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Mid-Atlantic Bankruptcy Workshop

Oversight Roles

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CONCURRENT WORKSHOP

2024

Oversight Roles in the Restructuring Process

HON. JEFFERY A. DELLER, UNITED STATES BANKRUPTCY JUDGE, WESTERN DISTRICT OF PENNSYLVANIA

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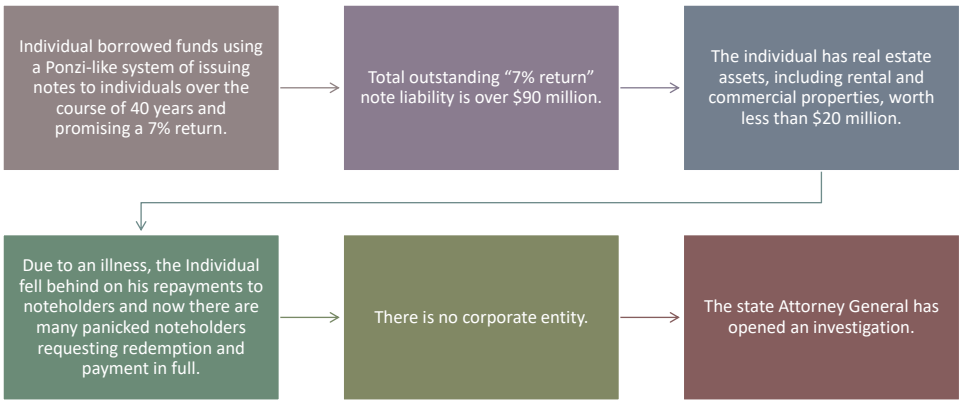
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Issues for Discussion

- Role of independent fiduciaries in the prefiling period.
- Protocols for appointing and paying independent directors/CROs and financial advisors.
- Appointing a chapter 11 trustee.
- Appointing a chapter 11 examiner.
- Scope of examiner's investigation and post-appointment actions.
- Privilege issues with trustees and examiners.
- Special issues for trustees and examiners exercising estate rights, commencing causes of action, etc.

Case Study

§ 1104(a) TRUSTEE



Background

Pre-bankruptcy planning

Individual hired Financial advisor (FA) to oversee operations.

FA's retention letter includes a duty of confidentiality to the (individual) debtor.

FA takes all direction from the individual and his counsel.

FA does not investigate the debtor's assets prior to bankruptcy and the debtor has several bank accounts and assets that do not get reported in the schedules.

FA does not set up oversight or controls with respect to business records or accounts

FA allows the individual to continue his business and personal expenditures through the same accounts.



Debtor's Pre-filing Duties

Does an individual debtor have fiduciary duties once insolvency occurs?

Does the business judgment rule protect an individual debtor?

Post-filing issues

An official committee is formed, including seven of the noteholders, representing the interests of approximately 1000 noteholder unsecured creditors.

The Debtor's responses to questions at the 341 meeting makes clear than new notes were sought to repay redemption requests by old noteholders.

The FA keeps the Committee's forensic accountant at arms' length.

The FA advises the debtor not to answer certain of the Committee's questions.

The FA allows the debtor to shred business records post-petition, despite a litigation hold letter and directive to preserve documents from the Committee.

The debtor still signs monthly operating reports and has control over bank accounts.

The FA takes direction from, and defers to, the debtor and his counsel post-petition.

Being a DIP is a privilege

DIP presumed to be in best position to continue operations.

What duties and obligations flow from this "privilege?"

If a debtor is a pre-petition fraud, does that "automatically" mean he or she loses the privilege of being a debtor in possession?

Are there valid steps that can be taken on the eve of bankruptcy to "cleanse" bad acts?

CRO as quasi-trustee?

- What are their duties and responsibilities?
- If appointed or hired pre-petition, does the filing of a bankruptcy disrupt or alter the landscape?
- Does continued employment as a CRO operate as a de facto work around the appointment of a trustee or examiner?
- Does it cleanse any "taint"?
- Are they "professionals" for purposes of appointment or retention?
- Should their continued operation of the business be deemed "non ordinary" and "not at arms length" thus warranting strict scrutiny and prior court approval?



Who has the "duty to investigate" when the debtor is a DIP and no trustee or examiner has been appointed?



What does the statute say?



Is there any common law that should apply?



Does *Rodriguez v. FDIC* change that common law?

Duty to investigate?

Motion to Appoint Chapter 11 Trustee

The US Trustee files a motion to appoint a trustee pursuant to 11 U.S.C. § 1104(a)(1).

The Committee joins the motion and seeks alternative relief under 11 U.S.C. § 1104(a)(2), maintaining that the appointment of an 1104 trustee would be in the best interest of creditors.

The Bankruptcy Court requires an evidentiary hearing to determine:

- For purposes of 1104(a)(1): "(a) whether there has actually been a change in management and (if so) whether there is (b) a cause for concern regarding [the financial advisor]'s management and (c) whether sufficient safeguards can be established to ensure the Debtor remains divested of control and deprived of any opportunity to engage in fraud, dishonesty, incompetence, or gross mismanagement."
- For purposes of 1104(a)(2), the Court noted that "if the Debtor remained in control, the elements of trustworthiness and past performance would toll heavily, if not disproportionately, in favor of appointing an 1104 trustee" but that the evidentiary record is "not well developed with respect to several other factors in the § 1104(a)(2) analysis"

Issues Trustee Faces

An 1104 Trustee is appointed pursuant to 11 U.S.C. § 1104(a)(1).

The Debtor's business involved providing services, and the Debtor requests business records to allow him to continue providing those services to customers.

The Debtor's elderly parent dies during the chapter 11 case after the appointment of a Trustee, and he signs a notice waiving his right to challenge his disinheritance in the parent's estate.

The Debtor's spouse seeks to protect her interest in their residence, which is also part of the chapter 11 estate.

The Trustee is faced with defenses that would prevent the debtor from recovering in litigation against third parties who could have, but did not, discover the fraud.

The SEC and State Attorney General issue subpoenas to the Trustee.

The Trustee acts quickly to wind down business operations and sell real estate assets.

IS THERE QUALIFIED IMMUNITY FOR ACTIONS TAKEN BY TRUSTEE?

Immunity?

Case Studies

§ 1104(c)(2)
EXAMINERS

Examiner Case Study 1

- Debtor supplier files a voluntary petition for relief under chapter 11 of the Bankruptcy Code.
- No unsecured creditors committee is formed.
- Eighty-five days into the case, a trade-creditor files a motion for an order authorizing the appointment of an examiner and seeking to terminate the plan exclusivity period, alleging:
  - the Debtor has failed to report assets on its schedules, and
  - the Debtor is failing to report revenue from alleged "cash only" transactions in an effort to continue hiding income from creditors.
- Notably, the trade creditor does not attach any evidence in support of its motion.
- Monthly Operating Reports have been timely and show reasonable post-petition operating expenses and asset loss.
- Neither the U.S. Trustee nor the IRS join in the motion.



Court's discretion?

What exactly goes into the Court's "discretion" to appoint a trustee or examiner?

Does it matter whether the Court acts sua sponte or upon motion by a party in interest?

What kind of "special circumstances" support such relief and which don't?

Burdens of proof? Do they shift?

What about creditor support generally? What if one creditor moves for appointment and others are apathetic?

Examiner Case Study 2:

- A chapter 11 debtor files a plan within 60 days of the petition including a blanket settlement agreement between the Debtor, ABC Bank, and the FDIC resolving lawsuits between the entities involving ownership of $3 billion in deposit accounts.
- The bankruptcy court enters an Order directing the appointment of an examiner to review, among other things, the settlement agreement between the parties.
- The Order contains the following passage:
  - *"The Examiner shall have the power to waive the attorney-client privilege on an issue-by-issue basis with respect to pre-petition communications relating to the proposed settlement agreement between the Debtor, ABC Bank, and the FDIC."*

Examiner v. Trustee

Difference between trustee and examiner?

Importance of clearly defined examiner duties and powers?

Can the examiner sue and be sued?

Are the examiner's duties expandable?

Who owns the various privileges?



Questions?

On Our Watch

By Clifford J. White III and Walter W. Theus, Jr.

Taking the Mystery Out of the Ch. 11 Trustee Appointment Process



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Clifford White is the director of and Walt Theus is a senior trial attorney with the Executive Office for U.S. Trustees in Washington, D.C. Mr. White also serves on the ABI Commission to Study the Reform of Chapter 11.

Every chapter 11 debtor becomes a debtor in possession, vested with most of the powers and duties of a trustee. In a careful compromise when adopting the Bankruptcy Code in 1978, Congress provided an alternative in cases where a debtor cannot or should not be vested with those trustee powers and duties: a chapter 11 trustee.[1] Although the Senate originally proposed that chapter 11 trustees be mandatory for all large cases, § 1104(a) of the Bankruptcy Code reflects the congressional compromise that bankruptcy courts must direct the U.S. Trustee to appoint a chapter 11 trustee if the court finds "cause" or that a trustee is in the interest of stakeholders.[2] In keeping with the Code's animating principle to separate the adjudication function from the enforcement and administration functions, the appointment itself is left to the impartial U.S. Trustee after "consultation with parties in interest."

Some commentators, including these authors, believe that greater use of the chapter 11 trustee mechanism to supplant management that cannot or will not act as fiduciaries on behalf of all stakeholders in the case would enhance sound corporate governance in bankruptcy.[3] Nevertheless, the appointment of a trustee should not be routine and requires great care.[4] This article will explain how U.S. Trustees approach this task through a comprehensive consultation and selection process to fulfill statutory obligations to select qualified and independent fiduciaries to represent the interests of all stakeholders in the chapter 11 case.[5]

The Consultation and Candidate Identification Process

Once the court orders the appointment of a chapter 11 trustee, the U.S. Trustee, after consultation with parties in interest, appoints a disinterested person. This trustee appointment is subject to court approval.[6]

U.S. Trustees approach the consultation and appointment process seriously. The U.S. Trustee Program (USTP) has developed thorough and rigorous processes, scaled to the needs of the case, to ensure a comprehensive search for and evaluation of the best candidates. Although a U.S. Trustee will never enter into an agreement to appoint a particular candidate, U.S. Trustees often encourage parties to begin considering skills and candidates before the court orders the appointment. Once the court enters the order, the U.S. Trustee expeditiously consults with major creditors, the creditors' committee, the debtor and other interested parties. This consultation might be in person, by telephone or by email. U.S. Trustees place a high value on the input provided by parties in interest.

During these consultations, parties occasionally recommend more than one candidate to the U.S. Trustee and may advise the U.S. Trustee of their first choice. An unsuccessful candidate may think that the U.S. Trustee has rejected the creditor's recommendation, wrongly believing that he/she was the creditor's first or only choice.

In addition to names of particular individuals, the U.S. Trustee seeks the interested parties' views of the "skill set" that the trustee should possess. In some cases, a businessperson with expertise in dealing with distressed companies in the relevant industry might be the best choice. In others, an attorney with significant experience handling complex financial litigation might be better suited, or a person with a background in the investigation of financial fraud might be more ideal.[7]

The U.S. Trustee also brings independent judgment to bear on what type of trustee the case needs and what person is best qualified to serve as trustee. The U.S. Trustee encourages and considers self-nominations to expand the pool of qualified and independent candidates. Unlike in chapter 7,[8] the U.S. Trustee can also conduct a nationwide

1 11 U.S.C. § 1104(a). For additional information on congressional deliberations leading to the adoption of the Bankruptcy Code, *see* Clifford J. White III and Walter W. Theus, Jr., "Chapter 11 Trustees and Examiners after BAPCPA," 80 *Am. Bankr. L. J.* 289, 293-97 (2006).

2 11 U.S.C. § 1104(a).

3 Charles J. Tabb, "The Future of Chapter 11," 44 *S.C. L. Rev.* 791, 857 (1992-93) ("Under the Code, trustees are almost never appointed.... Courts announce and apply a very strong presumption against the appointment of a trustee. The norm is that the debtor continues in possession. This ... is a perversion of what virtually everyone involved in the 1970s reforms intended.").

4 There are many reasons for the reluctance of parties to seek chapter 11 trustees. These include historical reluctance to oust entrenched management that pre-dates the changes to the Bankruptcy Code conferring the authority on the U.S. Trustee to make the appointment. Some courts apply an arguably unjustified burden of proof ("clear and convincing evidence" vs. "preponderance of the evidence") before granting a chapter 11 trustee motion. Creditors may wish to avoid possible retaliation by the incumbent management and its creditor allies. Some of the more powerful players in the case may also be concerned that they will lose control of the case and risk possible investigation into estate claims against them.

5 In contrast, conversion of a case from chapter 11 to a chapter 7 liquidation with a trustee appointed from the U.S. Trustee's statutory panel of chapter 7 trustees is not rare. The U.S. Trustee files a motion to convert or dismiss in about 40 percent of all chapter 11 cases. The motions are typically filed in smaller cases and on such grounds as negative cash flow diminishing the value of the estate, the failure to maintain insurance or the failure to file required financial reports. *See* 11 U.S.C. § 1112(b)(4).

6 11 U.S.C. § 1104(d); *see also* Fed. R. Bankr. P. 2007.1.

7 In smaller cases or cases where an immediate liquidation appears likely, parties frequently suggest that the U.S. Trustee appoint members of the chapter 7 panel of trustees to serve as chapter 11 trustees, recognizing the expertise of those persons in bankruptcy matters.

8 11 U.S.C. § 321(a)(1) (chapter 7 trustee must reside or have office in judicial district where case is pending or in adjacent district).

search for a chapter 11 trustee. In the most complex cases, the U.S. Trustee often reaches beyond the district in which the case was filed to identify candidates with unquestioned independence and the optimum skill set to best meet the needs of the case.

Professionals occasionally request meetings with senior USTP officials to discuss their qualifications and interest in future appointments. Such meetings, which are held at the headquarters or in regional offices, are welcomed and valuable. They are often scheduled to permit the attendance of multiple U.S. Trustees in person, by video or telephone conference. These prior meetings provide a good source of candidates to whom the U.S. Trustee may reach out, even if the candidate was not recommended by a creditor in the case at bar. The USTP urges bankruptcy and other professionals to request such meetings to strengthen the bench of potential candidates for future appointments, particularly in cases in which the need for a speedy appointment is most acute.

The Appointment Decision

In considering whom to appoint, U.S. Trustees first look for independence. A candidate cannot be beholden to the party that recommended him/her or to any other party in the case. The trustee must protect all interests and be prepared to "bite the hand that fed" him/her if required. For example, an attorney for a major creditor recently complained about the selection of a chapter 11 trustee who aggressively pursued causes of action against his client, notwithstanding the irony that his client had recommended the trustee to the U.S. Trustee. That trustee displayed admirable independence. The U.S. Trustee's impartiality in appointing trustees enhances trustees' ability to exercise this type of independence.

Beyond independence, the U.S. Trustee will consider a candidate's experience, qualifications and ability to muster necessary bankruptcy, financial and business expertise. The U.S. Trustee might have an informed view about the ideal skill set for the engagement. For example, a debtor might be an operating business and the U.S. Trustee and parties might agree that a turnaround specialist would be ideal for the position. The U.S. Trustee will seek to ensure that the specialist will engage the proper professionals and take appropriate steps to manage the costs of case administration.

How is this information gathered? The U.S. Trustee seeks CVs or résumés from recommended and self-nominated candidates. The U.S. Trustee may also request that candidates complete a preliminary conflict analysis and submit preliminary statements of their connections with a debtor, its insiders and creditors before a final, more rigorous review. In many cases, and certainly in every complex one, the U.S. Trustee will interview candidates before making the appointment. Candidates are interviewed by phone or in person, and might be interviewed more than once. The U.S. Trustee and others from the USTP will question the candidate about a broad range of topics, such as the candidate's expertise and amount of time available to devote to the job. In particular, the questions often focus on the candidate's prior experience in similar matters; how the candidate would economically assemble a team to address the multi-faceted aspect of a case; the candidate's knowledge of the case, including how that knowledge was obtained; and the candidate's initial plan to marshal assets and secure information to guide the case to a successful conclusion.

In-person interviews are strongly preferred, but the urgency of an appointment sometimes requires that interviews be conducted by videoconference or telephone. In major cases, it is not unusual for a multi-regional team, including Executive Office officials, to interview candidates along with the selecting U.S. Trustee. This enhances the thoroughness of the evaluation process in the particular case and helps acquaint a wider swath of USTP officials who are involved in the trustee appointment process with an array of candidates for consideration in future cases.

Reviewing conflicts and connections is often the most important and painstaking stage of the appointment process. Additional disclosures are often requested, and assessing connections, particularly in larger cases with candidates from large professional firms, can be difficult. Disqualifying conflicts are not always obvious. Often, a candidate who was tentatively selected is not appointed after a full review of his/her connections with the case and stakeholders. Although "conflicts counsel" may sometimes be countenanced to deal with limited attorney conflicts, "conflicts trustees" never can. A trustee must be "disinterested," but that is not the end of the inquiry. We seek to appoint trustees whose objectivity and independence is beyond question. For example, a candidate from a law firm, although technically disinterested and legally eligible to serve personally, may nevertheless be deemed unsuitable for appointment as a fiduciary because of the firm's representations or relationships in unrelated matters.[9]

Once the U.S. Trustee decides who to appoint, the appointment and approval process is relatively straightforward. The U.S. Trustee formally appoints the candidate and then files an application seeking approval of the appointment. Pursuant to Rule 2007.1,[10] the application must name the trustee and the trustee's connections with parties in interest, their attorneys and accountants, the U.S. Trustee and persons employed by the U.S. Trustee. The application must also list the parties with whom the U.S. Trustee consulted in connection with the appointment. A statement of connections verified by the appointee will be attached to the application. The court's approval of the appointment should be limited to a review of whether the person is statutorily qualified to serve; the court should not substitute its judgment for that of the U.S. Trustee.

The final check on the trustee appointment process is the right of creditors to seek a trustee election,[11] which is rarely invoked. The U.S. Trustee will not delay appointing a trustee until the time for an election request has expired, because the circumstances justifying the removal of management generally call for quick action.

9 Chapter 11 trustees are also subject to a government background investigation, similar to the process conducted for federal employment. This formal investigation generally involves filling out a detailed background questionnaire, followed by a public records search and field investigation. The background investigation process is usually completed after the appointment is effective. In rare cases, it has been necessary to withdraw the selection of a candidate due to information revealed on the background questionnaire or to seek the removal of a trustee after appointment.

10 Fed. R. Bankr. P. 2007.1.

11 11 U.S.C. § 1104(b).

continued on page 110

On Our Watch: Taking the Mystery Out of the Chapter 11 Trustee Process

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Conclusion

The Bankruptcy Code provides a straightforward mechanism to supplant managers who are unsuitable to serve in a fiduciary capacity for all stakeholders. The Code also provides standards and procedures that are assiduously followed by U.S. Trustees in selecting qualified and independent candidates. U.S. Trustees have appointed highly qualified individuals to serve as trustees and examiners[12] in chapter 11 cases, including top bankruptcy partners from major law firms, nationally known workout and turnaround professionals, financial professionals, retired bankruptcy judges, a former director of the Federal Bureau of Investigation and other former high-ranking law enforcement officials. Perhaps more discussion of the need for chapter 11 trustees and less mystery surrounding the selection process can lead to more diligent use of this important tool for sound corporate governance in bankruptcy cases. abi

12 The process for appointing examiners is identical to that for appointing trustees. 11 U.S.C. § 1104(d).

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United States Code Annotated
Title 11. Bankruptcy (Refs & Annos)
Chapter 11. Reorganization (Refs & Annos)
Subchapter I. Officers and Administration (Refs & Annos)

11 U.S.C.A. § 1104

§ 1104. Appointment of trustee or examiner

Effective: December 22, 2010
Currentness

(a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee--

(1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or

(2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

(b)(1) Except as provided in section 1163 of this title, on the request of a party in interest made not later than 30 days after the court orders the appointment of a trustee under subsection (a), the United States trustee shall convene a meeting of creditors for the purpose of electing one disinterested person to serve as trustee in the case. The election of a trustee shall be conducted in the manner provided in subsections (a), (b), and (c) of section 702 of this title.

(2)(A) If an eligible, disinterested trustee is elected at a meeting of creditors under paragraph (1), the United States trustee shall file a report certifying that election.

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(B) Upon the filing of a report under subparagraph (A)--

(i) the trustee elected under paragraph (1) shall be considered to have been selected and appointed for purposes of this section; and

(ii) the service of any trustee appointed under subsection (a) shall terminate.

(C) The court shall resolve any dispute arising out of an election described in subparagraph (A).

(c) If the court does not order the appointment of a trustee under this section, then at any time before the confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the 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, or owing to an insider, exceed $5,000,000.

