcy court."[427] Quinn Emanuel apparently did not investigate S&C's work for Bankman-Fried or other insiders.[428] Thus, there is no indication that Quinn Emanuel assessed the problematic tactics S&C used to wrest control of FTX from Bankman-Fried described in Part II.C above.

Second, there were limitations on the information to which Quinn Emanuel had access. Quinn Emanuel apparently interviewed seven S&C

420. *See supra* Part III.A.

421. The Examiner Report indicates that it did consider this question. Examiner Report, *supra* note 41, at 12 ("The Examiner has reviewed in detail the record before the Court regarding S&C's employment and *considered whether facts outside the record should have been brought to the Court's attention.*" (emphasis added)).

422. *Id.* at 35-41, 85.

423. *Id.* at 8, 36.

424. *Id.* at 36.

425. *Id.* at 37.

426. *Id.*

427. *Id.*

428. *Id.* This is not surprising, given that S&C almost certainly supported the retention of Quinn Emanuel, but seems important since that is the question which the Examiner was asked to investigate independently. Why rely on the investigation of someone else if they did not answer the question you were asked? The Examiner does not say.

attorneys, and no one else, in connection with its investigation of S&C.[429] They did not interview Miller, the former S&C partner who had become general counsel of FTX US,[430] or investigate S&C's work for Bankman-Fried or Singh, personally.[431] Nor, it appears, did they interview Bankman-Fried or the attorneys who represented him, and who could have confirmed or corrected S&C's assertion that it did not pressure or mislead Bankman-Fried.[432] Moreover, there were "also constraints on Quinn Emanuel's ability to collect certain documents."[433] Like Bankman-Fried, "some S&C attorneys used Signal," the auto-deleting encrypted messaging system.[434] "Notwithstanding these impediments," the Examiner reported, Quinn Emanuel was "comfortable with the scope of its review, including with respect to the Signal messages provided by S&C."[435]

The Examiner did not note another limitation: Like S&C, Quinn Emanuel had also performed work for FTX prior to bankruptcy, providing advice on, among other things, Foreign Corrupt Practices Act compliance, cryptocurrency disputes, and antitrust matters.[436] Given this prebankruptcy work, Quinn Emanuel, like S&C, might have had a vested interest in investigating and reporting on the role that professionals played in FTX's prebankruptcy misconduct. The Examiner's Report says nothing about this.

Based on the Quinn Emanuel interviews of S&C attorneys, the Examiner concluded that S&C was not made aware of any facts that "would have revealed to it the fraud at the FTX Group" because the S&C attorneys:

> confirmed that (1) the work they performed did not entail verifying the factual accuracy of statements made by the FTX Group; (2) at the time, they had no reason to question the veracity of the information they received from the

429. *Id.* at 36-37.

430. *Id.* at 37 ("Quinn Emanuel did not interview individuals outside of S&C, such as Miller, in connection with its investigation into S&C . . . . because such interviews were beyond the scope of Quinn Emanuel's investigative mandate.").

431. *Id.*

432. *See id.*

433. *Id.*

434. *Id.* At the closing argument in the Bankman-Fried trial, prosecutor Nicolas Roos maligned Bankman-Fried's use of Signal, a private messaging application which, when used by Bankman-Fried, was "a private space between [Bankman-Fried] and his coconspirator over an encrypted messaging platform with auto delete set." SBF Closing Argument Transcript, *supra* note 157, at 2999.

435. Examiner Report, *supra* note 41, at 38.

436. *See* Debtors' Application for Entry of an Order Authorizing the Retention & Employment of Quinn Emanuel Urquhart & Sullivan, LLP as Special Counsel for the Debtors & the Debtors in Possession, *Nunc Pro Tunc* to November 13, 2022 ¶ 28(a), *In re* FTX Trading, Ltd., No. 22-11068 (Bankr. D. Del. Dec. 21, 2022), ECF No. 280.

> Debtors; and (3) they relied upon the accuracy of these representations in rendering their legal advice.[437]

Consider what this means: The Examiner accepted a secondhand report of S&C's unverified claim that they did not check the accuracy of facts when they submitted a 400-plus page application to the CFTC, for which the firm billed roughly $2 million.[438] The Examiner accepted at face value S&C's claim that they had "no reason to question the veracity" of FTX information, even though FTX US terminated its chief risk officer and auditor shortly after submission of this application.[439] Notably, the Examiner failed to say whether he reviewed the application itself, which, as explained above, S&C withdrew from the CFTC docket the same day the firm filed the debtors' bankruptcy petitions, raising questions about its contents.[440]

Third, the Examiner's Report said nothing about the failure to sue Binance. As discussed in Part II above, Binance played an important role in the downfall of the debtors. And as explained in the next Part, Binance may have had significant liability to the debtors' estates as a result of its actions, but Ray and S&C did not pursue any cause of action against Binance prior to plan confirmation.

Thus, the Examiner's Report engaged none of the most critical evidence on the most important questions about S&C's role leading up to the bankruptcy. We do not fault the Examiner, however. Time and timing were problems, because he had only two months to complete the Report. S&C had delayed the inquiry for nearly a year and a half, by which time the endgame of the case—the company's plan of reorganization—was in sight.[441] If, however, an examiner had been appointed at the outset and with a more fulsome mandate, we expect that their report would have more effectively addressed the problems we have identified, and perhaps others about which we do not know.

V. Problems in the FTX Reorganization Process

The prior four Parts of this Article explained the role of the three public interests in bankruptcy and used the example of FTX and S&C to illustrate how advancing the third, non-bankruptcy interests may conflict with the first, process integrity. In this Part, we show how efforts to advance other interests also appear to have undermined the bankruptcy-specific interest in maximizing recoveries.

437. Examiner Report, *supra* note 41, at 55.

438. *See supra* Part II.B.2.

439. Examiner Report, *supra* note 41, at 55; *see supra* Part II.B.3.

440. *See supra* Part II.B.3.

441. *See supra* Parts III.A, IV.B.

A. Undercutting FTX 2.0

It is axiomatic that a profitable corporate debtor is worth more as a going concern than sold as scrap. This is the rationale for leaving the debtor-in-possession in the control of its management, rather than appointing a trustee.[442] Yet it is unclear whether Ray and S&C made any serious effort to maintain FTX as a going concern.

Before its liquidity crisis, FTX appears to have been profitable.[443] As an exchange, revenue was driven by fees rather than by the value of cryptocurrencies.[444] Indeed, within certain parameters, price volatility would be good for an exchange, because such volatility implies more trading and thus more fees from trading.

As explained in Part II, FTX halted withdrawals before the bankruptcy. It did so due to the liquidity crisis triggered by the run on deposits in November 2022.[445] Bankman-Fried, meanwhile, was trying to obtain new financing to cover the liquidity gap.[446] This made sense, and on the surface would appear to be why Dietderich assured Bankman-Fried on November 9, 2022 that S&C was "here to help" that rescue effort "however we can."[447]

According to documents produced in connection with his sentencing, it appears Bankman-Fried had at least preliminary success. On November 9, TRON, another crypto business,[448] executed a letter of intent to provide FTX a $4 billion credit facility.[449] $4 billion in liquidity might have enabled FTX to restart withdrawals and thus trading on the exchange. Of course, we do not know what this financing offer was really worth, or whether restarting withdrawals would have enabled Bankman-Fried to oversee a soft landing for FTX. He has claimed that the underlying technical problems—in particular the fiat@ account—had been addressed,[450] but this is a difficult claim to verify.

