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RESEARCH PAPER NO. 24-08

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

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Forthcoming, *Stanford Law Review*

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

Jonathan C. Lipson
David Skeel*

Chapter 11 of the Bankruptcy Code is often justified by vague assertions that reorganizing troubled companies is in the "public interest." This is trivially true in the sense that the power to create the system is vested in Congress by virtue of the Constitution's Bankruptcy Clause (art I, § 8, cl 4). 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 recent and 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, some revealed for the first time, which shows 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 troubling shadow over puzzling and costly decisions in the case—including bargain-basement asset-sales to favored insiders—thereby undermining the second, bankruptcy-specific form of the public interest. S&C has justified its actions by reference to the third, "other" facet of the public interest, supporting the prosecution of disfavored insiders such as Bankman-Fried, a pricey task (they have already charged creditors over $200 million) which may have distorted those 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 may yet shed light, but S&C's resistance to that intervention means that much of the damage cannot be undone. We situate our findings in a nascent body of literature exploring the public interest in bankruptcy, and offer guidance to improve the functioning of the principal custodians of the public interest in chapter 11: the debtor's attorney, the bankruptcy examiner, and the United States Trustee.

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Introduction

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

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. As recounted in two best-selling books and a plethora of media commentary,[2] Bankman-Fried was the intellectually precocious son of two law professors. He studied math and physics at MIT and then worked at Jane Street, a Wall Street trading firm, before moving into the cryptocurrency industry.

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.[3] Whereas Changpeng Zhao (or "CZ"), the head of Binance, the other leading crypto exchange and FTX's main competitor, positioned himself as a renegade who despised regulators, FTX sought credibility with investors, regulators, and even celebrities.[4]

This credibility benefitted from the company's affiliation with the elite New York law firm Sullivan & Cromwell (S&C), which represented the company in important regulatory efforts to legitimize and rationalize digital assets before bankruptcy. In 2021, for example, S&C helped FTX acquire LedgerX, which was a rare crypto exchange registered with U.S. regulators (the

[1] The legislative history of the Bankruptcy Code shows a Congress seeking to "protect the investing public, protect jobs, and help save troubled businesses." 124 Cong.Rec. 32,392 (1978) (statement of Rep. Edwards). *See also* NLRB v. Bildisco & Bildisco, 465 U.S. 513, 517 n. 1 (1984)(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 Lawrence 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] The two books offer opposed perspectives on Bankman-Fried. MICHAEL LEWIS, GOING INFINITE: THE AND FALL OF A NEW TYCOON (2023) is sympathetic. ZEKE FAUX, NUMBER GO UP (2023) views him as a charlatan.

[3] 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., *In re* FTX Trading (June 26, 2023), No. 1704, at 8 ("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.") [hereinafter "Commingling Report"].

[4] Tom Brady, Gisele Bundchen, and Larry David all appeared in FTX ads. *See* FAUX, *supra* note 2, at 89 (Brady), 90 (David), 131 (Bundchen).

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Commodity Futures Trading Commission). The purchase represented FTX's "plan to enter the regulated U.S. derivatives market."[5]

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 International, and the more precarious hedge fund, Alameda Research, had exposed billions of dollars of FTX customers' digital and fiat assets to loss.[6] Bankman-Fried was accused of knowing about these linkages and authorizing Alameda, run by his sometime-girlfriend Caroline Ellison, and insiders to secretly filch funds that belonged to FTX customers.

S&C dramatically intervened, persuading Bankman-Fried to give up control of FTX to turnaround expert John Ray in the early morning hours of November 11, 2022. 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 and, in the case of Bankman-Fried, convicted of fraud for having used customer assets to purchase such things as a lavish compound in the Bahamas and to make generous political and philanthropic donations. He faces potentially a century in prison.

Ray, and those he employed to save FTX—in particular S&C—have cast themselves as heroes to FTX's millions of stakeholders, even suggesting that customers may be made whole due to their herculean efforts to quench the "dumpster fire" they found.[7]

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;
- Despite this, S&C may have represented to U.S. regulatory authorities and to potential contract counterparties that FTX was "rock solid";[8]

[5] Alexander Saeedy, *FTX Poised for $250 Million Loss on LedgerX Sale*, WALL. ST. J., APR. 25, 2023, https://www.wsj.com/articles/ftx-poised-for-250-million-loss-on-ledgerx-sale-d591e99f

[6] Ian Allison, *Divisions in Sam Bankman-Fried's Crypto Empire Blur on His Trading Titan Alameda's Balance Sheet*, COINDESK, Nov. 2, 2022, https://www.coindesk.com/business/2022/11/02/divisions-in-sam-bankman-frieds-crypto-empire-blur-on-his-trading-titan-alamedas-balance-sheet/.

[7] Steven Church & Jonathan Randles, *FTX Plans to Repay Customers in Full, Drop Exchange Relaunch*, BLOOMBERG.COM, Jan. 31, 2024, https://www.bloomberg.com/news/articles/2024-01-31/ftx-expects-to-repay-customers-in-full-bankruptcy-lawyer-says?embedded-checkout=true. The "dumpster fire" image derives from testimony by FTX's turnaround CEO John Ray to Congress. Suppl. Decl. of John J. Ray III in Support of Retention Applications, *In re* FTX Trading, Doc. 511, at ¶ 9 (Jan. 17, 2023).

[8] On November 7, S&C attorney Andrew Dietderich sent an email to McDermott, Will & Emery attorney Darren Azman 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, and 11213, *In re* Voyager Digital Holdings, Inc., et al., Case No. 22-10943-mew (Bankr. S.D.N.Y. Feb. 2, 2023), Doc. 937-13 (quoting email from Andrew G. Dietderich, Sullivan & Cromwell, to Darren Azman, McDermott, Will & Emery, Nov. 7, 2022).

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- When FTX suffered a "run" on deposits in November 2022, S&C concluded for the first time that this commingling was potentially problematic—indeed, a crime;
- S&C may have violated ethical duties of confidentiality, candor, and loyalty by reporting allegations of these crimes to prosecutors without 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 surely knew were false.

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 insiders. Doing so not only reduced stakeholder recoveries, but 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.[9] Much of the evidence we present is in the public domain, and comes from statements made by S&C, Ray and others running the *FTX* chapter 11 bankruptcy. Some has been provided by third parties who 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.

Concerned about the public interest in *FTX,* the United States Trustee—an arm of the Department of Justice that is the principal watchdog in bankruptcy—initially objected to S&C's retention by FTX. The U.S. Trustee settled the objection in exchange for enhanced disclosures, made shortly before the hearing on the firm's retention.[10] None of the concerns noted above were raised in that objection or addressed in those disclosures, so Bankruptcy Judge John T. Dorsey approved S&C's retention under the applicable standard, that the firm was "disinterested."[11]

The public interest also led the Trustee to seek the appointment of an "examiner." Bankruptcy examiners have been appointed under section 1104(c) of the Bankruptcy Code in the biggest bankruptcies involving serious allegations of fraud or misbehavior, including *Enron, Worldcom,* and *Lehman Brothers,* to independently investigate and report on the causes and

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As discussed in Part II, Dietderich later declared under oath in *FTX* that, on that same day, "S&C also opened a matter for FTX Trading Ltd. for strategic matters relating to potential capital raises, sales, out-of-court restructuring matters or similar transactions arising out of liquidity concerns following press reports of a large liquidation of" FTX tokens known as FTT. *See* Supplemental Declaration of Andrew G. Dietderich in Support of Debtors' Application for an Order Authorizing the Retention and Employment of Sullivan & Cromwell LLP as Counsel to the Debtors and Debtors-in-Possession Nunc Pro Tunc to the Petition Date, *In re* FTX Trading, Ltd*.*, Case 22-11068-JTD (Jan. 17, 2023), Doc. 510, ¶ 54 [hereinafter "Dietderich 1st Supp."]. The role of Binance in the collapse of FTX is discussed in Parts II and V, below.

[9] We should note at the outset that we have no grievance with S&C, per se. In our view, it generally is a first-rate firm. Indeed, as we prepared this draft, S&C was recognized by the legal news service *Law360* as having the "Bankruptcy Group of the Year." *See* Emily Lever, *Bankruptcy Group Of The Year: Sullivan & Cromwell*, LAW360,Mar. 6, 2023, https://www.law360.com/articles/1782547?e_id=60456bb3-7724-4758-a3a0-6dd1c6511779&utm_source=engagement-alerts&utm_medium=email&utm_campaign=similar_articles.

[10] *See* discussion in Part III.A, below.

[11] *See* 11 U.S.C. § 327(a). *See also* discussion in Part III.A., below.

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consequences of the debtors' collapse. The United States Trustee argued here that an examiner was required because section 1104(c) says that the Bankruptcy Court "shall" appoint one in a case involving more than $5 million of debt—indisputably true for FTX—and the case involved massive fraud.[12] The debtors, represented by S&C and Ray, resisted, insisting that because Ray was obviously independent of Bankman-Fried, and S&C was "disinterested," they could handle the investigation internally.[13] Concerned that an examiner would be a costly redundancy, Judge Dorsey bought the argument and denied the examiner request.

The U.S. Trustee appealed the examiner decision, and the Third Circuit reversed the Bankruptcy Court. Notably concerned about S&C's potential conflicts of interest, the Court of Appeals held (obviously) that "shall" means "shall": an examiner has been appointed in *FTX.*[14] As of this writing the scope, duration and budget for the examination have not yet been determined. That would be left by the Third Circuit to Judge Dorsey.

Meanwhile, for well over a year, S&C and Ray had free reign to marshal and manage conflicting claims about the public and private interests at stake as they saw fit. These conflicts appear to have reduced recoveries, even as they have enriched S&C. We present evidence that FTX spent millions of dollars (much of it on S&C fees) to support prosecutions of questionable value to creditors. The debtors made no apparent effort to maintain the exchanges as a going concern, instead selling assets on the cheap to favored insiders when it appeared to protect S&C. The case has been marked by an extraordinary amount of secrecy, with over 100 items sealed, shrouding such things as orders appointing "ordinary course" professionals[15] and the subjects of the debtors' investigations and indemnification.[16] The debtors have conspicuously failed to pursue causes of action against some of those who may have hurt the company most—notably Binance, who apparently took $2.1 billion out of FTX days before bankruptcy—and the gatekeepers who were supposed to detect and deter the underlying misconduct. Perhaps this is not surprising, since S&C was one of those gatekeepers.

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[12] 11 U.S.C. § 1104(c)(requiring an examiner if the company has more than $5 million of unsecured debt). As explained below, the Third Circuit affirmed the mandatory nature of an examiner in *FTX,* reversing the Bankruptcy Court's refusal to appoint one.

[13] Although the U.S. Trustee's office brought the challenge, they devoted curiously little attention to the seeming conflicts of interest created by S&C's pre-bankruptcy representation of FTX. As explained in Part IV, we suspect that this reticence may reflect direct or indirect pressure on the U.S. Trustee from other branches of the Justice Department, whose U.S. Attorney's Office in New York was benefitting from significant assistance from S&C and Ray, who were much more willing to spend estate funds to support the prosecution of Bankman-Fried than on an examiner.

[14] *In re* FTX Trading Ltd., 91 F.4th 148, 157 (3d Cir. 2024) (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"). As of this writing, the U.S. Trustee has just appointed Robert Cleary as examiner, with the scope of his examination not yet officially defined. *See, e.g.,* Jonathan Randles, *Unabomber Prosecutor Tapped to Lead Fresh FTX Investigation*, BLOOMBERG, Feb. 28, 2024, available at https://www.bloomberg.com/news/articles/2024-02-28/unabomber-prosecutor-tapped-to-lead-fresh-ftx-investigation

[15] *See* Lowenstein Sandler Ordinary Course Declaration, *In re* FTX Trading, Ltd., Case 22-11068-JTD, Doc. 661 (Feb. 8, 2023) (SEALED); *id.* Covington & Burling Ordinary Course Declaration, Doc. 848 (Mar. 10, 2023) (SEALED).

[16] *See* Confidentiality Order, *In re* FTX Trading, Ltd., Case 22-11068-JTD, Doc. 656 (Feb. 8, 2023).

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S&C's apparent conflicts recall distorted incentives that were once ubiquitous in large scale reorganizations but are rare now. To show this, and to develop a typology of public interests, the Article starts with a brief historical overview. Large-scale corporate reorganization began with the railroad receiverships of the late nineteenth century. Lacking a statutory framework, Wall Street banks and law firms—including Cravath and Sullivan & Cromwell—fashioned one from ordinary foreclosure law.

The receivership strategy brilliantly achieved one public interest—expanding and protecting railroad transportation—but at the cost of another: these transactions depended on collusively-obtained jurisdiction and a sham sale, which would erode confidence in the judges and lawyers who ran the process.[17] In the 1930s, the Supreme Court signaled that it would tolerate the assault on judicial integrity in railroad and other common carrier cases, due to the special public interest at stake, but would not with other types of corporate debtors.[18] Congress finally codified large-scale corporate reorganization in 1933 and 1934, removing the need for collusion and sham sales, and achieving another public interest—providing a collective proceeding to preserve value and efficiently resolve financial distress in a market economy.[19]

William Douglas—soon to become a Supreme Court Justice—and other New Deal reformers quickly concluded that this didn't suffice for true system integrity, which they viewed (as do we) as the most important public interest.[20] Because the Wall Street banks and lawyers who controlled the restructuring invariably had represented the company before bankruptcy, they had an incentive to cover up pre-bankruptcy misbehavior. The Chandler Act, which radically reformed bankruptcy law in 1938, would thus preclude a debtor's prebankruptcy lawyers from representing the company, through a restrictive "disinterestedness" standard.[21]

But by 1978, Congress worried that the Chandler Act had gone too far, and deterred potentially viable debtors from restructuring. Congress thus 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.[22] But by this time, a very 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. Sullivan & Cromwell's role with FTX is thus a throwback to a problematic feature of an earlier era. S&C was no stranger to FTX's history. Having represented FTX in highly sensitive matters before its crash, S&C would be deeply interested in how FTX's pre-bankruptcy

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[17] The classic, pointedly sarcastic, critique of the dubious features of receiverships is Jerome N. Frank, *Some Realistic Reflections on Some Aspects of Corporate Reorganization*, 19 VA. L. REV. 541 (1933).

[18] *See* Part I(B), *infra*.

[19] *Id.*

[20] As discussed below, we array the public interests in the following order, from strongest to weakest: 1) system integrity; 2) insolvency-related objectives; 3) other public interests.

[21] 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, § 157, 52 Stat. 840, 888.

[22] 11 U.S.C. § 101(13) (excluding attorneys for investment bank but not attorneys for debtor).

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history was perceived and handled. As counsel to FTX in chapter 11, it would have unique control over how that history would be written.

Our study of the *FTX* bankruptcy enables us to specify three distinct facets of the public interest in chapter 11: (i) the paramount interest in judicial integrity and independence; (ii) bankruptcy-related interests in efficient distress resolution; and (iii) "other" public interests tangential to the first two, but which may be implicated in a bankruptcy, such as protecting railroad transportation or the prosecution and defense of crimes leading to financial distress.

FTX reveals the significant and underappreciated power that the debtor's counsel has to shape and arbitrate among these interests when they conflict, and to marshal claims about them to advance the lawyers' private interests in avoiding scrutiny if they represented the debtor prior to its distress, while billing hundreds of millions of dollars in the process.[23] In S&C's case, the apparent conflict that may have arisen from the firm's representations to the CFTC was compounded by seemingly deceptive tactics S&C used to wrest control of FTX from Bankman-Fried. While we recognize that an examiner's report may allay some of the concerns we have identified, the optics, costs, and questionable tactics in the case—including resistance to an examiner—have caused harm that cannot easily be undone.

At the same time, it may be hard to muster sympathy for Bankman-Fried, who quickly became among the most hated people in America (due in part to considerable media attention generated by Ray and FTX).[24] But rules of professional ethics and the Bankruptcy Code recognize no exception to the old adage, "two wrongs do not make a right." If S&C was right in reporting Bankman-Fried, they should thereafter have withdrawn, permitting other counsel to run FTX's reorganization.

Thus, the most obvious correctives would have been for Bankruptcy Judge Dorsey to decline to approve S&C's retention as bankruptcy lawyers for FTX and to appoint an examiner. But, based on the record before him (much of it shaped by S&C), he approved the former and denied the latter. Both decisions now seem regrettable given Judge Dorsey's sensitivity elsewhere to the importance of the lawyers' role. "The integrity of the bankruptcy system, indeed the entire legal system," he has written, "is dependent in large part on the ethical conduct of lawyers, their adherence to the law, and their compliance with the rules of the courts before which they appear."[25]

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[23] As of March 2024, S&C has received over $200 million. *See* Fifteenth Monthly Fee Statement of Sullivan & Cromwell LLP as Counsel to the Debtors and Debtors-in-Possession for Compensation for Professional Services Rendered and Reimbursement of Expenses Incurred for the Period from January 1, 2024 through and including January 31, 2024, *In re* FTX Trading, Ltd., Case 22-11068-JTD, Doc. 8306 (Feb. 29, 2024) [hereinafter "S&C Fifteenth Fee Statement"]. For February, 2024, S&C sought $8,870,398.88, reflecting 80% of the firm's billed time (consistent with common practice). This also shows that, through November 2023, the firm had received approved fees of about $223 million. *Id.* at p. 2.

[24] David Yaffe-Bellany, *'One of the most hated people in the world': Sam Bankman-Fried's 250 pages of justifications,* N.Y. TIMES, Oct. 4, 2023, https://www.nytimes.com/live/2023/10/04/business/sam-bankman-fried-ftx-trial-news#one-of-the-most-hated-people-in-the-world-sam-bankman-frieds-250-pages-of-justifications.

[25] *In re* NNN 400 Cap. Ctr. 16, LLC, 619 B.R. 802, 804 (Bankr. D. Del. 2020), aff'd sub nom. *In re* NNN 400 Capitol Ctr. 16 LLC, 632 B.R. 243 (D. Del. 2021), aff'd sub nom. *In re* NNN 400 Capitol Ctr. 16 LLC., No. 21-3013, 2022 WL 17831445 (3d Cir. Dec. 21, 2022).

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The effects of these conflicts did not subside after the New York jury convicted Bankman-Fried. They cast a shadow over the whole case. As with Lehman Brothers and other financial institutions that have filed for bankruptcy, FTX is using chapter 11 to liquidate its assets, rather than attempting to reorganize. In April of 2023, for example, the debtors sold LedgerX, the U.S.-registered crypto exchange that S&C helped FTX acquire during FTX's ascendency.[26] Ray and S&C made the puzzling decision to keep LedgerX out of bankruptcy, and then to sell its stock to its former owners and insiders who supported S&C's efforts to wrest control of FTX from Bankman-Fried, rather than accepting an outside bid, at what appears to be a deep discount. The sale purports to insulate S&C from liability for its pre-bankruptcy involvement with LedgerX. Similarly, FTX has never sued Binance, despite the catastrophic harm it caused—perhaps because S&C has quietly been awaiting an appointment as that company's monitor.[27] These and similar decisions suggest that concerns about S&C's private interests may have outweighed the public interest in maximizing creditor recoveries in chapter 11.

