FTX – A GLOBAL SETTLEMENT AFTER JURISDICTIONAL WARS BETWEEN THE BAHAMAS AND THE UNITED STATES, ADVERSARIAL CONFLICT AND PROFESSIONAL STANDOFF

Sophia Rolle-Kapousouzoglou
INSOL Fellow, Lennox Paton,
The Bahamas
and Lexa Hilliard KC
Wilberforce Chambers, UK

"[With the GSA], [i]n the meantime, peace and harmony, of sorts, has broken out between the Debtors, FTX DM and its JOLs."

FTX exploded onto the crypto world in 2019. Operating first out of Hong Kong and then The Bahamas. FTX, headed up by the then-golden wonder boy, Sam Bankman-Fried (SBF), quickly became one of the largest digital currency exchanges in the world. Until 10 November 2022, that is – when the FTX world disintegrated into insolvency in The Bahamas and the US.

This article describes the very unpromising start of attempts at collaboration between The Bahamas and the US, the rapid descent into acrimony, the claims and counterclaims, and their ultimate resolution, as the professionals came together to devise a settlement that is both in the interests of all customers and creditors and which preserves the integrity of the insolvency processes in the jurisdictions of both the US and The Bahamas.

Background

FTX Digital Markets Ltd (FTX DM) was incorporated in The Bahamas in 2021 as a subsidiary of FTX Trading Limited (FTX Trading), a company incorporated under the laws of Antigua and Barbuda. Since 2019, FTX Trading had carried on the business of the FTX.com exchange international platform (the FTX.com exchange) for non-US customers from Hong Kong, and the idea was that from around May 2021 onwards, the business of the FTX.com exchange would be migrated from Hong Kong to The Bahamas and be based there. To that end, a large number of employees were transferred to The Bahamas, and on 10 September 2021, FTX DM was registered as a digital assets business by the Securities Commission of the Bahamas (SCB).

FTX DM's provisional liquidation in The Bahamas

Seemingly, all was going well until 10 November 2022, when, against a backdrop of widespread rumours of the challenges faced by the FTX Group and SBF's failure to address repeated requests for information from the SCB, a winding-up petition was presented by the SCB against FTX DM in the Supreme Court of the Commonwealth of The Bahamas (the Bahamas Court). The SCB obtained orders putting FTX DM into provisional liquidation and appointing Brian C. Simms KC, Peter Greaves and Kevin Cambridge (collectively the JPLs) as provisional liquidators. The purpose of the appointment was to safeguard the assets of FTX DM for the benefit of its customers and other creditors, and for that purpose, the JPLs were given very wide powers, equivalent to those which an official liquidator would have under the Fourth Schedule of the Bahamas Companies Act 2011 (ch 308) (the Companies Act).

The Debtors' Chapter 11 cases in Delaware

A day later, SBF appointed John Ray III as the CEO of a large number of FTX companies including FTX Trading and FTX DM. On 11 and 14 November 2022, under the direction of the new CEO, Mr Ray, all FTX companies (other than FTX DM, which as stated above was already in provisional liquidation by this time) (collectively the Debtors) commenced Chapter 11 cases under the US Bankruptcy Code for protection in the United States Bankruptcy Court for the District of Delaware (the Bankruptcy Court).

The Cooperation Agreement

It was quickly apparent that the Debtors' Chapter 11 filings, specifically that of FTX Trading, did not sit well with and was likely to come into conflict with the provisional liquidation of FTX DM. Specifically, the Debtors had difficulty in acknowledging that FTX DM had its own assets and customers, and that the provisional liquidation was a separate process with its own rules to be applied under the supervision of the Bahamas Court. After a number of litigation filings in the Bankruptcy Court and in order to resolve the tensions between the two sets of estates, in January 2023 the Debtors and FTX DM concluded a Cooperation Agreement with the object of maximizing recoveries for customers and creditors of each estate, and avoiding redundant work, minimizing expense and respecting the sovereignty of the different legal systems.