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442. *See* H.R. REP. No. 95-595, at 220 (1977) ("It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets.").

443. *See* LEWIS, *supra* note 17, at 129.

444. *See id.* at 114, 148 (discussing fees charged by cryptocurrency exchanges).

445. *See supra* Parts II.A.1, II.C.2.

446. *See* November 9 Email, *supra* note 232.

447. *Id.*

448. *See About*, TRON, https://perma.cc/ZAN8-LYVT (archived Dec. 17, 2024).

449. SBF Sentencing Memorandum, *supra* note 184, Exhibit E, at 34-37.

450. *See* Telephone Interview with Sam Bankman-Fried, *supra* note 165 ("Once FTX obtained its own bank accounts in late 2021 and the spring of 2022, the portal on its website re-routed customers directly to its own accounts rather than the fiat@ account.").

Two days into the bankruptcy, on November 13, 2022, Bankman-Fried emailed Ryne Miller that he was "super happy to chat" with Ray.[451] This made sense, since S&C was continuing to assure Bankman-Fried that they were "happy" to discuss such possibilities with him, even though James McDonald, the partner that said this, had already committed FTX to cooperate with the government, apparently without telling Bankman-Fried.[452]

Despite S&C's assurances, Ray never responded. At a February 6, 2023 bankruptcy court hearing, he testified that he never spoke to Bankman-Fried because he "didn't think it was in the best interest of the estate to consult with lawyers for someone we now know has been charged with crimes."[453]

Ray's timing was curious. Bankman-Fried was not indicted until December 9, 2022, nearly one month after Bankman-Fried's offer to chat.[454] Until he was indicted, how could Ray know that he should not talk to Bankman-Fried about how to save the company—especially since Bankman-Fried already seemed to have secured critical new financing?

Not only did Ray refuse to talk to Bankman-Fried about keeping the exchange running, but he also permanently shut FTX down rather than making a serious effort to preserve it. S&C blamed it on Bankman-Fried: "FTX was an irresponsible sham created by a convicted felon," Dietderich said in January 2024.[455] "The costs and risks of creating a viable exchange from what Mr. Bankman-Fried left in a dumpster were simply too high."[456]

This is possible. But it is important to note that Ray and S&C said they rebuilt the debtors' books and records "from scratch,"[457] which they would have to do to determine which claims to pay. If so, and if the commingling of assets had stopped, Ray and S&C have failed to explain why the exchanges could not have resumed trading.

Indeed, for several months in the middle of the case, FTX told customers that restarting the exchange—which came to be known as "FTX 2.0"—might be possible.[458] In October 2023, FTX investment banker Kevin Cofsky said that

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451. Email from Ryne Miller to John Ray (Nov. 13, 2022, 11:12 PM) (on file with authors) (forwarding an email from Bankman-Fried saying, "[h]ey John, I'd be super happy to chat—here, phone, etc.!").

452. *See* McDonald Email, *supra* note 268; McDonald Letter, *supra* note 264, at 30-33.

453. Examiner Hearing Transcript, *supra* note 307, at 51.

454. *See* Sealed Indictment, United States v. Bankman-Fried, No. 22-00673 (S.D.N.Y. Dec. 9, 2022), ECF No. 1.

455. *FTX Scraps Plan to Revive Exchange and Will Repay Billions to Customers*, GUARDIAN (Jan. 31, 2024, 12:31 PM EST), https://perma.cc/AA5M-RJJ2.

456. *Id.*

457. Approved Disclosure Statement, *supra* note 144, at 4.

458. Sam Reynolds, *FTX Plans to Restart Crypto Exchange for International Customers*, COINDESK (July 31, 2023, 8:39 PM PDT), https://perma.cc/T8RM-N2HV.

he was "optimistic that we will have either a plan for a reorganized exchange, a partnership agreement or a stalking horse for a sale, on or prior to the December 16 milestone date."[459] The Wall Street Journal reported that FTX 2.0 won support among major creditors.[460]

Arush Sehgal, a former member of the FTX UCC, told us that he believed Ray and his team were never serious about rebooting the exchange because of "some kind of deep-seated insecurity" on the part of Ray and S&C, who were concerned about "anyone else outside of their circle get[ting] control of the records of FTX or the history."[461] Based on his observations, he believed that S&C and Ray may have had something to hide.[462]

Whether or not this is accurate, failing to reboot the exchange would be enormously consequential for stakeholders. While the plan proposed as of May 2024 would pay customers 127-142% of the face amount of their deposits as of the petition date, that date was in the depths of the crypto winter.[463] In the next year and a half, crypto assets tripled in value.[464] If customers had simply been permitted to keep their assets or been credited with their value based on the debtors' rebuilt books and records, many customers would have received 300-400% of the face amount of their deposits as of November 2022.

This is not so far-fetched, as it approximated what crypto exchange *Genesis* did under its bankruptcy plan.[465] Sehgal told the *Wall Street Journal* that Ray and S&C were "responsible for destroying billions of dollars in value" because FTX "had a thriving business that was the No. 2 exchange in the world, and all they had to do was turn it back on."[466]

Note also that FTX 2.0 might not have required the immediate payout of customers. Some, perhaps many, would want to withdraw and exit, which would require their full payout. But many former customers apparently

459. Shaurya Malwa, *Sam Bankman-Fried's Defunct Exchange FTX Receives Multiple Bids for Restart*, COINDESK (updated Oct. 25, 2023, 11:22 AM PDT), https://perma.cc/5MH8-HFF2.

460. Alexander Osipovich & Alexander Saeedy, *The Crypto Reboot That Wasn't: Why 'FTX 2.0' Floundered*, WALL ST. J. (May 27, 2024, 5:30 AM ET), https://perma.cc/K5NW-SFNS.

461. Telephone Interview with Arush Sehgal (May 24, 2024) (transcript on file with authors).

462. *Id.*

463. Approved Disclosure Statement, *supra* note 144, at 14.

464. Osipovich & Saeedy, *supra* note 460 ("Bitcoin has more than tripled in value since then and is trading around $70,000, near record levels.").

465. *See* Clara Geoghegan, *Gemini Returns $2.2B of Crypto from Ch. 11*, LAW360 (May 29, 2024), https://perma.cc/6E5F-SFP3.

466. Osipovich & Saeedy, *supra* note 460.

retained positive feelings about the exchange, even if they had little love for Bankman-Fried.[467]

A reboot would, however, vest control of FTX and evidence of its history in the hands of persons outside the orbit of Ray and S&C.[468] A new CEO, in turn, may have no loyalties to S&C and yet would have access to the company's books and records, which may reveal a history inconsistent with the narrative constructed by Ray and S&C.

Instead, the FTX plan's 119% payout would rest largely on the fortuitous appreciation in the value of crypto and the lucrative "dragon's lair" of assets that Bankman-Fried had caused Alameda to accumulate, in part with customer funds.[469] The problematic approach to FTX 2.0 may have been costly to FTX stakeholders, but benefitted S&C by assuaging any "insecurity" (to use Sehgal's term) the firm might have had.[470]

B. The LedgerX Problem

S&C and Ray did not want to terminate all of the FTX businesses, however. One that they sought to preserve—at considerable cost to the estates—was LedgerX, whose CFTC license application may have produced red flags that S&C missed or ignored.