Our study builds on, and advances, a new appreciation among scholars of the important role that public interests play in corporate reorganization. Professors Macey & Salovaara, for example, have recently assessed the public policy implications of using chapter 11 to reduce or eliminate regulatory obligations.[28] Professors Ellias and Triantis have explored how government actors interact in the crucible of chapter 11, for better and for worse.[29]

In addition to revealing new information about the *FTX* bankruptcy, our case study has important implications for understanding and operationalizing the public interest in large corporate bankruptcy cases. We develop these implications in the final part of the Article. We begin by elaborating on the triptych of public interests that emerged in our earlier discussion, judicial integrity; reorganizational interests; and "other" public interests. As *FTX* illustrates, the first objective is the most important, followed by the second. The use of bankruptcy to achieve non-governmental objectives, by contrast, must be monitored more carefully, because, among other things, it can interfere with system integrity and the objectives of an insolvency system.

We then propose correctives that might better align bankruptcy's three key gatekeepers—the debtor's attorneys, an examiner, and the U.S. Trustee—with these conceptions of the public interest. With the debtor's attorneys, we argue that the New Deal reformers had it nearly right. Although we do not believe that lawyers who represented the debtor before it fell into distress should be per se barred from representing the debtor in bankruptcy, courts should view these requests very skeptically. The presumption against retaining pre-bankruptcy lawyers should be

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[26] *See* Part V(B), *infra.*

[27] *See* Mutuma Maxwell, *Binance settlement monitoring: Sullivan & Cromwell takes the lead,* MSN.COM, Feb. 16, 2024, https://www.msn.com/en-us/money/markets/binance-settlement-monitoring-sullivan-cromwell-takes-the-lead/ar-BB1in3hP.

[28] Joshua Macey & Jackson Salovaara, *Bankruptcy As Bailout: Coal Company Insolvency and the Erosion of Federal Law*, 71 STAN. L. REV. 879, 880 (2019).

[29] Jared A. Ellias & George Triantis, *Government Activism in Bankruptcy*, 37 EMORY BANKR. DEV. J. 509, 523-30 (2021) [hereinafter "*Government Activism*"]; Jared A. Ellias & George Triantis, *The Administrative State in Bankruptcy*, 72 DEPAUL L. REV. 323 (2023) [hereinafter "*Administrative State*"]. We share their concern that pursuing governmental objectives in bankruptcy, as when the government incorporated green energy and labor objectives into the Chrysler restructuring, can inappropriately sidestep the role of the executive and legislative branches.

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especially strong if there appears to have been fraud or other misbehavior before bankruptcy, as with FTX.

As to examiners, we develop the novel idea of using them more frequently but on a more targeted basis, by conducting preliminary investigations to determine efficiently whether there is cause for a full-blown examination. We are sensitive to concerns that a sweeping investigation can be costly, as Ray and S&C contended. More frequent use of preliminary examinations would restore balance in the process without adding undue cost.

The ideal corrective for the U.S. Trustee would be to make the system watchdog more independent, akin to the Consumer Financial Protection Bureau, rather than a unit of the Department of Justice.

The Article proceeds as follows. Part I provides a brief historical overview, focusing on the public interest considerations that spurred Congress to create a large-scale reorganization framework and the complications that ensued. The FTX case study is in Parts II-V. For those who are unfamiliar with the saga, Part II begins with a brief overview of FTX and the crypto industry. That Part then provides a succinct description of S&C's role, including as an intermediary between FTX and public agencies (such as the CFTC) whose approval was central to the public credibility of both FTX and S&C.

This Part also provides a detailed chronology of what S&C apparently did and said in the tumultuous 72-hour period leading to the bankruptcy filings on November 11, 2022 and thereafter. We reveal new evidence showing that S&C appears to have misled Bankman-Fried and others, raising questions about the ethics of their conduct.

Parts III and IV chronicle the contested hearings on the retention of S&C as FTX's bankruptcy attorneys 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's resistance to the appointment of an examiner unwittingly revealed damning information about its conduct of the case, in particular that it was acting as a very expensive back office for prosecutors in New York, showing how S&C would harness claims about the public interest to advance their own, private interests.

Part V shows how the effects of S&C's potential conflicts, unchecked by an examiner, have permeated the case, including with the sale of LedgerX and the failure to sue Binance, eroding stakeholder recoveries and confidence in the judicial process. The Part concludes by explaining why stakeholders may have tolerated this.

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

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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 corporations.[30] A creditors committee is appointed early in the case to represent the interests of general creditors,[31] 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,[32] but the judge serves primarily as referee of a process run by the parties themselves. Indeed, when Professor Ronald Mann characterized chapter 11 as public three decades ago, given that government law and regulation shapes and supplies the forum, and contended that the government is entitled to use the surplus created by the system for its own purposes, his point seemed novel and counterintuitive.[33]

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

A) Public Interest and the Railroad Receivership

Unlike in other countries, where the railroads were often government-owned and run, the American railroads were private.[34] They expanded rapidly, with entrepreneurs trying to cobble together smaller railroads into interstate railroads that controlled important routes, or fighting over a well-positioned existing railroad. Railroad expansion was financed with debt, much as takeovers are today. As a result, if the economy crashed, as it did with alarming regularity in the nineteenth

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[30] *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)(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.").

[31] 11 U.S.C. § 1102 (appointment of creditors' committee).

[32] 11 U.S.C. § 1129.

[33] Ronald J. Mann, *Bankruptcy and the Entitlements of the Government: Whose Money Is It Anyway*, 70 N.Y.U. L. REV. 993 (1995).

[34] The discussion in this section draws on DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 49-69 (2001).

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century, many railroads would default.[35] During the 1893 Panic, 19.41% of all the railroad track in America was in default.[36]

The financial distress of a railroad 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 wasn't clear that lawmakers had constitutional authority to create a railroad reorganization law.[37] The dilemma was resolved by molding humble foreclosure law into the world's first large scale reorganization framework. In a process that became known as the equity or railroad 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.[38] Other creditors—usually mortgage bondholders—would file a foreclosure bill, saying that the railroad had defaulted on the bonds and asking the court to commence a foreclosure sale. But the lawyers would request that the court temporarily postpone the sale. 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. When they had agreed on the terms, they would combine the committees into a single reorganization committee. They would then invite the court to hold the foreclosure sale, at which exactly one bidder would appear: the reorganization committee, which offered to exchange the old stock and bonds of the railroad for stock and bonds with the agreed upon terms.[39]

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 filed by friendly creditors— the product of collusion rather than arms-length use of the legal system. 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. And the terms of the restructuring often ignored ordinary payment priorities, allowing current shareholders to maintain a stake in the reorganized railroad while giving little or nothing to creditors who weren't viewed as necessary to the future of the railroad.[40]

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[35] *Id.*

[36] *Id.* at 53 (chart showing 19.41% in default in 1894).

[37] If the problem arose today, Congress would point to the Bankruptcy Clause in Article I of the U.S. Constitution as authority. But for the first half of the nineteenth century, lawmakers debated whether the Bankruptcy Clause extended to corporations. Since the states incorporated and regulated railroads and corporations, some contended they must be outside Congress's authority under the Bankruptcy Clause. The other potential source of authority, the Commerce Clause, also was construed very narrowly in the nineteenth century. 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. 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. *Id.* at 52-56.

[38] The process is described in detail in *id. at* 57-59.

[39] Paul Cravath famously described the reorganizers' anxious wait to see if another bidder would emerge, and the reality that they never did. Paul Cravath, *Reorganization of Corporations: Certain Developments of the Last Decade*, in SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION 153, 204-205 (1917).

[40] *See, e.g.,* DOUGLAS G. BAIRD, THE UNWRITTEN LAW OF CORPORATE REORGANIZATIONS 22-45 (2022).

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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 perceived public interest in ensuring a robust system of railroads. The equity receivership thus achieved one public objective—ensuring a viable transportation system—but threatened to undermine another—the fairness and integrity of the legal 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 Sullivan & Cromwell, as it turns out—represented ordinary investors who had bought the stock or bonds.

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.[41] In a series of cases, the Supreme Court signaled that these receiverships needed to be more carefully scrutinized.[42] With railroads, the public interest in railroad transportation outweighed the public interest in a procedurally fair and evenhanded judicial system.[43] In other contexts, it might not.

One of the cases, *Harkin v. Brundage*, involved Daniel Boone Woolen Mills, a manufacturer of woolen cloth that had continued to struggle after its president and treasurer were replaced for mismanagement. On February 14, 1925, a shareholder filed a receivership bill in Illinois state court asking for the appointment of a receiver. Five days later, a friendly creditor who was allied with the current managers filed a receivership bill in a federal district court.[44] 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. After two lower courts blessed the federal receivership, the Supreme Court reversed. 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 the court when he requested a delay.[45] But he refused to countenance this interference by a lawyer with the integrity of the legal system.[46]

Four years later, the Supreme Court once again rejected a receivership on judicial integrity grounds. In this case, *Shapiro v. Wilgus*, a lumber dealer who was operating in his individual capacity transferred the assets of the business to a newly created Delaware corporation for the purposes of having a receiver appointed, who would prevent creditors from seizing the assets of

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[41] *See, e.g.,* SKEEL, DEBT'S DOMINION, *supra* note 34, at 104-105.

[42] *Id.* at 105.

[43] Even with railroads, the Supreme Court did try to limit the extent of the unfairness, most famously in the *Boyd* decision in 1913. Northern Pacific v. Boyd, 228 U.S. 482 (1913).

[44] The company immediately consented, 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* 276 U.S. at 5.

[45] 276 U.S. at 56.

[46] *Id.*

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the business.[47] The lumber dealer predicted "a surplus of $100,000 if the business went on under the fostering care of a receiver."[48] Although the debtor's motives were understandable, the creation of a receivership stymied the debtor's creditors, "a purpose which has been condemned in Anglo-American law since the Statute of Elizabeth [the earliest fraudulent conveyance statute, enacted in 1571]."[49]

At this point, the Court acknowledged that receiverships had been used to achieve public objectives. "True indeed it is," Justice Cardozo said, "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 [citing the Metropolitan Railway Receivership]. 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.[50]

Just what were the "legitimate private interests" justifying use of the receivership strategy in the non-railroad cases Justice Cardozo cites? 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."[51] Making a collective forum available for the purposes of maximizing the value of the debtor's assets serves the parties' private interests, but it can be seen as serving the public interest as well.[52]

We will characterize this as the second of three kinds of public interest in corporate reorganizations. The first is the fairness and integrity of the judicial process and legal system. Second is the use of bankruptcy law to preserve the value of assets and for other insolvency-related purposes, the focus here (and as further developed below). Third is the use of an insolvency system to achieve other, non-insolvency-related public objectives, such as keeping the railroad running.

If receivership practice had continued along its then-current path, courts might have further refined the distinctions among receivership cases in public interest terms, assessing how important a governmental interest needed to be to justify incursions on the fairness and integrity of the legal system. But Congress intervened, largely at the behest of the bankers and lawyers whose receivership practice had been destabilized by these cases. In 1933 and 1934, Congress codified large scale railroad and non-railroad receivership for the first time, incorporating both into the

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[47] Shapiro v. Wilgus, 287 U.S. 348, 352 (1932).

[48] 287 U.S. at 352.

[49] "A conveyance is illegal if made with an intent to defraud the creditors of the grantor, but it is equally illegal if made with an intent to hinder and delay them," Justice Cardozo wrote. *Id.* at 354.

[50] 287 U.S. at 356 (citations omitted).

[51] United States v. Butterworth-Judson Corp., 269 U.S. 504, 512 (1926); *see also* Michigan v. Michigan Trust Co., 286 U.S. 334 (1932).

[52] As bankruptcy scholars will recognize, this objective lies at the heart of the best-known normative theory of bankruptcy. *See* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (1986)(outlining the "creditors' bargain" justification for corporate bankruptcy).

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Bankruptcy Act.[53] The new rules removed the need for the collusive practices that had attended equity receiverships.

In effect, the codification of corporate reorganization in 1933 and 1934 re-established the commitment to the public interest in procedural fairness and legitimacy, the first and most basic public interest, as central to corporate reorganization. Courts had tolerated deviations because of the unique circumstances of the railroads—there was no other way to reorganize them. But procedural regularity would now be the norm once again.[54] The reforms also regularized the second type of public interest—providing a collective form—and continued to facilitate the specific objective of protecting and preserving the railroad system.[55]

C) The Public Responsibilities of Lawyers

The reformers of the New Deal era, several of whom were corporate reorganization experts, soon concluded that the 1933-34 codification was pathetically inadequate to assure the integrity of the system (the first public interest in our schema). 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.[56]

In 1934, Joseph Kennedy, the head of the newly created Securities and Exchange Commission, asked William Douglas, a Yale law professor who would later chair the SEC and then become a Supreme Court Justice, to oversee a study of corporate reorganization practice that the Securities Exchange Act of 1934 instructed the SEC to undertake.[57] Douglas and his team eventually produced eight volumes of case studies and analyses of reorganization practice.[58] A recurring theme is that bankers would seize control of the cases for their own purposes and the lawyers would fail to uphold the high standards of their profession.[59] The reformers lodged two pointed objections about lawyers, both relevant to the *FTX* case today. We briefly consider each in turn.

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[53] The push for codification and the enactment of the two reforms are described in SKEEL, DEBT'S DOMINION, *supra* note 34, at 103-108.

[54] Note that the special treatment of railroads did not disappear. Even today, chapter 11 has a special set of provisions for railroads and railroads cannot be liquidated under chapter 7.

[55] Even today, bankruptcy law protects railroads by requiring that they be reorganized in chapter 11 rather than liquidated in chapter 7. 11 U.S.C. § 109(b)(1).

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

[57] See, e.g., SKEEL, DEBT'S DOMINION, *supra* note 34, at 109.

[58] Securities and Exchange Commission, Securities and Exchange Commission Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, Volumes I-VIII (1937-40) [hereinafter "SEC Report"].

[59] *Id.* at 863.

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One concern was fees. The magnitude of the fees was not necessarily problematic by itself, given that so much of the work of a reorganization fell on their shoulders. But the lawyers abused their privileged position. "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 receive only modest fees."[60] The suggestion is that lawyers are key gatekeepers for the process and that their fees should be tempered to reflect the public dimension of their role.[61]

The second issue was conflicts of interest. "It is not unusual," the investigators wrote, "to find lawyers attempting to represent both senior and junior interests in a reorganization," often as "an aspect of the lawyer's representation of both the bondholders and the management or bankers."[62] The investigators also questioned whether it was appropriate for lawyers that had represented the company before bankruptcy or receivership to serve as counsel in a bankruptcy or receivership, given the possibility that "friendly alliances or prior professional connections" might discourage the lawyers from vigorously challenging problematic behavior by the debtor's managers or advisors.[63]

The New Deal reformers urged Congress to amend the Bankruptcy Act to forbid a debtor's pre-bankruptcy lawyer and bankers from continuing to represent the debtor in bankruptcy. They got their wish with the Chandler Act of 1938. 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 it prohibited a banker or lawyer from representing the trustee in bankruptcy unless they were "disinterested."[64] The definitions of "disinterested" expressly excluded any banker that had underwritten securities for the debtor and any lawyer that had worked for the company prior to bankruptcy.[65]

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 1933-34 codifications of large-scale reorganization had done. The lawyers at the heart of a large-scale corporation 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 bankruptcy. By the 1960s, an increasing number of large corporate debtors evaded Chapter X by filing under Chapter XI, which

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[60] *Id.* at 867.

[61] The report speculates that the specialized nature of big law firms and "the fact that the practice of financial law has been to a great extent monopolized by relatively few firms" may explain the insistence on exorbitant fees. *Id.* at 868.

[62] I SEC Report, *supra* note 58, at 526.

[63] *Id.* at 523.

[64] Amendments to the Bankruptcy Act of 1898, Act of June 22, 1938, ch. 575, § 157, 52 Stat. 840, 888.

[65] *Id.*

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was intended for smaller corporate debtors.[66] This set the stage for the most recent overhaul of bankruptcy law in 1978.

D) Public Interest and the 1978 Code

Although lawmakers initially were more concerned to reform consumer and small business bankruptcies—which were thought to be controlled by unsavory "bankruptcy rings" in many cities—the 1978 Bankruptcy Code dramatically reformed the reorganization of large corporate debtors as well. Chapter 11, the reorganization chapter, assumes that a debtor's managers will continue to run the business, 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.

The principal safeguards of the public interest in integrity and fairness in most cases are extensive disclosure obligations and ethical oversight by an entity created under the 1978 Act called the Office of the United States Trustee.[67] 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; a list of creditors;[68] and in larger cases, monthly operating reports reflecting sources and uses of cash and other assets.[69] Professionals must disclose any "connections" to parties in interest, including potential conflicts of interest. Every important matter in the case requires court approval which, in turn, requires public filings of pleadings and other documents.[70]

The U.S. Trustee, which is a branch of the Department of Justice, appoints the bankruptcy trustees in liquidation cases, the creditors' committee in reorganization cases, and examiners in the

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[66] *See, e.g.,* SKEEL, DEBT'S DOMINION, *supra* note 41, at 164-66.

[67] 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 filed in this District. 28 U.S.C. § 586. Under Section 586 and Section 307 of the Bankruptcy Code, Congress charged the U.S. Trustee with broad responsibilities in chapter 11 cases and the standing to rise and be heard on any issue in any case or proceeding. 11 U.S.C. § 307; see also United States Trustee v. Columbia Gas Sys., Inc. (*In re* Columbia Gas Sys., Inc.), 33 F.3d 294, 295-96 (3d Cir. 1994) (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").

[68] 11 U.S.C. § 521(a)(requiring filing of, among other things, a list of creditors and schedule of assets and liabilities).

[69] 11 U.S.C. §§ 521 & 704.

[70] *See* 11 U.S.C. § 363(b)(requiring court approval of transactions that are not in the ordinary course of business).

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rare cases where they are appointed.[71] The U.S. Trustee also challenges excessive fees charged by bankruptcy professionals.

In addition to the disclosure requirements and the U.S. Trustee, chapter 11 allows creditors and other interested parties to ask for appointment of a trustee in the event of fraud or mismanagement. After the *Enron* and *WorldCom* scandals in the early 2000s, Congress amended the trustee provision to require that the U.S. Trustee ask the court for appointment of a trustee if "there are reasonable grounds to suspect" that the debtor's current managers or directors "participated in actual fraud, dishonesty, or criminal conduct."[72]

For the vast majority of chapter 11 cases, no trustee is appointed. Instead, Chapter 11 authorizes the intermediate step of appointing an examiner if this is in the parties' best interest or the company has more than $5 million of debt and a party in interest asks for an examiner. 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.[73] Examiners have featured prominently in such notorious cases as *Enron* and *Lehman Brothers*. The question whether to appoint an examiner would prove to be a key threshold issue in FTX.

E) The Lawyers' Role in Chapter 11

Between the 1938 Chandler Act and the 1978 Code, large law firms disappeared from 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. Because it allowed the debtor's managers to continue running the business and relied on private negotiations among the parties, chapter 11 was more similar to the equity receiverships that big law firms had helped to pioneer than to the Chandler Act.

After 1978, the big law firms quickly re-entered bankruptcy practice.[74] But they did not return to the model of the equity receivership era. Large corporations that fell into financial distress did not use lawyers that had previously represented the company as their bankruptcy lawyers. Instead, the company brought in 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.

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[71] Prior to 1978, the bankruptcy judge appointed trustees, which seemed to many observers to implicate the judge too deeply in the administration of the case. The optics were especially problematic in cities where bankruptcy rings seemed to control the choice of trustee.

[72] 11 U.S.C. § 1104(e).