(d) If the court orders the appointment of a trustee or an examiner, if a trustee or an examiner dies or resigns during the case or is removed under section 324 of this title, or if a trustee fails to qualify under section 322 of this title, then 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.

(e) The United States trustee shall move for the appointment of a trustee under subsection (a) if there are reasonable grounds to suspect that current members of the governing body of the debtor, the debtor's chief executive or chief financial officer, or members of the governing body who selected the debtor's chief executive or chief financial officer, participated in actual fraud,

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dishonesty, or criminal conduct in the management of the debtor or the debtor's public financial reporting.

CREDIT(S)

(Pub.L. 95-598, Nov. 6, 1978, 92 Stat. 2627; Pub.L. 99-554, Title II, § 222, Oct. 27, 1986, 100 Stat. 3102; Pub.L. 103-394, Title II, § 211(a), Title V, § 501(d)(30), Oct. 22, 1994, 108 Stat. 4125, 4146; Pub.L. 109-8, Title IV, §§ 416, 442(b), Title XIV, § 1405, Apr. 20, 2005, 119 Stat. 107, 116, 215; Pub.L. 111-327, § 2(a)(30), Dec. 22, 2010, 124 Stat. 3560.)

11 U.S.C.A. § 1104, 11 USCA § 1104
Current through P.L. 118-70. Some statute sections may be more current, see credits for details.

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Case 23-60263-6-pgr Doc 106 Filed 06/27/23 Entered 06/27/23 10:42:37 Desc Main Document Page 1 of 15 Docket #106 Date Filed: 06/27/2023

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In Re:

M. BURTON MARSHALL,

Debtor.

Hearing Date: July 25, 2023
Hearing Time: 10:00 a.m.
Hearing Location: Utica, NY
(via AT&T Conference Line)

Case No. 23-60263
Chapter 11

UNITED STATES TRUSTEE'S MOTION UNDER 11 U.S.C. § 1104(a) TO APPOINT A CHAPTER 11 TRUSTEE OR, IN THE ALTERNATIVE, TO APPOINT AN EXAMINER UNDER 11 U.S.C. § 1104(c), AND MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORTAND RESERVATION OF RIGHTS

TO THE HONORABLE PATRICK G. RADEL, UNITED STATES BANKRUPTCY JUDGE:

William K. Harrington, United States Trustee for Region 2 (the "United States Trustee"), by and through his counsel, hereby moves the Court for an Order under 11 U.S.C. § 1104(a) directing the appointment of a chapter 11 trustee for debtor M. Burton Marshall ("Debtor") or, in the alternative, directing the appointment of an examiner under 11 U.S.C. § 1104(c) (the "Motion"). Cause exists for the appointment of a chapter 11 trustee or, in the alternative, for the appointment of an examiner for the reasons set forth below.

INTRODUCTION

Section 1104(a)(1) mandates that the Court appoint an independent chapter 11 trustee upon a sufficient showing of "cause," including fraud, dishonesty, incompetence or gross mismanagement of the affairs of the debtor, either before or after the commencement of the case, or similar cause. Here, "cause" exists as the Debtor admitted, under oath, that, for over thirty years, he borrowed millions of dollars, promising a return of 8%, only to use the newly borrowed funds to service existing debts and to finance his personal expenses. The Debtor induced more than a thousand people to give him money under the pretense of an investment opportunity he called the Eight Percent Fund. The Debtor also admittedly comingled his personal and business

funds, primarily using only a single bank account, Berkshire Bank #2301 ("Account 2301"). As a result, it is impossible to determine the Debtor's income and expenses; to evaluate possible preference transactions or to analyze a plan and disclosure statement.

The proper statutory remedy in a case such as this is for the Court to direct the United States Trustee to appoint an independent chapter 11 trustee as where the Court finds that cause exists, an order for the appointment of a chapter 11 trustee is mandatory. The scope of financial misconduct that has taken place, and the significant number of noteholders who invested in the Debtor's enterprise, make the appointment of an independent and disinterested party necessary to properly administer this estate.

In the alternative, the United States Trustee seeks the appointment of an examiner under section 1104(c) to examine the facts and circumstances that surround the Debtor's pre-petition financial misconduct, and to provide a recommendation to the Court upon completion of the examination.

STATEMENT OF THE FACTS

1. On April 20, 2023, the Debtor filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code (the "Petition Date"). The Debtor filed his schedules, statement of monthly income, and statement of financial affairs on the Petition Date. ECF No. 3.

2. An Official Committee of Unsecured Creditors was appointed by the United States Trustee on May 9, 2023. ECF No. 52.

3. The Debtor continues to operate his businesses and manage his properties as a debtor in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

4. The first meeting of creditors pursuant to 11 U.S.C. § 341 was scheduled to be held telephonically on May 22, 2023, but was adjourned to June 5, 2023, at which time the Debtor

appeared and testified under oath ("341 Meeting of Creditors"). The 341 Meeting of Creditors was continued to June 26, 2023. The transcript of 341 Meeting of Creditors is attached hereto as Exhibit 1.

5. The continued 341 Meeting of Creditors was held on June 26, 2023 at which time the Debtor appeared and testified further under oath ("Continued 341 Meeting of Creditors").

6. On Schedule A/B, the Debtor disclosed his interest in the following accounts and balances, Berkshire Bank: #2301, $396,637[1] balance; d/b/a MM Press #8128, $911 balance; d/b/a Marshall Tax Service #0522, $277 balance; d/b/a Marshall Moving #1246, $230 balance, d/b/a Marshall Storage #8136, $3,813 balance; d/b/a Marshall Maintenance #2218, $215 balance; d/b/a Marshall Rentals #8400, $1,532 balance plus tenant security deposit accounts. ECF No. 3.

7. On the Petition Date, the Debtor filed a Cash Management Motion, among other "first day" motions seeking expedited relief, including authorization to maintain his prepetition banking system. The Cash Management Motion identifies six accounts held at Berkshire Bank that are used in the Debtor's ordinary course of business to receive, hold, and distribute funds in addition to hundreds of segregated escrow accounts in which tenant security deposits are held. The Motion identifies Account 2301 as the Debtor's primary operating account. ECF No. 10.

8. The United States Trustee filed an Objection to the Cash Management Motion on May 8, 2023. ECF No. 54. The Cash Management Motion remains unresolved and is pending before the Court.[2]

[1] All amounts are rounded to the nearest dollar.

[2] The United States Trustee requests that the Court take judicial notice of the pleadings and documents filed in this case pursuant to Federal Rule of Bankruptcy Procedure 9017 and Federal Rule of Evidence 201, and reserves all rights, including the right to seek discovery in connection with this Motion.

JURISDICTION AND STANDING

9. This is a core proceeding under 28 U.S.C. § 157(b)(2)(A), giving this Court jurisdiction to hear this Motion.

10. Pursuant to 28 U.S.C. § 586, the United States 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 United States 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.

POINTS AND AUTHORITIES

The Controlling Statutory Framework

11. Under 11 U.S.C. § 1104(a)(1), the bankruptcy court must appoint a trustee if a movant, after notice and a hearing, demonstrates "cause." 11 U.S.C. § 1104(a)(1) ("[T]he court *shall* order the appointment of a trustee . . .") (emphasis added). Section 1104(a)(1) provides four non-exclusive circumstances constituting "cause" for the appointment of a trustee "including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause . . . ." *Id*.

12. A finding of "cause" under Section 1104(a)(1) mandates the appointment of a trustee. *In re Ashley River Consulting, LLC*, 2015 WL 1540941, at *8 (Bankr. S.D.N.Y. Mar. 31, 2015). The list of circumstances constituting "cause" for the appointment of a trustee is nonexclusive. *In re Altman,* 230 B.R. 6, 16 (Bankr. D. Conn. 1999), *aff'd in part, vacated in part*, 254 B.R. 509 (D. Conn. 2000).

13. "Cause" under subsection (a)(1) is not limited to the listed examples, such as gross mismanagement. Id. at 525. Some "factors that may constitute cause for the appointment of a

trustee include inappropriate relations between corporate parents and subsidiaries, misuse of assets and funds, inadequate record-keeping and reporting, and various instances of conduct found to establish fraud or dishonesty, lack of credibility, and lack of creditor confidence." *In re Futterman*, 584 B.R. 609, 616 (Bankr. S.D.N.Y. 2018).

14. Courts have discretion to determine whether cause exists, *In re Sharon Steel Corp*., 871 F.2d 1217, 1226 (3d Cir. 1989), but once "cause" is found, "there is no discretion; an independent trustee must be appointed." Id. at 525; see also Oklahoma Ref. Co., 838 F.2d at 1136.

Burden of Proof

15. Though the Second Circuit has stated that the United States Trustee has the burden of showing by "clear and convincing evidence" that the appointment of a trustee is warranted, *Adams v. Marwil (In re Bayou Group, LLC)*, 564 F.3d 541, 546 (2d Cir. 2009), a recent Supreme Court decision casts doubt on that holding. In *Octane Fitness, LLC v. ICON Health & Fitness, Inc.,* __ U.S. __; 134 S. Ct. 1749, 1758 (2014), the Court stated that "a preponderance of the evidence standard… is the 'standard generally applicable in civil actions.'"

16. The Supreme Court has consistently held that the presumptive standard of proof in civil cases is preponderance of the evidence unless a fundamental right is implicated or there is contrary Congressional direction. *See Halo Elec., Inc. v. Pulse Elec., Inc.*, 136 S. Ct. 1923, 1934 (2016) (rejecting heightened burden for award of enhanced damages for patent infringement); *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, 572 U.S. 545, 34 S. Ct. 1749, 1758 (2014) (rejecting heightened burden for attorneys' fees award in patent litigation); *Grogan v. Garner*, 498 U.S. 279 (1991) (rejecting heightened burden for exceptions to discharge); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 389-390 (1983) (rejecting heightened burden for securities fraud).

Cause Exists to Appoint a Chapter 11 Trustee for the Debtor Under 11 U.S.C. § 1104(a)(1)

Support for Finding of Fraud

17. A finding of fraud is amply supported by the record, including the Debtor's admission in his Declaration Pursuant to Local Bankruptcy Rule 2015-2 ("Declaration") that for over thirty years, he financed his businesses with personal borrowings pursuant to unsecured, thirty-day demand notes. ECF No. 7.

18. When questioned about the thirty-day demand notes at the 341 Meeting of Creditors, the Debtor acknowledged that he paid existing noteholders to whom he promised a return of 8% interest, by borrowing new funds from future noteholders to whom he likewise promised the same returns. Exhibit 1 at pp. 44-45.

19. The Debtor at the Continued 341 Meeting of Creditors admittedly commingled his personal and business income and expenses, using Account 2301 for deposits of his wages, social security, rental income, income from his other business, as well as funds from his investors. He likewise admitted using Account 2301 for his personal expenses as well as payments of obligations of his existing noteholders, including income tax payments, funeral expenses, charitable contributions, and car payments.

20. For nearly forty years, the Debtor engaged in a continuous cycle of depositing new money into his personal checking account while repaying noteholders and paying his personal expenses from the same individual checking account. Exhibit 1 at pp. 32-33.

21. In other words, the Debtor convinced the local community to invest in his real estate operations for a promised 8% return. The noteholders were paid their 8% interest with funds from new investors. But the Debtor's "business" was insolvent, unable to pay the debts as they came due without new funds from new investors. The Debtor's business model contains all the

hallmarks of a Ponzi scheme.

22. Many of the noteholders who filed proofs of claim ("POC") attached correspondence from the Debtor describing an Eight Percent Fund. For example, s*ee* POC 23-1, p. 5, and POC 16-1, p. 5, attached hereto as Exhibit 2.

23. When questioned about his knowledge of the Eight Percent Fund, the Debtor denied having knowledge of this fund and denied approaching anyone about investing in such a fund. The Debtor testified that he didn't know "where the word fund came from" … and "people would lend him money" by word of mouth. Exhibit 1 at pgs. 38, 45, 46. He stated that he did "not call it a fund" and that the word fund is "a mistake." Exhibit 1 at pgs. 45-46. In response to the question "did you present it as an investment opportunity," the Debtor replied that he "did not present it as an investment opportunity." Exhibit 1 at pg. 39.

24. At the 341 Meeting of Creditors, dozens of Mr. Marshall's creditors challenged his statements denying knowledge of the Eight Percent Fund when in fact, the Debtor issued hundreds of letters referring to the Eight Percent Fund and potentially thousands of promissory note addenda adding additional funds to a noteholder's "additional investment." As of the date of this Motion, more than two hundred claims have been filed by unsecured noteholders, many of which include documentation of the Eight Percent Fund and the "addendum to note."

25. Indeed, the Eight Percent Fund document (Exhibit 2), refers to noteholders as "investors."

> Mr. Marshall issues to the lender a promissory note for the amount of the loan at eight percent (8%) per annum. These funds can be treated as a savings account and earn interest, or some investors prefer a periodic check until the loan is paid in full.

26. While the Debtor claims that the noteholders simply loaned him money, and it was not an investment, the Debtor issued Form 1099-INT statements to his noteholders for interest,

causing the noteholders to pay taxes on interest payments they never received which they believed was being "reinvested." A sampling of Form 1099-INT statements received by noteholders is attached hereto as Exhibit 3. A letter to the Bankruptcy Clerk dated June 15, 2023 from one such noteholder further substantiates Debtor's 1099-INT scheme. ECF No. 100.

27. In fact, the Debtor testified to this at the Continued 341 Meeting, explaining that he would issue a 1099-INT statement to noteholders whose accumulated interest was "reinvested" in their note. Stated differently, some noteholders were forced to pay income tax on the increase of interest on the principal amount of money borrowed by the Debtor, even though they never actually received a penny from him.

28. A finding of cause based on fraud is warranted because: 1) the Debtor induced more than a thousand individuals to lend him millions of dollars, promising a return of 8% interest on a 30-day demand note; 2) the Debtor financed the Eight Percent Fund investment scheme by admittedly borrowing new sums of money to service existing debts; 3) the Debtor knew that he could not repay noteholders through his tax preparer and rental property businesses, yet he continued to borrow more money; and 4) the Debtor admittedly issued Form 1099-INT statements to noteholders in lieu of repaying them, causing them to incur greater losses by paying taxes on money they did not receive.

Support for Finding of Gross Mismanagement

29. The Debtor claims in his Declaration that an increase in requests by noteholders for payments of principal and/or interest was a result of the Debtor losing approximately $600,000 in revenue related to his tax revenue business after having been hospitalized in the several months before he filed for bankruptcy protection. ECF No. 7.

30. According to Debtor's 2022 Income Tax Return provided to the United States

Trustee, the Debtor grossed a total of $643,113 in revenue related to his tax preparation business. After expenses of $442,956, the Debtor had a net income, for the year, of $199,393 from his tax preparation business.

31. The Debtor reported on Schedules I and J, that his monthly net income from his businesses, with the primary source of income coming from the rental property business, is less than $20,000 per month. ECF No. 3.

32. The Debtor reported on Official Form 122B, Chapter 11 Statement of Current Monthly Income, that the average monthly net income he received during the six full months before he filed his bankruptcy case, was $42,669. *Id.*

33. The Debtor reported on Schedule E/F $90 Million in liabilities owed to unsecured noteholders, nearly all of them individuals, trusts, estates, associations from whom the Debtor issued thirty-day demand notes. *Id.*

34. Assuming, for discussion purposes, the principal balance of the Debtor's total liabilities is 50% of what was due as of the Petition Date, or $45 Million, at 8% per annum, the monthly debt service would be $300,000. Based on any reasonable assumptions, the Debtor's "cash flow from the business" could never support the debt service to his noteholders, even during its most profitable periods. ECF No. 7. The reality is that the Debtor could not support the debt service to existing noteholders without the ability to borrow new money.

35. The Debtor repeatedly responded to creditors' questions posed to him at the §341 Meeting of Creditors that his intention was to repay the noteholders with the increase of value of his real estate portfolio. However, the Debtor reported in his schedules that his interest in real estate has a value of less than $18 Million. Even if the property values doubled, which would be unrealistic, the Debtor could not come anywhere close to repaying his noteholders.

36. Yet, the Debtor continued to convince community members, their friends, and families to invest their money knowing that the value of his real estate portfolio was insufficient to cover the debt he owed to noteholders, putting his creditors at risk of recovery with every new dollar that he convinced them to invest.

Other Factors for Finding Fraud

37. While this case displays all the characteristics of a Debtor warranting the appointment of a trustee under § 1104 (fraud, dishonesty, incompetence, and gross mismanagement), the Court can look to other factors in determining whether there is cause. *In re Sillerman*, 605 B.R. 631 (Bankr.S.D.N.Y.2019) (citing *In re Futterman*, 584 B.R. 609, 616 (Bankr.S.D.N.Y.2018).

38. For example, in a case where an individual chapter 11 debtor remains in possession as a fiduciary of his own estate and for his creditors, there is a heightened concern of an inherent conflict of interest that may not otherwise exist in a corporate chapter 11. *In re Sillerman*, 606 B.R. 631, 647.

39. This is exactly the case here: the Debtor made payments of nearly $2 Million from January 1, 2023 through the Petition Date in various amounts to select noteholders. An independent trustee is necessary to review potential avoidance actions or fraudulent transfers; tasking the Debtor with the responsibility in bringing avoidance actions against those individuals which he chose to pay, is presents an unsurmountable conflict of interest. *See In re Soundview Elite, Ltd.*, 503 B.R. 571, 582 (Bankr. S.D.N.Y. 2014) ("It is wholly unrealistic to expect the Debtors' current management to appropriately investigate and prosecute potential breach of fiduciary duty actions and avoidance actions so long as current management, which will be the focus of much of the investigation, remains in place.").

40. Where a Debtor cannot fulfill his fiduciary duties to creditors, due to inherent conflicts, "cause" exists for the appointment of a chapter 11 trustee under Section 1104(a). The usual presumption in favor of allowing a chapter 11 debtor to remain in possession vanishes completely when management does not or cannot perform its fiduciary duties. *Commodity Futures Trading Comm'n v. Weintraub,* 471 U.S. 343, 355 (1985) ("[t]he willingness of courts to leave debtors in possession is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee.") (*quoting Wolf v. Weinstein,* 372 U.S. 633, 651 (1963)).

41. Moreover, in connection with the Cash Management Motion, according to in-court statements made by Debtor's counsel, the Debtor is unable to open new accounts compliant with 11 U.S.C. § 345 and United States Trustee Guidelines due to the notoriety that his bankruptcy filing has drawn in the community. The Debtor's bankruptcy estate should not be prejudiced due to the Debtor's inability to comply with these requirements. Instead, an independent fiduciary, lacking any stigma of fraud or dishonesty, could open bank accounts in compliance with the Bankruptcy Code and the United States Trustee Guidelines.

42. Absent a chapter 11 trustee, as the sole owner and manager of his businesses, the Debtor will remain in complete control of his assets following decades of deceptive business practices and fraudulent conduct. Congress has established only one remedy that can supplant management while allowing the case to remain in chapter 11 – the appointment of a trustee under section 1104(a).

If a Trustee is Not Appointed, the Appointment of an Examiner is Appropriate as Mandated by Section 1104(c)

43. Pursuant to 11 U.S.C. § 1104(c), the court shall order the appointment of an examiner at any time prior to confirmation of a plan:

> 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, or owing to an insider, exceed $5,000,000.

11 U.S.C. § 1104(c)(2).

44. The language in section 1104(c)(1) of the Bankruptcy Code calling for the appointment of an examiner if "such appointment is in the interest of creditors, any equity security holders, and other interests of the estate" reflects the language contained in section 1104(a)(2) with regard to the appointment of a trustee. An examiner "typically investigate[s] the debtor's business . . . , but do[es] not replace the debtor in possession in handling the day-to-day affairs of the business." *In re Gliatech, Inc., et al.*, 305 B.R. 832, 835 (Bankr. N.D. Ohio 2004), quoting *United States v. Schilling* (*In re Big Rivers Elec. Corp.*), 355 F.3d 415, 422 (6th Cir. 2004). A request for the appointment of an examiner must be supported by the given facts and circumstances. *See In re Gliatech*, 305 B.R. at 836 (citing *In re Mechem Fin. Of Ohio, Inc.*, 92 B.R. 760, 761 (Bankr N.D. Ohio 1988)).

45. Accordingly, in the absence of a trustee, the bankruptcy court should order an examiner to perform the duties specified in § 1106(a)(3)(investigate the acts, conduct, assets, liabilities, financial condition, operation of the debtor's business, and any other matter relevant to the case or to the formulation of a plan); (a)(4) (file a statement of any investigation conducted

under paragraph 3 including causes of action available to the estate) and (b) (duties of an examiner include those that the court orders the debtor in possession not to perform).