1. The LedgerX transaction and bankruptcy sale

LedgerX was never made a debtor in bankruptcy, although its parent entity, Ledger Holding Inc., was. Here, one month into the bankruptcy, FTX decided that it would sell LedgerX and a few other business lines.[471] Although

467. *Id.*

468. *See id.*

469. *See* Kyle Torpey, *FTX to Begin Repaying Customers in Early 2021—What You Need to Know*, INVESTOPEDIA (Dec. 16, 2024, 6:57 PM EST), https://perma.cc/Y6QZ-QT7Z (explaining that FTX's reorganization plan is set to repay 98% of users 119% of their claimed account values, and that "customers have missed out on the massive rally in the bitcoin and greater crypto markets that has ensued since that time"); LEWIS, *supra* note 17, at 6.

470. Telephone Interview with Arush Sehgal, *supra* note 461. If Ray and S&C controlled the wind-down of FTX, then information about S&C's role at the company would remain in their hands. Notably, S&C and other professionals apparently made "millions of dollars in fees" exploring the idea of FTX 2.0, even though it proved to have no benefit for stakeholders. Osipovich & Saeedy, *supra* note 460.

471. Motion of Debtors for Entry of Orders (I)(A) Approving Bid Procedures, Stalking Horse Protections & the Form & Manner of Notices for the Sale of Certain Businesses, (B) Approving Assumption & Assignment Procedures & (C) Scheduling Auction(s) & Sale Hearing(s) & (II)(A) Approving the Sale(s) Free & Clear of Liens, Claims, Interests & Encumbrances & (B) Authorizing Assumption & Assignment of Executory Contracts &

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selling assets in a restructuring is not unusual, the speed of the sale decision in this case was surprising given the chaos of the sudden collapse. Less than a month earlier, Ray had declared the situation a "dumpster fire"[472] that reflected "a complete absence of trustworthy financial information."[473] If so, it is unclear how Ray and S&C—much less potential bidders—could have known the value of the entities with confidence.

In the case of LedgerX, the debtors scheduled an auction between two bidders on April 4, 2023.[474] One of those bidders (OKC) dropped out after the debtors insinuated that they may not obtain regulatory approval.[475] This left only one purchaser, known as "M 7 Holdings," which agreed to purchase LedgerX for about $50 million.[476] The bankruptcy court approved the sale on May 4, 2023, after a ten-minute hearing.[477]

M 7 was a problematic purchaser. The connections between M 7 and LedgerX were thick. It had sold LedgerX to FTX back in 2021 (the first deal S&C did for FTX).[478] M 7 was also a subsidiary of Miami International

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Unexpired Leases ¶ 3, *In re* FTX Trading Ltd., No. 22-11068 (Bankr. D. Del. Dec. 15, 2022), ECF No. 233.

472. Ray Supp. Retention Decl., *supra* note 23, ¶ 9.

473. Ray First Day Decl., *supra* note 145, ¶ 5.

474. Notice of (I) Successful Bidder for the LedgerX Business & (II) Filing of the LedgerX Business Purchase Agreement at 2, *In re* FTX Trading Ltd., No. 22-11068 (Bankr. D. Del. Apr. 25, 2023), ECF No. 1342 [hereinafter LedgerX Bid Notice].

475. *See* Transcript of Hearing, May 4, 2023 at 5-6, *In re* FTX Trading Ltd., No. 22-11068 (Bankr. D. Del. May 5, 2023), ECF No. 1436 [hereinafter LedgerX Hearing Transcript]. The affidavit of Perella Weinberg investment banker Bruce Mendelsohn asserted that OKC, the disappointed bidder for LedgerX, was rejected because it might not pass muster with the Committee on Foreign Investment in the United States. *See* Supplemental Declaration of Bruce Mendelsohn in Support of Entry of the Order (I) Approving the LedgerX Business Purchase Agreement, (II) Approving the Sale of the LedgerX Business Free & Clear of All Liens, Claims, Interests & Encumbrances, (III) Authorizing Assumption & Assignment of Certain Executory Contracts, & (IV) Granting Related Relief ¶¶ 7, 10, *In re* FTX Trading Ltd., No. 22-11068 (Bankr. D. Del. May 3, 2023), ECF No. 1414. Counsel to OKC stated at the hearing on the sale that Mendelsohn's insinuations were "simply not true," but neither elaborated on what they were nor challenged the sale. *See* LedgerX Hearing Transcript, *supra*, at 6.

476. LedgerX Bid Notice, *supra* note 474, at 2.

477. "Well," Judge Dorsey said to laughter at the hearing, "that was easy." *See* LedgerX Hearing Transcript, *supra* note 475, at 9. Dietderich responded, perhaps knowingly, "[i]t won't always be, so we should enjoy it." *Id.* Interestingly, the Original Disclosure Statement claims that "[w]ith respect to LedgerX, the Debtors received multiple qualified bids and ultimately selected M 7 Holdings, LLC as the successful bidder." Original Disclosure Statement, *supra* note 144, at 26. The Notice of Sale, however, states that only two qualified bids were received, one of which was withdrawn. LedgerX Bid Notice, *supra* note 474, at 2.

478. *See* Tracy Wang, *FTX's LedgerX Derivatives Exchange Sold to Miami International Holdings in Bankruptcy Auction*, COINDESK (updated May 8, 2023 9:13 PM PDT),

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Holdings and was affiliated with former CFTC Commissioner Mark Wetjen, who from January 2020 to October 2021 had served as CEO of a Miami International Holdings exchange and, since 2015, had sat on the LedgerX board.[479] Zach Dexter had been CEO of LedgerX before bankruptcy and sat on its board with Wetjen.[480]

In a sworn statement, Ray assured the bankruptcy court that M 7 was not an "insider," although it is not clear how he came to this conclusion.[481] While Wetjen and Dexter had not been directors or officers of the debtors, they held their positions at an entity that was an affiliate of the debtors, which is well within the statutory definition of an "insider."[482]

The sale price—$48.8 million—was curiously low. FTX originally paid about $300 million for LedgerX in 2021.[483] The sale schedules (filed at the last minute) showed that, as of December 31, 2022, the net value of the company (the net equity) was about $98.8 million.[484] While balance sheet values are not dispositive, they invite the question: Why would FTX sell an asset (ownership of LedgerX) at nearly half its face value—and one-sixth its original purchase price only two years earlier—to an insider of the company (one led by a former FTX executive)? It is not clear, but at least some roads lead back to S&C.[485]

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https://perma.cc/CL5M-98FV. The notice of sale disclosed that the purchaser "was a stockholder of Debtor LHI from December 2016 until the time of LHI's acquisition by West Realm Shires, Inc. ('WRS') in October 2021." LedgerX Bid Notice, *supra* note 474, at 2.

479. *See* LedgerX Bid Notice, *supra* note 474, at 2-3; Derek Andersen, *FTX Proposes Sale of LedgerX to Affiliate of Miami-based Exchange Holding Company*, COINTELEGRAPH (Apr. 25, 2023), https://perma.cc/CMH6-FAL9; *MIAX Welcomes Industry Veteran Mark Wetjen to Lead Expansion of Futures and Digital Securities Products*, MIAX (Jan. 27, 2020), https://perma.cc/G7KG-V94Y.

480. *See* Press Release, FTX US Derivatives, *FTX US Derivatives Announces Board of Directors* (Jan. 19, 2022), https://perma.cc/655Q-WFBC; *supra* Part II.C.2.