[73] 124 CONG. REC. S17, 403–34 (daily ed. Oct. 6, 1978) (statement of Sen. DeConcini) (quoted in COLLIER ON BANKRUPTCY, app. 14.4(f)(iii) (15th ed. rev. 2002) [hereinafter COLLIER]).

[74] *See, e.g., Profiting from the Failures of Others*, NAT'L L.J, April 2, 1990, at 1, 29 (describing the re-entry of large law firms).

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There were occasional exceptions. One involved Leslie Fay, a company whose bankruptcy was triggered by an accounting scandal.[75] Weil Gotshal—which had one of the nation's leading bankruptcy groups then as now—had worked for Leslie Fay's audit committee before Leslie Fay filed for bankruptcy. 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 three Leslie Fay directors who were potential subjects of the investigation. 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.[76]

Another involved a Wisconsin mining tool manufacturer called Bucyrus-Erie that had gone through a leveraged buyout and later filed for bankruptcy.[77] John Gellene, a young partner at Milbank Tweed, the debtor's bankruptcy lawyer, didn't press to challenge the leveraged buyout as a fraudulent conveyance, contending that the statute of limitations had expired.[78] 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 as required by the Bankruptcy Code.[79] The creditor sought disgorgement of Milbank's fees and the U.S. Trustee contacted the U.S. Attorney's office.[80] 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.[81]

As we shall see, like Weil Gotshal and Milbank, Sullivan & Cromwell, the FTX bankruptcy lawyers, had a substantial prebankruptcy relationship with FTX which they only grudgingly, and perhaps incompletely, disclosed.[82] This relationship would create the kinds of conflicts of interests that the New Deal reformers excoriated in the equity receivership era—and would seem to have distorted the results in 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 two books, the more flattering of the two written by best-selling author Michael Lewis (*Going Infinite*)

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[75] *In re* Leslie Fay Companies, Inc., 175 B.R. 525 (Bankr. S.D.N.Y. 1994).

[76] *Id.*

[77] Professor 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 (2004).

[78] *Id.* at 167.

[79] *Id.* at 209.

[80] *Id.* at 210-11 (motion asking for disgorgement for violating Rule 2014 disclosure requirements).

[81] He was convicted of two counts of 11 U.S.C. section 153 of making a "false declaration," and one count under 18 U.S.C. section 1623 of submitting a document with "any false declaration." *Id.* at 273.

[82] *See* Part II(B), *infra*.

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and a less flattering account by Zeke Faux (*Number Go Up*).[83] The FTX bankruptcy figures only at the very end of Lewis's book and even more briefly in Faux's. 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, circling like twin moons around a gaseous mass of claims about serving the public interest.

The next four parts of this Article provide the first detailed case study of the bankruptcy. We begin by briefly describing the crypto industry and FTX's place in it. We then explore the misrepresentations that made the bankruptcy filing possible. In subsequent parts, we will consider the retention of Sullivan & Cromwell as bankruptcy attorneys, the question whether an examiner would be appointed, the Bankman-Fried fraud trial in New York, and the reorganization process.

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 consisting of two crypto currency 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.com, owner of FTX Trading).[84] FTX US—by far the smaller of the two but the basis for FTX's bankruptcy chapter 11 filing in the United States—was "an exchange for spot trading in digital assets and tokens;" and FTX.com ("FTX International") was "a digital asset trading platform and exchange."[85]

FTX's exchanges "were among the world's largest digital asset exchanges, where millions of customers bought, sold and traded certain digital assets."[86] 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."[87]

The hedge fund, Alameda Research LLC ("Alameda")—a name Bankman-Fried chose because it did not conjure up images of risky trading[88]—actually predated the exchanges. It was Bankman-Fried's first foray into crypto. He assembled a band of fellow "effective altruists" (his preferred utilitarian philosophy[89]), initially to exploit mismatches in crypto prices around the

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[83] LEWIS, *supra* note 2; FAUX, *supra* note 2.

[84] *See* Disclosure Statement for Debtors' Joint Chapter 11 Plan of Reorganization of FTX Trading Ltd. And its Affiliated Debtors and Debtors-in-Possession, at 12, *In re* FTX Trading, Ltd., Case 22-11068-JTD, Doc 4862 (Dec. 16, 2023) [hereinafter "Disclosure Statement"].

[85] Declaration of John J. Ray III in Support of Chapter 11 Petitions and First Day Pleadings, *In re* FTX, et al., Case 22-11068-JTD, Doc 24 (Nov. 17, 2022) [hereinafter "Ray First Day Decl."] at 4 (FTX US), 12 (FTX.com).

[86] *See* Disclosure Statement, *supra* note 84, at 12.

[87] *Id.*

[88] *See, e.g.,* FAUX, *supra* note 2, at 86 (reporting that the name was chosen because "Bankman-Fried and his friends wanted something innocuous to avoid setting off alarms at banks").

[89] LEWIS, *supra* note 2, at 50.

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world. Most of his early partners rebelled and left before the hedge fund surged into profitability.[90] As the FTX empire grew, Alameda engaged in a wide variety of trading activities and was used to make investments on behalf of FTX in an array of businesses, ranging from digital asset startups to artificial intelligence.[91]

Bankman-Fried owned the majority of shares of the 100+ entities in the group. He was the CEO and appears to have been a director of many or all of them.[92] Caroline Ellison, his sometime girlfriend and the star witness in the fraud trial against him, was the CEO of Alameda.

As crypto grew in 2021-22, 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."

1) Becoming Finite

All good things—apparently even infinite ones—come to an end. It appears that 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@."

It appears that the info@ account exempted Alameda from a rule on the exchange which required the automatic liquidation of any account that had a negative value.[93] Although the prosecution made much of this at the criminal trial, it is not clear how significant a problem this was if, as appears to have been the case, Alameda had a significant amount of assets that could

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90 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." *See, e.g.,* LEWIS, *supra* note 2, at 96, 99-100.

91 *Id.*

92 Ray First Day Declaration *supra* note 85, at ¶ 4 recognized that Bankman-Fried continued to own most of the debtors' equity:

> 2 To my knowledge, 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.

93 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://www.wsj.com/finance/ftx-employees-found-alamedas-secret-backdoor-months-before-collapse-7f983fcd.

Electronic copy available at: https://ssrn.com/abstract=4760736

collateralize any obligations to the exchange. In many ways, it appears that this feature simply permitted a kind of informal credit agreement between FTX and Alameda.

The bigger problem was that the assets at Alameda were in some cases acquired with the proceeds of customer assets. This was apparently due to the fiat@ account. This account was, according to Bankman-Fried, simply intended as a payment processing feature.[94] When the exchange was first created, it could not get a bank account, but Alameda could and did. According to an email Bankman-Fried sent us:

> The fiat@ account was created solely to serve as a payment processor for FTX, at a time when FTX had no bank accounts of its own and could only receive deposits in the form of digital assets. Instead, FTX processed all fiat deposits and withdrawals through a special account set up for that purpose, the fiat@ account. Once FTX obtained its own bank accounts that could serve as payment processors, it routed customers to use those alternatives rather than the fiat@ account. . . . There were, however, serious problems with the fiat@ account having nothing to do with the "back door" or auto-liquidation, that were the result initially of an inadvertent oversight. After FTX got its own bank accounts, existing customers who had saved the link to the fiat@ account continued to use it to deposit and withdraw funds. Their accounts on FTX were automatically adjusted to reflect those deposits and withdrawals, as they had been since the beginning. The account balance remained low until September 2021. But as a result of FTX's astronomical growth starting around then, it doubled in the last quarter of 2021, reaching its high point of roughly $8 billion by February of 2022.[95]

It appears beyond dispute that Alameda used these funds as if they were its own. In the criminal trial, the central issue was not whether Alameda used customer funds, but Bankman-Fried's state of mind: what did he intend? While there is no doubt what the jury thought, it is important to note that it appears that Alameda's debt to FTX was not entirely concealed. According to an SEC civil complaint, this $8 billion liability was reported as a debt on balance sheets provided to investors, though the nature of the debt (and identity of the "lender") were apparently not disclosed.[96]

Bankman-Fried continues to insist that Alameda's access to FTX assets was due to coding problems that were not corrected prior to the crash in crypto prices in June 2022. Caroline Ellison testified that Bankman-Fried personally authorized Alameda's use of customer assets. There is no evidence that customers of the FTX US exchange were exposed to these same sorts of risks.

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[94] *See, e.g.,* LEWIS, *supra* note 2, at 219-20.

[95] Email from Sam Bankman-Fried (via Barbara Fried) to Jonathan C. Lipson, dated Mar. 1, 2024 (on file with authors). It appears that this is consistent with the government's version of the story. The SEC complaint against Bankman-Fried, for example, recites that "This 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, Securities and Exchange Commission v. Samuel Bankman-Fried, Case 1:22-cv-10501, Doc 1 (12/13/22), ¶ 37 [hereinafter "SEC Complaint"].

[96] *See* SEC Complaint, *id.*, ¶ 38 ("In quarterly balance sheets that Alameda provided to its third-party lenders, Alameda tracked this liability as a "loan," but did not specify that the "loan" was from FTX. Instead, Alameda combined this liability with loans it had received from third-party lenders.").

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Alameda also held a significant position in FTT, the FTX Group's "native token," which magnified the problem because it appeared as an asset on Alameda's balance sheet but was effectively exposed to correlated risk. 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 one-third of the profits of FTX each year.[97] 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.[98]

2) The Binance Problem (Part 1)

While many things went wrong at FTX, it would appear that the company's main crypto competitor, Binance, the largest centralized digital asset exchange, contributed significantly to its demise. On November 2, 2022, the cryptocurrency news site CoinDesk published an article raising questions about FTX's undisclosed leverage and liquidity.[99] Four days later, on November 6, 2022 Changpeng Zhao (known as CZ), the CEO of Binance, announced that "[a]s part of Binance's exit from FTX equity last year, Binance received roughly $2.1 billion USD equivalent in cash (BUSD and FTT)."[100] It is not clear what, if anything, the FTT would have been worth to FTX at that point, since the exchanges were facing a liquidity crisis. It appears that some or all of the redemption of the FTT held by Binance was made with customer assets.[101]

Since CZ was Bankman-Fried's principal competitor (Michael Lewis depicts him as a regulator-despising crypto outlaw and Bankman-Fried as the more law-abiding alternative), CZ's motives were rather suspect. On November 8, 2022, Binance announced that it had entered into a non-binding letter of intent to acquire FTX.com, the international exchange, but subsequently terminated the potential transaction on November 9, 2022.

Between November 2, 2022 and November 11, 2022, "customers attempted withdrawals of several billions of dollars."[102] Although many were able to do so, FTX froze withdrawals.[103] In a very short time, FTX went from a $30+ billion valuation to bankruptcy as "liquidity dried up,

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[97] *See, e.g,* LEWIS, *supra* note 2, at 120.

[98] *See* Allison, *supra* note 6 ("As of June 30, the company's assets amounted to $14.6 billion. Its single biggest asset: $3.66 billions of "unlocked FTT." The third-largest entry on the assets side of the accounting ledger? A $2.16 billion pile of "'FTT collateral.'").

[99] *See* Allison, *supra* note 6.

[100] Dan Milmo, *How Binance played a key role as FTX collapse unfolded*, THE GUARDIAN, Nov. 11, 2022, https://www.theguardian.com/technology/2022/nov/11/binance-ftx-collapse-cryptocurrency-exchange-changpeng-zhao?CMP=Share_iOSApp_Other.

[101] Shaurya Malwa, *FTX Used Billions in Customer Funds to Buy Back Binance Stake*, COINDESK, Oct. 19, 2023, https://www.coindesk.com/policy/2023/10/19/ftx-used-billions-in-customer-funds-to-buy-back-binance-stake/.

[102] Disclosure Statement, *supra* note 84, at 17.

[103] Danny Nelson & Nikhilesh De, *FTX US Temporarily Froze Crypto Withdrawals, Adding to Chaos of Bankruptcy Proceedings*, COINDESK, Nov. 11, 2022, https://www.coindesk.com/business/2022/11/11/ftx-us-freezes-crypto-withdrawals-sending-millions-in-assets-to-bankruptcy-limbo/.

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customers demanded withdrawals and rival exchange Binance ripped up its nonbinding agreement to buy the company."[104] FTX founder Bankman-Fried and CEO admitted at the time that he "'f---ed up.'"[105]

In the early-morning hours of November 11, 2022, after significant pressure from S&C and others at FTX, Bankman-Fried docusigned an "Omnibus Corporate Authority" purporting to assign his corporate powers to bankruptcy specialist John Ray.[106] Ray had been selected by S&C and was presented as Bankman-Fried's only choice.[107] 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.[108] Ray's first act was to retain S&C as FTX's general counsel in the bankruptcy.[109]

B) S&C's Pre-Bankruptcy Work for FTX

Sullivan & Cromwell 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.[110] S&C initially characterized the work it had done for FTX previously as minor and incidental. In reality, S&C had performed significant and critically sensitive tasks that apparently brought the firm in close proximity with the alleged fraud committed by FTX.

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[104] MacKenzie Sigalos, *Sam Bankman-Fried steps down as FTX CEO as his crypto exchange files for bankruptcy*, CNBC, Nov. 11 2022, https://www.cnbc.com/2022/11/11/sam-bankman-frieds-cryptocurrency-exchange-ftx-files-for-bankruptcy.html.

[105] *Id.*

[106] In other work, we will analyze the "Omnibus Corporate Authority," which does not appear to have sufficed on its own to install John Ray as chief executive officer of FTX.

[107] An email from S&C partner Andrew Dietderich to Bankman-Fried and others November 11, 2022 at 12:58 am lauds Ray's qualifications. Here is a screenshot of a portion of that email:

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.

See Samuel Bankman-Fried's Sentencing Memorandum, United States of America v. Samuel Bankman-Fried, Case 1:22-cr-00673-LAK, Doc. 407-34 (S.D.N.Y, Feb. 27, 2024), Ex. E, at 14 [hereinafter "Sentencing Memorandum"], Ex. E, at 14 (reproducing email).

[108] Disclosure Statement, *supra* note 84, at 1. A discussion of S&C's role in inducing Bankman-Fried to convey these powers is described in Part II(C), *infra*.

[109] Debtors' Application for an Order Authorizing the Retention and Employment of Sullivan & Cromwell LLP as Counsel to the Debtors and Debtors-in-Possession Nunc Pro Tunc to the Petition Date, *In re* FTX Trading, Ltd., Case 22-11068-JTD Doc. 270 (Dec. 21, 2022).

[110] Dieterich 1st Supp., *supra* note 8, at 3-4.

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1) FTX Acquires LedgerX

Sullivan & Cromwell had a significant connection to FTX starting in early 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.[111] LedgerX was "the first exchange to offer cryptocurrency contracts in the U.S. using fractionalized portions of cryptocurrency."[112] Starting with LedgerX, Sullivan & Cromwell 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.[113] It appears that S&C also performed transactional work for Bankman-Fried personally, "arranged for and paid by Debtor Alameda Research Ltd. (total historical fees $195,000)."[114]

Andrew Dietderich, the Sullivan & Cromwell partner leading the bankruptcy, described S&C's prebankruptcy work in a sworn declaration filed shortly before the hearing to consider S&C's retention.[115] In addition to the LedgerX acquisition, S&C also advised FTX 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. Total fees and expenses received for this matter were approximately $1,405,000.[116] These engagements brought S&C into the heart of FTX's operations and, as importantly, would put S&C's own reputation as a regulatory intermediary at stake.

The LedgerX acquisition and CFTC work were significant because both sought to give FTX regulatory legitimacy that would have distinguished the company from other cryptocurrency exchanges, such as competitor Binance. In December 2021, shortly after FTX acquired LedgerX, S&C apparently filed an application with the CFTC's Division of Clearing and Risk to "allow FTX

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[111] Indap & Oliver, *How a prestigious Wall Street law firm got caught up in FTX's chaos*, FIN. TIMES, Jan. 25, 2023, https://www.ft.com/content/9d3345fb-cf19-4c4e-ac26-582dc0b6f741

[112] The Investopedia Team, *What Was FTX US Derivatives?*, Dec. 20, 2023, https://www.investopedia.com/terms/l/ledgerx.asp .

[113] Dieterich 1st Supp., *supra* note 8, at ¶¶ 48-50.

[114] *See* Decl. of Andrew G. Dietderich in Support of Debtors' Application for Order Authorizing the Retention of Sullivan & Cromwell Doc. 270-3, at 2, n. 1 (Dec. 21, 2022). 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://www.nytimes.com/2023/02/28/technology/ftx-guilty-plea-fraud.html. *See also* Dietderich 1st Supp., *supra* note 8, at 15.

[115] *See* Dieterich 1st Supp., *supra* note 8, at ¶ 47.

[116] Of the other 18 matters, the most economically significant was S&C's representation of FTX in the *Voyager* bankruptcy, where bankruptcy partner Dietderich assisted FTX in an attempt to acquire assets out of that bankruptcy. *See* Dietderich 1st Supp., *supra* note 113, at ¶ 48.

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to offer products that are not fully collateralized."[117] S&C would later withdraw this application the day that the debtors commenced the bankruptcy.[118]

S&C promoted its role in the FTX acquisition of LedgerX as a "client highlight."[119] 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."[120]

2) S&C as FTX's Regulatory Intermediary—Discovering the Linkages?

S&C would be a credible intermediary in fostering this relationship. S&C is among the nation's premier banking and financial regulatory firms.[121] The firm was chosen by FTX, the *Financial Times* reported, "because of its regulatory expertise."[122] The alleged misconduct at FTX might threaten S&C's otherwise sterling reputation as a regulatory intermediary if it were revealed that S&C knew or should have learned about the problematic linkages between Alameda and FTX in the course of these representations, and yet continued to vouch for the company.

In the summer of 2022, as S&C continued to work with the CFTC, it appears that FTX responded to a series of questions about linkages between the various entities in the FTX complex, including Alameda and FTX Trading. It is not entirely clear what role S&C played in preparing and presenting the responses, although there is reason to believe that S&C regulatory attorney Colin Lloyd may have prepared or contributed to the following response:

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[117] *See* Letter dated November 11, 2022 from Colin D. Lloyd, Sullivan & Cromwell, to Clark Hutchison, Director, Division of Clearing & Risk, Commodity Futures Trading Commission re LedgerX LLC's Application for an Amended Order of Registration as a Derivatives Clearing Organization, available at https://sirt.cftc.gov/sirt/sirt.aspx?Topic=CommissionOrdersandOtherActionsAD&Key=47841 [hereinafter "CFTC Withdrawal Letter"].

[118] Id.

[119] S&C Advises FTX in Acquisition of Regulated Crypto Exchange LedgerX, https://www.sullcrom.com/About/News-and-Events/Highlights/2021/November/SC-Advises-FTX-in-Acquisition-of-Regulated-Crypto-Exchange-LedgerX (Nov. 1, 2021) accessed Dec. 27, 2023.

[120] Id.

[121] Indap & Oliver, *supra* note 111 ("Its top practices are in banking, financial services and financial regulation and many of its senior partners are former regulators.").

[122] Indap & Oliver, *id.* (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.").

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in the holding company of FTX.com. AR is one amongst many other professional trading participants transacting on both FTX International and FTX.US. In both instances, AR has no preferential fee structures or special or unique access to the exchange, to exchange data, or to any other feature of either exchange, versus that which is available to any other professional trading participant (e.g., AR does have access to the fee schedule tiers available to any user that meets the relevant requirements). Similar to any other professional trading participant, AR may participate in FTX US's borrow-lend book as well as the FTX US letter of credit program, and AR may participate in similar programs on FTX.com. AR also provides liquidity through the over-the-counter and "convert" (i.e., crypto to USD) functionality on the FTX crypto exchanges.