Consequent upon the conclusion of the Cooperation Agreement, the provisional liquidation of FTX DM was recognised by the Bankruptcy Court as a foreign main proceeding pursuant to Chapter 15 of the Bankruptcy Code. Certain Debtors, including FTX Trading, also obtained recognition of their Chapter 11 cases by the Bahamas Court pursuant to Part VIIA of the Companies Act.

The Directions Application

Despite its name, the Cooperation Agreement did not result in cooperation. Specifically, the JPLs encountered difficulties accessing information about FTX DM's affairs and its customers and creditors, much of which was controlled by the Debtors, and which was intended to be disclosed under the terms of the Cooperation Agreement. As the JPLs continued to face challenges and were unable to achieve progress in FTX DM's provisional liquidation, they filed an application in the Bahamas Court for directions (the Directions Application). Notably, the JPLs sought directions on the meaning of

the applicable terms of service between FTX DM and its customers and whether such customers had trust claims or were only entitled to claim as ordinary unsecured creditors. Mindful that the Directions Application in the Bahamas Court might be seen as violating the worldwide automatic stay in favour of the Debtors in the Bankruptcy Court, the JPLs obtained leave of the Bahamas Court to issue a motion in the Bankruptcy Court for an order confirming that the issue of the Directions Application in the Bahamas Court would not violate the automatic stay (the Lift Stay Motion).

The Adversary complaint and counterclaim

When FTX DM issued the Lift Stay Motion in the Bankruptcy Court, the Debtors strongly opposed it. At the same time, the Debtors increased the stakes dramatically by issuing an adversary complaint in the Bankruptcy Court (the Adversary Proceeding) alleging that FTX DM was, in substance, a fraudulent sham. The Debtors claimed that all of FTX DM's customers were in fact the Debtors' customers, that digital assets, fiat currency, customer information and intellectual property associated with the FTX.com exchange all belonged to FTX Trading, and that every transaction in which FTX DM was involved during its existence was fraudulent and subject to avoidance. FTX DM and the JPLs responded by filing a motion to dismiss the Adversary Proceeding on grounds, among others, that it violated the automatic stay on proceedings against FTX DM created by its Chapter 15 filing. FTX DM also filed a strongly-worded rebuttal to the Adversary Proceeding and filed a counterclaim against all Debtors for US$9 billion.

Stalemate

On 9 June 2023, Judge Dorsey of the Bankruptcy Court handed down a judgment on the Lift Stay Motion finding that the issue of the Directions Application in the Bahamas would violate the Debtors' automatic stay. For the estate of FTX DM, this created a stalemate and was frustrating because, without some guidance from the Bahamas Court, it was impossible for the provisional liquidation to progress. Also, the existence of the Adversary Proceeding and FTX DM's counterclaims, which revealed the starkly polarised positions of the Debtors and FTX DM, foreshadowed years of bitter and unwelcome litigation. The one ray of hope was that Judge Dorsey directed the parties to mediate their differences.

Intense negotiation

In response to Judge Dorsey's encouragement, the parties commenced mediation, but also at the same time engaged in intense and prolonged negotiations with a view to resolving the large number of issues that divided them and their respective estates. The main issues were ostensibly caused by the fact that FTX DM had operated in The Bahamas for a relatively short period, and there was a question over whether its customers were in fact customers of FTX Trading. The problem was created partly because the terms of service used by FTX Trading and FTX DM lacked clarity, and partly because the means by which customers were intended to accept the new terms of service was by logging onto the FTX.com exchange. It was unclear whether that action constituted sufficient acceptance as a matter of law. Another issue concerned certain property valued at around US$256 million in the name of FTX Property Holdings Ltd (Propco), a company incorporated in The Bahamas and one of the Debtors undergoing Chapter 11 proceedings in the US. FTX DM claimed that the properties held by Propco were all financed by FTX DM and that the proceeds of their realisation should therefore be used to repay FTX DM, whereas the Debtors claimed that, to the contrary, and consistent with their claim that FTX DM itself was a fraud and sham, any FTX DM monies were in fact Debtor monies.