46. If a trustee is not appointed, alternatively, the facts and circumstances of this case compel the appointment of an examiner. The Debtor's schedules, statements, and testimony demonstrate the need for an investigation into the decades-old fraudulent scheme perpetrated by him. The Debtor's fixed, liquidated, unsecured debts exceed $90 Million. In a case where no trustee is appointed, a plan has not been confirmed, and the debtor's fixed debts exceed $5 million, and an investigation is appropriate, section 1104(c)(2) the Bankruptcy Code requires the appointment of an examiner. *See In re Residential Capital, LLC*, 474 B.R. 112, 121 (Bankr.S.D.N.Y.2012).

47. The appointment of an examiner is necessary and would benefit all parties-in-interest in these cases. *See In re New Century TRS Holdings, Inc.*, 407 B.R. 558, 566 (Bankr. D. Del. 2009) ("The Examiner performs his duties at the request of the Court, for the benefit of the debtor, its creditors and shareholders"); *In re Fibermark*, 339 B.R. 321, 325 (Bankr. D. Vt. 2006) ("The benefit of appointing an independent examiner is that he or she will act as an objective nonadversarial party who will review the pertinent transactions and documents, thereby allowing the parties to make an informed determination as to their substantive rights"); *In re Apex Oil Co.*, 101 B.R. 92, 99 (Bankr. E.D. Mo. 1989) ("The Examiner is appointed to act as an independent party to review without monetary interest, transaction and documents"). Disclosure and transparency are fundamental tenants of bankruptcy, and a crucial requirement to the effective functioning of the federal bankruptcy system. *See In re Kane*, 628 F.3d 631, 636 (3d Cir. 2010).

48. An examiner must act as the term suggests, for the purpose of conducting an examination, not to act as a protagonist in the case. *See In re Loral Space & Communications*

Ltd., et al., 313 B.R. 577, 583 (Bankr. S.D.N.Y. 2004), *rev'd*, 2004 U.S. Dist. LEXIS 25681. It is generally understood that an "investigation" pursuant to section 1104(c) is for the purpose of conducting a study "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, as the statute so clearly states. *See id*. at 585 (internal quotation marks omitted). The statute has been interpreted to provide for an investigation "of a particular transaction or series of transactions, in order to reveal ways and means to protect or augment the estate." *Id*. (citing *In re Gliatech*, 305 B.R. at 835).

49. Under 11 U.S.C. § 1106(b), an examiner performs certain trustee duties set forth in 11 U.S.C. § 1106(a), which provides in relevant part that an examiner shall:

> (3) except to the extent that the court orders otherwise, investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan;
>
> (4) as soon as practicable—
>
> (A) file a statement of any investigation conducted under paragraph (3) of this subsection, including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor, or to a cause of action available to the estate; and
>
> (B) transmit a copy or a summary of any such statement to any creditors' committee or equity security holders' committee, to any indenture trustee, and to such other entity as the court designates[.]

11 U.S.C. § 1106(a) (emphasis added). *See also The Official Comm. Of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 330 F.3d 548, 577 (3d Cir. 2003) ("An examiner's duties include investigation of the debtor, the debtor's business, and 'any other matter relevant to the case or to the formation of a plan'").

50. Here, an independent examiner will review pertinent transactions and documents

concerning the Debtor's financial affairs and file a report with various findings. The information contained in the examiner's report will serve as a road map for the parties by assisting them with the evaluation and pursuit of their respective rights. While the benefits of an examiner answers only to the bankruptcy court. Accordingly, if the Court does not appoint a trustee, an examiner should be appointed in this case.

CONCLUSION

WHEREFORE, the United States Trustee requests the Court enter an order directing the appointment of a chapter 11 trustee for the Debtor, or in the alternative, enter an Order directing the appointment of an examiner, and for other relief as the Court deems appropriate.

Dated: June 27, 2023

WILLIAM K. HARRINGTON
UNITED STATES TRUSTEE

/s/ Erin P. Champion
Erin P. Champion
Assistant United States Trustee
United States Trustee Department of Justice
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Exhibit 1

OFFICE OF THE UNITED STATES TRUSTEE
NORTHERN DISTRICT OF NEW YORK

IN RE:	.	Case No. 23-60263-6-PGR
	.	
	.	
M. BURTON MARSHALL,	.	One Lincoln Center
	.	110 W. Fayette Street, Suite 720
	.	Syracuse, NY 13202
	.	
Debtor.	.	June 5, 2023
. . . . .		

TRANSCRIPT OF 341 MEETING OF CREDITORS
BEFORE ERIN CHAMPION, ESQ.
OFFICE OF THE UNITED STATES TRUSTEE

APPEARANCES:

For the Debtor:	Barclay Damon LLP BY: BETH ANN BIVONA, ESQ. JEFFREY A. DOVE, ESQ. The Avant Building, Suite 1200 200 Delaware Avenue Buffalo, NY 14202-2150
For the Committee:	Bond, Schoeneck & King, PLLC BY: SARA C. TEMES, ESQ. ANDREW S. RIVERA, ESQ. One Lincoln Center, 18th Floor Syracuse, New York 13202

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MS. CHAMPION: Thank you. Good morning, everyone. Thank you for your patience this morning. My name is Erin Champion. I'm going to be conducting the meeting this morning, on behalf of the United States Trustee. I am the Assistant United States Trustee for the Utica Office here in the Northern District of New York where this bankruptcy case was filed.

This is the meeting of creditors, pursuant to Section 341 of the United States Bankruptcy Code in the Chapter 11 case of M. Burton Marshall, Case Number 23-60263. Today is June 5, 2023. The time is approximately 10:00 a.m. This is the adjourned date, actually, following the initially scheduled meeting of May 22nd, which was adjourned to today's date due to technical difficulties with the call last time. And, again, I appreciate everyone's patience during that process. I know it was tricky.

Anyway, before we begin with the meeting itself, I'm just going to take a couple of minutes to explain how I'm going to proceed this morning and how the meeting will go. And given that the meeting is being held on the phone, pursuant to the amended 341 notice, I just want to go over the procedure, so that we can make sure the meeting is productive, and that everyone has an opportunity to be heard, you know, whoever wants to ask questions, so we'll go over that process.

So, I'm going to be the moderator speaker for the day, and I'll be unmuted for the duration of the meeting,

obviously. And my role will be to ask the Debtor questions regarding his financial affairs. Some of you have already emailed me your name and your phone number to indicate that you would like to ask Mr. Marshall questions. Some of the emails I got, I did not have phone numbers for, and that's the way that we're going to be identifying you.

But just to make sure that everybody who wants to ask questions can ask questions, if I don't have the information, you will have the option of hitting star-zero to speak with the operator, and then she will be added -- she can add you into the list of speakers. But it'll probably be a little while before we get to that point in the meeting, because I will be asking the questions first.

So, the order of the meeting is going to be, after I take appearances from the attorneys, then I'm going to be putting Mr. Marshall under oath. I will be asking Mr. Marshall questions. I would just ask that you, please, listen carefully to all of my questions, as it might answer some of the questions that you have, as well. It would prolong the meeting unnecessarily if we continue to ask the same questions repeatedly, so I would just ask you to be mindful of that.

Then after I conclude my questioning, I will invite counsel for the Creditors Committee to ask questions of Mr. Marshall, and then any other attorneys that wish to appear and ask questions, and then I will be turning it over to those

creditors that contacted me in advance to let me know that you would be asking questions. And you're still welcome to do so. You can still email me your name and your telephone number, the line that you're calling from, and we can make sure you get added to the list of speaking parties or, like I said, if you don't have access to your email at the moment, you can just hit star-zero and speak to the operator.

The other thing I want to just mention today is that, it's possible that we might not get through everything that we need to today and maybe not everybody's questions today. If necessary, I can continue the meeting to another date. I would just ask everybody to be very patient, because this is a case, obviously, with many creditors, so we just have to make sure that we can get through this process as expeditiously and efficiently as possible.

So, another thing I will mention that since we are on a call, I would ask that you please identify yourself before speaking so we can have an accurate record. If the call is transcribed, we know who is speaking and when.

So, the statutory purpose, so the purpose behind the Bankruptcy Code statute for this meeting, it's to provide my office, as well as creditors and other interested parties with an opportunity to examine the Debtor under oath. If you don't have any questions for Mr. Marshall, that's fine. It's not required. You don't have to ask questions. You can leave the

meeting or drop off the call at any time. You're more than welcome to just stay and listen.

So, I would also ask another thing, to keep in mind that this is an opportunity for creditors to ask the Debtor questions related to the bankruptcy case. It's really not an opportunity to take individual discovery with respect to your individual claim. Of course, your questions are related to your own personal claims, yes, so what I'm asking is you keep the questions to a minimum and with respect to the Debtor's financial affairs.

So, I am recording this meeting on behalf of the Office of the United States Trustee, and I have to emphasize this, there can only be one official recording of this meeting, and it's the recording my by office, the Office of the United States Trustee. Anyone can get a copy of the recording. At the conclusion of the meeting today, you can either email me at Erin, E-R-I-N, dot Champion at USDOJ.GOV or you can call my office at (315)793-8191. I will repeat all of that information again later, at the end of the meeting, but just so you know that it's very important that there is only one official recording of the meeting.

Lots of you may not be familiar with the bankruptcy process, so I thought it would be good just to give a little two to three sentence overview. So, when an individual files for bankruptcy under Chapter 11, that individual is seeking an

opportunity to reorganize his financial affairs or liquidate assets to pay his creditors. So, filing the bankruptcy case allows that Debtor to try to come up with a plan to reorganize his financial affairs and propose a plan of repayment, and while he does those things, he can continue to operate his businesses. He can continue to own his assets. They are all still under his control while he's in the bankruptcy.

This will allow the Debtor and his professionals to come up with a plan of repayment based on what his assets are, what he plans to do as far as liquidating assets, payments that he might make over a plan of reorganization, and all of those details will be in that document, which will be filed, you know, later on in the case. That's not something that normally gets filed right away, but you will be looking for that, and you'll have an opportunity to review that and comment on it when that process happens.

So, also, in a Chapter 11 case, a Committee of Unsecured Creditors can be appointed by my office, and we, in fact, did that in this case, and there is a Committee, and I believe they're going to be participating in the meeting today through their perspective counsel, Bond, Schoeneck and King.

Let's see, okay, I think I probably covered all the preliminary remarks that I wanted to make, so we can actually move on to the portion of the actual meeting at this time. Let's --- so can I first get appearances by Debtor's counsel,

please?

MR. DOVE: Good morning, Jeffrey Dove of Barclay, Damon on behalf of Mr. Marshall.

MS. CHAMPION: Thank you. And, Mr. Marshall --

MS. BIVONA: Beth Bivona --

MS. CHAMPION: Oh, I'm sorry.

MS. BIVONA: -- of Barclay, Damon on behalf of the Debtor.

MS. CHAMPION: Beth, can you repeat that? I was talking over you.

MS. BIVONA: Sure, I'm sorry. Beth Bivona, Barclay, Damon, on behalf of the Debtor.

MS. CHAMPION: And is the Debtor present on the call?

MR. MARSHALL: I am.

MS. CHAMPION: Okay. Moving to prospective Committee counsel, can you enter your appearances?

MR. RIVERA: Hi. This is Andrew Rivera, Bond, Schoeneck and King, on behalf of the Committee, and I believe Sara Temes is also on the line.

MS. CHAMPION: Thank you. Are there any other -- well, if there are counsel on the line that want to make an appearance that don't have -- that are not unmuted, if you want to just go ahead and contact the operator by doing this -- by hitting star-zero, we can get your appearance noted now, or you can just wait until we do the questions, after I finish with my

questioning of Mr. Marshall, and you can enter it at that time.

MS. TEMES: Thank you, and this is Sara Temes. I think I was on mute. I'm appearing, also, from Bond, Schoeneck and King, on behalf of the Committee, as co-counsel.

MS. CHAMPION: Okay. Thank you. Okay. Mr. Marshall --

MR. MARSHALL: Yes.

MS. CHAMPION: -- would you, please, raise your right hand?

MR. MARSHALL: Yes.

M. BURTON MARSHALL, DEBTOR, SWORN

MS. CHAMPION: And for identification purposes, your attorney has provided me a copy with your driver's license. Can you just give me the last three digits of the identification number on your driver's license?

MR. MARSHALL: Oh, I don't have that on me. I wasn't aware of this.

MS. CHAMPION: Okay, not a problem. We can do that at the end or we'll figure out another way to handle that.

MR. MARSHALL: I have a copy in my office here, and I'll have someone get it for sure.

MS. CHAMPION: Okay, perfect.

EXAMINATION

BY MS. CHAMPION:

Q Okay, Mr. Marshall, did you review your petition,

schedules and the statements that were filed in this case before they were filed?

A Yes.

Q And are they true and accurate to the best of your knowledge?

A Yes.

Q Do you know if there are any amendments or changes that need to be made to the schedules?

A There may be a couple minor amendments of things we found after the fact. What they are, escapes my mind. They're very, very minor situations, I know that.

Q Okay. Thank you. And did you assist your attorney in preparing the schedules and statements?

A Yes.

Q Also, I have to ask you, since this is an individual case, do you have any obligation to pay anyone any type of domestic support?

A No.

Q All right. And, Mr. Marshall, what is your current address?

A 20 Payne Street, P-A-Y-N-E, in Hamilton, New York.

Q And how long have you lived there?

A Approximately 40 years.

Q Okay. And who else lives there with you?

A My wife, Megan Marshall.

Q Okay. And I think on the schedules, you indicated that that property has a value of $475,000. Is that a tax-assessed value?

A I don't have the tax in front of me. That's pretty close to the assessed value.

Q Okay. And you own a number of other properties, which we'll get to in a little bit, but do you have a residence in any of the other properties listed on your schedules, other than 20 Payne Street.

A Yeah, the camp. That's a seasonal dwelling that is solely used by my family, if that counts.

Q Yeah, where is that located?

A It is on Tara Grove Road, Hamilton, New York.

Q And how long have you owned that?

A Oh, 35 years -- 37 years.

Q Okay. Okay. So, Megan Marshall, she is your spouse?

A Yes.

Q And she lives at 20 Payne Street, as well, you said?

A Yes.

Q So, according to your schedules, you owe her $8,719.99. What was that for?

A That was, I had borrowed money from her mother, and her mother passed away, and that became Megan's share after her mother's death.

Q Okay. And who -- who is Taber Colletti.

A Taber is my step-daughter.
Q Does she live at 20 Payne Street?
A She lives in London. Her U.S. address is 20 Payne Street, but she lives, physically, in London and has for ten years, approximately.
Q And you owe her money, as well?
A Yes.
Q And what was that for?
A She got a bonus at work, and she lent me the money.
Q Okay. Did you pay back any money that you borrowed from Megan Marshall or Taber Colletti within the year before filing your case on April 20th?
A Megan, for sure, no, and I don't think Taber, although Taber's is relatively in the last six months, so, no.
Q Okay. Have you paid back any relatives, in the past year, money that you may have owed them?
A I think Marc Colletti is my step-son, and I think he was paid some money within the last year.
Q Okay.
A I think Keith and Mary Hyde are my brother and sister-in-law, and I think, within the past year, they were paid some money back, also.
Q Okay. And I believe those were listed in your statement of financial affairs, correct?
A I think so, yes.

Q All right. Let's move on a little bit to your business structure and the business assets. Other than your interest in your businesses, do you have any other type of employment?

A I -- I have two sources of employment. I get a W-2 from Miles B. Marshall, Inc., which is a separate entity, a sub-S corporation that I own all the stock in. It's an insurance agency, and I work for them, and I get a salary of, I think, $2,000 a week. And everything else is Burton Marshall, so I don't get any outside income, no.

Q That was Miles B. Marshall, Inc., you said, right?

A Correct.

Q So, you -- have you received W-2 income from Miles B. Marshall, Inc. routinely, let's say, in the past five years, is that -- does that --

A Well, over 53 years, yes.

Q Okay. All right. And then you also conduct a number of businesses, individually, through a d/b/a, correct?

A Through a series of different d/b/a's, yes.

Q Right, okay. So, let's just go through those and get a little bit more information on those. We'll start with M & M Press. Can you just describe the nature of that business?

A It's a small, local print shop where we print, you know, stationary and banners and things were local individuals and businesses.

Q And where is that business located?

A 37 Milford Street in Hamilton, New York.
Q Is that a property that you own?
A Yes.
Q So, what kind of clients does M & M Press have?
A Individuals and small businesses and some non-profits.
Q And are you continuing to do business?
A That business is still in operation, yes.
Q Okay. And you use the account at Berkshire Bank that was listed in the bankruptcy paperwork?
A Yes.
Q Okay. And is that the only bank account you use in connection with M & M Press?
A Yes.
Q And, then, who would handle the day-to-day operations at M & M Press?
A (Indiscernible) is my son, Matthew Marshall.
Q Do you receive any type of income from M & M Press?
A All the income goes into the M & M Press checkbook and then immediately goes into M. Burton Marshall's checkbook, and all the bills for M & M Press are paid out of M. Burton Marshall, what I would call, the big checking account. The only reason there's a separate checking account for M & M Press is the bank required it, along with a doing-business-as certificate. They would not let me deposit checks in the Burton Marshall account that were made out to M & M Press. So,

if you come in today and pay $100 for printing, it goes into M & M Press, and then when there's enough money in that checking account, it all goes over to the M. Burton Marshall checking account.

Q Okay. Is that the same set-up for the other d/b/a's, as well?

A Yes.

Q Okay. So, Marshall Tax Service --

A Well, that is Burton Marshall, and there's no separate checking account for that, other than Burton Marshall.

Q Okay. All right.

A Right.

Q That was my question. So, all of the income --

A Oh, wait, I take it back. There is a -- sometimes, people make checks out to Burton Marshall Tax Service, and the bank required that I get a doing-business-as and open a separate checking account for that, and if there's ever any money in there -- because that happens infrequently -- there might be $1,000 at most.

Q So, you'd have the same type of set-up, then? If somebody, you know, pays you, it gets deposited into the Marshall Tax Service account, and then you transfer it to the M. Burton Marshall account?

A If someone writes a check out to the Marshall Tax Service, it's a bank requirement.

Q Right.
A And that would transfer over to the M. Burton Marshall checking account, yes.
Q Okay. And then the expenses of Marshall Tax Services?
A Are all paid out of the M. Burton Marshall checking account.
Q Okay. What kind of services do you provide under Marshall Tax Service?
A I prepare income taxes for individuals and small businesses, and we do payroll taxes and sales tax preparation.
Q Okay. Have you ever provided any investment services, in relation to that business?
A Years ago, I was a certified financial planner, and that ended more than 20 years ago.
Q Okay. And who is in charge of the day-to-day business at Marshall Tax Service?
A Myself.
Q Okay. And do you have employees?
A I do.
Q And who are they?
A My employees? I have 25 --
Q Well, do you have --
A -- employees.
Q Do you have -- how -- okay. Well, how many full-time?
A In the office, there is Kim and Gary and Joy and -- and

right now, there's probably eight full-time inside employees.
Q Okay. And are any of them your relatives?
A The only relative that's my employee is Matthew Marshall, because the payroll for M & M Press goes through Burt Marshall.
Q You mean the M. Burton Marshall account?
A Yes.
Q Okay. So, the payroll for Marshall Tax Service, does that run through M. Burton Marshall, as well?
A Yes, yes.
Q All right. And then how about Marshall Moving? What kind of services do you provide through Marshall --
A We used to move -- and I closed that business. We haven't moved anyone in over a year. We've closed that business and closed -- either closed or are closing the checking account. I've given the documents to close the checking account. We used to move a lot of students from Colgate Campus to storage units is what that primarily was, and we no longer do that.
Q Okay. So, that business closed. When -- when did you say that was?
A I just closed it in the last couple of weeks, because we have this extra checking account that nothing's going through it, and it's a waste of time to horse around with it.
Q Okay. And then, how about Marshall Storage, what is that?
A That is -- again, that's a bank requirement. People make checks out to Marshall Storage to pay for the rent on the

storage units, but all of the money gets transferred over to M. Burton Marshall checking account. And that's just another rentals. I have three different storage locations.

Q Okay. So, you've got three different storage locations, and so, Marshall Storage is just, really, typical, what you would see, those big storage -- groups of storage units, right?

A Yes.

Q And, then, how many units are in each location?

A I think at the -- we call it the north side, I think there's 86. At the south side, I think there's 66 or something like that.

Q Okay. And how -- how --

A The third location is a big old beautiful dairy barn that we -- so we call it Big Stuff Storage. We store big stuff, such as cars and boats and campers.

Q Okay. And how long have you had that business?

A I've had that business for 15 or 20 years.

Q And what percentage, would you say, of the units are rented?

A Today, 99 to 100 percent.

Q And do you personally store any of your own belongings in any of the units?