Source: Email from Colin D. Lloyd, Sullivan & Cromwell, to Scott Sloan, CFTC, Aug. 8, 2022.[123]

Here, FTX is representing to the CFTC that Alameda "has no . . . special or unique access to the exchange, to exchange data, or to any other feature of either exchange . . . ." This would turn out to be false. As explained above, unlike other participants on FTX.com, Alameda could effectively borrow significantly from FTX because its accounts would not automatically liquidate when they went to zero. More importantly, about $8 billion in assets held by Alameda actually belonged to customers. It appears, in other words, that Alameda did have "special or unique access to . . . other feature[s] of the exchange"—it apparently "owed" those assets to the exchange.

It is not clear what role S&C played in preparing this response (although it appears that Lloyd sent it). It does, however, indicate that the CFTC licensure application process may have exposed S&C to the linkages that led to Alameda's significant obligations to FTX Trading and the commingling that was central to the misconduct at issue. If S&C did not know of such linkages, then it is not clear how it could have represented that, in effect, they did not exist.

An insider at FTX sought to raise some of these concerns—and was fired for her trouble. *The Wall Street Journal* has reported that Julie Schoening, the Chief Risk Officer of LedgerX, discovered the linkages in summer 2022,[124] which was the same time period as S&C represented FTX before the CFTC. After Schoening raised concerns about her team's discoveries with her boss, LedgerX head Zach Dexter, she was fired, according to the *Journal*.[125] Dexter would later be one of several insiders who worked closely with S&C alumnus Ryne Miller to urge Bankman-Fried to transfer control to Ray. It is not clear whether S&C knew of, or played a role in, the decision to terminate Schoening.

Much about these interactions is unclear. But if S&C knew about these underlying problems, they could have advised FTX to take steps to correct them. Conversely, a failure to have done so may have reflected poorly on the firm in light of FTX's later crises. Either way, S&C's

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[123] *See* Sentencing Memorandum *supra* note 107, Ex J. at 16.

[124] Holding a Ph.D. in physics, Schoening had previously worked at the CFTC, where she analyzed high-frequency trading and market manipulation.

[125] Alexander Osipovich and Angus Berwick, *FTX Employees Found Alameda's Secret Backdoor Months Before Collapse,* Wall St. J. Oct 5, 2023, https://www.wsj.com/finance/ftx-employees-found-alamedas-secret-backdoor-months-before-collapse-7f983fcd.

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CFTC work may have exposed it to knowledge of the commingling of funds which would form the factual heart of Bankman-Fried's prosecution.

C) Wresting Control from Sam Bankman-Fried

"*We are here to help . . . however we can*."[126]

During the bankruptcy case, S&C would characterize Sam Bankman-Fried as an indicted intermeddler, interfering with the reorganization efforts through tweets and other public statements critical of how Ray and S&C were handling the case. But that is not how they treated him several months earlier, when they urged Bankman-Fried to transfer control of the companies to Ray and to commence the bankruptcy. Indeed, they assured Bankman-Fried that bankruptcy could save the companies—and that he would play an important role in that process. S&C never suggested that Bankman-Fried or other insiders had criminal exposure—or that S&C may have played a role in triggering or accelerating that exposure.

Two days before bankruptcy, on November 9, 2022, around 9:30 in the evening, S&C partner Andrew Dietderich sent Bankman-Fried an email describing steps needed to "rescue" FTX. He 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." Preparation was important, Dietderich said, because "it usually takes two weeks to be ready in an organized manner." Although S&C had "that process underway," it was important to do a "few more things." "Ideally," Bankman-Fried would--

> "appoint a [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 so he does nothing before a decision to file if you prefer."

[126] Email from Andrew Dietderich to Sam Bankman-Fried, Nov. 9, 2022. [screen-captured below].

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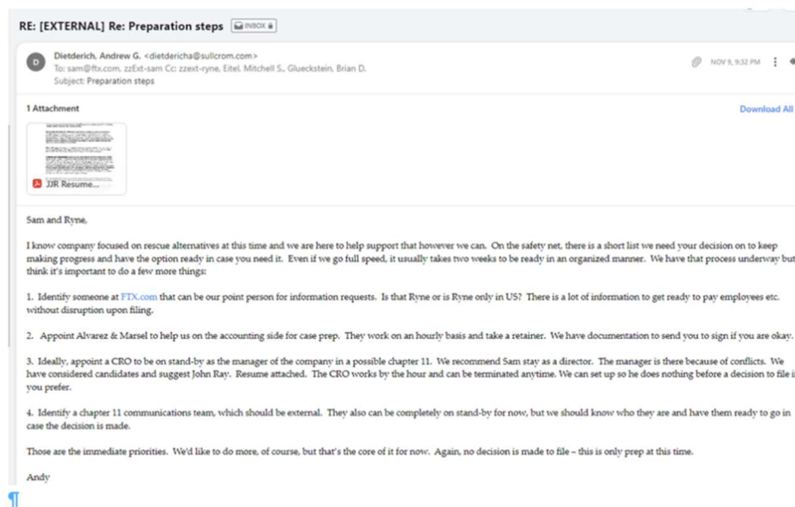
Here is a screenshot of the email:



RE: [EXTERNAL] Re: Preparation steps INBOX

Dietderich, Andrew G. <dietdericha@sullcrom.com>
To: sam@ftx.com, zzExt-sam Cc: zzext-ryne, Eitel, Mitchell S., Glueckstein, Brian D.
Subject: Preparation steps

NOV 9, 9:32 PM

1 Attachment

Download All

JJR Resume...

Sam and Ryne,

I know company focused 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 & Marsel to help us on the accounting side 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 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 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

Source: Email from Andrew Dietderich to Sam Bankman-Fried, Nov. 9, 2022.[127]

There are at least three notable things about Dietderich's November 9 email. First, Dietderich is not recommending that Ray be appointed as *chief executive officer* (CEO), but instead as *chief restructuring officer* (CRO), terminable at will. A CRO is someone who works alongside the CEO, and exerts significant influence, but who does not displace the CEO. This would imply 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 S&C was "here to help support . . . however we can." Months later, Ray and S&C claimed in the FTX Disclosure Statement they filed that Bankman-Fried "resigned," but there is no public evidence that he resigned from any of his positions at the company. The absence of documentary evidence that Bankman-Fried resigned implies that Bankman-Fried was assured he would not have to do so.[128]

Second, Bankman-Fried later claimed that he sought to rescind the appointment of Ray after executing it.[129] If in fact Ray were to be terminable at will, then he should have been terminated when Bankman-Fried sought to rescind the Omnibus Corporate Authority which would give all of Bankman-Fried's corporate powers to Ray.

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." Yet, according to Dietderich's sworn declaration submitted in support of S&C's retention, at 8:44 a.m. on November 8, 2022—one day before the reassuring email—Dieterich received an email from Can Sun, the general counsel for FTX International, asking that he join a

[127] *See* Sentencing Memorandum *supra* note 107, Ex. E, at 8.

[128] Disclosure Statement, *supra* note 84, at 24.

[129] *See Exclusive Transcript: The Full Testimony Bankman-Fried Planned to Give to Congress*, FORBES, Dec. 13, 2022, at 10, https://www.forbes.com/sites/stevenehrlich/2022/12/13/exclusive-transcript-the-full-testimony-sbf-planned-to-give-to-congress.

Electronic copy available at: https://ssrn.com/abstract=4760736

videoconference with him and Ryne Miller, general counsel for FTX US, and a former S&C partner.

> In that videoconference I [Dietderich] 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.[130]

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," although 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. Bankman-Fried wasn't the only recipient of this rosier depiction of FTX's condition. On November 7, 2022, Dietderich told an attorney in the *Voyager* bankruptcy that FTX's finances were "rock solid"—even as the firm was internally opening a new matter for a potential FTX bankruptcy.[131]

S&C was apparently 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 state regulators of prudential problems reconciling entitlements and digital assets on the FTX US exchange."[132] 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 [USAO], the Securities and Exchange Commission and the Commodity Futures Trading Commission.[133]

It is, as a preliminary matter, not clear whether S&C had the authority to report their concerns.[134] 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 "minimize disruption to the entity," including by asking the organization to halt the action and/or "if warranted

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130 Dietderich 1st Supp, *supra* note 8, at 3-4, Case 22-11068-JTD Doc 510 Filed 01/17/23 Page 3 of 34

131 *See supra* note 8, Voyager Doc. 937, Amendments 12, 13, 14, supra note 8.

132 Dietderich 1st Supp., *supra* note 8, at ¶ 16.

133 Dietderich 1st Supp., *supra* note 8, at ¶ 16.

134 Rule 1.13 of the New York Rules of Professional Conduct provides that attorneys who are concerned that an organizational client is engaged in misconduct shall proceed "as is reasonably necessary in the best interest of the organization." *See* N.Y. Rules Prof. Conduct § 1.13. In determining how to proceed, the lawyer "shall give due consideration to the seriousness of the violation and its consequences." *Id.* "Any measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization." *Id.*

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by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law."[135]

We have seen no evidence that S&C heeded this guidance. At the time, neither Mr. Sun nor Mr. Miller were the highest authorities at FTX. Instead, that would have been Bankman-Fried, who was chief executive officer (CEO), a director, and the majority equity interest holder. He was, for example, the person who had to authorize million-dollar retainers for S&C and other distress professionals and it was this authority that he soon would convey to Ray, sealing his own fate.

S&C did more than just report its concerns to prosecutors on November 9, 2022. They apparently also entered into (or caused FTX to enter into) an agreement with prosecutors to voluntarily produce documents.[136] The initial production occurred November 15, 2022 and included financial statements, general ledgers, and employee contact information.[137] S&C also promised to continue to produce information on a "rolling basis." Notably, S&C's transmittal letter did not copy Bankman-Fried, who appears to have known nothing about it at the time.

Yet, it appears that while S&C was making this report to prosecutors, it was simultaneously assuring Bankman-Fried that S&C was "here to help support" "rescue alternatives" "however we can," per Dietderich's email to Bankman-Fried at 9:30 that same evening.

If the quoted statements in the immediately preceding sentence were sent to Bankman-Fried at or after S&C had contacted the U.S. Attorney, then they there is a good chance they were false, and Dietderich knew it when he wrote the email. The truth might have been that S&C was "here to help however we can." But it was at least equally plausible that S&C was, instead, seeking to induce criminal prosecutions and to commence a chapter 11 case immediately.

Still, S&C continued to reassure Bankman-Fried that S&C was there to help, and that Bankman-Fried would play a role in the reorganization. Around 12:30 in the afternoon of November 10, shortly before the first 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."[138]

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From: "Eitel, Mitchell S." <Eitelm@sullcrom.com>
To: "Dietderich, Andrew G." <dietdericha@sullcrom.com>, Joe Bankman <joebankman@ftx.us>, Joe Bankman <joebankman@gmail.com>, zzExt-sam <sam@ftx.us>
Cc: "Glueckstein, Brian D." <gluecksteinb@sullcrom.com>, "sam@ftx.com" <sam@ftx.com>, zzext-ryne <ryne@ftx.us>
Subject: RE: [EXTERNAL] Re: Preparation steps
Sent: Thursday, November 10, 2022 12:37:58 PM

Sam/Joe/Ryne — Please
reach out if we can be helpful in thinking through the structuring of any transaction you are looking at. Particularly around minimizing execution risk and avoiding legal pitfalls, among all the other items that will need to be taken care of and documented.

Best

Mitch

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[135] *Id.* at 1.13(b)(3).

[136] Letter from Sullivan & Cromwell Partner James McDonald to U.S. Attorneys Nicolas Roos and Danielle Sassoon, Nov. 15, 2022, reproduced in Sentencing Memorandum *supra* note 107, Ex. E, at 30-33.

[137] *Id.*

[138] Sentencing Memorandum *supra* note 107, Ex. E, at 8.

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Source: Email from Mitchell Eitel to Sam Bankman-Fried, et al.

The next day, S&C reassured Bankman-Fried of his role in selecting the new FTX board:

Date: Friday, November 11th 2022, 02:37:12 AM -05:00 EST
Subject: RE: Updated Instrument
From: Dietderich, Andrew G. <dietdericha@sullcrom.com>
To: Ziman, Ken <kziman@paulweiss.com>, Flumenbaum, Martin <mflumenbaum@paulweiss.com>, <sam@ftx.com>, <tim@ftx.com>, zzext-ryne <ryne@ftx.us>
Cc: Bromley, James L. <bromleyj@sullcrom.com>, Eitel, Mitchell S. <eitelm@sullcrom.com>, Kranzley, Alexa J. <kranzleya@sullcrom.com>, Glueckstein, Brian D. <gluecksteinb@sullcrom.com>, Hopkins, Christopher <chopkins@paulweiss.com>, <dmills@dmills.com>

Okay. We will interpret instruction that way. Note the board probably appoints the chair in some jurisdictions, but we will propose him as such everywhere and make that clear to other director candidates.

As late as November 13, 2022, S&C partner James McDonald wrote to attorney Martin Flumenbaum, at Paul Weiss, who was Bankman-Fried's individual counsel, to say that "We'd be happy to discuss with you any ideas Sam might have."[139] Here is a screenshot of that email.

From: McDonald, James M. <mcdonaldj@sullcrom.com>
Date: Sunday, Nov 13, 2022, 11:19 PM
To: Flumenbaum, Martin <mflumenbaum@paulweiss.com>, Ziman, Ken <kziman@paulweiss.com>
Cc: Peikin, Steven R. <peikins@sullcrom.com>, Dietderich, Andrew G. <dietdericha@sullcrom.com>, Croke, Jacob M. <crokej@sullcrom.com>
Subject: FW: [EXTERNAL] Re: Connecting John Ray and Sam Bankman Fried

Guys,

We'd be happy to discuss with you any ideas Sam might have. If a discussion makes sense, just let us know.

Thanks,

Jamie

James M. McDonald
Sullivan & Cromwell LLP

Source: Email from James M. McDonald to Martin Flumenbaum, et al.[140]

Since McDonald also happened to be the S&C white collar defense lawyer who was at the same time voluntarily producing FTX documents to prosecutors, it is not clear what "ideas" of Bankman-Fried's he would have been "happy to discuss."

The timing of these emails and subsequent emails offering similar assurances raise troubling questions about S&C's candor to Bankman-Fried and to the Bankruptcy Court (none of the material facts was publicly disclosed to the Bankruptcy Court). Although ethics questions are beyond the scope of this paper, it is not hard to see that deceiving a current or former client is not acceptable. Such failures might, in turn, affect counsels' incentives in subsequent related, judicial proceedings, as our findings in Part V suggest.

It is important to be clear that there may be more to the story than we know. 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. Moreover, Bankman-Fried had his own counsel, brought in only days earlier, the firm of Paul Weiss. Those lawyers could have counseled Bankman-Fried to better understand the risks he ran in ceding control to Ray and to negotiate for better protections. We have seen no evidence that they did so.

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[139] Email from James M. McDonald to Martin Flumenbaum, et al. Nov. 13, 2022, 11:19 pm (on file with authors) [hereinafter "McDonald Email"].

[140] *Id.*

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But there is also no evidence that Bankman-Fried or Paul Weiss had any idea that S&C had already gone to prosecutors by the time he executed the Omnibus Corporate Authority in the early morning hours of November 11, 2022.[141] Nor have we seen evidence that the Bankruptcy Court or creditors knew any of this when S&C was retained or through much of the case. Indeed, as discussed below, S&C's resistance to an examiner suggests that they may have sought to suppress evidence about their conduct before and at the commencement of the case. Moreover, Ray and S&C have made a number of seemingly value-impairing decisions which are better explained as efforts to protect S&C than to maximize the value of the FTX bankruptcy estate, which we discuss in Part V, below.

D) What Would have Happened if FTX Hadn't Filed?

Even if the pressure to wrest control from Bankman-Fried was ethically questionable, one might ask: So what? S&C's best defense for any deception is that immediate intervention was needed to stop what the lawyers at S&C may have believed was massive fraud at FTX.

The response in part is that the cliché that two wrongs don't make a right holds true in market transactions, as it does in family life. A desire to stop the harm doesn't justify the use of unethical means. Moreover, there is no evidence that S&C attempted to determine whether the harm was ongoing or to halt it, if it was, as ethics rules seem to require. This may be because it appears that problems with the info@ and fiat@ accounts had been fixed by the time S&C interceded.

From a bankruptcy perspective, the more important question is about distributive implications. What would have happened if Sullivan & Cromwell had honored its promise to Bankman-Fried to work with him, at least for a few days, rather than immediately filing a chapter 11 petition? The most optimistic possibility is that Bankman-Fried would have done what S&C promised he could do: secure new funding to meet FTX's liquidity needs during the crisis (as he insists he did). If new funding was in place, the exchanges would again have been able to permit withdrawals and the companies would have returned to operations.

This is not as far-fetched as it may seem. We produce evidence in Part V, below, that Bankman-Fried had offers of financing that might have solved FTX's liquidity crisis. A successful rescue of FTX would not necessarily have kept FTX out of bankruptcy or Bankman-Fried out of

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[141] 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*.

See Joshua Oliver, *'Sam? Are you there?!' The bizarre and brutal final hours of FTX*, FIN. TIMES FEB. 9, 2023, https://www.ft.com/content/6e912f25-f1b7-4b19-b370-007fbc867246 (emphasis added). This indicates nothing about potential criminal exposure—only that the Department of Justice would be informed of the halt in trading.

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the criminal dock. But it was plausible and—critically—potentially better for FTX's stakeholders than what actually happened.

Even if he were indicted, and FTX did go into bankruptcy, he would have remained CEO, as promised, in the near term.[142] Bankman-Fried would have retained control of his company's resources—both financial and data—that would be essential for his defense. He might ultimately have been removed from office and convicted but, as we explain below, the prosecutors would not have been able to use his company—and its "dragon's lair" of assets, data, and cash[143]—immediately against him, as appears to have happened in fact. In that case, the prosecution of Bankman-Fried (and the other insiders) would probably resemble other white-collar prosecutions: long, drawn-out legal skirmishes that end in a settlement, not a splashy jury verdict.

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

When many of the entities in the FTX Group filed for bankruptcy on November 11, 2022, John Ray signed the chapter 11 petitions, identifying himself as CEO (not CRO, as Dietderich had promised Bankman-Fried). At the same time, he asked the Bankruptcy Court to permit FTX to retain Sullivan & Cromwell as its principal bankruptcy attorneys. 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. Troubling though they are, however, none of the material facts in the preceding discussion—S&C's erroneous representations to the CFTC, 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.

In this Part, we chronicle concerns that were raised in the retention hearing. We also describe the assistance Ray and S&C gave to the U.S. Attorney's Office in New York after the bankruptcy was commenced, which was prosecuting Sam Bankman-Fried. The assistance, which Ray and S&C touted, was paid for by the bankruptcy estate. While some assistance and cooperation would have been prudent, the millions of dollars apparently spent in the effort seem excessive.

A) The Retention of Sullivan & Cromwell as FTX's Bankruptcy Lawyers

As noted earlier, chapter 11 counsel ordinarily has little or no significant history with the corporate debtor.[144] This is due in part to special ethics rules imposed by the Bankruptcy Code.