FTX DM official liquidation

On 10 November 2023, and on the SCB's further application, a winding-up order was made against FTX DM by the Bahamas Court and its former JPLs were appointed as its joint official liquidators (JOLs). As the JOLs and the Debtors continued to engage in discussions in an effort to resolve their issues, the entry by the JOLs and the Debtors into a cross-border protocol for the coordination of the respective proceedings proved to be difficult. Notably, FTX DM was not the subject of a concurrent bankruptcy proceeding under the law of a foreign country, and the assets of FTX DM located in the US were not the subject of a bankruptcy proceeding or receivership under the laws of the US. Moreover, Mr. John Ray III did not fall within the statutory definition of a 'foreign officeholder' because he had not been appointed by a foreign court. In the circumstances, entering into a Global Settlement Agreement seemed a viable route for surmounting these obstacles.

The Global Settlement Agreement

After months of negotiation, FTX DM and the Debtors were finally able to enter into a Global Settlement Agreement (GSA) on 19 December 2023. The GSA had as its express object *"avoiding the uncertainty, delay, cost and expense that is associated with litigation of the disputes between the Parties including the novel, legal, factual and equitable issues raised in connection with the Adversary Proceeding, the Lift Stay Motion, the Cooperation Agreement, the FTX DM liquidation and the Chapter 11 Cases, generally"*.

The GSA is a lengthy and complex document and includes a number of ancillary agreements. However, it has as its overarching aim a process for customers to elect whether they wish to claim in the Debtors' Chapter 11 cases in the US or in the FTX DM official liquidation in The Bahamas. For the JOLs, such a condition was a key component of any settlement because both FTX DM and FTX Trading were non-US companies who had never traded in the US, and creditors who had no connection with the US might not want to claim in the US proceedings. Another equally important component of the GSA was that customers of the FTX.com exchange should receive the same pro-rata distribution regardless of the jurisdiction in which they decided to claim. As it was impossible to know in advance which customers would claim against which estate, and to ensure that each customer received the same pro-rata distribution, it was necessary to agree a form of pooling arrangement pursuant to which the Debtors and FTX DM would, as far as possible, pool their assets and liabilities and co-ordinate their processes for the adjudication of claims and payments of distributions. To facilitate the making of distributions, the GSA provided that there would be transfers of assets between the Debtors and FTX DM to ensure that all customers receive the same distributions.

Other important provisions of the GSA are:

- an agreed allocation between the estates of the disputed assets and property;
- the allocation of recovery actions between the parties, so that the estate that was best placed to pursue those claims would do so for all parties' benefit;
- that FTX DM and the JOLs were to carry out the marketing and sale of the Bahamian properties on behalf of Propco, with FTX DM being accepted as a creditor of Propco in the sum of US$256m;

- all parties were to co-operate with and assist each other in the realisation of their respective estates;
- all claims of whatever nature including the Adversary Proceeding, the Directions Application and all intercompany claims between the Debtors and FTX DM including the US$9 billion proof of claim filed by FTX DM in the Chapter 11 cases were to be settled on the terms set out in the GSA;
- there would be a potential exception to *pari passu* distribution in that non-customer creditors of FTX DM were to share in a fund of US$15 million, potentially causing them to receive more or less than customer creditors;
- a dispute resolution protocol providing for a concurrent sitting of the Bankruptcy Court and the Bahamas Court in a manner that is consistent with the Judicial Insolvency Network's Guidelines for Communication and Cooperation between Courts in Cross-Border Matters to determine any issue that cannot be resolved by the parties.

The Debtors intend to promote a Chapter 11 plan of reorganisation incorporating all the elements of the GSA. For that reason, the GSA comprises, and is conditional upon, two stages. The first stage is the Initial Settlement Effective date, which was to be triggered when the GSA was sanctioned by the Bahamas Court and approved by the Bankruptcy Court. These conditions were fulfilled on 24 January 2024. The second state, is a Final Settlement date, which will trigger upon the confirmation of the Chapter 11 plan of reorganisation by the Bankruptcy Court. This is expected to take place in mid-July 2024.