481. *See* Declaration of John J. Ray III in Support of Entry of the Order (I) Approving the LedgerX Business Purchase Agreement, (II) Approving the Sale of the LedgerX Business Free & Clear of All Liens, Claims, Interests & Encumbrances, (III) Authorizing Assumption & Assignment of Certain Executory Contracts & (IV) Granting Related Relief ¶ 6, *In re* FTX Trading Ltd., No. 22-11068 (Bankr. D. Del. Apr. 25, 2023), ECF No. 1343 ("Upon reviewing the applicable information from Buyer and information supplied by persons working under my direction whose information I rely upon, I believe that Buyer is not an 'insider' of the Debtors, as that term is defined in section 101(31) of the Bankruptcy Code.").

482. 11 U.S.C. § 101(31)(E) (defining "insider" to include "affiliate, or insider of an affiliate as if such affiliate were the debtor").

483. Wang, *supra* note 478 (indicating 2021 purchase price of $298 million).

484. Notice of Revised LedgerX Proposed Sale Order & Revised Sealed Disclosure Schedules at 42, *In re* FTX Trading Ltd., No. 22-11068 (Bankr. D. Del. May 4, 2023), ECF No. 1422.

485. Intercompany claims may explain some of this. According to financial statements audited by Grant Thornton for LedgerX and attached as a schedule to the sale

footnote continued on next page

2. S&C and the LedgerX sale

Recall that in the summer of 2022, S&C may have missed red flags regarding the misconduct at FTX. As explained in Part II.B, in late summer 2022, LedgerX fired its Chief Risk Officer (Julie Schoening) and affiliate FTX US fired its auditor, both for raising concerns related to FTX's misconduct. Because former S&C partner Ryne Miller was general counsel of FTX US, it is improbable that S&C did not know of these events at the time.

If missing red flags in connection with representing LedgerX presented S&C with professional and reputational risk, the LedgerX sale in the bankruptcy provided a solution. The sale included a "release" of all of LedgerX's agents,[486] which in theory includes legal malpractice claims that LedgerX had against S&C.[487]

The Examiner reviewed S&C's investigation of the LedgerX sale.[488] He recognized that the debtors' inability "to obtain a sale price anywhere near the price that [the debtors] paid for the assets less than two years earlier suggests that [the debtors] overpaid for [a Ledger X holding company] in October

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agreement filed with the Bankruptcy Court, it appears that at the end of December 2022, LedgerX repaid the debtors $175 million of $250 million contributed as regulatory capital by the debtors to LedgerX. *Id.* at 53.

486. Order (I) Approving the LedgerX Business Purchase Agreement, (II) Approving the Sale of the LedgerX Business Free & Clear of All Liens, Claims, Interests & Encumbrances, (III) Authorizing Assumption & Assignment of Certain Executory Contracts, & (IV) Granting Related Relief at 89-90, 98, *In re* FTX Trading Ltd., No. 22-11068 (Bankr. D. Del. May 4, 2023) [hereinafter May 4 Order], ECF No. 1433 (characterizing S&C as a "Released Party" and providing that "[t]he Debtors are hereby authorized and directed to (a) sell and convey to Buyer, effective upon the Closing, the Acquired Claims and the Coverage Claims," which include "any and all claims, liabilities and causes of action that the Debtors have or may have against . . . (b) LedgerX's current directors, officers, employees, agents and the predecessors, successors and assigns of each of the foregoing (in each case, solely in their capacity as such)"). S&C was then a "current . . . agent" of LedgerX and so, it would appear, any malpractice claims belonging to LedgerX would have been released by the Debtors and gone with LedgerX to its purchasers. *See id.* Even so, S&C later asserted to the Examiner that it did not view itself as an "agent" within this language. *See infra* note 492.

487. *See* Examiner Report, *supra* note 41, at 47. Section 5.3 of the LedgerX sale agreement provides that (except for claims against the prebankruptcy insiders), "the Seller and each of its affiliated Debtors hereby sells, transfers and conveys to the Buyer any and all claims, liabilities and causes of action that such person has or may have against (i) the Company, (ii) the Company's current directors, officers, employees, agents." May 4 Order, *supra* note 486, at 47.

488. Examiner Report, *supra* note 41, at 47. Despite its promise to do so, S&C did not have Quinn Emanuel investigate this transaction. *Id.* ("S&C failed to turn over the investigative work related to WRS' prepetition purchase of [LedgerX] to Quinn Emanuel . . . .").

2021."[489] Accordingly, the original transaction, "which S&C advised on, could be the subject of an avoidance action."[490]

Nonetheless, the Examiner thought this was largely unproblematic. Because the bankruptcy sale released the original insider shareholders (who were now the buyers in the bankruptcy), he believed it was "unclear whether" the sale "had any impact whatsoever on the estates."[491] The Examiner did not, however, say whether the releases were appropriate in the first place.

He also did not question whether the release would have covered malpractice claims against S&C because he accepted S&C's assertion that they did not consider themselves to be "agents" for this purpose.[492] It is not clear why the Examiner failed to conduct his own investigation or form his own conclusions. He did recommend a further investigation of potential avoidance actions against the non-insider shareholders who were not released in the sale and were apparently overpaid in the original transaction.[493]

The timing and low value received in the LedgerX transactions suggest that S&C's own interests may have conflicted with the interest in maximizing recoveries.

C. The Binance Problem (Part 2)

Another way to maximize recoveries is through litigation. Chapter 11 debtors have the power to sue those who have obligations to the company (such obligations being property of the debtor's estate); to exercise special bankruptcy powers to "avoid" transfers of property of the debtor made before

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489. *Id.* at 46.

490. *Id.*

491. *Id.* at 47.

492. *Id.* at 48. The Examiner reasoned that "it is not obvious that the term 'agent' is meant to include a law firm or any other professional, because the rest of the phrase refers to directors, officers and employees. Furthermore, S&C was not acting as LedgerX's counsel in either the prepetition or postpetition sale transaction." *Id.* "Notably," he reasoned, "in a meeting with the Examiner, S&C represented that it does not view itself as an 'agent' that was released by this language. The Examiner expects that S&C would stand by this stated position." *Id.* The Examiner also agreed with S&C that it "was not acting as LedgerX's counsel in either the prepetition or postpetition sale transaction." *Id.* ("Prepetition, S&C represented [debtor] WRS."). That, however, is not the point: If S&C made any errors as to LedgerX, those errors involved its work before the CFTC, not in the original sale transaction. Although the Examiner apparently to failed to recognize this, S&C was clearly counsel to LedgerX for these purposes: It said so in the letter it sent to the CFTC withdrawing the controversial licensure application on the same day it filed the debtors' bankruptcy petitions. *See* CFTC Withdrawal Letter, *supra* note 202.