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[142] Several alternative bankruptcy scenarios are plausible, including that Bahamian or Australian proceedings would have been commenced first, as to entities in those jurisdictions. It is unclear whether Bankman-Fried would have chosen to put the rest of the companies into a chapter 11 case in the U.S.

[143] Lewis used the phrase "dragon's lair" to describe the menagerie of assets Alameda held. *See* LEWIS, *supra* note 2, at 6-7 ("The closer you got to Alameda Research, the less it seemed like a hedge fund and the more it resembled a dragon's lair, stuffed with random treasures.).

[144] *See supra* Part I(E).

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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."[145] 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."[146]

A claim that the bankruptcy estate has against the lawyers would be an "adverse interest."[147] 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. Assuring that the bankruptcy lawyers had no role in pre-bankruptcy 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 retained in the bankruptcy. 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.[148]

In *FTX,* the initial declaration of S&C's lead bankruptcy lawyer, Andrew Dietderich, downplayed Sullivan & Cromwell's prepetition legal work for the FTX Group entities. The disclosures in the S&C application were limited to three sentences:

> 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.[149]

S&C's initial retention application did not describe the type of regulatory and transactional work that S&C had performed for FTX. Nor did it disclose that a former Sullivan & Cromwell partner, Ryne Miller, was the general counsel at FTX US and one of the highest ranking legal

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[145] 11 U.S.C. § 327(a); *see also* In re BH & P, Inc., 949 F.2d 1300, 1314 (3d Cir. 1991).

[146] 11 U.S.C. § 101(14)(C).

[147] *See, e.g*., BH&P *supra*, 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."). 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).

[148] One of us was an expert witness retained by the creditors committee in *Enron* after the bankruptcy, in order to assess and potentially litigate against Enron's former lawyers, Vinson & Elkins and Andrews Kurth. After Enron's plan was confirmed, its creditors committee "brought allegations similar to those stated in the 2003, final report by court-appointed examiner, Neal Batson." Those allegations produced a settlement of $30 million for the benefit of creditors. *See In re*: Committee of Unsecured Creditors of Enron Corp., 2006 WL 1889497. Interestingly, Ray would later claim that he led the prosecution of Enron's lawyers. Hr'g Trans, *In re* FTX Trading, Ltd, Case 22-11068-JTD, Doc. 632, at 68:14-20 (Feb. 7. 2023) ("I le[]d the prosecution of . . . accounting malpractice, legal malpractice, breach of fiduciary duty, crime.")[hereinafter "Examiner Hearing Transcript"]. Neither author had ever heard this before.

[149] S&C Application, Dietderich Initial Declaration, at ¶ 16.

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officers in the FTX group before its collapse, and that other S&C alumni also worked at FTX.[150] 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, and its questionable conduct pushing FTX into bankruptcy, the firm would be highly qualified to represent the FTX debtors. S&C has expertise in "all of the key practice areas" likely to matter in the case (as John Ray put it in his affidavit), including financial services regulation, civil and criminal investigations, cybercrime, international money laundering, and sanctions compliance.[151] 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, as "advising the Debtors with respect to responses and discussions with local and federal governmental authorities and regulators."[152] This list was an early indication about the role that S&C expected to play in defining and controlling the public interest in the *FTX* chapter 11 case.

The United States Trustee and certain customers objected to S&C's retention. The U.S. Trustee asserted two overarching concerns. First, S&C had failed adequately to disclose its connections to FTX and its prebankruptcy insiders, as required by the Bankruptcy Code.[153] This mattered because "publicly available information thus far raises the specter that S&C may have a

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[150] Mr. 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. Dietderich 1st Suppl, *supra* note 8, at ¶ 62. 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*. at ¶ 63. Ms. 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.* at 19. Ms. Kelly Yamashita, a former Alameda employee in Hong Kong, was an associate of S&C from September 2015 to September 2018. *Id.* at ¶ 65.

[151] Ray stated:

> S&C is one of the leading law firms in the world in all of the key practice areas anticipated to influence whether or not the Debtors can accomplish their objectives, including U.S. bankruptcy law, cross-border restructuring, financial services regulation, new financial service technologies, civil and criminal investigations, cryptocurrency transactions, cybercrime, payment systems, international money laundering, U.S. and European sanctions compliance, international corporate law, mergers and acquisitions and litigation.

Declaration of John J. Ray III in Support of Debtors' Application for an Order Authorizing the Retention and Employment of Sullivan & Cromwell LLP as Counsel to the Debtors and Debtors-in-Possession Nunc Pro Tunc to the Petition Date, at 3, *In re* FTX Trading, Ltd., Case 22-11068-JTD Doc 270-2 (Dec. 21, 2022).

[152] Declaration of Andrew G. Dietderich in Support of Debtors' Application for an Order Authorizing the Retention and Employment of Sullivan & Cromwell LLP as Counsel to the Debtors and Debtors-in-Possession Nunc Pro Tunc to the Petition Date, at 3, *In re* FTX Trading, Ltd., Case 22-11068-JTD Doc 270-3 (Dec. 21, 2022).

[153] Objection of the United States Trustee to Debtors' Application for an Order Authorizing the Retention and Employment of Sullivan & Cromwell LLP as Counsel to the Debtors and Debtors-in-Possession Number Pro Tunc to the Petition Date, *In re* FTX Trading, Ltd., Case 22-11068-JTD Doc 496, ¶ 3 (Jan. 13, 2023) [hereinafter "UST S&C Objection"] ("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.").

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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."[154]

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. In chapter 11, only bankruptcy trustees and examiners (under 11 U.S.C. § 1106 (b)), not debtors in possession, have authority to investigate "the acts, conduct, assets, liabilities, and financial condition of the debtor."[155] Section 1107(a) permits debtors in possession to exercise most trustee powers—but not that one. This was, according to the UST "intentional," to preserve the integrity of the reorganization process.[156]

The scope of S&C's retention should have been narrowed, the UST argued, because Bankruptcy Code sections 1106(a)(3) and 1107(a) "specifically preclude debtors in possession from investigating themselves, which is exactly what the Debtors proposed in the S&C Application. S&C's close connection with an insider of the Debtors also render[ed] S&C too conflicted to investigate Debtors' downfall."[157] Moreover, "any investigation led by S&C would be duplicative and wasteful of estate resources if the Court were to grant the U.S. Trustee's pending motion to appoint an examiner," which had been filed a month and a half earlier, on December 1, 2022. There is no evidence that the United States Trustee knew, or could have known, about S&C's representation before the CFTC or Dietderich's November 9, 2022 email assurance to Bankman-Fried.

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. On January 17th, 2023, less than 72 hours before the hearing on S&C's retention, Dietderich submitted the first of two supplemental declarations in support of S&C's retention. That declaration set out 34 pages of additional disclosures and exhibits relating to Sullivan & Cromwell's connections with the debtors.[158]

Two customers (Winter and Brummond) continued to challenge FTX's request to retain the firm. Winter argued that S&C's retention was "the most flagrant attempt by a fox to guard a henhouse in recent memory."[159] Sullivan & Cromwell was, Winter and Brummond 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

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[154] UST S&C Retention Objection, *supra* note 153, at ¶ 3.

[155] 11 U.S.C. §§ 1106(a)(3) and 1107(a).

[156] UST S&C Retention Objection, *supra* note 153, ¶ 4.

[157] *Id*. at ¶ 4.

[158] Other objectors argued that "this chronology shows gamesmanship" on the part of S&C. *See* Hr'g Trans, *In re* FTX Trading, Doc. 558, at 17:6-7 (Jan. 20, 2023) [hereinafter "S&C Retention Transcript"]. Marshal Hoda, on behalf of customers Warren Winter and Richard Brummond stated that "[t]here is no excuse for a firm, with the resources available to Sullivan & Cromwell, to wait until less then 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*. at 17:10-16.

[159] Amended Objection [of Warren Winter] to Debtor's Application for an Order Authorizing the Retention and Employment of Sullivan & Cromwell LLP as Counsel to the Debtors and Debtors-in-Possession Nunc Pro Tunc to the Petition Date, *In re* FTX Trading, Ltd, Case 22-11068-JTD, Doc 459, at 2 (Jan. 10, 2023) [hereinafter "Winter Amended Objection"].

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the estate and create a rigged game, undermining creditors' and the public's faith in the bankruptcy process."[160] But, this objection offered few specifics.

A hearing on the retention application was held January 20, 2023.[161] 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 they are explosive," the objectors argued.[162] Friedberg oversaw compliance and other legal issues from early 2020 to November 2022.[163]

Friedberg's declaration outlined several claims that Mr. Friedberg believed the bankruptcy estate had against Sullivan & Cromwell. It also listed what the declaration characterized as false statements in the Dietderich declarations, and it alleged inappropriate conduct by Ryne Miller, the former Sullivan & Cromwell partner. Friedberg declared that he would testify competently to the facts in his declaration if given the opportunity.[164] But none of the facts in his objection included those that seem to matter most, the apparently mistaken representations to the CFTC and efforts to mislead Bankman-Fried.

The objectors sought an emergency adjournment in order to depose Friedberg, arguing that it was "in the best interest of our clients and all stakeholders to have additional time to arrange testimony, secure a deposition and, otherwise, get to the bottom of this unexpected development."[165]

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."[166] 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."[167] 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

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[160] *Id.*

[161] *See* S&C Retention Transcript, *supra* note 158, at 15:10-17.

[162] *Id.* at 18:12. Debtors' counsel, S&C, seemed to share this view, characterizing it as an "incendiary device." *Id*. at 22:18-24.

[163] Declaration of Daniel Friedberg in Support of Amended Objection of Warren Winter to Debtors' Application for an Order Authorizing the Retention and Employment of Sullivan & Cromwell LLP as Counsel to the Debtors and Debtors-in-Possession Nunc Pro Tunc to the Petition Date, *In re* FTX Trading, Ltd, Case 22-11068-JTD, Doc 530 (Jan. 19, 2023) [hereinafter "Friedberg Decl."].

[164] S&C Retention Transcript, *supra* note 158, at 18:14-22.

[165] *Id*. at 19:2-9 & 19:11-13 ("the bankruptcy system depends on the self-policing conduct of lawyers in making robust timely disclosures. The failure to get this right at the outset can result in a lot of pain down the road.").

[166] *Id*. at 22:18-24.

[167] *Id*. at 21:3-7.

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is exactly what is happening."[168] Bromley's suggestion that S&C was a vital resource for the prosecutors who had indicted Sam Bankman-Fried, and that that firm was furthering the public interest in policing fraud, would become a common refrain in the FTX bankruptcy.

The court concluded that it would pay no attention to the Friedberg statement because "it's a rambling declaration." In any case, Bankruptcy Judge Dorsey seemed to believe, "Mr. Frie[d]berg is not here."[169]

This was not quite true, however. Friedberg "appeared twice on the zoom screen here and wa[]ved his hand" while the judge was speaking.[170] "He is apparently in virtual attendance at this meeting,"[171] a participant said. Judge Dorsey knew this, but deemed it insufficient. "I did see him," he said, "and I did not recognize him intentionally because, as I said, he has not filed a motion. He has not joined any motion. He is simply trying to be a witness, I suppose, but witnesses are not allowed unless [they're] here live."[172] Winter's counsel sought to cross-examine Friedberg, but Judge Dorsey denied this, too, because Friedberg did not attend in person.[173] It is not clear that Friedberg's testimony would have mattered, however. Judge Dorsey appears to have concluded that it would not have been inadmissible in any event, and it does not appear to have identify the concerns we have noted.[174] But Friedberg could have provided useful details about S&C's pre-bankruptcy role.

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."

> 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.[175]

Not surprisingly, Bromley did not tell the court about the deception S&C used to persuade Bankman-Fried to relinquish control to John Ray; nor did he tell the court that S&C was already actively supporting the prosecution (e.g., by providing evidence to prosecutors). Bromley did concede that S&C had done work for certain FTX entities prior to the petition date, "but that, . . . as case law is clear, is not in and of itself disqualifying. Indeed, it's virtually unheard of for a major law firm who can handle the type of matters that are raised in a case of this complexity to not have a pre-existing relationship . . . . the mere fact that Sullivan & Cromwell had done work is

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[168] *Id.* at 21:21-24. The estate would late sue Friedberg to avoid certain transactions and for alleged malpractice. *See* First Amended Complaint, Alameda Research, LLC, et al. v. Daniel Friedberg, Case 23-50419-JTD Doc 32 (Jan. 1, 2024).

[169] S&C Retention Transcript, *supra* note 158, at 22:18-24.

[170] *Id*. at 24:14-18.

[171] *Id*. at 24:14-18.

[172] *Id*. at 24:24-25-25:1-4.

[173] S&C Retention Transcript, *supra* note 158, at 25:13-16.

[174] "I have read the declaration," he stated, "and, frankly, it's full of hearsay, innuendo, speculation, rumors; certainly not something I would allow to be introduced into evidence in any event." *Id.* at 24:6-10.

[175] *Id.* at 21:8-13.

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irrelevant."[176] "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."[177]

Of course, it now appears that S&C's work before the CFTC did "go[] to . . .the issues that we're facing": it was central to concerns about commingling customer assets.

It is hard to imagine a bankruptcy judge would find S&C disinterested, as required by section 327 of the Bankruptcy Code, were they fully informed about the nature of S&C's involvement before and at the commencement of the bankruptcy. Still, 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 debtors] is here, the Landis firm [local counsel to the debtors] is here, and Paul Hastings [counsel to the creditors' committee] is here."[178]

The Bankruptcy Court approved the retention of Sullivan & Cromwell despite these concerns.[179] "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."[180] But that finding was possible only by ignoring Friedberg's declaration and only because Judge Dorsey had no information about S&C's exposure to the underlying problem and its apparent misleading of Bankman-Fried.

Although Judge Dorsey said that other counsel could address potential conflicts presented by S&C's prior work,[181] the retention order he signed neither required this nor provided a process

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176 *Id.* at 29:22-25 & 30:1-8. There was, he argued, "nothing in the record that indicates that Sullivan & Cromwell holds an interest adverse to the estate." *Id.* at 34:5-7. That would be true only because Judge Dorsey refused to take the Friedberg statement or to permit him to testify.

177 *Id.* at 30:9-14. This was because "We 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 32:18-22.

178 *Id.* at 33:3-7. 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. Paul Hastings' Hansen stated that the UCC "intends to do the job that it's authorized to do under Section 1103(c)(2) of the code, 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 37:11-18. As discussed below, that job does not contemplate writing a report about what is found. Not surprisingly, Hansen made no offer to do so.

179 Ord. Authorizing the Retention and Emp't of Sullivan & Cromwell LLP as Counsel to the Debtors and Debtors-In-Possession Nunc Pro Tunc to the Pet. Date, 2, 22-11068-JTD Doc 553 (Jan. 20, 2023) [hereinafter, "S&C Retention Order"].

180 *See* S&C Retention Transcript, *supra* note 158, at 48:18-20.

181 *Id.* at 49:9-10 ("Here, any potential conflicts are ameliorated by the fact that there's conflicts counsel in place" [but the order does not so provide]).

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for doing so (e.g., through the appointment of "conflicts counsel").[182] As discussed below, an examiner appointed with an appropriate scope and resources could have ameliorated the concerns with S&C's retention, but S&C and FTX resisted any such appointment, and Judge Dorsey denied the request.

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. 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 Sam Bankman-Fried all took place in less than a year, barely enough time for Michael Lewis to complete his best-selling book on the FTX saga. One expert described the remarkable speed of the case as "the prosecutorial equivalent of breaking the sound barrier."[183] 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."[184] Bankman-Fried was in the Bahamas at the time and could have fought extradition. He did not, instead consenting to extradition on December 20, 2022.[185] The next day, he was taken into U.S. custody.[186]

In just under a year, Bankman-Fried would go from being a billionaire CEO to a convicted felon facing potentially 100 years in prison. U.S. District Judge Lewis Kaplan set a tentative sentencing date of March 28, 2024.[187] During the trial, jurors heard testimony from three FTX insiders who pled guilty and cooperated with the government. Caroline Ellison, Nishad Singh and Gary Wang each testified that Bankman-Fried orchestrated a scheme to funnel FTX customer deposits to his crypto hedge fund Alameda Research for use on venture investments, lavish real estate and political donations, they testified.

Bankman-Fried's lawyer, Mark Cohen, said in a closing statement that Bankman-Fried was not a "villain" or "monster," as the government made him out to be, just a "math nerd" who made

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[182] *See* S&C Retention Order, *supra* note 179. At the retention hearing, S&C stated that "conflicts counsel" (in particular, the firm of Quinn Emanuel, retained as special counsel) would address any potential conflicts of interest. *See* S&C Retention Transcript, *supra* note 158, at 33:3-7. Judge Dorsey did provide that the retention order would "not . . . impede the Court from directing relief with respect to the scope of professional services in the event an examiner is subsequently appointed." *Id.* at 5.

[183] Ankush Khardori, *The Indictment of SBF is a Bombshell: Federal Prosecutors Broke New Ground With This Shockingly Fast Arrest*, NEW YORK MAG., Dec. 13, 2022 ("We are not talking about a swift arrest. This is more like the prosecutorial equivalent of breaking the sound barrier."), https://nymag.com/intelligencer/2022/12/the-indictment-of-sam-bankman-fried-is-a-bombshell.html.

[184] United States v. Bankman-Fried, No. 22-CR-0673 (LAK), 2023 WL 4194773, at *2 (S.D.N.Y. June 27, 2023).

[185] *Id.* (quoting Dkt 137-1, at 3).

[186] United States v. Bankman-Fried, No. 22-CR-0673 (LAK), 2023 WL 4194773, at *2 (S.D.N.Y. June 27, 2023)

[187] Pete Brush & Rachel Scharf, *Bankman-Fried Found Guilty Of Massive Fraud That Sank FTX*, LAW360, NOV. 2, 2023,https://www.law360.com/articles/1739862/bankman-fried-found-guilty-of-massive-fraud-that-sank-ftx?copied=1

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a few mistakes running FTX. "In hindsight, he may not have been perfect," Cohen said. "But again, poor risk management is not a crime. Again, bad business judgments are not a crime."[188]

The jury of nine women and three men disagreed. On Thursday, November 2, 2023, they deliberated for four hours and convicted Sam Bankman-Fried of seven counts of wire fraud, conspiracy and money laundering which, according to prosecutors, enabled Bankman-Fried to "steal[] as much as $10 billion from customers to finance political contributions, venture capital investments and other extravagant spending."[189]

Speaking to reporters outside after the verdict, Manhattan U.S. Attorney Damian Williams said the defendant "perpetrated one of the biggest financial frauds in American history" as he sought to become the "king of crypto." "It's a warning — this case — to every single fraudster out there who thinks that they're untouchable. Those folks should think again and cut it out. And if they don't, I promise we'll have enough handcuffs for all of them," Williams said.[190]

The swift verdict reflected the overwhelming evidence that prosecutors marshaled against Mr. Bankman-Fried, including millions of pages of internal messages, spreadsheets and memos.[191] It appears that much of this material came from FTX, courtesy of CEO John Ray and the work of Sullivan & Cromwell. 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 review and synthesize the evidence for them."[192]

Bankman-Fried's criminal defense counsel documented hundreds of hours of attorney-time on calls and correspondence "collecting, reviewing, and analyzing documents" costing the estate "tens of millions of dollars."[193] They asserted (unsuccessfully) that the government used FTX and S&C to evade *Brady* duties to produce exculpatory evidence and to "deflect blame from themselves."[194]

Indeed, there is evidence that S&C "coordinat[ed]" with the government's efforts to seize insiders' assets—assets to which the Debtors may assert conflicting claims—raising further questions about the commitment of Ray and S&C to maximizing creditor recoveries.[195] Notably, although Ray was eager to cooperate with prosecutors, he would be less enthusiastic about cooperating with an examiner. As discussed below, at a hearing to consider a request for an

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[188] *Id.*

[189] David Yaffe-Bellany, Matthew Goldstein & J. Edward Moreno, *Sam Bankman-Fried Is Found Guilty of 7 Counts of Fraud and Conspiracy*, N.Y. TIMES, Nov. 2, 2023, https://www.nytimes.com/2023/11/02/technology/sam-bankman-fried-fraud-trial-ftx.html.