Sanction by the Bahamas Court

From a Bahamas law perspective, the GSA was, and is, an unprecedented agreement. It involved novel use of provisions of the Bahamas statutory regime for the winding up of companies. In particular, there was no previous case law on how the Bahamas Court should approach a request for the sanction of an official liquidator's power of compromise or the entry into a pooling agreement. In addition, it was arguable that digital assets and fiat were held on trust by FTX DM. Accordingly, the JOLs applied under the Companies Act, Section 205(3) and the Fourth Schedule, Part I, paragraphs 3 to 9, seeking various orders for sanction by the Bahamas Court of the exercise of the JOLs' powers to cause FTX DM to enter into the GSA and the ancillary agreements. To deal specifically with the potential trust issues, the JOLs sought an order pursuant to the Bahamas Trustee Act 1998, Sections 77, 79 and 79A and/or the inherent jurisdiction of the Bahamas Court that FTX DM, acting by its JOLs, might distribute such assets pursuant to the terms of the GSA to customers who elect to prove in the official liquidation of FTX DM.

Legal arguments in the Bahamas Court

At the hearing of the sanction application the JOLs drew on case law in England, the Cayman Islands, Singapore and Australia to support their argument that the Bahamas Court had jurisdiction to sanction a compromise agreement in the terms of the GSA. Essentially, the test is whether a compromise agreement is in the best commercial interests of the company and its creditors. The English cases[1] display a slightly higher threshold for sanction than the Cayman Islands, in that they emphasise that it is for the court to determine what is in the best interests of the company and its creditors. In the Cayman Islands, the court will only refuse to sanction a compromise if the liquidator has entered into a compromise that is so unreasonable or untenable that no reasonable liquidator would have entered into it.[2]

The Bahamas Court had substantial evidence from one of the JOLs setting out in detail the reasons why the JOLs had caused FTX DM to enter into the GSA. Those reasons included:

(i) the elimination of the delay (which could last for many years) that would ensue if the Adversary Proceeding continued to trial and possibly thereafter;

(ii) the very substantial legal and other professional costs that would be expended on the Adversary Proceeding and other disputes with the Debtors, which may have been necessitated if the GSA was not entered into;

(iii) the potential risks to creditors and customers of FTX DM in connection with the defence of the Adversary Proceeding and FTX DM's counter claims;

(iv) the limited funds available to FTX DM and the JOLs to fund legal proceedings with the Debtors; and

(v) the fact that the GSA provided for customers to receive as closely as possible the same distributions, regardless of whether they chose to claim in the US or in the Bahamas official liquidation.

Other provisions of the GSA which had not previously been considered by the Bahamas Court were the jurisdiction to sanction a compromise agreement containing a pooling arrangement and one which involved a possible departure from the *pari passu* rule of distribution. Both of these issues had been addressed by the English Court of Appeal some 20 years previously in *Re Bank of Credit and Commerce International SA (In Liquidation)(No. 3)*.[3] The pooling agreement in that case provided for the assets of BCCI SA (a company incorporated in Luxembourg and in liquidation in Luxembourg and England) and BCCI Overseas (a company incorporated in the Cayman Islands and in liquidation there) to be pooled and then distributed to creditors of BCCI SA and BCCI Overseas.

Some observations made by the English courts in the BCCI case were particularly relevant. On the issue of pooling, Dillon LJ in the Court of Appeal approved the following observations made at first instance [4] by Sir Donald Nicholls VC:

"I am in no doubt that the agreements are so plainly for the benefit of the creditors that I should approve them without further ado. I am satisfied that the affairs of BCCI SA and BCCI Overseas are so hopelessly intertwined that a pooling of their assets, with a distribution enabling the like dividend to be paid to both companies' creditors, is the only sensible way to proceed. It would make no sense to spend vast sums of money and much time in trying to disentangle and unravel".