493. Examiner Report, *supra* note 41, at 48 ("[T]he Examiner recommends he conduct an investigation into the potential claims against the non-released shareholders.").

bankruptcy; and to bring other causes of action against those who, intentionally or not, harmed it.[494] Here, the estate under Ray filed many claims against prebankruptcy insiders and their relatives (e.g., the law professor parents of Bankman-Fried) to avoid fraudulent transfers and for breaches of fiduciary duty.[495]

Yet during the bankruptcy, they failed to sue Binance, the former crypto competitor who set the stage for the company's liquidity crisis when the debtors redeemed (repurchased) over $2 billion in preferred stock in 2021.[496] This was a surprising and costly omission. Under the Bankruptcy Code and applicable state law, a redemption of equity by a company that is undercapitalized is voidable as, in substance, a fraudulent transfer.[497] This is especially so where the redemption was intended to harm the debtor, as may have been the case with Binance as FTX's competitor. At Bankman-Fried's trial, the prosecution established that Binance was paid with FTX customer assets.[498] Prosecutors argued that the Binance redemption was a leading reason jurors should convict Bankman-Fried of fraud.[499]

Despite Binance's apparently significant role in the debtors' demise, FTX and Ray took no public action against the company until the last minute. The delay would make it difficult for creditors to know whether the complaint was being prosecuted aggressively on their behalf, since that would take place after the plan was confirmed, when creditor and court oversight would be reduced. Incredibly, the Examiner's Report said nothing about it, either.

Why would the estate fail to pursue a claim potentially worth over $2 billion? Again, some signs point toward issues with S&C itself. First, it appears that since at least January of 2022, S&C white-collar defense lawyer James McDonald (who had committed FTX to cooperating with prosecutors

494. 11 U.S.C. §§ 541(a), 548(a).

495. *See, e.g.*, Complaint, Alameda Research LLC v. Bankman (*In re* FTX Trading Ltd.) ¶¶ 135-65, 170-219, No. 22-11068 (Bankr. D. Del. Sept. 18, 2023), ECF No. 2642 (asserting estate causes of action for fraudulent transfers, breaches of fiduciary duties, aiding and abetting breaches of fiduciary duty, unjust enrichment, and so on). On or about November 10, 2024, long after filing other complaints, FTX also sued Binance asserting various causes of action, including fraudulent transfer. *See* Alex Wittenberg, *FTX Sues Binance, Former CEO Zhao Seeking $1.8B Clawback*, LAW360 (Nov. 12, 2024), https://perma.cc/VG6E-GGDT; *see also* Complaint, FTX Trading, Ltd v. Binance Holdings, Ltd. (*In re* FTX Trading Ltd.), No. 22-11068 (Bankr. D. Del. Nov. 10, 2024), ECF No. 27852. Because the FTX plan was already confirmed, and the post-bankruptcy estate remained under the control of Mr. Ray, the fate of the action would be unclear.

496. *See supra* Part II.A.

497. 11 U.S.C. §§ 544(b)(1), 548(a)(1)(B)(ii)(II); DEL. CODE. ANN. tit. 6, § 1305.

498. *See supra* text accompanying note 173.

499. *See* SBF Closing Argument Transcript, *supra* note 157, at 2950.

without telling Bankman-Fried)[500] was counsel to Catherine Coley, "who launched Binance.US in 2019 and left suddenly two years later."[501]

Second, on February 16, 2024, Bloomberg reported that S&C was "poised to be appointed Binance Holdings Ltd.'s independent monitor following the crypto giant's multibillion-dollar settlement with the US government."[502] It turned out that Binance had problems of its own, resulting in the company admitting guilt to charges related to anti-money laundering and sanctions violations.[503] To settle the charges, Binance agreed to pay the government $4.3 billion and to accept court-appointed monitors, who would have exclusive access to all of the company's data.[504] S&C was a leading contender for the job.[505] After concerns were expressed, however, the Department of Justice announced that Binance would have two independent monitors, only one of which would be S&C.[506]

Once this became clear, it is not difficult to imagine that S&C would resist suing Binance. If S&C also wanted to be that company's monitor through a different proceeding, it would in effect be at odds with FTX's bankruptcy estate, which should have been pursuing Binance to recover over $2 billion. S&C's private interest in the lucrative task of monitoring Binance conflicted with the interests of FTX stakeholders in maximizing recoveries.

D. Where Were the Stakeholders? Other Watchdogs That Did Not Bark

Failing to maximize value ordinarily hurts creditors in a chapter 11 case, so why did the UCC not insist on pursuing these potential claims? Indeed, if, as some signs suggest, FTX was solvent (or could be rendered so by restarting the exchanges), why didn't shareholders take action?

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500. *See* McDonald Email, *supra* note 268; McDonald Letter, *supra* note 264, at 30-33; *supra* notes 264-65 and accompanying text.

501. Angus Berwick & Chris Prentice, *Exclusive: Ex-CEO of Binance's US Firm Has Enlisted Lawyer for US Investigations*, REUTERS (Mar. 29, 2023, 5:11 PM PDT), https://perma.cc/63PT-2RX3.

502. Ava Benny-Morrison, Sabrina Willmer & Allyson Versprille, *Sullivan & Cromwell in Line for Coveted Binance Watchdog Role*, BLOOMBERG (Feb. 16, 2024, 10:41 AM EST), https://perma.cc/96MZ-EH5H.

503. *See* Mutuma Maxwell, *Binance Settlement Monitoring: Sullivan & Cromwell Takes the Lead,* MSN.COM (Feb. 16, 2024, 1:57 AM), https://perma.cc/4BUB-WVMS.

504. *Id.*

505. *Id.*

506. Mengqi Sun, *Binance Gets Two Compliance Monitors in Settlements with U.S. Authorities,* MSN.COM (May 17, 2024, 10:13 AM), https://perma.cc/PMD2-Q4MP.

As a preliminary matter, these causes of action belonged to the estate, which was controlled by Ray.[507] He frequently opted against action which might threaten S&C.[508] Still, Ray's control was not absolute. The UCC could seek "derivative standing" to sue Binance on behalf of the estate if they could show that the debtor-in-possession was falling down on the job.[509] Why didn't they? The UCC's attorneys, Paul Hastings, are regular players in large reorganizations, and so may have been reluctant to pick a fight here without some clear benefit.[510] Moreover, evidence in the Bankman-Fried trial revealed that Paul Hastings had been counsel to Binance in the very transaction at issue—FTX's 2021 repurchase of shares held by Binance.[511] Thus, Paul Hastings would not ethically have been able to challenge the transaction.

Turn now to the FTX shareholders. The debtors' financial information showed assets with estimated recovery values between $14.9-16.7 billion and creditor claims (other than governmental claims) of about $11.7 billion.[512] Assuming these valuations were correct, and excluding government claims, there should have been between $3.2 and $5 billion in equity. Under the FTX plan as proposed in May 2024, however, holders of equity would receive nothing.[513] Why take no action to protect their interests?

In part, it may be because Bankman-Fried himself owned much of the equity. In addition, the outside venture investors who did put money in (e.g., Sequoia) may have been embarrassed by their lack of diligence.[514] Thus, the

507. *See, e.g.*, Trimble v. Woodhead, 102 U.S. 647, 649 (1880); *see also* Bd. of Trs. of Teamsters Loc. 863 Pension Fund v. Foodtown, Inc., 296 F.3d 164, 169 n.5 (3d Cir. 2002) (explaining that causes of action are property of the estate).

508. For example, as discussed in Part V.C above, Ray took no action against Binance despite the harm it caused FTX, which was coincident with S&C's interest in becoming the Binance monitor.

509. *See* Off. Comm. of Unsecured Creditors of Cybergenics Corp. *ex rel.* Cybergenics Corp. v. Chinery, 330 F.3d 548, 580 (3d Cir. 2003) (en banc) (holding that in chapter 11, a bankruptcy court may grant derivative standing to a creditor or creditors' committee to pursue avoidance claims).

510. *See* S&C Retention Transcript, *supra* note 228, at 22, 33-37 (noting that Paul Hastings represented the UCC).