[190] Brush & Scharf, *supra* note 187.

[191] Yaffe-Bellany, Goldstein & Moren, supra note 189.

[192] Discovery Br., U.S. v. Bankman-Fried, No. 22-cr-00673, Doc. 143, at 1 (S.D.N.Y. May 8, 2023).

[193] *Id.*

[194] *See id.* at 12.

[195] *See, e.g.,* S&C Third Fee Application, Doc. 818-2, at 3, 29, 29 (Mar. 6, 2023) (correspondence regarding Robinhood shares); S&C Fifth Fee Application, Doc. 1388-2 at 15 (Apr. 28, 2023) (time entry describing "coordination of federal regulator forfeiture and asset recoveries").

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examiner, Ray testified that he would cooperate with any court order—but not necessarily with an examiner.[196]

IV. The Battle Over an Examiner

The most obvious corrective to the distortions created by Sullivan & Cromwell's role as FTX's bankruptcy lawyers was to appoint an examiner to investigate S&C's pre-bankruptcy role and other problematic pre-bankruptcy behavior. An examiner who did not have any ties to S&C or Ray could objectively assess the severity of any conflicts of interest and whether the estate should take action.

The appointment of examiners has been a standard feature in the largest corporate bankruptcies, especially if the company's managers are thought to have committed fraud. Examiners' reports figured prominently in the *Enron, Lehman Brothers* and *ResCap* cases (ResCap was a leading securitizer of subprime mortgages.) Moreover, the statute appears to require the appointment of an examiner in large cases if a party in interest asks for one.[197] The U.S. Trustee did ask for an examiner in *FTX*. But Ray and S&C fiercely resisted the request, and they persuaded Judge Dorsey to deny it. The Third Circuit reversed quickly and unequivocally, but left to Judge Dorsey's discretion the scope of examination.

In this Part, we chronicle the battle over an examiner in detail. We begin by briefly describing the examiner provision and the role Congress imagined examiners would play in vindicating the public interest in corporate reorganization. We then recount the debate over an examiner for FTX. We highlight and assess Ray's and S&C's principal contention: that the cost to creditors and the estate in this particular case, rather than any broader public interest, should be the focus in determining whether an examiner should be appointed and the scope of any examination.

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[196] 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?"
>
> 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 148, at 71:22-25; 72:1-9. At this point, S&C attorney James Bromley objected on grounds that this asked Ray to speculate, and so he did not answer. *Id.*

[197] 11 U.S.C. § 1104(c).

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A) Chapter 11 Examiners

An examiner is an individual appointed to investigate and report on the causes and consequences of a debtor's failure. 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, if […]": (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.[198]

Despite the statutory language—"shall" usually means "shall"[199]— judges bridle at being told they must appoint an examiner when they question the value.[200] Thus, some don't, despite the statute.[201] Even though Congress apparently expected them to be common (indeed, mandatory) features of large cases,[202] an empirical study found that they were "vanishingly rare" for two basic reasons.[203]

First, parties rarely sought them. In a sample of 1225 cases from 1991 to 2010, examiners were sought in only 104 (8.5% of) cases, and appointed in forty-eight, fewer than half of cases where requested, and less than 4% of the sample.[204] Even in the 661 large cases in the sample—where appointment would likely have been mandatory given the $5 million threshold—they were

[198] 11 U.S.C. § 1104(c).

[199] *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")(quoting Black's Law Dictionary (5th ed. 1979) and Lexecon Inc. v. Milberg Weiss Bershad Hynes & Lerach, 523 U.S. 26, 35 (1998), respectively).

[200] *See, e.g., In re* Residential Cap., LLC, 474 B.R. 112, 120 (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 the Code should be amended, forthwith, to delete § 1104(c)(2), and to give bankruptcy judges (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." Hr'g Trans, *In re* Lyondell Chemical Co., No. 09-10023 (REG) (Oct. 26, 2009) (docket no. not available), at 35.

[201] 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.").

[202] *See* S. 17404 (daily ed. Oct. 6, 1978) ("There will automatically be 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") (statement of Sen. DeConcini).

[203] *See* Lipson & Marotta, *Examining Success, supra* note 30, at 5, 7.

[204] *See* Lipson & Marotta, *Examining Success, supra* note 30, app. 1 (for a list of cases in which they were appointed, along with the district and year the case was commenced).

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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.[205]

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.[206] 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.[207]

Although creditors chiefly bear these costs, other estate professionals will, too, in the form of lost work. Creditors' committee counsel may believe that they have a duty to do the sort of an investigation that an examiner might undertake, and want to protect that turf.[208] Creditors' committees do in fact often object to the appointment of an examiner.[209]

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.[210] The examiner represents no party, and instead answers only to the court.[211] But the cost of the examiner is borne by the bankruptcy estate. To the extent bankruptcy examinations constitute a public good, in other words, private creditors foot the bill.

Examiners have nevertheless featured prominently in some of the nation's largest and most controversial chapter 11 cases, including *Enron,*[212] *Worldcom,*[213] *Lyondell Chemical,*[214] *Washington Mutual*,[215] *Lehman Brothers*,[216] *The Chicago Tribune*,[217] *Residential Capital* ("*Res*

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205 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". *See* Lipson & Marotta, *Examining Success, supra* note 30, at 4.

206 Lipson, *Understanding Failure*, *supra* note 201, at 53.

207 *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.").

208 *Id.* at 51

209 *Id.* (official committee of unsecured creditors was found 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).

210 *Id.* (quoting interview with L-1 dated Sept. 20, 2007).

211 *In re* Big Rivers Elec. Corp., 355 F.3d 415, 432 (6th Cir. 2004) ("answers solely to the Court.") (quoting *In re* Baldwin United Corp., 46 B.R. 314, 316 (Bankr. S.D. Ohio 1985)).

212 *In re* Enron Corp., No. 01-16034 (Bankr. S.D.N.Y. Dec. 2, 2001).

213 *In re* Worldcom, Inc., No. 02-13533 (Bankr. S.D.N.Y. July 21, 2002).

214 *In re* Lyondell Chemical Co., No. 09-10023 (REG) (Bankr. S.D.N.Y. Oct. 26, 2009).

215 *In re* Washington Mutual, Inc., No. 08-12229 (Bankr. D. Del. Nov. 1, 2008).

216 *In re* Lehman Bros. Holdings, Inc., No. 08-13555 (Bankr. S.D.N.Y. Sept. 15, 2008).

217 *In re* Tribune Co., No. 08-13141, *Agreed Order Appointing Examiner*, Dkt. No. 4120 (Bankr. D. Del. Apr. 20, 2010). The examiner's role in the *Tribune* bankruptcy is discussed in detail in Daniel J. Bussel, *A Third Way: Examiners as Inquisitors*, 90 AM. BANKR. L.J. (Winter 2016 Forthcoming).

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Cap"),[218] and *Caesar's Entertainment*.[219] They appear to be especially important in "freefall" cases—large chapter 11 reorganizations commenced without prior planning-- such as *Enron* and *Lehman Brothers*.

FTX was frequently compared to *Enron* and *Lehman Brothers* because it was a massive freefall case precipitated by allegations of serious misconduct.[220] The debtors in these cases also had significant unencumbered assets, implying that there was plenty of money sloshing around, enough to pay the usual professionals plus an examiner. *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, 2023, about three weeks after the *FTX* case was commenced, for two basic reasons.[221] First, the UST has long taken the position that the Bankruptcy Code's examiner provisions are mandatory, and should be treated as such by Bankruptcy Courts, notwithstanding the strong resistance noted above.[222]

Second, the U.S. Trustee argued that the public had an inherent interest in knowing how and why FTX collapsed. A public report of the examiner's findings could reveal the "wider implications" that FTX's unprecedented collapse had for the cryptocurrency industry.[223] 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. One of those implications was public confidence that, in the case of "such a precipitous and devastating failure . . . affecting stakeholders worldwide, any investigation

[218] *See* Residential Cap *supra,* 474 B.R. 112.

[219] *In re* Caesars Entm't Operating Co., No. 15-01145 (Bankr. D. Del. filed Jan. 15, 2015) *transferred to* Bankr. N.D. Ill., 2015 WL 495259 (Bankr. D. Del. Feb. 2, 2015). *See also In re* Caesars Entm't Operating Co., 526 B.R. 265, 270-71 (Bankr. N.D. Ill. 2015) (discussing examiner's appointment).

[220] *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, November 11, 2022, https://fortune.com/2022/11/11/larry-summers-ftx-crypto-collapse-more-like-enron-than-lehman/.

[221] Motion of the United States Trustee for Entry of an Order Directing the Appointment of an Examiner, *In re* FTX Trading, Ltd., Case 22-11068-JTD Doc 176 Dec. 1, 2022), at 23 [hereinafter "Examiner Motion"].

[222] *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.").

[223] *Id.* at 151.

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here must not only be legitimate and independent but also must be seen as beyond reproach by stakeholders and the public."[224]

John Ray and Sullivan & Cromwell (representing the debtors), the Creditors' Committee (UCC) and the Joint Provisional Liquidators of FTX Digital Markets Ltd (the Antiguan parent of FTX.com), forcefully resisted. They argued that the phrase "as is appropriate" means every request for an examiner is discretionary, even where qualifying debts exceed $5 million.[225] Here, 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."[226]

The UCC asserted that creditors should not have to bear the costs of satisfying the public's interest in understanding this failure. [227] This is understandable, but Ken Pasquale, UCC counsel also hinted at the turf-battle would lie 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."[228]

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 him. "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."[229] 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 [UST] at the hearing, would be in the tens of millions of dollars and would likely exceed $100 million."[230] There were, he reasoned, "already multiple investigations underway by incredibly competent and independent parties."[231] Thus, he said, "[e]very dollar spent in these cases on administrative expenses is a dollar less to the creditors."[232]

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 (un)der-disclosed potential conflicts. If S&C has conflicts, and S&C for all practical

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[224] *See* Examiner Motion, *supra* note 221, at 22.

[225] *See* 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."(citing Joint Appendix 299, 307).

[226] 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, [that] the cost of an examiner will come out of the unsecured creditors' recoveries." Examiner Hearing Transcript, *supra* note 148, at 117:24-35.

[227] *Id.* at 121:18-23.

[228] *Id.* at 121:23-25 & 122:1-3.

[229] Hr'g Trans, *In re* FTX Trading, Ltd, Case 22-11068-JTD, Doc. 632, at 9:8-11 (Feb. 15. 2023) [hereinafter, "Examiner Ruling Transcript"].

[230] *Id.* at 9:17-20.

[231] *Id.* at 10:9-11.

[232] *Id.* at 10:18-20.

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matters hired Ray, it is unclear how Ray could be the equivalent of an examiner. He may well be a seasoned bankruptcy professional, but his incentives would be different from those of an examiner. In principle, he would focus on maximizing creditor recoveries.[233] But, he might also have an interest in shielding S&C from investigation—after all, as a practical matter, they recruited him. 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.[234]

2) The Appeal

After Judge Dorsey denied the request, the U.S. Trustee took a direct appeal to the Third Circuit.[235] The oral arguments before the Third Circuit panel were lopsided. The panel appeared to view the lower court's decision not to appoint an examiner as clearly mistaken, for two reasons.

First, the statute obviously requires an examiner; it was a matter of "straightforward" [236] statutory interpretation.[237] The statute says that the court "shall" appoint an examiner if the debtor has more than $5 million in general unsecured debt and a party in interest asks for one. While there is discretion in the scope and budget of the examination, Judge Dorsey had no choice on the appointment: it was mandatory.

Second, the mandatory nature of the appointment reflected Congressional intent to protect the public interest. The Court of Appeals focused particular attention 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."[238] 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."[239] 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."[240] The need for independence would be especially salient given the allegations of S&C's potential conflicts.

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[233] As we discuss in Part V, 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 incredible "burn rate" in professional fees incurred in the case.

[234] 11 U.S.C. § 1109(d)("the 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.").

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

[236] *Id.* at 150 ("Sometimes highly complex cases give rise to straightforward issues on appeal. Such is the case here.").

[237] *Id.* at 153 ("We hold that it does. The Bankruptcy Court erred in denying the U.S. Trustee's motion to appoint an examiner to investigate FTX Group.").

[238] *Id.* at 155.

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

[240] *Id.* citing 11 U.S.C. § 1102(b)(1))

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The Court of Appeals recognized that stakeholders' economic interests in the outcome are distinct from the need for an independent examination and report in large and notorious cases. In the terms we have used in this Article, it plays a crucial role in assuring the integrity of the system, the first and most important type of public interest.

The Court of Appeals did not tell the Bankruptcy Court what the scope of an examination should be, though it offered 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."[241]

C) Conflicts of Interest 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, and one of its key roles is "to police the bankruptcy system for conflicts of interest by professionals (lawyers), "cronyism," or debtor misconduct."[242]

The U.S. Trustee's approach in *FTX* was more tentative. He did object 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."[243] But the U.S. Trustee quickly agreed to settle and withdraw the objection in return for additional disclosure by S&C, which they made at the last minute.

The U.S. Trustee's decision to stand down proved enormously consequential. S&C repeatedly said that it was qualified to lead the investigation because it had been found to be disinterested by Judge Dorsey.[244] In the examiner appeal, the issue of S&C's potential conflict

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[241] *Id.* at 157.

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

[243] *See* S&C Retention Objection*, supra* note 153*,* at ¶ 3.

[244] 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...

Third Circuit Hr'g Trans, at 26:24-25; 27:1-2 & 8-15. Bromley maintained this even after the Bankruptcy Court was reversed. After reversal, at a status conference on the appointment of an examiner, Bromley argued that "counsel that have been [ap]pointed to represent [Ray] are disinterested . . . Those orders were entered finding disinterestedness and those orders are final, unappealable." Hr'g Trans Examiner Status Conf Hr'g Trans 1/24/24, at 18:10-11 & 17-18. As explained above, there is no evidence that Judge Dorsey knew of S&C's potentially problematic CFTC work or the

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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.

Surely, the U.S. Trustee understood this. The appearance of S&C's potential conflicts, coupled with their control of the case, would be very strong grounds for 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.[245] If, as the evidence above suggests, the prosecution of Bankman-Fried and other insiders was triggered and/or materially supported by S&C, probing questions about S&C's potential conflicts might have posed a problem for prosecutors. This might raise doubts about the speed of the prosecutors' decision to prosecute Bankman-Fried, their motives and independence in making the decision and—just as important—their ability to rely on S&C to provide what appears to have been millions of dollars in litigation support.

Thus, the U.S. Trustee and the U.S. Attorney would represent different facets of the public interest in chapter 11. Here, the Trustee may have wanted to vindicate the first—procedural 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—one which would also enable it to bury any evidence of incompetence or misconduct, and to bill millions of dollars in the process.

It is not clear how conflicts of this sort—within the DOJ—are resolved. We speculate that it may have been the subject of a compromise between the Trustee and prosecutors reflecting what actually happened: 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, which meant refraining from saying anything about S&C's role in connection with that prosecution.

This would in all likelihood do two important things. 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 15 months after the case was commenced—the U.S. Attorney's Office would continue its prosecution of Bankman-Fried as quickly as possible, perhaps driving even greater (and more costly) reliance on FTX's chapter 11 estate.

sequence of events leading to the commencement and prosecution decisions. Whether they should have disclosed these matters is beyond the scope of this Article.

[245] For similar concerns that the U.S. Trustee may be influenced by other actors within the Department of Justice, see Lindsey D. Simon, *The Guardian Trustee in Bankruptcy Courts and Beyond*, 98 N.C. L. REV. 1297, 1310-11 (2020).

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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 the "watchdog" that did not bark.[246] While we do not fault the U.S. Trustee (assuming our speculations are correct), 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 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."[247]

On the other hand, they argued, if there was a public interest, other public actors—prosecutors—would address it. "Given the investigations 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."[248] 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."[249]

But of course, creditors and other stakeholders would be forced to bear this cost. The only difference was that their money would go to S&C, Ray and other case insiders, rather than to an examiner and her professionals.

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. He testified extensively about the work that he, FTX and S&C had done to support public actors—support that would, they 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."[250]

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[246] 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, *The Adventures of Silver Blaze*, in THE MEMOIRS OF SHERLOCK HOLMES (1894).

[247] Debtors' Objection to Motion of the United States Trustee for Entry of an Order Directing the Appointment of an Examiner, Case 22-11068-JTD, Doc. 573 (Jan. 25, 2023) at 4 [hereinafter, "DIP Examiner Objection"].

[248] Examiner Hearing Transcript, *supra* note 148, at 122:15-18.

[249] *Id.* at 130:9-17.

[250] *Id.* at 51:23-25; 52:1-10.

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> 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.[251]

There is little doubt that FTX was prudent to cooperate with prosecutors under these conditions. It is, however, hard to see how Ray could know that any given act of cooperation was in the interests of the estate if, as he testified, he was providing "full access" to the government "on a real time basis." 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 [pro]ffers of 24 current and former employees. And then, we've also provided an analysis relative to the transactions inside the companies databases.[252]

Prosecutors later described the information sharing as "routine practices by companies cooperating in an investigation."[253]

Ray testified that he was in near daily contact with the U.S. Attorney's office:

> Our teams have been involved with, you know, virtually daily requests. As you can see, we've had over 150 requests from the Southern District, produced substantial amounts of information, and provided substantial cooperation relative to instances where they wanted specific information … So, it's virtually an ongoing exercise, but the last, you know, roughly 90 days have been an extremely intense effort to provide the information that the Government has requested which, obviously, you know, yielded substantial results in record time.[254]

He did not say what these "substantial results" were, though the prosecutors and S&C would appear to have been the principal beneficiaries. In any case, 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

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[251] *Id.* at 51:23-25; 52:1-10.

[252] *Id.* at 53:1-16.

[253] David Yaffe-Bellany & Matthew Goldstein, *Sam Bankman-Fried Makes His Last Stand*. N.Y. TIMES, Feb. 27, 2024, https://www.nytimes.com/2024/02/27/technology/sam-bankman-fried-fraud-ftx.html.

[254] *Id*. at 53:21-25; 54:1-7.

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House, to the Senate, to the U.S. Attorney's Office in the Southern District of New York and three other Districts.[255]

The "burn rate" in *FTX*—the costs of professionals such as lawyers and accountants—is astronomical, perhaps the highest ever, and estimated to be $1.5 million *per day*.[256] The tremendous cost to the estate, or at least some of it, may have been justified by the importance of the prosecutorial process. But it is quite ironic, given that cost was the principal argument Ray and S&C made for eschewing an examiner.