A There's one unit that has stuff that we use in business for the rentals, so they brought -- I don't know what's up there. I've never been in the unit. There's probably salt for

when we plow the driveways in the Winter, and that's pretty much what's in there. But my own, personal items, no.

Q Okay. And then same type of set-up with the banking? Do you know, would money go into Marshall Storage, the account, and then get swept into the M. Burton Marshall big account, as you called it?

A Yes.

Q How do you designate or keep track of what went into the M. Burton Marshall account, based on which business it came from?

Do you know what I'm asking? Maybe I'm not asking that in a -- so, when all of these -- all of this revenue --

A Well, I get to see what -- it's sent electronically, so you can see it goes from account, you know, whatever the numbers are, into the other account, whatever the numbers are.

Q So, if you wanted to figure out, okay, well, how much money is Marshall Storage making versus Marshall Moving --

A Well, we have a -- we keep separate records of how much rent we take in.

Q Okay. All right.

A But, that's all separate records. We have all of those, of course.

Q And how -- how do you keep those records, what format?

A (Indiscernible).

Q Like is it Excel or what kind of --

A Oh, It's a -- we have a service -- a storage service that provides it to me electronically through the storage, an app.
Q So, what -- if you wanted to do a revenue comparison with all of your business interests, how would you look at that?
A How would I find it out, you mean?
Q Yeah.
A Well, with the storage business, we ask the machine how much revenue we took in, in such and such a period of time, and the same with the regular rental company. We have an application for that. It's a different service, but it's the same sort of thing. For the tax business, we do it out of the receipt book. Anytime I do a tax, we write a receipt, and we add those up, and M & M Press, we keep track of manually, on a yellow piece of paper. Anytime we take in money, we write down the receipt number, and the sales tax we collected and keep it by the month.
Q Okay. So if I were to look at your bank statements for the last year, with -- well, if I were to look at the M. Burton Marshall big account statements, how would I know which amounts are coming into that account that came from rentals versus storage versus M & M Press?
A Well, M & M Press would be a withdraw from the M & M Press account going into Burt Marshall. That's how you would find that out.
Q Well, no, if I'm just looking at the M. Burton Marshall

account statements, how do I tell where that money came from?
A It would be the deposits from the other accounts would have the account that it came from. You can tell that way.
Q So, really, you can't tell unless you're looking at the transfers from the other accounts?
A Well, with the caveat that anything -- the storage units and the rents are on these apps, and those people deposit us once periodically when they receive the monies. And you can tell where that money came from. And, certainly, the bulk of the storage and the bulk of the rents, 90 percent is coming in through this service, and they're depositing it to my account.
Q Do you know the name of the service?
A One is AppFolio. We can find out the other one.
Q AppFolio?
A Yeah. I also have the last four of my driver's license, is you want that now.
Q Oh, great. Yeah, I think just three numbers.
A The numbers are four, one, two.
Q Oh, perfect, that's what I have. Okay, check that off now.

Okay. So, the money -- so, tenants or people renting the storage units, they just, when the hit the payment on line, pay it, like, electronically pay, then that money gets held by this electronic service, AppFolio, and then they make a deposit to your account directly.

A Yes.
Q And is that once a month?
A No. It's as they receive the money. There's a little lag time, maybe two or three days. So, today, I'm getting -- today's the fifth -- I'm getting a lot of rents in today that people probably paid on the first of the month. The biggest day for the rents won't be until the 7th or 8th, and I'll take in a lot of money on the 7th or 8th. This is that lag time.
Q Okay. So, each of these businesses that we've talked about -- and there's others -- you know, Marshall Maintenance, I don't think we've covered -- and then, obviously, the rentals, have you always used Berkshire Bank for those accounts?
A No. Before Berkshire, which I've used for ten years or so, I used the Community Bank in town, and before that, I used the NBT Bank in Hamilton.
Q Okay. And other than the accounts that you listed in your schedules, which are all at Berkshire Bank, do you have any other checking, savings or any other money market accounts?
A I have no money market accounts. I have no savings accounts, and I am pretty sure I don't have any other checking accounts.
Q Okay. So you have the M. Burton Marshall account, which is the big account.
A Yes.

Q You have M & M Press, Marshall Tax Service, Marshall Moving, Marshall Storage, Marshall Maintenance and Marshall Rentals, right?
A Right. And the Marshall Maintenance and the Marshall Moving are in the process of being closed, if they haven't already been closed.
Q Okay. So, Marshall Maintenance is being closed, you said?
A Yes.
Q What did that -- what was the purpose of that business? What did it do?
A People would ask me if we had a handyman available to go over and do jobs at their home or business. So someone would say, I need someone to, you know, change my water heat or put salt in my soft water or some small, little job like that.
Q Okay. And then, Miles B. Marshall, Inc., what -- is there a separate bank account for that business?
A Two separate bank accounts for that.
Q Where are those bank accounts?
A Berkshire Bank.
Q And when was Miles B. Marshall incorporated?
A 1962.
Q And you're the sole owner, correct?
A I own all the stock of Miles B. Marshall, Inc., yes.
Q And it's an active corporation?
A Yes.

Q And I think you said earlier that you receive a salary of $2,000 a week, was it?
A $2,000 a week, and then I'll take bonuses out. The bonuses and insurances come the end of January or February, so there's -- and, in fact, left-over money in that business, I'll take it out then as a distribution or bonus, whatever you want to call it.
Q Right. Okay. So that business is an insurance agency, right?
A Yes.
Q Okay. So, how does that work? I mean, are you an agent, and you sell a particular --
A Yes.
Q -- type of insurance? Explain that.
A Miles B. Marshall, Inc. is an agent, yes.
Q For which insurance companies?
A For many different insurance companies, the largest of which is New York Central Mutual Fire Insurance Company.
Q Okay. And then, what kind of insurance do you sell?
A Auto insurance, home owner's insurance, small business insurance, worker's compensation.
Q Okay. So, you don't do any life insurance?
A Yes, we do a little bit of life insurance, but not a lot. But, yes, we do.
Q Okay. So, in your schedules, you attributed a value of $3

million to Miles B. Marshall, Inc. What was the basis for that value?

A Well, currently, we're having an appraisal made, and I should receive that within, hopefully, this week. This person's late, but it's three times annual commissions, which, generally, has been a good rule of thumb for the value of an insurance agency.

Q Three times that annual commissions, okay?

A Last year, it exceed 1.1 million, I think.

Q And have you ever sold investments as part of the insurance company, insurance agency?

A No. I take that back. I had a Series 6 or Series 7 license years and years ago, 30 years ago, and I would sell tax-deferred annuities, mostly to people who worked at non-profits, so, like, school teachers and people that worked in the hospital, that sort of thing. And I used that back then. And at some point, that came around to me doing full-time, and I was not able to do that, and so I surrendered my license. This was back in th '80s, at least.

Q All right. So, I'm just going to make a couple of document requests while I'm thinking of it. I would like to see the tax returns for the corporation for 2022 and 2021. And I do have your personal income tax for 2022, but I'd also like to see 2021.

A My lawyer has been provided --

Q And I can follow-up with your attorney.
A -- (indiscernible) he can forward that to you.
Q Yeah, I can -- I can follow-up with him. I just wanted to get that on the record before I forgot.
A '21 and '20, you want the corporate tax?
Q Yes.
A Okay, that's not a problem, and we'll get it to you, probably, today.
Q Okay. So, other than what we've talked about and what we've covered, do you have any other ownership interests in any other businesses?
A No.
Q And what is your education background, Mr. Marshall?
A I went to high school. I have a lot of years worth of college. I quit college.
Q Okay. So are you a CPA?
A No, I am not.
Q So you are a tax preparer, is that a correct term?
A The service has a designation called enrolled agent to practice for the IRS --
Q Oh.
A -- which involved a two-day exam, and I did that 37 or 38 years ago, so I'm an enrolled agent.
Q Okay. So, you're an enrolled agent. Do you have any other types of licenses or certifications?

A I'm a certified insurance counselor, and the license, I have a New York State life insurance agent's license and a property and casualty agent's license.

(Telephone conference interruption)

A Are you there?

Q I'm still here. I'm not really sure what that is.

MS. CHAMPION: Jeff, are you still on?

MR. DOVE: Yes, I am still on.

MS. CHAMPION: All right. Let's just take a quick little break. I'm just going to message the operator to see what happened there.

THE OPERATOR: Excuse me. You're back in the call.

MS. CHAMPION: Okay, great. Thank you.

BY MS. CHAMPION:

Q Okay. So, Mr. Marshall, you can hear me still?

A Yes, I can.

Q Okay, great. Okay. So, we had just left off, and you had just described that you had agents licenses. Okay. So, that's still -- you are still active. You are still an agent. You're still selling policies through Miles B. Marshall Insurance, right?

A Yes.

Q Okay. And then your tax preparation business, when is the last time you prepared a tax return for a client?

A Saturday.

Q Okay. So, you're continuing to do that?
A Yes.
Q Okay. I know that you had had some health problems. We don't need to get into details, but you had said that that affected your -- your tax service business. Is that still the case?
A It's the case that I lost a significant portion of my business while I was sick, and some of that business will never ever come back, because you do taxes predominantly late in January, February, March and April, and I was sick the end of January, February and March, and I got back in the office, I think the end of March on a limited basis.
Q Okay. So, but you expect to be still doing those services, let's say, next tax season?
A As of today, that's what I expect, yes. A lot of it depends on all of this bankruptcy stuff plays out, and --
Q Okay.
A -- it's very discouraging, but, yes, that's my plan today.
Q Okay. So, in your schedules under other amounts that someone owes you, so we're talking about people that owe you money --
A Right?
Q -- it shows that you're a mortgagee on a couple of different properties, several different properties?
A I think it's four, yes.

Q Okay. Do you know when you loaned those individuals money?
A Not off the top of my head. I can certainly find out pretty quickly.
Q Okay, yeah, that would be great. And if you need reference to where it is in your schedules, it's Part 4 --
A Well, the Strong Collins --
Q -- question 30.
A -- one is right here. It looks like I sold you that property.
(Pause)
A The one in Poolville that goes to Strong Collins, it looks like I sold about March of 2010.
Q Okay. So, then, what, you just took back the mortgage yourself, then?
A Yes. And the Miller property, it looks like their first payment was September of '18, so I would have sold it, probably, August of '18.
Q Okay. And then what about the other two?
A I'm digging as fast as I can. And Jones, it looks like 2000.
Q Okay.
A October 26th, 2007 is looking at that quickly.
Q There's a fourth one?
A Oh, the fourth one is Hubbertville, and I think I sold

that. Wrong folder. I can't put my hands on that fourth one now, but it's been eight years, probably.

Q Okay. All right. It wasn't within the last year?

A No, no, certainly not.

Q And those individuals are continuing to make payments under those mortgages to you?

A They are.

Q Okay. I know I asked you about money markets earlier, but you do have any interest in any bonds or mutual funds or stocks?

A No. My use for those were all liquidated prior to the filing of the bankruptcy.

Q And when were they liquidated?

A Well, I was in the hospital, so probably February of this year.

Q And what was it? Was it stocks, mutual funds? Was it in a brokerage account?

A There was no bonds. And there was a brokerage account with Leigh Baldwin in Cazenovia, and I owned some individual stocks, all water type stocks.

Q Okay. So, all of your stocks have been liquidated at this point?

A Yeah. I own no stock, other than Miles B. Marshall, Inc.

Q Right, right, right. What about any retirement accounts?

A None.

Q Have you ever had any?
A In the past, I have had, yes.
Q How recently?
A 15 years ago.
Q Okay. And, Mr. Marshall, have you ever been subject to an audit by the IRS?
A No, I've never been audited by the IRS.
Q All right. We're going to move on now to the portion of your schedules, Schedule E/R where you list your creditors and the people to whom you owe money.
A All right.
Q So, there's roughly about 900 individuals that you list in your schedules from whom you borrowed money in the form of promissory notes, is that correct?
A Yes.
Q Okay. So, a key piece of information that's actually required to be disclosed that was not included in that information was the dates that those debts were actually incurred. So I'll get to that in a few minutes, but I do have a couple of questions I want to ask you before we get into that deeper. So, in general, when you received these monies from these individuals that you owe money to, was that deposited into the big account, the --
A Yeah.
Q -- M. Burton Marshall Berkshire Bank account?

A Yes.
Q Okay. And some of them are probably notes that you had prior to the Berkshire Bank account, is that --
A Yes.
Q -- is that possible?
A Yes.
Q Okay. So, the older ones could go back to that Community Bank or MBT account that you referenced earlier?
A Yes.
Q Okay. But would those be the only three possible places where those monies that you borrowed would have been deposited?
A Yes.
Q Okay. And, then, did you also make the payments under those notes from that same account?
A Yes.
Q Okay. And how did you keep track, then, of what was due under each of those promissory notes?
A Each promissory note was, by itself, segregated, and there's a -- each note would have a balance there. There's a column for money they put in and a column for interest they've earned, and a column for money that's taken out.
Q Okay. So when you say segregated --
A So, each person, person A will have a separate account, person B, person C, da-dah, di-dah, di-dah.
Q So, they had a separate account, what do you mean by that,

if it was all going in the M. Burton Marshall big account?
A I mean, they would have a separate note.
Q Okay. All right, a separate note.
A I always attach this worksheet, so to speak, that shows how much their balance is.
Q So, the worksheet, is that an electronic worksheet or is that actually something you're doing on paper?
A Well, originally, we did it manually, and then, at some point, we switched over to electronically.
Q Okay. So, what kind of electronic program are you using? What kind of software? Was it an Excel program or something else?
A Well, no, it's a program we designed ourselves.
Q Okay. All right. Who designed it?
A David Will.
Q I'm sorry, say that again?
A David Will.
Q David Will, W-I-L-L?
A Correct.
Q Okay. And does he work for you?
A Yes.
Q He's an employee?
A Yes.
Q Is he still an employee?
A Yes.

Q Okay. So, this program that he created, then, you keep on your computer in your office?
A Yes.
Q Okay. Now, do you also keep, like, a separate file on each of these notes, a physical file?
A Yes.
Q And that would include, what, like correspondence, statements?
A It would include, well, all of the above. It would include a copy of the original note, and then the transaction history and any correspondence or anything we receive, so some of them are very thick, and many are very thin.
Q Okay. How many of those files would you say that you have?
A 900.
Q Okay. So, 900, and so, equal to the number of people that were listed in your schedules, roughly?
A Roughly.
Q Okay. Okay. So, getting back to the requirement to include the date that those debts were incurred, I think that's important information, and you would be able to get that information, correct?
A Yes.
Q Okay. So, I think your schedules should reflect that and need to be amended to show when those dates were -- when those

debts were actually incurred.
A Okay.
Q So, would you -- if I wanted to take a look at, just, like, let's say, just a list of all these notes and the dates that they were incurred, would you be able to access that information relatively easily?
A The notes that were created after it was electronically, yes. There's still some notes that were done manually that we converted to electronic on such and such a date, and those would be somewhat more difficult to obtain, but, ultimately, you can obtain them, yes.
Q Okay. So, you would be able to extract information out of this software or this program that David Will created. Like, you know, I want a list of all of the notes and --
A Those that were created before we went electronically, yes.
Q Okay. All right. So, did you convert, then, all of the pre-electronic filing system, did you convert all of those folders or those notes --
A Yes.
Q -- into the electronic format --
A Yes.
Q So, everything should be accounted for in that program?
A Yes.
Q Okay. So, when you borrowed these funds from these

individuals, it was on a promissory note?
A Yes.
Q Okay. So, what did you promise these individuals in return for the money you borrowed?
A Eight percent interest in most cases.
Q And so, what were the terms?
A Each note was different terms. Some people, we said, well, we'll pay you the interest monthly, if that's what they wanted, or quarterly or annually. Some people, we'd pay their quarterly estimated income taxes. Each one was individual to itself.
Q So, how did you keep track of that if they were all different types of arrangements?
A With good bookkeeping.
Q This information would somehow be --
A It would be incorporated into the electronic system, so if somebody was getting paid quarterly, we would update that note three months from today, for example, and it would kick it out of the suspend system or if it was monthly interest or next year, if we're paying somebody's quarterly payments, we have a list of whose quarterly payments we were paying for the income taxes.
Q And did you provide these individuals with a periodic statement of their account?
A Yeah. Anytime money went in or went out, they would get a

statement.
Q But not on a regular -- you know, like say I give a loan to somebody or take a loan, you know, I would get a monthly statement showing what my balance is, so --
A They weren't all monthly. Some people wanted it quarterly. Some people wanted it annually. Some people didn't want us to update the interest at all for tax purposes, said wait until I retire or some such time.
Q Okay. So, how did these arrangements come about?
A Rephrase the question, please.
Q Tell me about -- I'm just curious. I mean, these are a lot of different -- 900 different individuals that you borrowed money from. So, is it a situation -- you know, what was that conversation like. Ho did you approach these people for money?
A Well, primarily speaking, most people had heard about through word of mouth, so they'd come in, and say that they wanted to lend me money.
Q So, they heard that, through word of mouth, that other people were lending you money --
A Yes.
Q -- and so they also wanted to lend you money?
A Yes.
Q So, they knew this was a situation -- to the best of your knowledge -- I know you can't speak for these individuals, but your understanding is that they knew that this was money that

they were lending you?
A Yes.
Q Okay. And did you present it as an investment opportunity for them?
A I did not present it as an investment opportunity. I presented it as they were lending me money, in return for, generally speaking, eight percent interest.
Q What did you tell them that they were lending you money for?
A For my -- predominantly, the real estate business, to buy more real estate, to make improvements in the real estate, to pay bills in the normal course of business for the real estate, pay debt service on the real estate loans.
Q And did you make them aware of that -- were they aware of -- well, let me rephrase that.

So, you told them, when they said, hey, I want to lend you some money, you said, okay, I'm going to borrow X amount of dollars, and I'm going to buy real estate with that? Is that how most of those went?
A They -- most people -- some people asked. Some people didn't ask what I would do with the money. Some people would come in and say, gee, I'd like to lend you $10,000, and that would be, basically, the end of the conversation. And some people would sit down and have a lengthy conversation. And some people, I would take out to different projects or

buildings and show them. It depends on what someone wanted.
Q Okay. So, let me skip ahead to a couple of things. When did you first start that program of borrowing money to and (indiscernible)?
A I don't know for sure, but it was in the early '80s.
Q Okay. So, that's about 30 years?
A Well, it's about 40 years.
Q It's about 40 years. Okay. So, I reviewed just some of the proofs of claims that were filed in the case, just to kind of get an idea of what these notes were about, and I saw that there was an addendum to a note that had a number of 4,818 on it. So, does that mean that there is -- potentially, there was 5,000 promissory notes or borrowing agreements out there?
A It means that if you had a note, and then you came in a year later, and said, I want to --
Q Right, I get that.
A -- add $10,000 to the loan, it would be an addendum, as opposed to a new note.
Q So, the note, itself, though, had a number on it. It was like 4,818.
A Correct.
Q So, in your estimation, would you have about that many notes, meaning, over the years, that's how many notes you were generating?
A Oh, no, there's not that many outstanding, because some of

them paid off. Many have been paid off.
Q Well, right. Right.
A People came in to -- but over the course of years, yeah, that's the number.
Q Okay, all right. So, what's the average you would -- I was -- the average yearly total, I guess, of all the payments that you were making under these notes, I would say? I mean, you don't have to go back 40 years. But let's just say in the last five years, how much were you paying out on average?
A I don't know off the top of my head. I'd have to check my end-of-year statements to see, because those, I don't have at this -- you know, at this desk.
Q Okay. So, and you said that the individuals could decide whether they wanted, you know, interest payments monthly, quarterly, yearly or deferred until retirement, correct?
A Correct.
Q Okay. So, say an individual wanted their interest on a quarterly basis, then, would you write a check, then, out of that M. Burton Marshall account?
A Yes. Yes, we'd write a check.
Q Okay. All right. So, just before you filed your case, you made several payments to creditors on the same day. How did you determine who you were going to pay before you filed your bankruptcy?
A What do you mean several payments? I paid everyone a half

of one percent of the principal. That was just before we filed bankruptcy.

Q Yeah. I have a couple of those questions, but specifically, so you -- you took a certificate -- or you took a credit counseling class online, probably, right?

A Yes.

Q Okay. And that was for the purpose of you filing for the bankruptcy, correct?

A I took that counseling because I understood, based on what my attorney said, that I had to take the class, yes.

Q Okay, good. And it looks like that was done on April 10th, so just ten days before you filed. But you also made several payments to creditors on that same, exact day. So you cut checks to different people that you owed money to.

I am asking you, why those people?

A Not knowing the specifics of who it was, I'm not sure. One was Ed Vollmer. I know he's dying, and we wanted to give him 1,000 bucks or something like that.

Q Okay.