511. Binance Repurchase Agreement, *supra* note 172, at 6. Notably, the action commenced against Binance after the FTX plan was confirmed was prosecuted by neither S&C nor Paul Hastings, but instead the law of firm of White & Case. *See* Wittenberg, *supra* note 495.

512. *See* Approved Disclosure Statement, *supra* note 144, App. C, at 8 (Consolidated Debtors Estimated Net Assets Available for Distribution).

513. *See id.* at 20. The May 2024 plan estimated the debtors had issued about $2 billion in preferred stock before bankruptcy. *Id.* Its holders would receive nothing on account of those interests. *Id.*

514. *See* Erin Griffith & David Yaffe-Bellany, *Investors Who Put $2 Billion into FTX Face Scrutiny, Too*, N.Y. TIMES (Nov. 11, 2022), https://perma.cc/6RNK-SHUZ.

stakeholders with the most to gain from (1) maximizing value at the margin, such as through FTX 2.0, and (2) keeping professional costs in check are absent.

There was another factor as well, one which makes concrete our concerns about conflicting public interests. Key government claims held by the Internal Revenue Service and the CFTC were valued under the plan at about $10 billion and would eliminate any equity value for shareholders.[515] Those claims were the product of settlements among the government and the debtors.[516] It is difficult to know the merits of those claims, since they were not tested in litigation.[517] But the settlements had the effect of ensuring that shareholders—including noninsider shareholders of FTX—were "out of the money" and would not recover, even if significant additional value were retrieved for the estate.[518]

VI. Implications and Correctives

The last four Parts showed how S&C's prebankruptcy history with FTX gave it an incentive to mold the reorganization process to reflect its interests. Doing so undermined the first-order interest in judicial-process integrity at the expense of stakeholder recoveries, the second form of public interest. The complex alliance between S&C and the government gave S&C cover to claim that it was serving a third, non-bankruptcy public interest and may have distorted the criminal justice process. In this Part, we explore the implications of these findings and offer suggestions for improving the effectiveness of the key bankruptcy gatekeepers.

S&C's role in *FTX*, and the conduct of the case, threaten a troubling return to the norms of the equity-receivership era, sketched in Part I. If, as seems to be the case, S&C can ignore red flags prior to financial distress, mislead its client's

515. *See* Approved Disclosure Statement, *supra* note 144, app. C at 8 (Consolidated Debtors Estimated Net Assets Available for Distribution).

516. *See id.* at 6, 9.

517. In June 2024, FTX agreed to settle the IRS's $8 billion claims for $885 million. *See* Haley Konnath, *FTX, IRS Propose Settling $8B Tax Fight for Just $885M*, LAW360 (June 3, 2024, 11:22 PM EDT), https://perma.cc/5XE2-3GLA.

518. *See* Approved Disclosure Statement, *supra* note 144, app. C at 8. "In October 2024, shortly before the confirmation hearing, FTX's plan was amended to create a fund to provide potential payments to preferred shareholders from the proceeds of recoveries from actions against insiders." Steven Church & Jonathan Randles, *Sam Bankman-Fried's Bankrupt FTX Crypto Exchange Is Cleared to Repay Customers*, BNN BLOOMBERG (Oct. 7, 2024, 3:19 PM EDT), https://perma.cc/AC2S-8SUX. However, any such payments would be subject to approval by the United States government, which at that time was not forthcoming. *Id.* Some customers were troubled that preferred stockholders would receive payment when they were not receiving the full, present value of the digital assets. *Id.*

CEO, and earn hundreds of millions of dollars by controlling the company's reorganization process—all while claiming to be acting in the public interest—other lawyers may find this attractive, too. S&C and FTX may invite bankruptcy insiders to use sharp tactics in and around corporate financial distress, to advance their own interest at the expense of both confidence in the process and in maximizing recoveries.

A. Managing Conflicting Public Interests in Bankruptcy

In important recent work, scholars have begun to focus on the long-neglected issue of the public interests at stake in large corporate-reorganization cases. Melissa Jacoby has made the point, familiar in other contexts, that even in a market system, private parties depend on the government to enforce contracts and property rights.[519] Bankruptcy is thus a "hybrid system," public as well as private.[520] Focusing on a series of coal-company bankruptcies, Joshua Macey and Jackson Salovaara have shown that bankruptcy can sometimes be used to undermine the public interest by evading regulatory objectives.[521]

The most sustained attention to governmental actors and the public interest in bankruptcy has come from Jared Ellias and George Triantis. In one recent article, they explored the use of bankruptcy by governmental actors to achieve public-interest objectives, concluding that bankruptcy can be a "force multiplier,"[522] but also cautioning that this strategy may sidestep the ordinary constraints that operate when the legislative or executive branches pursue public-interest objectives.[523]

An important lesson of the *FTX* bankruptcy is that failure to protect the integrity of the judicial process—in this case, by policing the lawyers' conflicting interests—will infect every phase of the case. Not only did the conflicts undermine judicial oversight and the legal system, but they also seem to have interfered with the second public-interest objective, achievement of insolvency-specific objectives such as maximizing the value of the bankruptcy estate through the reorganization process. Finally, although facilitating the prosecution of fraud is an important non-bankruptcy objective—the third category of public interest—S&C's conflicts may have distorted its incentives in providing assistance to the U.S. Attorney and interfered with Bankman-Fried's

519. Jacoby, *supra* note 50, at 1725.

520. *Id.* at 1730.

521. Joshua Macey & Jackson Salovaara, *Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law*, 71 STAN. L. REV. 879, 935-42 (2019).

522. Jared A. Ellias & George Triantis, *Government Activism in Bankruptcy*, 37 EMORY BANKR. DEVS. J. 509, 512, 543-45 (2021).

523. *Id.* at 523-49 (collecting cases).

defense. Adequate defense in a criminal case is also a public interest which, while distal from bankruptcy concerns, was apparently not considered important by the debtors in FTX.

The third form of public interest, use of bankruptcy to achieve substantive non-bankruptcy governmental goals, needs to be carefully policed. Government actors may be tempted to sacrifice judicial process integrity or bankruptcy objectives such as maximizing the value of the estate. In addition, as Ellias and Triantis have pointed out, bankruptcy tends to be more rushed than the administrative or judicial process, it lacks some of the safeguards of those traditional venues for pursuing non-bankruptcy public interests, and "bankruptcy judges are generally not experienced in being arbiters of complex policy debates."[524]

In *FTX*, some assistance given by John Ray and S&C to the U.S. Attorney's office would have been justified, since it enabled prosecutors, who often face debilitating resource constraints, to present a more effective case. But Ray and S&C did far more than simply make information available. Their advisors processed it for the prosecutors.[525] This assistance may have undermined Bankman-Fried's defense; it is possible, for instance, that Bankman-Fried lacked access to exculpatory information to which he would have been entitled under the *Brady* doctrine if prosecutors searched FTX directly, rather than receiving information that had already been analyzed by Ray and the FTX advisors.[526] And the assistance was paid for by FTX's stakeholders, since S&C billed millions of dollars to the FTX estate, despite the absence of any apparent benefit to the estate from the prosecution.

Just as *FTX* illustrates how pursuit of substantive, non-bankruptcy public interests can prove problematic, it also hints, by negative implication, at the most obvious way to minimize the potential distortions: vigorously protecting the first and second forms of public interest—the integrity of the judicial process and the promotion of insolvency-related objectives such as maximizing the value of the debtor's assets. If FTX had not been permitted to retain bankruptcy attorneys whose conduct cast a cloud over their role in the bankruptcy (i.e., if the first public interest had been properly recognized), it

524. *Id.* at 545.