V. Failing to Maximize Value in the FTX Reorganization Process

We suffer the burdens of chapter 11—the stay of litigation; the paperwork and delay; the professional fees—because we believe that the benefits for all creditors outweigh other options. Value maximization is the "consensus goal" among bankruptcy scholars because it is so obviously both a public and private good.[257]

As explained in Part I, the chapter 11 system outsources specific decisions about how this should happen to the distress professionals who operate the debtor and represent its stakeholders in the chapter 11 case. Often, they conclude that value can be maximized by selling the assets of the debtor, rather than trying to achieve a reorganization in place.[258]

There was thus nothing inherently surprising about the fact that FTX would seek to sell assets through its bankruptcy, as it did. Bankruptcy courts will approve such sales under section 363 of the Bankruptcy Code following a fairly light "business judgment" review.[259] The goal is to maximize value for stakeholders. Unfortunately, FTX may have used questionable insider sales to bury potential evidence of S&C's prebankruptcy failings, depriving creditors of value that more independent decision-making could have preserved. The debtors also curiously failed to pursue causes of action against those who may have caused the debtors the greatest harm, in particular Binance. In many cases, these decisions appear more consistent with protecting or advancing the interests of S&C than the interests of the debtors' estate.

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[255] *Id*. at 113:11-23.

[256] *See* Rick Archer, *FTX [Fee] Examiner Report OKs $111M In Professional Fees*, LAW360, Sept. 6, 2023, https://www.law360.com/articles/1718547/ (noting that $320 million of the estate's funds have been spent on professional fees so far, "with the burn continuing at $1.5 million a day.").

[257] Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 821 (2004) ("the maximization of distributions to beneficiaries is a consensus goal").

[258] Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 735 (2010) (often, a "sale is too attractive a business disposition for many bankrupts to give up.")

[259] 11 U.S.C. § 363; Roe & Skeel, *supra* note 258, at 736 (to approve a section 363 sale, there "must be an appropriate business justification for the sale").

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A) Early Bid Procedures

About one month into the bankruptcy, the debtors sought to establish "bid procedures" to sell certain key subsidiaries under section 363, including nondebtor LedgerX and the licensed businesses in Europe and Japan.[260]

Coming so early in such a large and chaotic case, there were few objections. The strongest was asserted by the U.S. Trustee. They worried that the debtors could be selling causes of action that FTX would otherwise have against insiders, and would lose access to books and records.[261] Either or both would be a problem, since the U.S. Trustee had already asked for the appointment of an examiner, who might want to investigate those causes of action and would need books and records to do so.

Although selling assets is not surprising, the speed of the sale decision was, given the chaos. Only a month before, Ray had declared that the debtors had suffered "a complete absence of trustworthy financial information."[262] How could he make such a significant decision after only a month on the job? FTX did not then even know enough to file basic information about assets and liabilities, yet they already committed to sell these entities.[263]

The debtors' investment banker, Kevin Cofsky, stated in a sworn declaration that the debtors had, in less than a month, engaged in a "strategic review" and, based on this, "decided to prioritize a bidding process for the Embed, LedgerX, FTX Japan and FTX Europe Businesses" in light of their potential value and "independence" from "the rest of the Debtors' operations", and "certain regulatory and commercial pressures" affecting those entities."[264]

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[260] Motion of Debtors for Entry of Orders (I)(A) Approving Bid Procedures, Stalking Horse Protections and the Form and Manner of Notices for the Sale of Certain Businesses, (B) Approving Assumption and Assignment Procedures and (C) Scheduling Auction(s) and Sale Hearing(s) and (II)(A) Approving the Sale(s) Free and Clear of Liens, Claims, Interests and Encumbrances and (B) Authorizing Assumption and Assignment of Executory Contracts and Unexpired Leases, Case 22-11068-JTD Doc 233 Filed 12/15/22 Page 1 of 49.

[261] Objection of the United States Trustee to Motion of the Debtors for Entry of an Order (A) Approving Bid Procedures, Stalking Horse Protections and the Form and Manner of Notices for the Sale of Certain Businesses, (B) Approving Assumption and Assignment Procedures and (C) Scheduling Auction(s) and Sale Hearings, at ¶ 27, Case 22-11068-JTD, Doc 400 (Jan. 7, 2023) ("Where, as here, there have been serious and widespread allegation of wrongdoing at the Debtors, and criminal charges have been brought against certain insiders, the sale of potentially valuable causes of action against the Debtors' directors, officers and employees, or any other person or entity, should not be permitted until there has been a full and independent investigation into all persons and entities that may have been involved in any malfeasance, negligence or other actionable conduct.") [hereinafter "UST LedgerX Objection"].

[262] *See* Ray First Day Decl., *supra* note 85, at ¶ 4.

[263] The UST Objection asserted that "none of the Debtors have filed Schedules, Statements or Rule 2015.3 reports, and the Debtors currently seek permission to delay such filing until after the proposed sale hearing dates." *See* UST LedgerX Objection, *supra* note 261, at ¶ 22.

[264] Declaration of Kevin M. Cofsky in Support of Motion of Debtors for Entry of Orders (I)(A) Approving Bid Procedures, Stalking Horse Protections and the Form and Manner of Notices for the Sale of Certain Businesses, (B) Approving Assumption and Assignment Procedures and (C) Scheduling Auction(s) and Sale Hearing(s) and (II)(A) Approving the Sale(s) Free and Clear of Liens, Claims, Interests and Encumbrances and (B) Authorizing Assumption and Assignment of Executory Contracts and Unexpired Leases, Case 22-11068-JTD Doc 413 (Jan. 8, 2023), at ¶ 9 [hereinafter "Cofsky Aff."].

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At least initially, these sales sounded promising. Cofsky reported that FTX had already received over 100 expressions of interest and had entered into about 60 confidentiality agreements with potential bidders (a key first step, to enable the bidders to conduct due diligence).[265]

Ultimately, however, it appears that only the LedgerX sale was consummated—to a problematic purchaser and at what may have been a bargain price.[266] The sales of the other entities have either fallen through or, in the case of FTX Europe, been challenged on a variety of grounds, including that the debtors reneged on their own bid procedures, and refused to consummate the sale to a stalking horse.[267]

B) The LedgerX Auction

Bid procedures in hand, the debtors scheduled an auction between two bidders for LedgerX on April 4, 2023. One of those bidders (OKC) dropped out, leaving a purchaser known as "M7 Holdings," who agreed to purchase LedgerX for about $48 million.[268] This bid was approved by the Bankruptcy Court May 4, 2023.[269]

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[265] Cofsky Aff, *supra* note 264, at ¶ 16 ("As of the date hereof, approximately 117 parties, including various financial and strategic counterparties globally, have expressed interest to the Debtors in a potential purchase of one or more of the Businesses. As of the date of this Declaration, the Debtors have entered into 59 confidentiality agreements with potential counterparties who have expressed interest in any one or more of the Businesses, and are in the process of entering into a number of additional confidentiality agreements with potential counterparties.").

[266] "With respect to the other three businesses," the debtors' conceded in December 2023, their "strategic decisions have evolved based on a number of different factors." *See* Disclosure Statement *supra* note 84, at 32.

[267] As of this writing, FTX seeks to sell the Swiss and Greek entities to a debtor-parent in a transaction that appears to amount to moving coins from one pocket to the other, with no obvious benefit for creditors. *See* Bidder 1's Objection to Motion of Debtors for Entry of an Order (1) Authorizing and Approving (A) Entry Into Free and Clear of Liens, Claims and Encumbrances and (II) Dismissing the Chapter 11 Case of Certain Debtors Effective Upon the Earlier of the Closing of the Termination of the Share Purchase Agreement, Case 22-11068-JTD Doc 5954 (Jan. 18, 2024) ("In their Sale Motion, the Debtors2 seek bankruptcy court approval for one debtor to sell two of its debtor subsidiaries, FTX Cyprus and FTX Switzerland GmbH (the "Subject Debtors"), to its debtor parent in a private sale transaction on the grounds that the private sale is better than the agreement they had reached with Bidder 1 3 (the "Bidder 1 Agreement"), although the Sale Motion makes clear that the Debtors never provided any opportunity for bidders to meet or beat the terms of their private sale.").

[268] Notice of (I) Successful Bidder for the LedgerX Business and (II) Filing of the LedgerX Business Purchase Agreement, at 2, Case 22-11068-JTD Doc 1342 (Apr. 25, 2023) ("the Debtors and one of the Qualified Bidders determined shortly thereafter that they would be unable to reach a satisfactory transaction, this Qualified Bidder requested the return of its deposit and the Debtors disqualified this bidder as a Qualified Bidder and refunded the deposit.") [hereinafter "LedgerX Bid Notice"].

[269] Disclosure Statement, *supra* note 84, at 26. Interestingly, the 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." *Id.* The Notice of Sale, however, states that only two qualified bids were received, one of which was withdrawn. *See* LedgerX Bid Notice, supra note 267, at 2.

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M7 was a potentially problematic purchaser. The connections between M7 and LedgerX were thick. It had sold LedgerX to FTX back in 2021 (the first deal S&C did for FTX).[270] It appears that M7 was a subsidiary of Miami International Holdings and affiliated with former CFTC Commissioner Mark Wetjen who, according to CoinTelegraph, had sat on the LedgerX board since 2015.[271] It appears that FTX executive Zach Dexter had been CEO of LedgerX before bankruptcy and also on its board, with Wetjen.[272]

> Mark Wetjen, former CFTC Commissioner and later head of policy + regulatory strategy at FTX US, has been sitting on the board of LedgerX since 2015.
>
> Wetjen was CEO of MIAX Futures for almost 2 years. pic.twitter.com/zFZtqSou8l
>
> — Wave (@waveninja1) April 25, 2023

In a sworn statement, Ray assured the Bankruptcy Court that M7 was not an "insider," although it is not clear how he came to this conclusion.[273] While Wetjen and Dexter had not been directors or officers of a "debtor"—oddly, LedgerX was never made a "debtor" in the chapter 11 cases—they held their positions at an entity that was an affiliate of the debtors.[274]

The sale price—$48.8 million—was curiously low. It appears that FTX originally paid nearly $300 million for LedgerX in 2021.[275] The sale schedules (filed on the day the sale was approved) showed that, as of December 31, 2022, the net value of the company (the net equity) was about $98 million.[276]

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[270] 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."

[271] Derek Andersen, *FTX proposes sale of LedgerX to affiliate of Miami-based exchange holding company*, COINTELEGRAPH, Apr. 23, 2023, https://cointelegraph.com/news/ftx-sells-ledgerx-for-50m-to-affiliate-of-miami-based-exchange-holding-company.

[272] Press Release, FTX US Derivatives, *FTX US Derivatives Announces Board of Directors*, PR NEWSWIRE, Jan. 19, 2022, https://www.prnewswire.com/news-releases/ftx-us-derivatives-announces-board-of-directors-301463938.html.

[273] 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 and Clear of All Liens, Claims, Interests and Encumbrances, (III) Authorizing Assumption and Assignment of Certain Executory Contracts and (IV) Granting Related Relief, at ¶ 6 ("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").

[274] 11 U.S.C. § 101(E)("insider" includes "affiliate, or insider of an affiliate as if such affiliate were the debtor").

[275] Tracy Wang, *FTX's LedgerX Derivatives Exchange Sold to Miami International Holdings in Bankruptcy Auction*, COINDESK, Apr. 25, 2023, https://www.coindesk.com/business/2023/04/25/ftxs-ledgerx-derivatives-exchange-sold-to-miami-international-holdings-in-bankruptcy-auction/ (indicating 2021 purchase price of $298 million).

[276] Notice of Revised LedgerX Proposed Sale Order and revised Sealed Disclosure Schedules, Case 22-11068-JTD Doc 1422-1 (May 4, 2023) at 53.

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LedgerX LLC
Statement of Changes in Member's Equity
As of December 31, 2022

	Member's Equity
Balance at January 1, 2022	$265,646,174
Capital contributions	27,461,482
Capital distributions	(175,000,000)
Net Loss	(19,329,538)
Balance at December 31, 2022	**$98,778,118**

Why would FTX sell an asset (ownership of LedgerX) at nearly half its face value—and one-sixth its original price only two years earlier—to an insider of the company (and a former FTX executive)? How could *that* have value for creditors? It is not clear, but at least some roads lead back to S&C.[277]

C) <u>S&C and LedgerX</u>

The LedgerX sale included both a "release" of all of LedgerX's agents[278] and (it appears) a sale of any legal malpractice claims that LedgerX may have had against S&C.[279] These claims may, in turn, derive from what S&C knew and did regarding Alameda's "secret privileges"—its unlimited and un(der)-disclosed linkages to FTX International.

As explained in Part II, it appears that Alameda's linkages to FTX, the info@ and fiat@ accounts, were discovered by LedgerX's Chief Risk Officer, Julie Schoening. She was fired after reporting her concerns to Dexter. This was all happening while S&C was apparently seeking to expand FTX's regulatory permissions with the CFTC, through LedgerX. As also noted above, it appears that S&C was representing (or participating in representations) assuring the CFTC there were no such linkages.

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277 It is possible intercompany claims may explain some of this. According to financial statements prepared by Grant Thornton for LedgerX, and attached as a schedule to the sale 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. Notice of Revised LedgerX Proposed Sale Order and Revised Sealed Disclosure Schedules, Case 22-11068-JTD, Doc 1422-1 (May 4, 2023) at 53.

278 The order approving characterized S&C as a "Released Party" and provided that "The Debtors are hereby authorized and directed to (a) sell and convey to Buyer, effective upon the Closing, the Acquired Claims and the Coverage Claims (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, it would appear, any malpractice claims belonging to LedgerX would have been released by the Debtors and gone with LedgerX to its purchasers. Case 22-11068-JTD, Doc 1433 (May 4, 2023) at 11.

279 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 . . ." Order (I) Approving the LedgerX Business Purchase Agreement, (II) Approving the Sale of the LedgerX Business Free and Clear of All Liens, Claims, Interests and Encumbrances, (III) Authorizing Assumption and Assignment of Certain Executory Contracts and (IV) Granting Related Relief, LedgerX Interest Purchase Agreement at 41, Case 22-11068-JTD, Doc 1433-1 (May 4, 2023) at 47.

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It is not clear whether S&C knew of Schoening's discovery or participated in her firing. Nor do we know what representations S&C made about the linkages she apparently discovered. As noted above, on the same day the bankruptcy was commenced, S&C withdrew from the CFTC docket the application it had filed on behalf of FTX.[280]

The hearing on the LedgerX sale, held May 5, 2023, took about six minutes, from 1:04 to 1:10 that afternoon.[281] The transcript runs nine pages (ten including the transcriber's certification). It shows the disappointed bidder reserving his rights (but not otherwise disturbing the sale)[282] and the buyer making clear how important it was to purchase claims by and against the company.[283]

"Well," Judge Dorsey said to laughter, "that was easy." Dietderich responded, perhaps knowingly, "[i]t won't always be[,] so we should enjoy it."

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5        THE COURT:  Well, that was easy.
6    (Laughter)
7        MR. DIETDERICH:  It won't always be so, we should
8  enjoy it.
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D) Other Ways to Minimize Value

The sale of LedgerX is not the only reason to worry about the commitment of Ray and S&C to maximize value. There is cause for concern about FTX's commitment to other, basic means of maximizing value, including maintaining the exchange as a going concern and pursuing viable causes of action against those who harmed the company.

1) Abandoning the Going Concern

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 of its management, rather than appointing a trustee. Yet, it is unclear whether Ray and S&C made any serious effort to maintain FTX as a going concern.

Here, it appears that FTX halted trading before bankruptcy due to the liquidity crisis triggered by the run on deposits in November 2022. Bankman-Fried claims that he had lined up

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280 *See* CFTC Withdrawal Letter, *supra* note 117.

281 Hr'g Trans, May 4, 2023, Case 22-11068-JTD Doc 1436 Filed 05/05/23 [hereinafter "LedgerX Hearing Trans"].

282 *Id.*, at 5:23-25 ("the OKC entities reserve all of their rights to seek appropriate relief relating to certain statements made in Mr. Mendelsohn's supplemental declaration").

283 The only other appearance came from counsel to the purchaser, M7. Lisa Schweitzer, of the Cleary Gottlieb firm on behalf of M7, told the court that the buyer "would not have entered into the purchase agreement if the sale of the LedgerX business did not include the sale and conveyance of the acquired claims and the coverage claims of the debtors." *Id.* at 7:19-22.

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other sources of bridge financing, in order to keep the exchanges going. Here, for example, are screenshots of a letter of intent executed by TRON on November 18, 2022 for a $4 billion financing.

Transaction whereby:

(i) "**TRON Credit Facility**". TRON will provide a liquidity facility with $TRX, $BTT, $JST, $SUN and $HT (together the "**TRON Tokens**") to fund up to US$4,000,000,000 of the crypto asset withdrawal from FTX Platform by its user accounts.

Dated this 18th day of November 2022

TRON NETWORK LIMITED

By:

Name: Steve Liu
Title: CEO

Source: Letter of Intent Among Tron Network Limited and FTX Digital Markets Ltd.[284]

It is not clear what this financing offer was really worth. It would have been funded with digital assets that were, themselves, of uncertain value.

But that is not the important point. Incredibly, Ray refused even to discuss financing offers with Bankman-Fried. It appears that on November 13, Bankman-Fried emailed Ryne Miller that he was "super happy to chat."[285] As explained in Part II, it appears that S&C encouraged this, at least initially. Yet, at the February 7, 2023 hearing on the examiner motion, Ray said 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."[286]

But Bankman-Fried was not indicted until December 9, 2022. In bankruptcy-time, this was long after Bankman-Fried had apparently obtained and sought to share the financing offers he claimed to have found. How could Ray have known back then that he should not speak to the CEO and founder of this massive company that had just free-fallen into bankruptcy? Dietderich, too, declared that he "never spoke with Mr. Bankman-Fried again" after a November 10, 2022 video conference with him and his lawyers.[287] Yet, as late as November 13, 2022, Dietderich's partner, James McDonald, was assuring Bankman-Fried that they were "happy" to discuss such possibilities—possibilities that may have saved the company.[288]

Not only did Ray and S&C refuse to talk to Bankman-Fried about keeping the exchange running, they appear to have permanently shut FTX down rather than make a serious effort to preserve it. Not surprisingly, they blamed it on Bankman-Fried.[289] "FTX was an irresponsible

[284] *See* Sentencing Memorandum *supra* note 107, Ex. E, at 34-37.

[285] Email chain on file with author.

[286] Examiner Hr'g Trans, 51:11-13, Case 22-11068-JTD Doc 632 (Feb. 7, 2023) at 51.

[287] *See* Dietderich 1st Supp. *supra* note 8, at ¶ 21.

[288] *See* McDonald Email, *supra* note 139.

[289] The debtors' disclosure statement devotes one sentence to the effort: "The Debtors have considered multiple options related to FTX Japan, including seeking to restart operations, the possibility of including the digital asset exchange of FTX Japan in a potential restart/reboot of the FTX international exchanges or a possible sale to interested investors." Disclosure Statement, *supra* note 84, at 27.

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sham created by a convicted felon," attorney Andrew Dietderich said in January 2024. "The costs and risks of creating a viable exchange from what Mr. Bankman-Fried left in a dumpster were simply too high."[290]

But this decision may also reflect an incentive to justify the bankruptcy and prosecution decisions in the first place. If the exchanges were viable, that might buttress Bankman-Fried's claims that the FTX Group as a whole was sound, illiquid but not insolvent.