A I think I have that written down somewhere. I'm just trying to look through my notes. I'll get back to it. So, do you know how much average income that you get from your rental properties in a year, on average?

A The rents take in, I think -- I think close to $3 million.

Q Okay. And how much do you pay out in property taxes a

year?
A Oh, in taxes -- we just (indiscernible) village taxes -- they were roughly 150. The school tax is much larger. It's probably 300, and probably six or $700,000.
Q Okay. All right. So, there's creditors that you list that aren't individuals, necessarily. There's, you know, fire departments, cemetery associations --
A Correct.
Q -- living trusts, estates that you list in your schedules. Was that also for the same type of arrangement under the promissory note for those transactions?
A Yes.
Q So, it was the same terms, the eight percent?
A Yes.
Q And did those associations -- I'm just asking you in general, because, I mean, there's a lot of creditors here so it's difficult to narrow down on just one single one, but you had just said earlier that people approached you, because they had heard, oh, I leant Burt Marshall money, and, you know, you should do that, too.

Was that the same type of thing that happened with these other creditors, non-individual creditors?
A These would be someone or someones that had lent me money that's on the Board or is trustee or some such thing like that.
Q Okay. So, what about, like decedents' estates, were you

approached by, what, the Executor of that estate?
A Those -- there's no new money coming in from an estate, to the best of my knowledge. Those all came about, someone that had a note passed away --
Q I see, okay.
A -- so we rewrote the note in the name of the estate.
Q I understand. Okay. All right. When was the last time you borrowed money from an individual under the promissory note agreement?
A I would think in January, because I'd been in the hospital. I got out in December, and then I was working a little bit, and then I had, effectively, a relapse in the end of January, and that -- there was no money borrowed after I went in the hospital the second time, so in January.
Q So, the -- do you remember how much it was for?
A I do not.
Q Do you remember what you did with the money?
A Put it into the Bur t Marshall checking account.
Q So, the payments that you made under these notes to these creditors over the years, what source of money, income or revenue did you use to make those payments or interest payments?
A Again, all the monies coming in, effectively, went into the Burt Marshall checking account. So, my wages went into that account. My Social Security check was in that account.

All of the rents go into that account. All of the money from M & M Press was in the account. People lend me new money, it goes into that account. So, all the money goes into that pot, if you will.

Q So, the new money, then, that you were getting by borrowing money from individuals could have been paying out money you owed to other individuals, correct?

A It could have been partially used for that, yes.

Q So, there is no separate account or any type of fund for this eight percent fund?

A Correct.

Q And, like, can you explain that, again, to me? What is the eight percent note fund?

A Well, there is no fund. People would lend me money, and I don't know where the word fund came from. I did not --

Q I think it's actually on your documentation.

A Well, I did not put it there to the best of my knowledge. Certainly, other people that I'd loan money to call it a fund, but I do not call it a fund. But the money would just come into the checkbook, and we had all of the notes that we kept track of separately, so we could keep track of how much I owed them.

Q So, you never contacted people in writing and said, you can always put more money into this eight percent note fund, eight percent promissory note fund is exactly the words?

A Well, if the word fund is in there, it's a mistake, and it ought not be included there, and I recall I ever wrote any letters that they could put money in, you know, but I borrowed more money from them.

Q Okay. All right. And then, how was the interest calculated? What type of formula did you use?

A It was a formula on the computer divided by 365 days. So if you had X amount on January 1st, and you come in February 15h, we would update the interest, and that would be calculated by 46 days divided by 365 days times eight percent.

Q Okay, so a straight eight percent, then?

A Yes. I mean, there's one case where it's six percent, but 99.9 percent are eight percent, yes.

Q Okay. So, based on your schedules, it looks like most of your creditors are in the Central New York area, but definitely not all of them. In fact, you owe a lot of money to people from all over the country and even out of the country, you know, Alaska, Hawaii, California, Montana, Japan. Did those individuals reach out to you or was it the other way around?

A No, they reached out to me. They were -- I did their taxes or they were friends of friends, word of mouth, or they were people that were here that moved away, and in a lot of cases, they're family. So, the parents might live here and they moved to, for example, California. There's the one person in Japan or Taiwan or something, I know, and that person, he's

from Sherburne, New York, which is ten miles down the road. He just happens to live there -- family.

Q So, again, okay, you would do these people's individual tax returns, and they would say, oh, Burt, I also heard I can lend you money? Is that how you're saying the transactions went?

Q Or -- or was it, were you -- were you approaching them, saying, hey, if you lend me X-amount of dollars, I can --

A Certainly, on occasion, I would approach them and ask them if they would lend me money, but not the majority of the times. The majority of the times, they would ask me.

Q And what would they ask you exactly?

A Well, everyone would ask differently. They'd ask, you know, I heard you paid eight percent or some such thing like that, and then, we'd have a conversation about it.

Q Okay. Okay. So, moving to the rental properties, you own more than about 100 different properties located in the Madison County area, correct?

A Correct.

Q And how did you attribute a value for each of those properties when you were preparing your schedules?

A The values were based on the taxable assessed value.

Q And are you going to be having those properties appraised?

A Presumably. That's going to be up to the financial people and my attorney. It probably won't be my decision.

Q Have you ever had an appraisal done of all of your assets?
A No.
Q Okay. And then, you've got about 240 tenants, according to your schedules and --
A Well, there are apartments, and then there's another 160 -- 140 storage tenants, yes.
Q Okay. So, and they're primarily residential properties, right?
A Not totally, but, yes.
Q So, you do have commercial tenants?
A Yes.
Q Do you know how many?
A Well, in this office here, I rent to myself, and that was, you know, our sole one. I have a commercial building next door, here, and that is, one, two, three, four, so that would be five, and then (indiscernible) four or five tenants, ten, so 15 or so commercial tenants.
Q And do you have written commercial lease agreements with the commercial tenants?
A The lease is different than the residential lease, yes.
Q So, you do have written leases in the commercial lease agreements, right?
A Yes.
Q Okay. And then, what about your residential properties? Do those tenants have a written lease?

A Yes.
Q Okay. And how do tenants normally pay their rent?
A Most people pay through the app, and so it's mainly electronically.
Q Do any of your tenants pay in cash?
A Yes.
Q How many would you say, what percentage of your tenants?
A I would say 85 to 90 pay through the app, and the cash people pay one percent or two percent.
Q Okay.
A A small number.
Q And did that cash get deposited into the M. Burton Marshall account?
A Yes, it did. Once in awhile, I would take out $100 for myself, but we've noted that down, and we have a cash thing, because the cash would come up short by what I took out. But normally, yes, all the cash is deposited except for that. I give myself an allowance of $100 a week.
Q $100 a week allowance for, what?
A Cash. You know, to get a hair cut or stop at the farmer's market or some such thing.
Q From the rental income?
A Yeah.
Q Okay. Or the tax income. Sometimes, tax clients would pay in cash, but it all goes into one area, and I would just,

like, write a note to whoever was in charge of that, that I took out $100 in cash.

Q Okay. So, there's a mortgage listed on a property located at 98 Holland Street in Hamilton, and it's just shy of $80,000 owed to George Bullock, Sr.?

A Yes.

Q And it looks like you incurred that debt January 24th of this year?

A We acted to buy it -- and I don't have it in front of me -- in October/November, and it took that long for the attorneys to catch up with the paperwork.

Q Okay. So the closing was probably some time in January, then?

A Well, I don't have it in front of me, but that sounds about right, December or January.

Q Okay. So, it looks like, based on the County records, that you purchased it for $110,000?

A Right, I gave them a down payment.

Q Okay. The down payment was about $30,000, then?

A I think it was 25, but --

Q 25/30? Okay.

A Yes.

Q Would that 25 or $30,000, would that have come out of the M. Burton Marshall account?

A Yes.

Q Okay. So, as far as the vehicles that you own, you list a 2016 Dodge Caravan, a 2016 Subaru Forester and a 2019 Ford 250. Are those the only vehicles that you own?

A Yes.

Q And which vehicle do you primarily drive?

A I drive the Chrysler product. My wife drives the Subaru product. And the truck is a plow truck. I've never driven that. One of my people is the plow person, and they drive it, and they, you know, move materials around, but predominantly, it's used for plowing.

Q Okay. You also, in your schedules, list some household items, including a painting and jewelry. How did you arrive at those values?

A Just a ballpark. The one painting, we paid $4,500 for, so we figured that's worth a little bit more. That's a local artist who just passed away.

Q Okay.

A And the jewelry was my wife's, and (indiscernible). I listed that, and she inherited that from a family member.

Q Do you have an insurance policy covering the contents of your home?

A Yes.

Q Do you know what the value is?

A On the contents?

Q Yeah.

A Well, it's 100 percent of what's on the house, and so, it's -- the house is insured for one and a half million or some sort, so it'd be another one and a half million on the contents.
Q Okay.
A But only because it's a function of how much insurance you write on the house --
Q Right.
A -- with that particular insurance contract.
Q But you have any, like, specific riders for --
A Just for the jewelry.
Q You do have a rider for the jewelry?
A Yes.
Q And do you know how much that is for, how much the policy is for?
A It's for the same values as that jewelry is listed for.
Q Okay. So, you also list five different life insurance policies?
A Correct.
Q And they're all term life policies, is that correct?
A Yes. Yes.
Q And I don't think you listed the beneficiaries of those policies?
A The Estate of M. Burton Marshall is on the three big ones.
Q That have the face value of six million?

A Right. And then the small ones with Globe, I think, my wife, Megan Marshall, is the beneficiary.
Q Okay. So there's three separate policies that have a face value of six million, so are those the ones that the Estate of Burt Marshall is the beneficiary?
A Correct.
Q That's correct?
A Yes.
Q So, on your 2022 federal income tax return, you did report dividends from several water companies and utility services, is that the -- with respect to the stock that you were referencing earlier?
A Yes.
Q Okay. And you don't have any of those anymore?
A I own no stock currently other than Miles B. Marshall, Inc.
Q Do you own any type of Crypto currency?
A I do not.
Q Have you ever?
A I have not.
Q Okay. And do you own any real estate in any country, other than the U.S.?
A No.
Q And have you ever?
A No.

Q Do you have any accounts that are outside the United States?
A I do not.
Q And have you ever?
A No.
Q Okay. So, when you filed different applications that were heard by the Court -- well, your attorney filed them. But you prepared an affidavit in support of those requests, you know, and one of the -- in that affidavit, you had discussed that your Chapter 11 case was precipitated largely by your recent hospitalization and your loss of income as a result of that. Do you remember that affidavit that I'm referring to?
A Yes.
Q Okay. So, prior to that onset of that illness and the hospitalization, were you having any financial difficulty?
A No, it was business as usual. I always paid all my bills on time for -- up until when I got sick.
Q So, were you able to make payments to your creditors when they came due or when they asked for their money?
A Yes, until I got sick. Yes.
Q And what time frame was that, approximately, when you --
A 30 days.
Q Just 30 days ago?
A No.
Q No. I'm asking, like, when -- when did that illness

hospitalization come about?
A December, last year, December 5th.
Q Okay. So prior to December, 2022, you were able to make payments to creditors when they came due or when creditors asked for money?
A Yes.
Q Okay.
A I think I made payments all the way through the first illness, when I came home, through the end of January.
Q Okay. All right. I'm going to move to your schedules of your income and in your expenses. And I might have to get some clarification from your attorney, and maybe an amended schedule -- I'm not sure -- because it just seemed a little bit confusing to me.

And, specifically, when you listed your income from your rental properties and from operating a business, you listed $225,807.
A That's a lovely income, I presume.
Q Right.
A Yes.
Q Is that -- was that gross or net income?
A Gross.
Q Okay.
A $225,000 a month.
Q Okay, all right. Because on the schedule, itself, it asks

for the net income, so that's actually gross is what you're saying?
A Yes. That's either my mistake or the attorney's mistake, but it's definitely gross.
Q Okay. So, then, on the expense side of it, then, would the expenses from your rental property business, are those accounted for in your list of your personal expenses?
A I'm not sure what you mean when you say personal expenses.
Q Okay. So, this is your personal bankruptcy, and in your personal bankruptcy, you have to disclose the information about your income, your personal income, and then, also, the expenses that you have on a monthly basis. But since your individual income and expenses are so closely -- so closely intertwined, it's a little bit difficult to tell what exactly is going out as far as expenses not related to the rental business.
A The expenses listed at the bottom under line 21 for the different businesses definitely, yes.
Q Okay, all right. So, the $225,807, the gross amount of income that you just referred to in Schedule I, is that for all of your businesses?
A Well, let me see Schedule I.
Q I don't think it is. I think it's just because the rental income, because if you look -- that's at line eight on schedule --
A Wages, line 8A is the gross monthly income.

Q Is that just with respect to the rental properties?
A Yes.
Q Okay. And then the other income is listed below under 8H, correct?
A 8H is the storage income.
Q The storage and then the different mortgages.
A And then the U-Haul and the M & M Press.
Q Okay. So, now, going back to Schedule J. Just flip your page over if you're looking at Schedule I.
A Right.
Q Then, if you see under line 21 --
A Okay?
Q -- so, those are the payments that you're making -- that you're making -- or, basically, the expenses of the various businesses, correct?
A Line 21?
Q Yeah. So, you've got mortgages. You've got M & M Press.
A Mortgages. Ten or 12 properties have mortgages, and that's the properties were the mortgages are on, and then the rest is a monthly expense for each of those businesses, yes.
Q Oh, okay. All right. So, under rentals, there's $180,000 of monthly expenses listed.
A Right.
Q What would that be for?
A Real estate taxes and insurance, maintenance, repairs.

Q Okay. And then what kind of expenses do you have related to the M & M Press business?

A Payroll, costs of good sold, electricity, heat, supplies, repairs.

Q Okay. Okay. Okay. So you also completed another statement of your income that's actually called Chapter 11 Statement of your Current Monthly Income, and what that is, is it takes the income that you received in the last six months prior to filing, and it -- it shows, you know, what your gross wages were, what income from -- that you had from your rental properties and what not.

It shows a net monthly income average, during the six months prior to filing, from rental or other real property in the amount of $11,547 a month. Do you see that?

A No, I don't know what schedule we're looking at.

Q There's a separate form. It, sort of at the top, it says, Official Form 122-B. It's about maybe a quarter --

A Yeah, 1220B, here.

Q Okay, great. Okay. So, go down to the bottom, where you see, number six, net income from rental and other real property.

A Right.

Q So, this $225,000, that came from Schedule I that we had just talked about.

A Right.

Q And then the expenses $214,000 that I am assuming is the $180,000 for the rental, and then the M& M Press expenses, and the other things that we just went over. So, if you see, it shows what the net of that is, monthly, as $11,547. Do you see that?

A Yes, I do.

Q Okay. All right. So, your net monthly income, then, now, wait. Before I get to that question, then, going above that, do you see net income from operating a business, profession or farm?

A Yes.

Q And that's $49,449. What -- what is that -- what is that from?

A That is -- I assume that's the tax business of the M & M Press business.

Q Okay, all right. So that would -- probably would add up, if we went back and added all of the income from the mortgages and then the M & M Press, right?

A Well, the mortgages are listed on line ten. I get Social Security, plus those four mortgage payments, and that's listed on line ten.

Q Okay. So, this form, basically -- let's go back to the statements of the current monthly income. So it adds, basically, all of the net income that you have that, you know, it's kind of summarizing, if you will, the information that was

in your Schedules I and J.
A Right.
Q So, at the very bottom of the next page, so, under line 11, it says, calculate your total monthly income. Do you see that?
A Yes.
Q And it's about $42,669 --
A Right.
Q -- would be your monthly income, is that correct?
A That's what it says, yes.
Q Okay. So, then, that's a long way around to ask you this next question, how is it that you were able to afford to make such large payments to your creditors in the 90 days before you filed?
A Well, I cashed out all the stocks.
Q And how much did you get for that?
A Close to a million dollars. There was 400-and-some-thousand in the brokerage account, and there was a number of utility stocks, and they were between 30 and $50,0000 apiece.
Q Okay. So, the payments that you made, according to your paperwork, the statement of financial repairs, the payments that you -- the loan repayments that you made to individuals, just in January, totaled over 1.2 million dollars.
Is that -- did you get -- well, let me ask you, where did you get that money to make those payments?

A Well, it came from my wages, my Social Security, the cash flow, people would lend me money still in January. A lot of that -- at the end of January, my bonuses came in. I think I took out approximately $120,000 in bonuses in January.
Q Okay. So, when you liquidated the stock, did you get a check in the mail?
A Yes.
Q And then what did you do with that check?
A I deposited into the M. Burton Marshall checking account.
Q For each of those stocks that you had, is that the case?
A Yes.
Q Okay. So, in January, you paid over 1.2 million dollars. In February, you paid $50,000 to noteholders, $50,000 to your attorney and $50,000 to Lee Woodard, who I believe is your wife's attorney, is that correct?
A Yes.
Q Okay. So, you paid for her legal expenses?
A Well, she has no other income. Yes, I did.
Q Okay. So, 1.2 million in January. About 150 in February. In March, you paid about $123,000 for property taxes, but you also paid over $455,000 to various noteholders, do you remember that?
A I know that it was done, yes.
Q Where did that money come from?
A Well, it was left over. There was a large balance in the

checking account from January from cashing in the different stock investments. I got my bonus, and I continue getting Social Security and a paycheck all that time and profits from the rentals.

Q So, the noteholders to whom you paid out of that $455,000, how did you decide who you were going to pay?

A Everyone got paid.

Q What do you mean?

A All the 900 people got paid.

Q They got paid what?

A One-half of one percent of what we calculated the balance was.

Q And why did you decide to do that?

A Because that was all the money that I could afford at that time.

Q So, you -- was it your intention, then, to try to pay people before you filed your bankruptcy case?

A It was my intention to show good faith, and I -- that's the only good faith I had at that point.

Q Okay. And, then, you made two additional payments to your attorney in April, just shy of $95,000. Did that money come from the M. Burton Marshall account?

A Yes.

Q Okay. And where did you get the money to pay for that?

A Out of that checking account, the same thing.

Q So, the stock sale, the money that you had from your wages, bonuses, et cetera, correct?
A Yes.
Q Okay.
A And profits from the rentals.
Q Okay. I probably have more questions, but I'm just going to go back through my notes, at this point, and while I do that, I'm going to actually turn it over for questions, first, by Committee counsel.
A Let me go pee, first, okay?
Q Oh, okay, sure. Sure. We can take a quick, you know, a few minute break. Not a problem.

(Off the record)

(On the record)

MS. CHAMPION: Okay, great. We are back on the record, and as I was saying, I probably have a couple of more questions, but at this point, we will go ahead and turn it over to the Committee. But before we do that, I just want to -- the individuals that had emailed me that wish to ask questions, if you haven't already, and I'm just trying to figure out the best way to do this -- I think probably you should do the star-zero to connect with the operator, so then you will be unmuted at the time when we are ready to call on you for questions.

So, we'll just do the best we can with that process, but I'd just ask everybody be patient. Okay, at this time, I'm

going to go ahead and turn it over to Committee counsel.

MS. TEMES: Thank you. This is Sara Temes.

EXAMINATION

BY MS. TEMES:

Q Mr. Marshall, thank you for taking our questions. Many of our questions have already been asked by the U.S. Trustee, but we also have just a few related to, starting with the area Ms. Champion was just referring to, the payments within 90 days of the bankruptcy filing. Were these payments mostly interest? The payments that are not the half-of-one-percent payment, the other payments listed, were they mostly interest payments to noteholders?

A Can you rephrase that question? I'm not quite sure I understand.

Q Yes. So, those listed payments that were made within 90 days, and some of them are listed as loan repayments, and they're payments that were made throughout the 90 days prior to the filing of the petition. There is one payment listed, obviously, for the noteholder payments, half of one percent that was in the amount of, I think, $455,000. There are many other payments that are listed, also, as loan repayments. For example, and I would say that these are the first few that are listed there on page -- of part 3 of the statement of financial affairs, there are payment to, maybe, Jimmy Fisher (phonetic) for $10,000 on January 21st.