On the issue of the possible departure from the *pari passu* rule, Lord Justice Dillon held:

"in a liquidation there can be a departure from the pari passu rule by a scheme of arrangement under section 425; but equally there can be a departure from the pari passu rule if it is merely ancillary to an exercise of any of the powers which are exercisable with the sanction of the court …"

1 Notably *In re Edennote Ltd (No 2)* [1997] 2 BCLC 89 and *In re Greenhaven Motors Ltd (in liquidation)* [1999] 1 BCLC 635
2 *Re SAAD Investments Company Limited (in Official liquidation)* (Grand Court Unreported 1 October 2019)
3 [1993] BCLC 1490
4 Ibid at 1501 f-h.

In The Bahamas there are no statutory provisions with respect to schemes of arrangements so the departure from the *pari passu* rule was exercised ancillary to the exercise of powers which are exercisable with sanction of the court under the Companies Act.

On the trust issue, the JOLs had, prior to entering into the GSA, finally been given access to the books and records of the Debtors and FTX DM. These disclosed that the assets and liabilities of the Debtors and FTX DM were so seriously intermingled that it would be impossible to trace FTX DM's assets into the commingled assets, still less, the digital assets or fiat of individual customers. The JOLs placed this evidence before the Bahamas Court in support of their argument that the only basis for tracing customers' assets, if they were indeed held on trust, would be if the Court were to find that they were part of a customer trust pool in contrast to separate trusts for each individual customer. Even if the assets were found to be held in a trust pool, customers would receive (very broadly) the same level of distributions from the trust pool as they would have received under the GSA (albeit qua creditor rather than beneficiary). Accordingly, customers would not be prejudiced by being paid pursuant to the terms of the GSA.

The ruling of the Bahamas Court

In an *ex tempore* judgment handed down on 22 January 2024 the Honourable Mr. Justice Loren Klein held:[5]

"the GSA and the ancillary agreements and arrangements necessary to support it, represent a practical modus operandi for proceeding with the liquidation by the JOLs, and will be in the commercial best interests of the company, and the creditors and customers of FTX DM. And I say that in regard to the novel and complex legal issues raised by this liquidation. In this regard, I have in mind the adversarial proceedings between FTX DM and the US Debtors which are being compromised as a result of the GSA, the multiple cross-border issues, and the concurrent proceedings here and in the bankruptcy courts of Delaware. I also have in mind what has been described [by counsel] as the "inextricably co-mingled assets"– in the BBCI case (Re Bank of Credit and Commercial International SA (In Liquidation) (No. 3) [1993] BCLC 1490) it was described as a "hopeless intertwining" of assets–because I think this is important for supporting the approach for the pooling of assets for distribution. Further, I think the evidence clearly supports the conclusion that the JOLs have done everything within their power to strike the best possible deal for the stakeholders in question, and one which is not at all unreasonable in the circumstances."

Mr. Justice Klein made orders sanctioning the exercise of the JOLs' power to enter into the GSA and to distribute the assets to customers pursuant to the GSA, notwithstanding such assets might be trust assets.

Approval by the Bankruptcy Court

As stated above, on 24 January the Bankruptcy Court approved the GSA.

Next steps

With the sanction of the GSA, the Initial Settlement Effective Date has now taken place. The next stage will be the approval of the Debtors' plan of reorganisation by the Bankruptcy Court and distributions to customers and non-customer creditors of FTX DM. Whether the Chapter 11 Plan will be approved is an issue which is largely outside the JOLs' hands and depends on the extent to which the Debtors can persuade their stakeholders to support a complicated plan that spans not only the FTX.com exchange, but also the US side of the business.

In the meantime, peace and harmony, of sorts, has broken out between the Debtors, FTX DM and its JOLs. With continued goodwill on both sides, it is to be hoped that the effect of the GSA will result in substantial returns to customers and creditors, much quicker and more economically than would have otherwise been the case. The GSA also preserves the integrity of each of the parties' insolvency processes with customers being able to elect against which FTX company they wish to claim.

5 At [8] - [9].