525. *See supra* Part III.B (describing S&C's assistance of the prosecution).

526. If prosecutors obtain exculpatory evidence, the *Brady* doctrine requires them to turn it over to the defense. *See supra* note 356 and accompanying text. However, if S&C processed any exculpatory evidence but did not give it to prosecutors, *Brady* would not be triggered. S&C's role in determining which information prosecutors received may thus have limited Bankman-Fried's access to exculpatory evidence. Bankman-Fried raised this concern in his defense. *See* Discovery Brief *supra* note 353, at 11-13 ("[T]he government has outsourced its *Brady* obligations to an entity than has no *Brady* obligations whatsoever.").

would have been considerably less likely to overzealously support the Bankman-Fried fraud prosecution, and fewer questions would have emerged as to whether FTX was maximizing the value of its assets.

How might we have expected a debtor and its professionals to determine how much support to give to a prosecution effort? In our view, a debtor should always provide a basic level of cooperation, such as turning over documents requested by prosecutors. But in deciding whether to go beyond basic cooperation, the debtor and its professionals should balance the request for assistance against the objective of maximizing the value of the estate. If additional cooperation will benefit the estate, the debtor and professionals should provide it; but they should not supply costly additional assistance at the expense of creditors and the estate. In *FTX*, this balancing does not seem to have taken place.

FTX is hardly the only case involving conflicting public and private interests. The *Chrysler* bankruptcy provides another illustration.[527] As the bankruptcy judge in *Chrysler* rightly pointed out, the U.S. government was fully entitled to serve as debtor-in-possession financer and to promote a sale of the carmaker's assets, just as a private lender might.[528] But the Court permitted the U.S. government to restrict potential bidders to those that would support the government's non-bankruptcy objectives of protecting Chrysler's unionized employees and promoting energy-efficient and green cars.[529] A bid that failed to conform to Treasury's bid—by declining to assume Chrysler's collective bargaining obligations and specified prebankruptcy debt, for instance—"would be considered only if the debtor, after consulting with creditors, the Treasury, and the UAW, accepted it as qualified."[530] This chilled potential bidding, thus undermining the bankruptcy objective of maximizing the value received in a sale.

It is important to acknowledge that the second and third forms of public interest can clash in the opposite direction as well: Pursuing bankruptcy objectives can undermine important non-bankruptcy objectives. Macey and Salovaara's work on corporate debtors' use of bankruptcy to minimize pension obligations furnishes a ready illustration.[531] In our view, these frictions are

527. *In re* Chrysler LLC, 405 B.R. 84 (Bankr. S.D.N.Y. 2009).

528. *See, e.g., id.* at 106 ("Here, the Governmental Entities, as lenders of last resort, are dictating the terms upon which they will fund the transaction, thereby leaving the Debtors with few options. Nevertheless, the usual marketplace dynamics play out and the Court applies the same bankruptcy law analysis.").

529. Others have also made this point, including one of us. *See* Mark J. Roe & David Skeel, Jr., *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 747-48 (2010); Ellias & Triantis, *supra* note 522, at 523-30.

530. Roe & Skeel, *supra* note 529, at 747-48.

531. Macey & Salovaara, *supra* note 521, at 885.

best remedied by legislation, rather than by bankruptcy judges unilaterally departing from bankruptcy objectives, although the wait for legislative reform can sometimes be long.

B. What are "Disinterested" Bankruptcy Lawyers?

Perhaps the single most disturbing theme in our findings is the extent to which S&C's conflicting incentives permeated FTX's bankruptcy filing and every aspect of the case. Although S&C touted the Examiner's findings,[532] it is important to note that the Examiner did not say the firm was "disinterested"—the standard that matters. Instead, he said that the bankruptcy court made "no error" in appointing the firm in light of the "wide discretion" governing appointments and the record before the court at the time.[533]

S&C's conflicts appear reminiscent of the conflicts in the old equity receivership cases, but in especially worrisome form due to the allegations of ongoing fraudulent behavior prior to bankruptcy.[534] S&C came in well before FTX's collapse and was linked in important ways to FTX's prebankruptcy misbehavior.[535] Given that so many large law firms now have both a corporate and a chapter 11 practice, the S&C problem is likely to recur. That is, elite law firms representing other large businesses will attempt to use their existing relationship with the company to secure the lucrative role of serving as the debtor's attorneys in bankruptcy if the company encounters trouble. Chapter 11 would then provide protection for both debtors and their lawyers.

The most decisive solution to this risk would be to restore the definition of disinterestedness that the New Deal reformers incorporated into the 1938 bankruptcy reforms, as updated for modern chapter 11.[536] Congress could forbid lawyers who represented a debtor before its distress from serving as its lawyers in bankruptcy. But a debtor's desire to retain its prebankruptcy lawyers in chapter 11 is not always problematic. If there is no evidence the lawyers were aware of or involved in potentially problematic prebankruptcy behavior, the likelihood of conflicts may be low. And the debtor's

532. Dietrich Knauth, *FTX Bankruptcy Lawyers Were Not Complicit in Fraud, Report Finds*, REUTERS (May 23, 2024), https://perma.cc/VG2F-HWSE/ (noting S&C's statement that "we welcome the examiner's findings to date rejecting various baseless allegations about our work for FTX").

533. Examiner Report, *supra* note 41, at 35.

534. S*upra* note 108 and accompanying text.

535. *See supra* Parts II.A-.B.

536. The old disinterestedness requirement applied to the trustee, because Chapter X required that the debtor's managers be replaced by a trustee. Because trustees are rarely appointed in chapter 11, the requirement should apply to the debtor (the "debtor-in-possession," in bankruptcy speak). We discuss this history in Parts I.C through I.E above.

prebankruptcy lawyers have the advantage, as compared to a new law firm, of already being familiar with the company and its operations.

Rather than barring prebankruptcy lawyers from chapter 11 debtor representation altogether, we recommend a more nuanced approach. If the law firm represented the debtor when the debtor may have engaged in serious misconduct, a court should apply a nearly irrebuttable presumption that the firm cannot serve as the debtor's bankruptcy counsel. The firm certainly should not be retained without a preliminary examination by an outside investigator of the sort we propose in the next section.

Even absent allegations of fraud or misbehavior, courts should scrutinize applications for retention of debtors' pre-distress lawyers more closely than with entirely new counsel. The court should take into account the extent of the prebankruptcy representation and the types of matters handled. Courts should be especially wary of last-minute disclosures by firms with a significant prebankruptcy relationship with the debtors or other parties in interest. A law firm that played a limited role and was not involved in transactions that may be the subject of avoidance actions is less worrisome than a law firm that was intimately involved in potentially problematic transactions.

The scrutiny we advocate requires no legislative change. Under the current definition of disinterestedness, a law firm does not qualify if it has an interest "materially adverse" to the estate.[537] Our proposal does, however, require bankruptcy judges to ask harder questions earlier in large and complex cases.

C. Re-Examining Examiners

A critical tool to help avoid these conflicts already exists, in the form of examiners. Prior research has found that the timing of an examiner request matters: The earlier it is made, the more likely it is to succeed.[538] This did not happen in *FTX*, however, due to S&C's objections and the unusual secrecy of the case.