A Well, we're still doing the normal course of business so he apparently called for the $10,000 to be repaid, and we paid him.
Q Okay. So, when did you cease making those regular payments to noteholders?
A Sometime when I was in the hospital, and there was -- I think it was the first week in February or something like that.
Q Okay. Okay. And then the -- turning, then, a little bit farther on to part four of the statement of financial affairs, where there's a list of pending lawsuits, were any of these -- there's not really a date on these, but they do mostly relate to 2023, as far as I can tell.
A All of the lawsuits against me are related to noteholders.
Q Okay. And none of them are commenced before January, 2023?
A Correct.
Q Okay. I have just one other related to the schedules of assets and liabilities. There were -- Ms. Champion asked a question earlier related to one of the most recent mortgages, and I think that -- that was --
A Yes?
Q -- the George Bullock was from January -- January 24th, 2023, but it was related to a transaction earlier that didn't close until later. The -- going to the list of real property owned, were any -- was any real property purchased after that

property that was purchased --
A No, that was the last property I purchased.
Q Okay. All right. That makes sense. And, then, I guess, just one last thing. The security deposits that are held in separate accounts for tenants, were there -- are there escrow accounts that have not been set up yet or even just, as your general practice in the past, before you do set up a new escrow account, are those monies in the general Burton Marshall bank account?
A Well, if someone gives us cash, then, yes, we'll write a Burton Marshall check to open it, but most people, we get them to write their own check directly to Berkshire Bank.
Q Okay. Okay.
MS. TEMES: That's all I have for now, Ms. Champion.
MS. CHAMPION: Thank you.

EXAMINATION

BY MS. CHAMPION:
Q Mr. Marshall, I just want to clarify your testimony to make sure I have this and it's accurate, did you or did you not ever approach any one of your creditors to invest in an eight percent fund?
A I wouldn't use the word invest, no. I didn't use the word fund, no, but I approached some people, not many, some people, and asked if they would loan me, yes.
Q But you did not approach them about an investment

opportunity, correct?
A No, I did not.
Q Okay. Okay.
A They lent me money, and they received eight percent interest.
Q Okay. All right.
MS. CHAMPION: We are going to try to do this. Hopefully, this works. I do have a couple of people already on the line that are unmuted, but are -- the operator is having trouble with some of the individuals' phone numbers that have already contacted me. So, I think if you still want to ask Mr. Marshall questions, please dial star-zero and speak with the operator.
But, first, we do have Tina Wayland-Smith on the line and ready to go if the operator wants to unmute her line. Ms. Wayland-Smith, you can go ahead and ask your questions.
MS. WAYLAND-SMITH: Thank you, Ms. Champion.

EXAMINATION

BY MS. WAYLAND-SMITH:
Q Mr. Marshall, I represent a lot of people, and I'm getting asked a lot of the same questions by them, and I'm going to start off with, how is it that you thought you were going to be able to provide all these creditors with eight percent interest on the money they gave you?
A I thought that the real estate would appreciate more than

the eight percent interest that I was paying.
Q And how was that going to happen in your mind?
A Well, it was being improved continually, and the appreciation of real estate, particularly, Hamilton real estate has appreciated significantly in the last three/four years.
Q Many of these people, you've destroyed generational wealth, and they want to know how you feel about that.
A I feel horrible. I'm suicidal. I'm depressed. I'm getting counseling. You know, this was never intended. This is not a purposeful thing.
Q Do you have any offshore accounts?
A I do not.
Q Okay. When was the last time you received money for a promissary note?
A Probably in January of this year.
Q Okay. And did you speak with any creditors or anybody who was seeking to invest with you in January?
A Yes.
Q Do you know who you spoke to?
A Not off the top of my head, no.
Q Okay. And did you tell people how things were going in January?
A I probably said that 2022 was the best year we ever had. The insurance business had the best year. The rentals had the best year they ever had. M & M Press had the best year it ever

had. Things were --
Q So things were going well?
A Except for the medical, and the second medical thing.
Q When was the first time you consulted with a bankruptcy attorney?
A I was in the hospital, so it must have been February of 2023.
Q And was that Mr. Dove?
A Yes.
Q And when did you realize you were having financial difficulties?
A When I was laying in the hospital, and my staff notified me that many people were calling notes, and there wasn't going to be enough money to pay people.
Q Okay. Talking about all of these notes that went out in January, who signed those notes. I'm sorry. Let me rephrase that. Who signed those checks? You sent checks out.
A I'm not sure if they have a stamp with my name on it or if one of my employees was authorized to sign checks. I don't have those checks in front of me and don't know who actually signed them.
Q Are any of your employees authorized to sign checks on your behalf?
A Denise could sign checks, if they have the money, and there might be a couple. I'd have to look at the signature

first to see who was authorized to sign.
Q Okay. Did you ever tell any of the 900 people that you had enough life insurance to cover all of the debts you owed?
A No. I told people I had life insurance. I never intimated it was enough to cover all of the debts.
Q You told them not to worry about it, because if you died, you had enough life insurance to cover it, you never told anybody that?
A Not to my knowledge, I did not.
Q Okay. And you spoke with Ms. Champion and answered a question of hers, saying that you never used the eight percent fund language, is that true?
A That's true.
Q Okay. And what if I told you, I had a hand-out with your letterhead on it that's dated, by my client, December 3rd, 2010, that the title of it is the "Eight Percent Fund". It does say that you would earn eight percent interest, and that funds could be added to the promissory note at any time.
Did that come from you?
A It probably did. I'd say I'd forgotten that we ever had such a paper.
Q And I have several clients, because I represent 25 or 26, that have handed me these from different -- different time frames when they invested with you.
A Well, then I thank you for making --

Q Do you want to change your answer?
A Well, apparently, I did use the word, fund.
Q Okay. And isn't it also true that on many occasions, when you would be doing somebody's tax return, you would note to them how much interest income they had, and tell them that you could get them more interest income?
A Oftentimes, when I was doing taxes, we'd discuss how much interest they'd earned and how much eight percent would earn them in a year or so.
Q Okay. So, you did have those discussions with your tax clients?
A Occasionally, yes.
Q And it's probably more than occasionally, wasn't it?
A Well, that's not likely. I do a lot of taxes.
Q Well --
A At least 700 taxes a year.
Q And what do you charge for a tax return?
A The (indiscernible) is a hundred and --
Q An individual tax return, nothing fancy with it?
A 150-bucks to 200-bucks, depends what's involved.
Q Okay. I'm just looking at my notes. And you're -- you made -- is it your testimony that you only took out $100 a week from all of this money that came in?
A For cash, I took $100 a week.
Q Okay.

A Most bills would be through the checking account, of course.
Q Okay. So, all your personal bills were paid through M. B. Marshall --
A Yes.
Q -- checking account, as well, correct?
A Yeah. The $100, that was just for cash purchases, a hair cut or the farmer's market or whatever.
Q Okay. So, if you went grocery shopping, that money came out of the M. B. --
A Yeah, it would go onto a charge card, and at the end of the month, they would pay the charge card.
Q Okay. So, you did all your personal business on a charge card, and then that would be paid through M. B. Marshall.
A Most of the personal business on a charge card that was paid through Burt Marshall's checking account, yes.
Q Okay. And did your wife also have a card to that account?
A Yeah, a Discover card.
Q Okay. Did any of your other family members have credit cards that would have been paid through the M. B. Marshall bank account?
A No.
Q Okay. Let me just check my notes.
MS. WAYLAND-SMITH: Ms. Champion, I believe those are all of my questions.

MS. CHAMPION: Okay, thank you. Before we move onto the next person to ask questions, I have a couple of more questions for you, Mr. Marshall.

EXAMINATION

BY MS. CHAMPION:

Q When is the last time that you purchased real estate investment property?

A The Bullock property which closed in January of 2023.

Q How many real estate investment properties do you think you purchased in 2022?

A Zero.

Q What about 2021?

A Zero.

Q Okay. Pursuant --

A I haven't brought any properties in four or five years.

Q Okay, four or five years.

A The last year, I brought four or five in one year, and then none until Bullock.

Q Okay. And some of the documentation that was attached to several of the proof of claims, just ones that I reviewed, there was a letter on your letterhead prepared by Denise Schultz. Who is Denise Schultz?

A She's an employee of mine.

Q Is she still employed by you?

A Part-time, yes.

Q Okay. And, in the letter, she refers to the eight percent promissory note fund, and then also refers -- or -- or notes that the individual giving you money for that fund can make a withdrawal request upon 30-days' notice. So, what were they withdrawing from?

A They were withdrawing from their promissory note.

Q So, they were taking back the money that you owed -- that they -- that they lent you?

A Yes.

Q But that money was coming from where, exactly?

A The M. Burton Marshall checking account.

Q Okay. So, did you ever use any other individual's money that they lent you to make payments, if a creditor did want to withdraw from their note or this fund?

A Well, I don't use the word fund, so --

Q Okay. Let's just say, note, because you said they can withdraw from their note.

A The money would go into the M. Burton Marshall checking account, and it was not segregated, people funding money on a promissory note, so, yes, people were paid back out of what was in the checking account. Whether it came from people lending me money or it came from cash flow out of the different businesses or my paychecks or the bonuses or the Social Security, it's all in one checking account.

Q Did you ever have any type of difficulty making those

payments if a creditor did request a withdrawal from their note?

A There were difficulties, sometimes, when the school taxes would come due or the town taxes would come due, sometimes. Not the town taxes, so much, because the bonds (indiscernible), sometimes the village taxes, and those were when the difficulties would occur.

Q So, another question, and I -- I appreciate Ms. Temes asking about this, because I had this in my notes but just skipped over it, but you list a number of lawsuits in your statement of financial affairs. What's the basis for those suits?

A Me not being able to pay back the people that filed the suits.

Q Okay. So, in other words, those people made a request for a withdrawal, and you couldn't pay them, is that right?

A Correct.

Q Okay. All right.

MS. CHAMPION: At this point, I have Martha Berry unmuted, and you can go ahead and ask your questions.

MS. BERRY: Thank you, Ms. Champion.

EXAMINATION

BY MS. BERRY:

Q Mr. Marshall, I'm Martha Berry, and I represent a number of noteholders, and I have a few follow-up questions. You told

Ms. Champion that you previously had a retirement account, and I think you said it was about 15 years ago, but what happened with that account?

A I cashed it out.

Q Why did you cash it out?

A I probably needed the money.

Q Did you need the money to pay noteholders?

A It was a long time ago, and I can't recall, and it was not a large amount of money.

Q Do you know what the value of your retirement account was when you cashed it out?

A It was around $100,000, perhaps less. It was a long time ago.

Q Okay, thank you. You've told people that at times you did solicit monies -- I will note use the word, fund -- from noteholders, and I just have a couple more specific questions about that. Did you solicit monies in January of 2023?

A Probably, yes.

Q And what about in December of 2022, did you solicit monies?

A Probably, yes. I was in the hospital for part of that time, so I'm not clear about December. In January, yes.

Q And were the funds -- the monies that -- well, did people, then, give you money in response to your requests for funds in December and January?

A In January, I know of one person that lent me some money. They did not give me any money. And in December, I don't know. I can't recall asking but I certainly could have, but I was in the hospital most of the time.

Q And what did you use the monies for that were loaned to you in December of 2022 and January of 2023?

A Well, some of the money was used to make the down payment on the Bullock property, regular cash flow expenses and to -- to debt service.

Q Did you use any of the monies that were given to you in December of '22 and January of '23 to pay any noteholders?

A Partially, probably, yes.

Q At some point, did you or somebody from your office inform noteholders that you were not making any payments on their notes, if they asked to withdraw their funds?

A In February of 2023, yes.

Q Was anybody told before February of 2023 that they could not withdrawal the funds from the notes that they had with you?

A No. No, I don't think so.

Q In the past, did you ever have difficulties paying a lump sum withdrawal request, and did you need, instead, to make payments over time?

A No, not to the best of my knowledge, I -- to the best of my knowledge, I've always made all of the payments within the 30-days' notice.

Q When -- at what point did you realize you would not be able to pay back the noteholders?
A In February of 2023.
Q Mr. Marshall, is it fair to say that a good portion of the monies that you owe people on these notes is interest?
A I think we calculated the, roughly, 55 -- these are rough numbers -- $55,000 in principal and the amount over and above as interest.
Q 55-million?
A Million, yes, excuse me.
Q Okay, all right. Thank you. Did you tell any noteholders that you were not able to pay them the balance due on your notes when you were -- at a time when you were also paying other noteholders back on their notes?
A When I stopped, I stopped. The only exception to that is, three or four people came, and they had extreme circumstances, and need a thousand or 2,000-bucks. I talked with my attorney, and he said, that's okay for small amounts. So, there were, you know, four people, maybe five people that received small amounts, and that's the only exceptions to that.
Q In January, you made a significant payment to a noteholder of over $600,000. At that time, had you told other noteholders that you were not able to pay them back?
A No.
Q Where did you get the $600,000 to pay the noteholder in

January?
A How do you know it was a $600,000 payment?
Q I'm sorry. I didn't hear that, Mr. Marshall.
A (Indiscernible) making a $600,000 payment.
Q On your schedule, it lists a $660,000 payment on January 13 of 2023.
A I -- is that a handwritten thing? There was a payment of 60-some-thousand dollars.
Q This is on your bankruptcy schedule, sir. This is where I got the information.
A What --
Q The payments that you made -- the payments that you made before you filed for bankruptcy.
A There is not a $600,000 payment. I think -- when I do these forms, I do them in hand, and the attorney's office does it on the computer, and there was a 60-some-thousand dollar payment to someone in January. I'm thinking that it was a typographical error is what I think.
Q Okay. I think that's all the questions that I have. Thank you.
A You're welcome.
MS. CHAMPION: Thank you. Okay. I think -- let's see. Where are we next. Are there -- let's start with, are there any other -- if there's any other attorneys that want to be unmuted to ask questions? If you could --

MR. LEVINE: Yeah, me, Lou Levine.

MS. CHAMPION: Okay, all right. Great. Thank you, Lou. Yes, if you could just note for the record, your appearance, and then you can go ahead and ask your questions. Thanks.

MR. LEVINE: Okay. Lou Levine, Melvin and Melvin. I represent Carol Salati and Steven Scheinman and a few other people.

EXAMINATION

BY MR. LEVINE:

Q Mr. Marshall, in your statement of monthly income form, you said you're spending $214,260 as operating expenses, and you may have been asked this, but what were those operating expenses?

A Operating expenses, let me see this form here. This is form 122-B?

Q Yes.

A Operating expenses are real estate taxes, payroll, repairs, maintenance.

Q Is any -- let me ask you, is any part of that $214,000 interest payments to your investors?

A I wouldn't use the word, investors. I would use the word, noteholders, and, no.

Q Okay. So, none of that is interest. Okay. And do you know how much in interest payments you were making to your

noteholders every month?
A I have it on an annual basis, not a monthly basis.
Q What is it on an annual basis?
A Well, 90 times eight is -- just this last year, we've been close to $7 million.
Q And you paid off -- every year, you paid off $7 million in interest?
A Well, it's not necessarily paid out. A lot of that, is we would update the notes, and that would trigger that numbers, so if you had a note --
Q Okay. Well, I'm asking -- I'm asking about cash payments. How much in cash --
A Oh, that I do not know.
Q -- and by cash, I mean, check, but --
A I do not know.
Q Okay. You think it was $7 million a year?
A No, not that we sent out in checks, no.
Q Okay. So, do you know how much you were paying out in interest in actual checks and cash?
A Well, no cash, all checks, and I do not know. I could -- someone can find that out, when the computer guy gets off vacation.
Q Okay. I would like to know that. Of your -- how many notes -- you paid off some notes in total, is that correct or not?

A In what time frame? You mean just recently?
Q Anywhere in the last ten years.
A Oh, yeah, many notes were paid in full.
Q Okay. And who has the records of that?
A They're in this office.
Q Okay. Is there any person except you who has those records?
A Denise Schultz would be able to pull them up.
Q Okay. Well, what I meant, you, I meant you or your employees.
A No, no one else.
Q Did you ever use an independent accountant?
A No.
UNIDENTIFIED SPEAKER: Where did the money go in '21 and '22 if you didn't buy properties?
MR. LEVINE: I'm sorry, Mr. Marshall, I didn't hear you.
MR. MARSHALL: I didn't say anything.
MR. LEVINE: Well, I hear somebody saying something. Okay.
MS. CHAMPION: Yes, there is somebody speaking, and I'm sure you're in the conference room unmuted, because you're going to ask questions, but if you could just, you know, hold your questions or your comments until you are called upon, that would be helpful so Mr. Levine can finish his questioning.

Thanks.

MR. LEVINE: Thank you, Erin. I'm just looking at my notes right now.

BY MR. LEVINE:

Q How many -- in the last ten years, how many parcels of your real estate did you sell?

A The only parcels I sold in the last ten years, I sold the four that I get mortgages on, and I can't recall selling anything else in the last ten years.

Q Okay.

A There was a townhouse that I owned that I sold, and that was close to -- yeah, maybe 11 years ago or maybe nine years ago. I don't know off the top of my head.

Q Okay. Okay. If I understand you, you weren't sending out a check every month to all of the noteholders for interest, is that correct?

A Correct. Some people wanted a monthly check. Some people wanted it quarterly. Some people wanted it to just accumulate. It was, what they wanted is what we did.

Q Okay. Of all of your holders, how many people got an interest check at some time during the year of 2022?

A Well, probably three-quarters, I would guesstimate.

Q Okay. Do you have any ideas right now how your plan of reorganization might treat these --

A No.

Q -- your assets and your debts?
A I'm going to sign a contract with the Elgon Group, and they're the money guys, so they've been in here going over the books, and we've toured the properties. And they're going to come up with a plan very shortly. They just came in here a week ago or ten days ago. It's not too long now.
Q Okay. On your properties, did you -- did you pay cash for all of them or do some of them have mortgages that you have to pay?
A I think there's 12 or 14 mortgages that I pay.
Q Let me just look at my notes one more time. I think that's all the questions I have for now. Thank you very much, Mr. Marshall, and Erin.
MS. CHAMPION: Thank you. Thank you. Okay. We've got a bunch of people in the waiting room, so I'll just go ahead and call on these various creditors. Catherine Riggal, do you still have questions for Mr. Marshall, and if you do, you can ask those now.
MS. RIGGAL: Thank you, Ms. Champion.

EXAMINATION

BY MS. RIGGAL:
Q Mr. Marshall, you're contending that these are just personal loans?
A Yes.
Q Why does my letter say from M. Burton Marshall for

investment in the eight percent fund?
A Well, they were personal loans. There was never a fund, and those were mistakes on my staff's part.
Q And my other question was, you said you had 12 to 13 mortgages that you pay?
A Yes.
Q When were these mortgages taken out?
A Oh, a variety of times. Some are close to fruition, and some are -- nothing in the last two or three years, except Bullock -- Bullock cause he's a new one -- and within the last ten years.
Q Okay. That's all I had.
MS. RIGGAL: Thank you, Ms. Champion.
MS. CHAMPION: You're welcome. We can go to Tom Parish next.
MR. PARISH: Hi, can you hear me?
MR. MARSHALL: I heard you.
MR. PARISH: Okay.

EXAMINATION

BY MR. PARISH:
Q Burt, earlier, when you were talking to Ms. Champion, it was said you had a net income of about $42,000 in your business per month, is that correct?
A Yes.
Q Okay. So, if you have a net income of $42,000, and you

have to pay $600,000 a month in interest, please explain to me how that makes sense?
A Because the income was done after I stopped paying the noteholders, so this does not include any of that.
Q That's okay. What would you say it was in December or October, during the best year you ever had?
A Well, it would be greater than $42,000.
Q Obviously, but I'd like a number please.
A I do not have a number off the top of my head.
Q Okay. Is it less than $100,000?
A Probably, yes.
Q Okay. So, you have to pay $600,000 a month on your notes, and yet, you're only making net, you say, $100,000, what happened -- where's -- how do you make up that half a million dollars?
A Well, some of it, obviously, was borrowed money, and --
Q So, you got that much in a month, half a million dollars?
A Yes, some months. Yes.
Q Okay. So, you had the best year ever, and two months later, you're declaring bankruptcy, so that's kind of surprising. My other question is you have abused and taken advantage of the trust that the Hamilton community placed in you for decades. Why haven't you publically apologized to our community?
MR. DOVE: This is Jeff Dove. I'm going to object to

this form of questioning and instruct Mr. Marshall not to answer.

BY MR. PARISH:

Q Okay. So, I guess you have single-handedly ripped this town apart to the point where it may take years to heal.

MR. DOVE: This is Jeff Dove. I'm going to object to the form of the question, if there is a question and ask that Mr. Parish ask about assets and liabilities and restructuring proposals, as is the intention of a Section 341 Meeting.

MR. PARISH: Okay, okay, fair enough.

BY MR. PARISH:

Q Now, Mr. Marshall, you stated to the noteholders that you were going to invest that money in Hamilton real estate. You also just stated that you have brought one property for a little over $100,000 the last two years. You've also stated that, I believe, you spend less than $100,000 a month maintaining these properties. So, if, as you stated, you're getting up to, like, half a million dollars a month from new noteholders, what did you do with all that money that came in the last two years, if you had very little in your bank account?

MR. DOVE: I'm just going to object to the form of the question, but Mr. Marshall may answer, if you can.

MR. PARISH: Well, do you want me to rephrase it?

MR. MARSHALL: I'll answer your question. I don't

have a problem with it. A large part of the money goes into capital improvement. We just finished a job on Manson Street that cost 350 to $400,000.