2) "Avoiding" (Some) Complaints

Another way to maximize creditor recoveries is through litigation, for example by using special bankruptcy powers to "avoid" transfers of property of the debtor made before bankruptcy as well as other causes of action against those who, intentionally or not, harmed it. Here, the estate under Ray filed many complaints against insiders and their relatives (e.g., the law professor parents of Bankman-Fried) to avoid fraudulent transfers and for breaches of fiduciary duty. Yet, it would appear that they "avoided" (so to speak) bringing others that might have been even more valuable.

They did pursue claims against philanthropies and other recipients of FTX's largesse, in particular those who sold companies to FTX for ostensibly more than they were worth. But these have so far settled quickly, perhaps because FTX and S&C knew that they could not establish a predicate element to most of these claims: that FTX was insolvent.[291]

a) Missing Malpractice Actions

Notably missing are malpractice claims against the debtors' gatekeepers, including accountants and lawyers, such as Fenwick & West, S&C, and S&C's backup counsel in the bankruptcy, Quinn Emanuel, who also represented FTX before bankruptcy.[292] These claims do not require a showing of insolvency. While it is not clear why the estate has failed to pursue claims against Fenwick, they have aggressively sued FTX's former chief legal officer, Dan Friedberg—even as they apparently let former FTX US counsel (and S&C partner) Ryne Miller walk away.[293]

b) The Binance Problem (Part 2)

Perhaps more significant is the pass given to Binance. Recall that this crypto competitor of FTX triggered the debtors' liquidity crisis by requiring the debtors to redeem about $2.1 billion in assets shortly before bankruptcy. Under the Bankruptcy Code and applicable state law, a

[290] Betsey Reed, *FTX scraps plan to revive exchange and will repay billions to customers*, THE GUARDIAN, Jan. 31, 2024, https://www.theguardian.com/business/2024/jan/31/ftx-crypto-exchange-cancelled-refund-customers.

[291] Andrew Ross Sorkin, Ephrat Livni and Sarah Kessler, *What Happens to FTX Clawback Cases if the Company Repays Its Creditors?* N.Y. TIMES DEALBOOK, Feb. 3, 2024, https://www.nytimes.com/2024/02/03/business/dealbook/what-happens-to-ftx-clawback-cases-if-the-company-repays-its-creditors.html.

[292] Quinn Emanuel Application, *In re* FTX Trading, *In re* FTX Trading, Ltd., No. 22-11068-JTD, Doc. 280, at 11 (Dec. 21, 2022).

[293] *See* First Amended Complaint, Alameda Research, LLC, et al. v. Daniel Friedberg, Adv. Proc. Case 23-50419-JTD Doc 32 (Jan. 22, 2023).

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redemption of equity by an insolvent company (or a redemption that renders the company insolvent) is voidable as, in substance, a fraudulent transfer.[294] This is especially so where the redemption was intended to harm the debtor, as may have been the case with Binance.

Yet, the debtors clearly have sued some recipients of ostensibly fraudulent transfers, even noninsiders. Take the LayerZero litigation. On September 8, 2023, about nine months into the bankruptcy, the debtors commenced an adversary proceeding against a company known as LayerZero Labs, which had sold an equity stake of about 5% to Alameda for about $70 million,[295] among other things. According to the complaint, the transfers were voidable because there were "multiple badges of fraud," including that "[t]he value of the consideration received by [debtor] Alameda Ventures was not reasonably equivalent to the value of the assets transferred or the amount of the obligations incurred" and "Alameda Ventures was insolvent when, or became insolvent shortly after, the transfers were made."[296] Relying on the criminal indictment of Bankman-Fried, the complaint strongly insinuated that the purchase had been made with customer funds.[297]

Suing transferees like LayerZero is not controversial in chapter 11. It is a central way that debtors in possession maximize the value of the estate. Instead, what is striking is the contrast with Binance. Like LayerZero, Binance received a significant payment shortly before bankruptcy that surely contributed to the debtors' downfall—at $2.1 billion, thirty times the $70 million paid to LayerZero. Like LayerZero, Binance appears to have provided inadequate consideration—indeed, none if the FTT was worthless.[298]

Despite Binance's apparently significant role in the debtors' demise, FTX and Ray have so far taken no public action against the company. The name does not come up in a search of the docket, which would indicate that pleadings had been filed against Binance to recover these transfers.[299] It appears only twice in the Disclosure Statement.[300]

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[294] 11 U.S.C. §§ 548 & 544(b)(1).

[295] FTX Trading, Ltd., et al. v. LayerZero Labs, Ltd., et al., Adv. Proc. __, *In re* FTX Trading, Ltd., Case 22-11068-JTD, Doc 2457 (September 8, 2023) [hereinafter, "LayerZero Complaint"].

[296] LayerZero Complaint, *id.*, at ¶¶ 3, 64.

[297] *Id.* at ¶ 45 ("Bankman-Fried supplied potential investors with a purported Alameda Research balance sheet that included a liability of $8 billion in a "Hidden, poorly internally labled [sic] 'fiat@' account." *See* Superseding Indictment ¶ 56, United States v. Bankman-Fried, 22-cr-00673 (S.D.N.Y. 2022), ECF No. 115. However, Bankman-Fried "well knew" that this liability reflected "FTX customer fiat deposits accepted into Alameda Research's bank accounts that had not been maintained for the benefit of customers or repaid to FTX[.]" *Id.* at ¶ 57. The FTX Insiders used these funds "to make investments in the name of Bankman-Fried and his associates, rather than in the name of Alameda." *Id*. ¶ 26.").

[298] It is not clear what the FTT would have been worth. The debtors' Disclosure Statement says that they "correlated with the value of the FTX Exchanges as a whole". Disclosure Statement, *supra* note 84, at 17. The Disclosure Statement implies that they are functionally worthless, since holders under the proposed plan would be deemed to reject the plan, which is true only for interests that receive or retain no property under the plan. *Id.* at 54.

[299] See Docket, *In re* FTX Trading Ltd., Case No. 22-11068, available at https://restructuring.ra.kroll.com/FTX/Home-DocketInfo (searched Mar. 2, 2024).

[300] Disclosure Statement, *supra* note 84, at 17.

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Ray and S&C made a great show of attacking the prebankruptcy insiders and even smaller-fry noninsiders. Why let Binance off the hook, since they appear to have played an important role in the downfall?

Although there may be other reasons for this, 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 was counsel to Catherine Coley, "who launched Binance.US in 2019 and left suddenly two years later."[301] Recall that, as noted in Part II, McDonald was the S&C attorney who assured Bankman-Fried that FTX wanted his input into the reorganization—even after S&C white collar lawyers (perhaps including McDonald) had told prosecutors of concerns about FTX.

Second, on February 16, 2024, Bloomberg reported that Sullivan & Cromwell was "poised to be appointed Binance Holdings Ltd.'s independent monitor following the crypto giant's multibillion-dollar settlement with the US government."[302] It turns out that Binance had problems of its own, resulting in the company admitting guilt to charges related to anti-money laundering and sanctions violations.[303] To settle the charges, Binance would pay the government $4.3 billion and accept a court-appointed monitor, who would have exclusive access to all of the company's data. That monitor would be S&C.

As of this writing, S&C's Binance appointment has not been finalized. The government may have had second thoughts, given the developing controversy over S&C's role in *FTX*. Nevertheless, it is plausible that S&C did not want to sue Binance in order to avoid competition with the government for the company's assets. S&C's interest in becoming the Binance monitor, in other words, may have dampened its enthusiasm for causing FTX's bankruptcy estate to sue Binance to recover some or all of the $2.1 billion in FTX customer assets it apparently received shortly before bankruptcy. If so, it is hard to see how such decisions were in the interests of the debtors' estates.

c) Where Were the Real Parties in Interest?

Failing to maximize value ordinarily hurts creditors in a chapter 11 case, so why did the official committee of unsecured creditors (UCC) not insist on pursuing these potential claims? Indeed, if, as some signs suggest, FTX is solvent (or would be rendered so by these litigations), why aren't shareholders seeking to enforce these rights?

As a preliminary matter, these causes of action belong to the estate, which is controlled by Ray.[304] He seems unwilling to take action that might threaten S&C. The real parties in interest—creditors and equity holders—are hostage to Ray's interests.

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[301] *See* Angus Berwick & Chris Prentice, *Exclusive: Ex-CEO of Binance's US firm has enlisted lawyer for US investigations*, REUTERS, Mar. 29, 2023, https://www.reuters.com/legal/ex-ceo-binances-us-firm-has-enlisted-lawyer-us-investigations-2023-03-29.

[302] *See* Ava Benny-Morrison, Sabrina Willmer, & Allyson Versprille, *Sullivan & Cromwell In Line for Coveted Binance Watchdog Role*, BLOOMBERG, Feb. 15, 2024, https://www.bloomberg.com/news/articles/2024-02-15/sullivan-cromwell-in-line-for-coveted-binance-watchdog-role?embedded-checkout=true.

[303] *See* Maxwell, *supra* note 27.

[304] *See, e.g.,* Trimble v. Woodhead, 102 U.S. 647, 649 (1880). *See also* Bd. of Trs. of Teamsters Local 863 Pension Fund v. Foodtown, Inc., 296 F.3d 164, 169 (3d Cir.2002) (causes of action are property of the estate).

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Still, Ray's control is not absolute. Stakeholders could seek "derivative standing" if they can show that the debtor in possession is falling down on the job.[305] Why have stakeholders who would benefit from suing potentially deep-pocketed defendants such as Binance not challenged this state of affairs?

Two theories seem plausible. First, counsel to the UCC would, for all practical purposes, guide the UCC in deciding whether to challenge S&C. The committee'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. Because FTX had hundreds of thousands, perhaps a million, creditors, there were no obviously sophisticated lead stakeholders who might push the firm to take a more aggressive stance.

Second, it appears that professionals in the case are on track to charge and collect half a billion dollars. If, as FTX claims, customers will be paid in full, with plenty of money to spare, then there would be enough to pay Paul Hastings all it could realistically bill. While they clearly did not want to give up billable work to an examiner, they appear to have been content to allow S&C and Ray to take the lead, because they would stand to collect millions of dollars through the case.

One might think that if the company were solvent (as FTX may be the case), shareholders would be in the money, and thus should actively police the professionals who were husbanding their interest. Here, however, equity has so far played no role in the case. In part, this was because Bankman-Fried himself appears to have owned most of the equity. But it may also be because the outside venture investors who did put money in (e.g., Sequoia) may have been embarrassed by their lack of diligence.[306] Thus, the stakeholders with the most to gain from maximizing value and keeping professional costs in check are absent.

VI. Implications and Correctives

The last four Parts documented a breakdown of the oversight function in the *FTX* bankruptcy. The conflicts of interest of S&C, the debtors' attorneys, undermined the integrity of the judicial system, the first and most important of the three public interest concerns we have identified. The conflicts also undermined the second public interest concern, achieving insolvency related objectives, and may have caused John Ray and S&C to provide excessive assistance to the U.S. Attorney's office. In this part, we explore the implications of these findings for the public interest and offer suggestions for improving the effectiveness of the key bankruptcy gatekeepers.

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

306 Erin Griffith & David Yaffe-Bellany, *Investors Who Put $2 Billion Into FTX Face Scrutiny, Too*, N.Y. TIMES, Nov. 11, 2022, https://www.nytimes.com/2022/11/11/technology/ftx-investors-venture-capital.html.

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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. Professor 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.[307] Bankruptcy is thus a "hybrid system," public as well as private.[308] Focusing on a series of coal company bankruptcies, Professor Joshua Macey and Jackson Salovaara have shown that bankruptcy can sometimes be used to undermine the public interest by evading regulatory objectives.[309]

The most sustained attention to governmental actors and the public interest in bankruptcy has come from Professors 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,"[310] but also cautioning that this strategy may sidestep the ordinary constraints that operate when the legislative or executive branches pursue public interest objectives.[311] In another article, they study the tendencies of governmental actors in bankruptcy, finding that government entities usually defend against perceived encroachment rather than using the levers available in bankruptcy proactively.[312]

The historical analysis and FTX case study in the previous parts of this Article advance the nascent literature by categorizing and exploring the public interest considerations at stake in bankruptcy. By far the most important of these objectives is protecting the fairness and integrity of judicial oversight and the legal system. From a historical perspective, this is ironic, given that the original receiverships prioritized the nation's transportation needs, a substantive non-insolvency public interest (the third form of public interest), over the integrity of the legal system. This may have been justified at the time, but it has things precisely backwards for an established bankruptcy or insolvency framework.

A clear lesson of the FTX bankruptcy is that failure to protect the integrity of the legal system—in this case, by policing the lawyers' conflicts of interest—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 sales and 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 their incentives in providing assistance to the U.S. Attorney and interfered with Bankman-Fried's

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[307] Jacoby, *supra* note 30.

[308] *Id.*

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

[310] Ellias & Triantis, *supra* note 29, at 543-45.

[311] *Id.* at 545, 548-49 (discussing *Chrysler*, *PG&E* and *Purdue Pharma* cases).

[312] *See* Ellias & Triantis, *Administrative State*, *supra* note 29.

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defense. Adequate defense in a criminal case is also a public interest which, while distal from bankruptcy concerns, was apparently not considered 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 system integrity or bankruptcy objectives such as maximizing the value of the estate. In addition, as Professors Ellias and Triantis have pointed out, bankruptcy tends to be more rushed, it lacks some of the safeguards of the administrative or political process, and "bankruptcy judges are generally not experienced in being arbiters of complex policy debates."[313] In *FTX*, some assistance given by John Ray and S&C to the U.S. Attorney's office may 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. This assistance may have undermined Bankman-Fried's defense—it is possible, for instance, Bankman-Fried did not have access to exculpatory information 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. And the assistance was paid for by FTX's customers and creditors, since S&C billed millions of dollars to the FTX estate, despite the absence of any obvious benefit to the estate.

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 legal system 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 conflicted bankruptcy attorneys (i.e., if the first public interest had been properly recognized), it would have been considerably less likely to overzealously support the Bankman-Fried fraud prosecution.

The *Chrysler* bankruptcy provides another illustration. 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. 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.[314] This chilled potential bidding, thus undermining the bankruptcy objective of maximizing the value received in a sale. To minimize the distortions introduced by the pursuit of substantive non-bankruptcy objectives, courts need to be especially careful to protect the integrity of the legal system and the integrity of the procedures designed to achieve insolvency-related objectives.

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[313] Ellias & Triantis, *supra* note 29, at 545.

[314] Ellias and Triantis also make this point. Ellias & Triantis, *supra* note 29, at 523-30. *See also* Roe & Skeel, *supra* note 258.

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B) What are "Disinterested" Bankruptcy Lawyers?

Perhaps the single most disturbing theme in our findings is the extent to which S&C's apparent conflicts of interest permeated FTX's bankruptcy filing and every aspect of the case. These 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. In the retention hearing, S&C claimed it is common for a debtor's bankruptcy attorneys to have represented the debtor before bankruptcy. But this was a highly misleading statement. In most other cases, the attorneys are brought in only after the company has fallen into distress, when it is contemplating bankruptcy. S&C came in well before FTX's collapse and is implicated in FTX's pre-bankruptcy misbehavior. Given that so many large law firms now have a chapter 11 practice, the S&C problem is likely to recur—that is, the 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.

The most decisive solution to the problems this can create 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.[315] Congress could forbid lawyers who represented a debtor before its distress from serving as its lawyers in bankruptcy. But courts have discretion to address the problem even under the current rules. In our view, courts should cast a skeptical eye on requests to retain lawyers who represented the debtor prior to its financial distress. The presumption should be especially strong if there are allegations of fraud or misbehavior. With FTX, Judge Dorsey should never have allowed S&C to serve as the company's principal bankruptcy lawyers. To be fair, the extent of S&C's conflicts was obscured by S&C's initial disclosures, and it would have been disruptive to require new representation given the extensive work S&C had already done in the case. But the court should have insisted on lawyers that did not have major conflicts of interest.

C) Re-Examining Examiners

Another overarching implication of our findings is that insiders in chapter 11 reorganizations—not technical "insiders," but repeat players in the system—need independent checks. One of those checks could be an examiner.

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. Concern about the appearance of conflicts of public and private interests in *FTX* underlay much of the reasoning of the Third Circuit's opinion. But, as noted above, as of this writing, we do not yet know what an examiner will find or whether the examiner will be given the resources and scope needed to lay to rest the questions we (and the Third Circuit) identify.

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[315] 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).

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Regardless of the outcome in *FTX,* however, the underlying problem persists: bankruptcy insiders will usually resist examinations on grounds of cost, if nothing else. Given the exigencies of financial distress, the resistance is understandable.

To address the cost issue, bankruptcy judges could authorize a preliminary examination to determine whether further inquiry is appropriate.[316] 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. A recent scandal in the Houston bankruptcy court has drawn considerable negative attention.[317] The decision by the bankruptcy judge who oversaw the Purdue Pharma reorganization to retire early and go to work for one of Purdue Pharma's key law firms also raised eyebrows.[318] Unaddressed, the darker answers to the questions we raise would be similarly problematic.

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.[319] Large cases tend to be dominated by the same law firms. Sullivan & Cromwell's entrance into this practice area via FTX shows how lucrative it can be.

This proposal, like others discussed in this final Part, is likely to face resistance from many who would most directly be affected—chapter 11 practitioners, chief among them. But we take the insiders' resistance as evidence that reform is badly needed.

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.

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[316] *See* Lipson & Marotta, *supra* note 30.

[317] *See* Sujeet Indap, *The downfall of the judge who dominated bankruptcy in America*, FT.COM, Nov. 21, 2023, https://www.ft.com/content/574f0940-d82e-4e4a-98bd-271058cce434.

[318] *See* Sara Merken, *Judge who oversaw Purdue, Sears bankruptcies to join law firm Skadden*, REUTERS.COM, Apr. 13, 2023, https://www.reuters.com/legal/government/judge-who-oversaw-purdue-sears-bankruptcies-join-law-firm-skadden-2023-04-13/.

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

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Attorney for the 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. 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 would be borne by FTX creditors (and not US tax payers).

The Bankruptcy Code provides that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title."[320] But the role of the U.S. Trustee is unusual because it, like much of bankruptcy, acts to advance a mix of public and private interests.[321]

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. Presumably, those higher in the chain of command would resolve a dispute of this sort?

Practitioners such as S&C benefit from the uncertainty. As sophisticated intermediaries between public and private actors (e.g., LedgerX and the CFTC), 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*. 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 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, which is housed in the Federal Reserve but largely insulated from interference, is an obvious example of how this might be done. 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.[322]

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." While we do not challenge the jury's verdict or the company's need to use chapter 11, we worry about BigLaw attorneys who marshal and manipulate arguments about the "public interest" in order to advance or protect their own interests.

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[320] 11 U.S.C. § 307.

[321] *See, e.g.,* Simon, *supra* note 245, at 1307-09 (outlining U.S. Trustee's role).

[322] We also recognize that certain features of the CFPB have been challenged, in a case pending before the Supreme Court at this writing. *See* Cmty. Fin. Servs. Ass'n of Am., Ltd. v. Consumer Fin. Prot. Bureau, 51 F.4th 616 (5th Cir. 2022) (holding that Bureau's self-funding structure violated the Appropriations Clause and the separation of powers), cert. granted, 143 S. Ct. 978, 215 L. Ed. 2d 104 (2023), and cert. denied sub nom. Cmty. Fin. Servs. Ass'n of Am. v. Consumer Fin. Prot. Bureau, 143 S. Ct. 981, 215 L. Ed. 2d 106 (2023).

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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.

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