If the U.S. Trustee's request for an examiner had been granted at the outset, the report might have looked very different. That report might have more fully considered the evidence that emerged after the retention decision, including the evidence presented in Part II. It might have resulted in a recommendation to change the debtor's general counsel (S&C could have remained special counsel for certain purposes under Section 327(e)). If so, the concerns we raised may have been allayed.

537. 11 U.S.C. § 101(14)(C).

538. Lipson & Marotta, *supra* note 50, at 33.

The parties in *FTX* resisted an examiner on grounds that it would be expensive and redundant with other investigations, including those being conducted by counsel in the bankruptcy and the prosecutions of insiders.[539] Concerns about cost are legitimate but ironic given that the *FTX* examiner cost less than one percent of estimated professional expenses.[540] But the Third Circuit's opinion teaches that these costs, large or small, must be balanced against the first-order public interest in judicial integrity.[541]

To address problems of timing and cost, bankruptcy judges should authorize preliminary examinations to determine whether further inquiry is appropriate.[542] In a preliminary examination, the U.S. Trustee would appoint an independent examiner at the outset of any case in which there were credible concerns of the sort identified by Congress (e.g., fraud, mismanagement). Bankruptcy courts would then approve these appointments early in the case, giving the examiner a clear focus and limited budget. If the preliminary examination finds no reason for further inquiry, the public interest is satisfied and costs are minimized.

If, however, the preliminary examination reveals the need for further inquiry, a full examination would be required. The preliminary examiner should presumptively be ineligible to undertake a full examination, in order to reduce the incentive to "find" matters for further investigation.

Preliminary examinations in a broader swath of cases could help to address growing concerns about the integrity of the bankruptcy system. Understanding that an outsider will investigate and report on credible allegations of problematic conduct may also help to ameliorate a persistent sense that corporate reorganization is rigged in favor of insiders.[543] S&C's efforts to return to a leadership role in this practice area via *FTX* shows how lucrative it can be.[544]

D. Re-Examining the Role of the U.S. Trustee

Another implication of our findings is that public actors pursuing different public-interest objectives may come into tension, just as the private parties in the case do. With *FTX*, we suspect that the U.S. Trustee's watchdog obligations may have conflicted with the needs of the U.S. Attorney for the

539. *See supra* Part IV.B.1.

540. *See supra* Part IV.E.

541. *See In re* FTX Trading Ltd., 91 F.4th 148, 156 (3d Cir. 2024) (rejecting concerns about cost as not "persuasive, given that Congress has guaranteed that an investigation under subsection 1104(c)(2) would differ from those conducted by the Appellees").

542. *See* Lipson & Marotta, *supra* note 50, at 51.

543. *See, e.g.*, David Skeel, *Bankruptcy's Identity Crisis*, 171 U. PA. L. REV. 2097, 2101 (2023).

544. *See supra* note 415 and accompanying text.

Southern District of New York, another branch of the Department of Justice, which apparently relied heavily on S&C for information and analysis—and possibly even the tip that triggered or accelerated the prosecution in the first place.[545] If the U.S. Trustee had pursued S&C's conflicts more aggressively or questioned the use of estate funds to support the Bankman-Fried prosecution, these efforts might have compromised the government's interest in a speedy prosecution whose cost was borne by FTX creditors (and not just U.S. taxpayers).

How is a conflict between the U.S. Trustee and others within the Department of Justice supposed to be resolved? It is not clear which units have priority. But it seems likely that the U.S. Trustee would be expected to be responsive to the interests of other branches of the Department of Justice, especially an important U.S. Attorney's office such as the Southern District of New York.[546]

Practitioners such as S&C benefit from the uncertainty. As sophisticated intermediaries between public and private actors (e.g., LedgerX and the CFTC before the collapse), they may be able to triangulate negotiations among public actors in ways that help their clients or, indeed, themselves, as appears to have been the case in *FTX*.[547] While public-on-public conflicts are inevitable in a large and fractious democracy, we worry about the implications of leaving the U.S. Trustee at the mercy of other, larger forces in the Department of Justice and in private practice.

These problems would be greatly alleviated if the U.S. Trustee had more independence. The Consumer Financial Protection Bureau (CFPB), which is housed in the Federal Reserve but largely insulated from interference, is an obvious example of how this might be done.[548] The best way to enhance the U.S. Trustee's capacity might be to give it a similar status, although we recognize this currently is not politically feasible, given how controversial the CFPB's protection from outside interference has been and the pushback a proposal to enhance another watchdog's authority would face.[549]

545. *See supra* notes 262-66 and accompanying text (describing S&C's outreach to prosecutors and agreement to provide them with documents).

546. For analogous concerns, see Simon, note 33 above, at 1310 (noting that "the [bankruptcy] system creates a fundamental separation-of-powers tension—the executive may influence judicial procedures through a constant presence in cases not involving the U.S. government").

547. *See supra* note 357 and accompanying text (noting that S&C billed repeatedly for meetings with prosecutors).

548. *See* CFPB v. Cmty. Fin. Servs. Ass'n of Am., Ltd., 144 S. Ct. 1474, 1479 (2024) (describing the CFPB's independent structure).

549. The most recent challenge to the CFPB's independence was resolved by the Supreme Court in the CFPB's favor. *Id.* at 1478 (holding that the CFPB's funding arrangement satisfies the Appropriations Clause).

Alternatively, the U.S. Trustee could be subject to "firewall" protection, as happens within law firms that have potential conflicts of interest. That system would assure that the lawyers with the conflict are screened out of the case (and away from the lawyers who work on it). Other public actors within the federal government (especially the Department of Justice) who may be adverse to the U.S. Trustee or the debtors' estate, should be restricted in their capacity to influence the U.S. Trustee and its actions in chapter 11.

The U.S. Trustee is often seen as a gadfly in chapter 11 by the insiders who dominate large cases.[550] Whereas many bankruptcy judges are prominent bankruptcy lawyers before ascending to the bench, the staff of the U.S. Trustee's office are often outsiders. Greater independence might not alter the U.S. Trustee's outsider status, but it would enhance the prestige of the U.S. Trustee's office and enhance its ability to attract top talent, akin to the Securities and Exchange Commission or CFPB. This would enable the U.S. Trustee to better promote all three forms of public interest and to police efforts by the debtor's attorneys or other professionals to compromise the public interest in pursuit of their own private interests.

Conclusion

Sam Bankman-Fried was quick to concede that he "f'd up," and there is little doubt that he did. This Article has shown that, in relinquishing control of his companies at the behest of lawyers who appear to have been motivated by their own concerns, he was also "FTX'd up," inadvertently aiding the subversion of all three forms of public interest. While we do not challenge the jury's verdict or the company's need to use chapter 11, we worry about attorneys who marshal and manipulate arguments about the "public interest" in order to advance or protect their own interests. Chapter 11 knows no exception to the old adage, "two wrongs do not make a right."

Our worries derive from our detailed case study of *FTX*, the first of its kind of one of the most important bankruptcies of recent decades. Based on our investigation and an examination of the historical evolution of conceptions of the public interest in corporate reorganization, we have developed a typology of public-interest concerns and suggested ways in which the principal custodians of the public interest in chapter 11 can be improved. To fail to take these public interests seriously is to risk further harm to the chapter 11 system.

550. *See generally* Simon, *supra* note 33, at 1311 (noting criticism of the U.S. Trustee but characterizing the watchdog as generally well-respected).