BY MR. PARISH:

Q Okay, but, so that's the income of one month. What about the other 11 months?

A Now, that's just one project. There are ongoing projects all the time.

Q Okay. So, this is my final question. Then I'll stop. You stated earlier that you thought you had about $55 million in principal, is that correct?

A Yes.

Q Okay. Your properties are only worth $21 million.

A Well, that's the assessed value. I think --

Q Well, tell me the real value, then.

A Well, I don't have the real value, but I think it's significantly more than $21 million, which is just the assessed value. The assessments are way, way low. One example is of a property in Earlville where the assessment is $105,000, and the annual income is $85,000. So, how much is that property worth? Hundreds of thousands of dollars more than the assessed value.

Q But, still, there's a -- just with the principal, not including all the interest, you know, because that 55 is really $90 million, where are those tons of millions of dollars? Where did they go? They weren't put in property improvement,

because you can't tell me that, you know, every property is worth a million dollars more than --

A Every property is not worth a million dollars more.

Q You think?

A They are not worth a million dollars more.

Q Right. So where did that $70 million go?

A Tom, there is no hidden money or offshore money or anything. It went into my checkbook, and paid out those expenses that I pay out of the checkbook.

Q I don't understand how it could -- well, I'm going to let other people talk. Thank you for listening, and I'll get off. Bye-bye.

MS. CHAMPION: Okay. Thank you, Mr. Parish. We can have Karen Mirabella, at this time, ask your questions. And if you could just try to keep to the financial affairs, assets, liabilities and restructuring of the Debtor? Thanks.

MS. MIRABELLA: Yes. Good afternoon, Ms. Champion and Mr. Marshall.

EXAMINATION

BY MS. MIRABELLA:

Q Now, Mr. Marshall, did you personally sign each and every promissory note that you issued to the creditors? Is it your signature?

A Yes.

Q Okay. How was the value of your -- well, you may have

answered this, but I just want to make sure I'm correct, the value of your real estate parcels, that was determined by assessed value only?

A Yes.

Q This part of the schedule? Okay. Okay. Who was managing your business during your illness?

A Well, my staff took over, and different people did different things, at that point. I had a very good staff, and they were able to continue with the businesses, not necessarily as usual, but keep up with the work flow, except for the taxes.

Q Okay. Could you state the names of the person or persons employed by you who were aware of this eight percent situation?

A Denise Schultz was the person that wrote the checks, and everyone in the office is aware of what's going on here, but Denise is the -- you know, the check writer.

Q Okay. And how many people are currently employed by you, as opposed to the number of people employed by you a year ago, if you lost employees?

A Oh, I have lost employees. I lost, I think, four employees.

Q Okay. And is Daryl Marshall employed by you?

A He is.

Q And what is his role as an employee?

A Files.

Q Files? Okay. How much revenue does your insurance

business -- does the insurance business produce annually?
A It did over a million this past year.
Q One million, okay. And how about the storage business?
A $170,000 roughly.
Q 170, okay. And if you prepare taxes year round, how much does your tax preparation business produce annually?
A Well, last year, 2022, was roughly $650,000, but, now, you know, the business is gone, if I do business next year, I have no idea what it will be.
Q Okay. And are you entitled to an inheritance or the life insurance proceeds upon someone's death, such as a spouse or a parent or a sibling?
A Well, my mother is 97, and I don't know if I'm in her Will or not. Probably, I am. And my wife has life insurance. I'm probably a beneficiary on that, and that's all I'm aware of.
Q Okay. Do you have any idea of the value that that might be?
A My wife's life insurance?
Q Yeah.
A Probably $150,000, maybe 250, not more than that.
Q Okay. And are you the beneficiary or a trustee of a Trust?
A No.
Q Okay. And are you an investor in --
A Nothing.

Q -- any -- anything in another state or in another country?
A No.
Q Okay. And going back to -- oh, what is the value of the Miles B. Marshall stock? Do you know what the value of that is?
A We're waiting for an appraisal. I always thought it was $3 million, and now, it's a lot less because I'm losing a lot of business, so --
Q Okay.
A -- it's $2 million now.
Q $2 million okay. And you mentioned that you have a truck that has a seasonal plow business. How much revenue does this bring in?
A None. It's our own buildings.
Q Oh, okay. Okay. Now, let's see. Are you being audited by the IRS?
A No.
Q No. And how about, are you being investigated by the Securities and Exchange Commission?
A No.
Q No, okay. Let's see. And from January 1st, 2023 to April 20th, 2023, you sent checks to 32 individual creditors that were not were not business or expense-related. The total amount was $1,170,418.85. Three of those checks were dated after April 10th, which was the date you completed your

bankruptcy creditor counseling, so you were well aware that you would be filing for Chapter 11. Please explain how you selected all of these individual creditors, and why checks were sent when you knew you would be filing for bankruptcy, which could show favoritism on your part?

A I don't believe we showed any favoritism, and who were the checks to?

Q Well, there's a list. There's a list in your schedules. There's a list of the 32 individuals, as well as businesses and expense-related, but there is a list of the 32 individual creditors that were sent checks after January 20th -- after January.

A What page?

Q Oh, I don't have it in front of me right now.

MS. CHAMPION: It's in the statement of financial affairs. This is Erin Champion.

MS. MIRABELLA: Oh, thank you, Erin.

BY MS. MIRABELLA:

Q That is the same list you listed that you said was, possibly, an error. Randall and Nancy Blass received on January 13th, 2023, according to your schedule --

A That was before everything happened, they had called for a note payment in January.

Q Yeah, that was the one that you listed $660,000 -- $660,019, leaving down a balance owed to them of $532,000. So,

that's the one you said might be a typographical error?
A There was one to Estate of McSwain that was $60,000 that we paid in January.
Q Well, I can't -- and so, I'll get the list up. So, do you see the list that I'm referring to?
A I don't see the list. I have a lot of papers here.
Q Yeah, take your time. It is -- it's the statement of financial affairs, and it's page 14 of 17 -- page four. I'm sorry. I apologize. Page four of 17.
(Pause)
MS. CHAMPION: Do you have that, Mr. Marshall?
MR. MARSHALL: I can't find it here. Again, there's a lot of paperwork here.
MS. CHAMPION: At the top, there's case number, and then it'll say document number four at the very top of it, and it's 17 pages. And I think what she is referring to is page eight of 17 under Randall and Nancy Blass.
MR. MARSHALL: I don't have a copy of that. Oh, wait, here it is, statement of financial affairs.
MS. CHAMPION: Yeah.
MR. MARSHALL: Is that the page?
MS. CHAMPION: And at the top, there's page eight of 17.

MR. MARSHALL: Page eight. There's six. There's

seven. There's eight.
BY MS. MIRABELLA:
Q And it's on the third line down.
A Yeah. See, when I did these, I did these in pencil, and sent them to the attorney to computerize, and I think that should be $60,000, not $660,000.
Q Okay. Well, I just wanted to call to your attention these 32 individuals that were paid after January 1st and prior to April 20th, just, again, asking how these people were selected, when many other folks asked for payment and were not even met -- their calls weren't returned. Their emails weren't returned, but yet, they asked for payments, and that didn't happen?
A Well, the bulk of those was before February 8th. Well, all of these in January was before February 8th, and a lot of these others were supplies and that sort of thing.
Q Well, I understand that, Mr. Marshall. I was just referring to the 32 creditors were loan repayment is the (indiscernible).
MS. CHAMPION: Ms. Mirabella, do you have a question in that regard or --
MS. MIRABELLA: No. Actually, I don't. I think -- I think I've finished with my questions. Thank you very much, Ms. Champion and Mr. Marshall.
MS. CHAMPION: Okay. How about Ronald Harp, do you

have questions? And just keep in mind, too, if questions have already been answered just to move the process along, so we can get to everybody, I would be appreciate -- or appreciative of that. So, Mr. Harp, with that, you can go ahead.

MS. HARP: Yes. My name is Diane Harp. Thank you, Ms. Champion and Mr. Marshall.

EXAMINATION

BY MS. HARP:

Q I'm just calling in regards to (indiscernible) what he had invested with you. You stated January, 2022 is the last time you received money from any creditors, and that on January 24th, you purchased a home, I believe, for $135,000, if I'm not mistaken?

A It was in that ballpark, yes.

Q Okay, yeah. No, that's fine. My mother-in-law had requested, a formal written requested her money on December 12th. We had sent that to you, and I was just wondering why she never received payment?

A She called me after the fact. I talked with Rhonda, who is your sister, I believe?

Q Yes.

A Her daughter. And Ronnie (indiscernible), and then she said, don't pay her, and then, later on, your Mom sent the second request saying, oh, now, I really do want the money. That's how that happened.

Q Yeah. No, I know, but we all made that one request, and that was January 12th.
A Well, I think there's two, but I can certainly check my offices. We would have copies of them.
Q I'm sorry?
A There were two, and the first one was made by Rhonda, and then, there was a second one sent, and, again, I have copies of those in the file somewhere.
Q All right. I guess that is my only question. Thank you for your time.
MS. HARP: And thank you, Ms. Champion.
MS. CHAMPION: Okay. Thank you. Can we go with Brian Empie, at this point.
MR. EMPIE: No, basically, what I've already heard, this question that I had in mind was asked, so --
MS. CHAMPION: Okay, thank you.
MR. EMPIE: -- it has been answered, so thank you.
MS. CHAMPION: Okay. And then, how about Scott Devereaux? Mr . Devereaux?
MR. DEVEREAUX: Yes, hi, I'm here.
MS. CHAMPION: Okay, great. If you have questions, you can go ahead and ask now.
MR. DEVEREAUX: Oh, yes.

EXAMINATION

BY MR. DEVEREAUX:

Q So, Burt, I guess one of my questions would be, how do you -- how do you regularly monitor or assess the amount of what you owe to creditors versus what your investments are currently worth and how much income they're producing in order to basically stay out of the red? Do you have monthly actuarials or a yearly actuarial that you look at?

A I do not.

Q Spreadsheets or anything like that that kind of let you know that this is -- this is basically where we're at as far as what everything is worth and versus what I owe creditors?

A No, I do not have any such statements like that.

Q Okay. I -- I have another question. So, I had spoke to you on the phone right after you had filed for bankruptcy, and you apologized to me for this mess, and you stated you took full responsibility for it. What, specifically, were you apologizing for, and what was the mess you had created that is leaving your creditors with basically -- well, according to the media outlets at 20 cents on the dollar of their -- of their -- the money that they have loaned you?

A I apologize for money that I am now not able to pay back.

Q Okay. Anything more specific on how that works?

A On how me being sorry works?

Q Well, I guess, specifically, I guess, what exactly happened? What caused the -- the failure of the ability to pay off your creditors?

A The initial cause is myself being in the hospital for six weeks, not getting cash flow.
Q Okay. The last question is, normally each year we get -- during tax season, we get a form showing the interest income that we're required to pay taxes on. What would we expect to get this year?
A I'm not sure if interest will be paid, you know, up until now or up until some future date. If we do accrue some interest or pay some interest, you'll get a 1099, but I would also not do your taxes, but I would assume that you will be able to take a -- they'll deduct something on the claim that you file, and that as money comes back, you'll have income.
Q Okay.
A You know, it's capital gain income, at that point, but you'll have -- but you'll have a loss initially, but, yeah, I'm not doing your taxes, so I don't that specifically, but probably, that's what it'll be.
Q Okay. And then my last question is, I understand that the -- that the assessments of all of your properties may be a low ballpark figure of what they're worth, do you, I guess, in your head or your mind, do you think that the properties are worth enough to pay back your creditors at least their principal?
A That, I don't know. It depends on how the creditors community feels about the restructuring. In other words, if they force us to sell all the property at once, we'll get a low

number. And if some people are willing to take payments over, as an example, five years, then, you know, we could get more over a longer period of time. It depends. If Koby comes in and buys something or if it all goes to non-Koby. I just -- there's too many variables for to speculate at this point.

Q Okay. I'm sorry. I'm just looking at the list of questions I had to see if they've already been answered.

MS. CHAMPION: Okay, thank you. We can take questions from Troy Taylor next.

MR. DOVE: This is Jeff Dove. Troy is the financial advisor. I'm not sure if he actually has questions.

MS. CHAMPION: Oh, that's right.

MR. TAYLOR: I don't have any questions. I'm just here, basically, listening, and also to the extent, Jeff, there's a question that I can answer, I'm happy to, so --

MS. CHAMPION: That's fine. Yeah, we just got a list of people that are on unmute. I'm just making sure that none of them have any questions. How about Debbie Donaldson?

MS. DONALDSON: Yes, hi. Thank you, Ms. Champion.

EXAMINATION

BY MS. DONALDSON:

Q Mr. Marshall, first of all, I was glad to know that you were able to be released from the hospital and were on the mend. I was very glad to hear it for you.

A Thank you.

Q You're welcome. Well, my aunt and uncle did business with you. My mother and father did business with you. When my parents passed, I had the account rolled over to me as the only surviving heir, and that was in March of 2019. My only question, I think, is you said that you, you know, started the bankruptcy proceedings and weren't able to make payment because of a loss of income. And I'm interested to know, did all of your tenants stop paying rent, your rentals, and your --

A The tenants are paying rent, but the calls to repay the loans exceeded the cash flow.

Q I see, okay, so you still had income coming in; it just wasn't enough to cover everything?

A Yes, exactly.

Q I see.

MS. DONALDSON: And, Ms. Champion, one question for you, please? I am my own person. I am not represented by an attorney, at this point, but are we, as individuals, allowed copies of all of these schedules that are being referenced?

MS. CHAMPION: You would have -- you are entitled to them, yes, but you can request a copy through the Bankruptcy Court Clerk's Office.

MS. DONALDSON: Okay.

MS. CHAMPION: I think there's probably copying charges, but you'll have to call them and ask the Clerk's Office. That information can be found on line. I just don't

have their number handy at the moment.

MS. DONALDSON: No worries. Thank you so much. Thank you, Mr. Marshall.

MS. CHAMPION: Okay. We can go with James Cook next?

MR. COOK: Thank you. Can you hear me?

MS. CHAMPION: Yes.

MR. MARSHALL: Yes.

MR. COOK: Okay.

EXAMINATION

BY MR. COOK:

Q Let's go back to 2022. Do you believe that in 2022, that the value of your properties, which is what we all assumed you were doing with our money was investing it in properties, which should have -- I mean, the property that you first bought years and years ago should be worth much more than what you paid for them. Do you believe that the best value, at that time, in 2022, was enough to repay everybody?

A No, it was not.

Q Okay. Well, obviously, even though your mother is in her nineties, you're not going to live forever. What was the plan when you were going to retire to pay everybody back the money that you borrowed?

A Again, I thought that the real estate would appreciate more than the interest, but I also didn't -- didn't realize how much the COVID raising the cost of materials had affected the

renovation projects, too, and that -- that was also a factor.
Q Well, the renovation projects would have been for new properties. You could have stopped buying new properties or stopped taking money.
A Renovations are on, not necessarily new properties. It was -- a lot of it's on old properties and their time to come up to renovate. But, again, in my mind, the properties would appreciate more than the interest cost.
Q Well, I would be very surprised if they didn't considering the current state of real estate. And this whole this was precipitated by your inability to do tax returns, which begs the question, why did you need money from your interest tax returns to pay money invested in your real estate properties?
A The tax preparation business created cash flow, which went into that checkbook and paid people back.
Q So you were -- yeah, but that's not what we invested in. We didn't invest in or have any -- many of us didn't even know you did taxes. There should have been enough money generated from the rental income to meet ongoing expenses, and if -- if you had -- and if you did have that much income coming in, none of this would have happened, but you, somehow or the other, you're not getting enough income from your properties, so you're relying on other sources of income, which had nothing to do with our loans.
MS. CHAMPION: Mr. Cook, do you have a question for

Mr. Marshall.

BY MR. COOK:

Q Yeah. What -- what was -- okay. What is your estimation of what percentage we're going to get?

A Well, it's too early to tell that. It depends on what the real estate sells for, and I don't have a clue. I suspect it's going to be significantly more than the number that the newspapers were parroting about.

Q Well, you've been in this business an awful long time, and you know your properties, and the real estate is on the high end right now, so I'm just curious why you think that you're not going to get enough to give us at least a significant amount of what you owe us?

A Well, it depends on how you define significant, and, again it depends on how the properties sell. If somebody comes in and buys 50 properties all at once, it will be a different price than if they have to be sold one at a time and involve real estate brokers. There's many variables. I would be remiss to give a number now.

Q All right. Thanks. I'm done.

MS. CHAMPION: Okay, thank you. I have, next, Alex Raketa.

MR. REGINA: Yes, Alex Raketa.

MS. CHAMPION: Regina, sorry. Go ahead.

EXAMINATION

BY MR. RAKETA:

Q Mr. Marshall, Alex Raketa. I'm with Hinman, Howard and Kattell. I apologize if you answered this. You were about to talk about something tangentially related to this when the operator jumped on with me, but the value of the real estate that you reported on your schedule, did you say that those are the assessed values of those properties?

A Yes.

Q Are you familiar with the fractional assessment of real estate in New York?

A No.

Q Have you ever heard of an equalization rate?

A I've heard of that, yes.

Q So in some municipalities, the assessed value of the property could be 80 percent of the full value of the property or six percent of the full value of the property or in some places, it's 100 percent, but usually, on the tax form, there is reported somewhere on the tax roll, here is the full value of the property. Do you know if you used the full value of the property or --

A No, I used the assessment.

Q I'm sorry, say that again?

A The assessed value was used.

Q Okay.

MR. TAYLOR: This is Troy Taylor from the Elgon

Group, the financial advisor. I just want to reinforce something that Mr. Marshall said a few times. How strategically these properties are monetized are going to drive a tremendous amount of the value -- the determination of the value, from a timing standpoint, if their sold in bulk, and to some -- to some extent, for anyone on this call to ask Mr. Marshall or ourselves to try to put on a value, we need to let the marketplace determine the value. But strategically, how these things are done is going to be the single most important thing that is going to determine the amount of recovery for all the noteholders. It's very early on right now. We're getting our arms around things. But the strategic part of how these things are sold will be, probably, the single most important day of the case.

MR. RAKETA: Thank you for your commentary.

BY MR. RAKETA:

Q Mr. Marshall, you've been very careful, now, not to use the word investor or the word fund. Has somebody instructed you not to use those words?

A No, I have not been using those words myself for a long time.

Q Other than in the various correspondence that people have brought to your attention?

A Yeah, right, which was an error in office procedure.

Q But nobody has said to you, please don't use the word

investment with regard to these accounts or these promissory notes or please don't call it a fund? Nobody has said that to you recently?

A Not to the best of my knowledge, no.

Q Okay. I have no further questions. Thank you.

MS. CHAMPION: Thank you. And then the last individual I have on line waiting with the operator is Stephanie Broomfield, so if there are other creditors that believe their question hasn't been asked yet, if you want to just hit star-zero to connect with the operator and we'll make sure that you can ask it, but I believe that we only have one more individual, and that is Ms. Broomfield, you can go ahead.

MS. BROOMFIELD: Thank you. Good afternoon, everybody.

EXAMINATION

BY MS. BROOMFIELD:

Q My question is -- I have a few questions. Burt, did you feel, given that you have financial background, do you feel that keeping all the accounting, all the deposits and withdrawals in one account was good -- acceptable business practice?

A It was acceptable to us, but I don't know what you mean by acceptable business practice.

Q It seems to me it's probably more difficult to trace the deposits and withdrawals and interest payments for all of the

parties, the promissory noteholders, when it's bundled with several different businesses, M & M Press, the moving, et cetera, so that those that were -- believe in you, you were not protecting. I do not believe that was the best way to be able to report on those funds.

Do you? Did you ever think about separating the accounting, so that your different businesses would be mutually reportable?

A I did not think about that, no.

Q I didn't think you had, but just wondering. It is very clear, after you filed Chapter 11, it's a ten minute's math exercise that the interest that -- that these interest payments, just the interest payments far exceeded the amount of the business profit in addition of these legal liabilities far outweighed your assets, and I did calculate that the principal amount is probably in a $50 million range, which you confirmed at slightly higher than that.

And my question is, why didn't you understand that you would not be able to honor neither the interest nor the principal note (indiscernible)?

A I assumed that the real estate would appreciate more than the interest cost.

Q It seems like a gross overestimation from my perspective. At any point, did you ever consider capping the funds and not accepting new funds, say, in 2010, when you probably were under

water?
A I don't recall thinking that in 2010, no.
Q Well, is there any way for you, at any given time, given how quickly you did file Chapter 11, that you knew what the principal amounts were, and could you access that information quickly?
A I never made my people run a total of the notes until after we filed the bankruptcy.
Q Do you know approximately when you hit about $20 million in principal amount?
A No, I don't know.
Q You said earlier that Denise Schultz was aware of and can access some of this information, and you did mention another person that did develop a proprietary program so that you could get out of the paper world on these promissary notes, which is, again, rather surprising, but didn't he know -- wasn't he able to put it together and test the numbers and run scenarios where you could determine at any given point what's the principal and what the interest due was for any particular noteholder or as a group?
A Well, any particular noteholder, it was easily accessible how much their principal and interest was, yes, and we could have added all of the noteholders together to get those numbers.
Q And you weren't interested to do so?

A Well, I did the interest once a year when I did the taxes.
Q Oh, speaking of that, of course, since all of us have been paying taxes on the interest -- I was going to add an adjective, but I'll leave that to your imagination -- so, we have been paying taxes on a well -- that's my final statement.
MS. CHAMPION: Okay. We do have a few more people to ask questions who have just joined, but I do have to take a quick bathroom break, so we'll just take a quick break and then get back on. Thank you.
(Off the record)
(On the record)
MS. CHAMPION: Okay. This is Erin Champion. We can go back on the record.
MR. MARSHALL: Erin, can I clarify one thing?
MS. CHAMPION: Absolutely.
MR. MARSHALL: Someone asked me the question if anyone instructed me not to use the word fund or investments, and I -- my attorney had reiterated not to use those words. I was aware of that and was not using them before, but he did reemphasize to me that, so I just wanted to clear that up.
MS. CHAMPION: Okay. Thank you. Okay. We have another attorney on the line, so I'm going to take her next. Kristin Tiffany, if you want to ask your questions, you can do that now, and if you would just note your appearance, first.
EXAMINATION

BY MS. TIFFANY:

Q Someone previously mentioned Gerald Marshall was an employee of yours. Are they related to you?

A Daryl -- Daryl Marshall.

Q Daryl?

A D-A-R-Y-L. Daryl is my brother.

Q And they're in charge of files?

A Well, he's not in charge of anything. He files.

Q Oh, he files? He's files away documents?

A Right.

Q And does that include the notes?

A No. He has nothing to do with the notes. Daryl is sort of quasi-special needs. He had spinal meningitis when he was young, and he's as deaf as can be, and he just files. That's all Daryl does.

Q Okay. And is it your position that -- I believe today I've heard that the Miles B. Marshall, Inc., may be valued at $3 million, but I think I've heard $2 million, as well.

A Prior to this bankruptcy stuff, it was worth about $3 million, and since we've filed bankruptcy, I've lost a lot of business, and I think now, I'd be lucky to get $2 million. I'm waiting for the appraisal. We're getting it appraised. It's been taking six weeks. It should come in this week, but that was pre-bankruptcy, and I think that number will come in close to three, but I think now business is fleeing, so I think it's

down around two.
Q And what program was it that you used to keep the ledger on each note?
A We have a program we devised ourselves. It's not a commercial program.
Q And is this program through Microsoft Excel or is it coordinated with QuickBooks or affiliated with --
A It has nothing to do with QuickBooks, and I don't know -- it's a program using File Maker as a base.
Q And is there a person in your office, in particular, who maintains this program?
A David Will.
Q Wells?
A Will, W-I-L-L.
Q And if you hadn't purchased property in 2022 and in the four years prior to that, what were you telling these creditors who were lending you money? What were you telling them that this money was being used for if you weren't purchasing properties at that time?
A That it was being used for capital improvements to priority owned properties.
Q And that's what you were telling them?
A Yeah. I told them it was used for business, cash flow, to pay bills and for capital improvements. That's where -- improvements were expensive.

Q And did all the noteholders receive the same guidance to, you know, contact you and give you 30 days, and they could have their note repaid?
A Yes.
Q And why did you need 30 days?
A Because, oftentimes, if somebody requested money the day that school taxes or town taxes or something like that, there's not enough money, but 30 days is a reasonable amount of time.
Q And so, what did you need to do during those 30 days to get, say, additional money?
A Well, sometimes I didn't need to do anything. Sometimes, we paid them that moment, and sometimes, we waited until the rents came in or cash flow or grabbed someone else that owed me money or whatever until the checkbook got up to the amount.
Q And if I wanted a list of the names, addresses and phone numbers of your employees who worked for you in the last three years, how would I go about obtaining this?
A Talk to my attorney.
Q Is there something on file in your office? Is it a record with your payroll company?
A We do our own payroll, and I know my people's names and addresses and phone numbers.
Q And you said you do your own payroll?
A In the house, yes.
Q And those funds come from the M. Burton Marshall account?

A Yes.
Q I have no further questions. Thank you.
MS. CHAMPION: Kristin, if you could just put your appearance on again, because there was a little bit of a delay, so I didn't get your appearance and who you were appearing on behalf of.
MS. TIFFANY: Absolutely. Kristin Tiffany, attorney from the Crossmore Law Office on behalf of Youth Policy Institution and Martin Murray.
MS. CHAMPION: Great. Thank you so much. So we do have some additional folks that are waiting to ask questions. Again, I'd just remind people, if you can avoid, you know, repeating some of the same questions that were already asked, we can probably get this done -- this portion of the meeting, anyway, done fairly soon. Okay. So we've got -- next up is Stephen Wickwire. You can go ahead and ask your questions now.
MR. WICKWIRE: Can you hear me?
MS. CHAMPION: We can hear you, yes.
MR. WICKWIRE: Okay.

EXAMINATION

BY MR. WICKWIRE:
Q Burt, Steve Wickwire with a question. You have, over the years, told me repeatedly that you had a $100 million policy in case something happened.
A I never said that, Stephen. I have $18 million in life

insurance.
Q I repeatedly heard you say that. You've told me that. You told my wife that that you had a $100 million policy.
A I disagree 100 percent. I have never told anyone that I have $100 million life insurance policy because I don't.
Q That's fine. I feel very deceived. I always thought the world of you, but that's all I have to say.
MS. CHAMPION: Okay, thank you. Can we move next to Ian Sole?
MR. SOLE: Yes, this is Ian Sole. Can you hear me? You can hear me okay?
MS. CHAMPION: Yes, we were just getting a little bit of background noise maybe from another caller, but we can hear you.
MR. SOLE: Okay.

EXAMINATION

BY MR. SOLE:
Q I basically have two questions. As a preamble to that, Burt, you have been doing business for, I believe, many, many years, if not decades, in Madison County.
A Yes.
Q And, obviously, you didn't get to having what I believe from the filings is about $90 million in promissory notes, outstanding overnight. That happened over a long period of time.

A Yes.
Q And over a number of years. Would it be a fair question to ask that, at some point, along the curve between your ongoing business, which generates X-amount of monthly income and the liability that you were getting in order to service the debt from the promissory loans led you to realize that you needed new loans in order to cover the debt serving costs of existing loans, and if so, when did you realize that that was the case?
A I always thought that the real estate would appreciate more than the interest cost.
Q So, recognizing, based on earlier conversations -- I don't want to repeat a lot of what earlier people have said, but based on approximately a $7 million annual servicing debt and three -- I think I heard you say approximately three-quarters of that was being paid out in checks, that would equate to approximately $400,000 a month in check payments to service these promissory notes. And I think I heard you say that, in your best month, you were netting from your ongoing business, approximately $100,000 in net profit. That gap of $300,000, you were covering that with new loans?
A Some of it, yes.
Q I guess -- I guess that's a statement from me, and also my question -- my first question is, it's obviously disappointing -- extremely disappointing that someone involved in finance, as

far as taxation and so forth, it didn't overly concern you at a much earlier time that, clearly, it was -- the numbers weren't working, that you had a much higher debt servicing cost than you were able to cover with the income from ongoing businesses.

My second question, however, is absolutely debt service costs with the promissory note, would it be a fair question to say that your current ongoing business, which is the rental income, storage units, potentially may go back to doing tax preparation. I believe, do you also have an insurance business?

A I have an insurance agency, yes.

Q An insurance agency. Would it be fair to say that the combined income from those businesses make it a viable, ongoing business, absolutely cost of the debt servicing of the promissory notes?

A Maybe, but I don't know how much the insurance business is going to suffer from the bankruptcy, and I don't know how much the taxes is going to suffer, I mean, about by a third, and th taxes is probably by a half or more. I have no idea at this point.

Q But I think it's also fair to say that a majority or a large portion of the gross income, if not net income, of your businesses is the rental properties of residential and commercial, the 100-plus properties and the -- I'm not sure how many storage units you have, but unless people just stop living

in your properties, you still have all that income, correct?
A Correct.
Q So, I'm not sure I heard a clear answer.
A Correct.
Q Thank you. Those are my questions.
MS. CHAMPION: Thank you. We can move to Paul Forth.
MR. FORTH: Good afternoon. Can you hear me?
MR. MARSHALL: Yes.
MS. CHAMPION: Yes, we can.
MR. FORTH: Thank you, Erin. Thank you, Burt.

EXAMINATION

BY MR. FORTH:
Q I didn't get notified of this meeting today. I only found out by chance by one of the neighbors, somebody that is on that. I'm just wondering why that didn't occur and how many other people may have not known about this meeting today, so I wanted to make that point. And I was curious, do we know how many participants are on today for this meeting? We knew we were up to 100 or so when the system crashed last time.
MS. CHAMPION: I don't really know the answers to those questions, but do you have any questions related to Mr. Marshall's assets, liabilities. You can certainly email me any other administrative type questions, you can email me directly, but as far as questioning Mr. Marshall, do you have anything for him.

MR. FORTH: No, most everything I had has been answered, so we thank you.

MS. CHAMPION: Okay. Thank you. Okay. Let's move to Kirstin McVaugh. I think I'm saying that right, Kristin McVaugh. Okay, maybe she dropped off. Okay, we can go --

MS. McVAUGH: No, I'm here, can you hear me?

MS. CHAMPION: Yes, we can hear you.

MS. McVAUGH: Okay, great. Thanks.

EXAMINATION

BY MS. McVAUGH:

Q I have two quick questions or hopefully quick. I want to circle back to the term life insurance policy. I know that life insurance was brought up in conversations with my husband, as well, as being an important factor in terms of repayment, if anything was to happen to Burt, so I am curious, what is the term on those policies, and how much is being paid out per year for those policies?

A Each of those three big policies are about 14 or $1,500 a month, and they're, each of them, 20 or 25-year terms, and I think there's one year, two years and three years left on each of the three different policies.

Q Okay. Thank you. And my second question, perhaps, is for the financial advisor who is on the call. I know that Burt mentioned that three-quarters of the creditors received interest payments in some form throughout the year. Well,

about a quarter, roughly, did not, and so that means that one quarter of the promissory noteholders have not received interest, but will also have to pay taxes on that interest, so I'm curious if all of the noteholders will be treated the same in the repayment process once this is all figured out.

MR. TAYLOR: This is Troy Taylor. We've been engaged, now, approximately a week. We're addressing issues exactly like you just said. At this stage, we're trying to get facts, (indiscernible) what's been done and what hasn't been done. You know, a number of the things that we've talked about on this call, by (indiscernible) we want to basically make sure we've got our hands wrapped around the facts around these things, and obviously, everything will be done according to what's -- the program, the bankruptcy law and the, you know, the chapter. But right now, it is a very complicated set of facts, and we are about to (indiscernible) complex.

MS. McVAUGH: Thank you. That's all I have. Thanks.

MS. CHAMPION: Let's move to Dennis Sullivan.

MR. SULLIVAN: Hello, Dennis Sullivan.

EXAMINATION

BY MR. SULLIVAN:

Q Burt, with my two notes, my son's note and my mother's two notes, since we had our interest set up to be automatically reinvested, was the money considered a new principal deposit, so in the future, through bankruptcy, would the money be paid

by a percentage, have the rollover interest compilated in? I know some people receive monthly checks with interest, where ours was reinvested, so I'd like to know how that is --

A That's probably a question for the attorney, but I think the interest -- everyone's interest is going to be accumulated up to date, as I understand it, and then everyone will get their pro rata share, as I understand it.

Q But what -- what my question, Burt, is, that can go back one month. Let's go back for the last 20 or 25 years. Every time that we've given interest instead of taking that check and cashing it, you automatically reinvested it --

A Right.

Q -- and paid yourself. So I want to know if -- so, right now, what our balance is should be our principal. There shouldn't be any -- the only interest there, it should be the interest that accumulated when you stopped making payments to us.

A Right, correct.

Q So, for the record, what my balance is, there's five, six notes we have there, those -- all those notes that reinvested in, all the other people out there that have notes that the money is then reinvested with you, instead of taking the money out monthly, yearly or quarterly, however they had it set up, that money is now considered principal not interest?

A Correct.

MR. DOVE: This is Jeff Dove of Barclay, Damon. Mr. Marshall's opinion on the topic is certainly relevant. It may not be the legal answer that the Court issues, but that is an open topic that will be discussed under the Chapter 11 Plan and will be discussed with the Creditor's Committee.

MR. SULLIVAN: So, Mr. Dove, so what you are stating is that when we've had money, we're going to go back, we're going to say 1998, okay, and that year, the interest, we didn't get a check from him, now, it's rolled-over to reinvest with him, automatically, through Burt, you're saying that's not considered principal, now? You're saying that's considered interest only?

MR. DOVE: No. That's not what I said. What I said was, that issue is an open issue at this point in time, and at the end of the day, the Bankruptcy Court will have the ultimate determination as to how to characterize the interest that was reloaned to Mr. Marshall, unless there is a consensual resolution of that topic.

MR. SULLIVAN: Okay.

BY MR. SULLIVAN:

Q Next question. Burt, recently, the Miles B. Marshall recently closed and moved to the Hamilton office, which is part of your business there. Was that your mom's business that moved to Hamilton or was that closed or is that part of your business that was in Morrisville?

A I own that business, Miles B. Marshall, Inc., Morrisville and Hamilton .

Q Also, for the record, a friend also had no clue about today's meeting and so, I mentioned it to her, and in discussing things with her, where she was unable to get on the phone, one of the things was the life insurance policy would cover was a big topic, also, and many people, myself, I wasn't told that, because I was going through my parents that were invested through you, but that has been a topic I heard from many, many people that the life insurance policy would cover it, if there was ever any issues, so just for the record.

A Thank you.

Q All right .

MS. CHAMPION: Do you have any further questions?

MR. SULLIVAN: That's all. No further questions. Thank you.

MS. CHAMPION: Okay. So, next, we have Richard Garland?

MR. GARLAND: Hello?

MS. CHAMPION: Yeah, we can hear you, go ahead.

MR. GARLAND: Okay, thank you.

EXAMINATION

BY MR. GARLAND:

Q Yeah, my question is, in terms of the rental portfolio income, what is the net profit on a monthly basis?

Hello?
A It looks like $11,547.
Q Okay. And where is that money currently going to?
A Into the checkbook of Burt Marshall.
Q Okay. Well, I hope they're going to stop order on that, and why isn't that being distributed to the creditors?
A That's a -- you'd have to ask the attorneys that question. I don't know that.
MR. DOVE: This is Jeff Dove.
MR. GARLAND: Well, I'm asking them now.
MR. DOVE: This is Jeff Dove. Mr. Marshall is considered a debtor-in-possession and remains in possession and control of his assets during the pendency of the bankruptcy case, unless and until there is an order to the contrary. It is the ordinary course and business in a Chapter 11 case for the Debtor to remain in possession and control of the income of his business, and so that's exactly what is going on at the moment.
BY MR. GARLAND:
Q Okay. And can you, please, tell us if that money is staying in that account or is it being used to pay any kind of salary?
A Peoples' salaries are being paid per usual. I'm paying a shitload of attorney's fees and will have some financial expenses here from the Elgon Group shortly, so that's what the

money is going for currently.
Q I see. Okay. And, you know, just one comment I wanted to make, because, you know, I happen to be a real estate professional, and I was born in Hamilton, upstate New York, and the property value has not gone up much, you know, like that -- I brought this house over a decade ago, sold it for, maybe, a $20,000 profit, and that was the market late at the time. That was before COVID. So I'm just curious, you know, how you kind of get into this all confused lie that the interest that you were promising people would be able to, you know, well, the real estate investment would be able to catch up with that?
A I don't know how to answer that question. I always thought the real estate would appreciate more than the interest would cost, and --
Q But, Mr. Marshall, the interest never even came close to catching up. You were in water practically from, you know, the '90s. If you do the math, you're losing around, you know, $2 million a year in principal that you owe people, not to mention the interest that you're promising them. The deficit is so large --
MR. DOVE: This is Jeff Dove, I'm going to interrupt. Is there a question here or is this commentary?
BY MR. GARLAND:
Q No. The question is, how did he feed into this argument that he's making that the interest would be able to catch up

with the real estate investment, because it clearly has never done. If you look at the data, if you look at the Market over the last 30 years of Hamilton real estate or Morrisville or Upstate New York, Utica, it's barely gone up in value.

MR. DOVE: I think that Mr. Marshall has been asked and answered that question several times. He may not like the answer, but he has given an answer.

MR. GARLAND: But based on pure facts, right --

MR. DOVE: I'm not going to argue with you, sir, I'm simply stating that he has been asked the question; he has answered the question.

MR. GARLAND: I'll rephrase the question.

MR. DOVE: So, whether it's this year, last year, five years ago, ten years ago, 20 years ago, the Hamilton real estate has barely gone up in value, correct, so --

MR. DOVE: I don't know if that is an accurate statement.

MR. GARLAND: I mean, compared to other urban markets, it is.

MR. DOVE: Okay, if that's your position, that's your -- that's not a fact, so that's fine.

BY MR. GARLAND:

Q So, what is Mr. Marshall's assessment on how much his real estate portfolio has gone up in value over the last 30 years?

A I have no assessment to compare it to. I could look at

some values from 30 years ago and see what they are today. Real estate is not (indiscernible) particularly in Hamilton. There's a house across the street from us that just sold for 700-and-some thousand dollars that just three years ago sold for 50 or $60,000. I mean, real estate has gone up.

Q Okay. All right. That's my only question. Thank you.

MS. CHAMPION: I see we have Peter Crosby. Do you have questions for Mr. Marshall? Mr. Crosby?

MR. CROSBY: Yes, I'm sorry. I was having difficulty.

MS. CHAMPION: Yes, that's okay. Do you have questions? You can go ahead.

EXAMINATION

BY MR. CROSBY:

Q I have two questions. One is that I assume from the description you gave of the businesses and the Hamilton funds that a single, as it were, consolidated tax return is filed for the commercial activities, am I correct, there?

A Miles B. Marshall, Inc. is a separate entity and files a commercial tax return for that, and everything else is part of my own individual tax return, so there's a number of Schedule Cs and a hundred different schedules for each different rental.

Q Second question would be whether or not the (indiscernible) is done on an accrual or a cash basis?

A Cash.

Q Okay. Thank you.
A You're welcome.
MS. CHAMPION: Next we can move to John Bierworth.
MR. BIERWORTH: Yes, thanks, Erin, this is John Bierworth.

EXAMINATION

BY MR. BIERWORTH:
Q My father has a fund unfortunately, and he has for 30 years, and he took ill. And so, it brings me to the question about beneficiaries. How were those treated?
A If the note was written on a joint account with right of survivorship, it would automatically go to the survivor, and if not, it would become of your dad's estate.
Q Okay. Well, we called. There's five of us grown kids, and my dad is currently in the hospital, and, you know, I thought this was, like, everybody is saying the same thing, not sustainable. But, anyway, my question is, we did add ourselves. We called your office. You passed me along to, probably, Denise, and we added the children as beneficiaries. But, at this point, that's good, but my question is, if there wasn't any next of kin, how would you legally handle if you couldn't locate anybody, did you ever keep the funds or is there some --
A I don't think that's ever happened. It's always been, if someone passed away, and there wasn't a beneficiary, it would

go to the estate.

Q Okay. All right. That's my question. Thank you.

MS. CHAMPION: So, I have a couple of more people that want to ask questions that have already asked questions, so I can go ahead and do that, but I would just remind you to keep in mind, the questions that have already been asked of Mr. Marshall, if we can avoid that, and if they are truly questions versus statements, that is also helpful to the process, so, just, if you could keep that in mind, and we will go back, now, to Debbie Donaldson.

MS. DONALDSON: Thank you, Ms. Champion.

EXAMINATION

BY MS. DONALDSON:

Q Mr. Marshall, you have consistently given the prior answer that you thought real estate faster than interest would cull, yet you have also told us that you only sold four properties in the last, I want to say it was, in the last ten years, you'd only sold four properties. So, given that you were banking -- counting on the fact that the real estate would appreciate, why did you only sell four. Was your plan to sell more as the need increased or what was the plan for the property to pay off?

A Well, there was no formal, written plan, and as the cash flow dictated what I did, and the longer I held the properties, my belief was they would appreciate more and more, so the longer I held them, the better off it would be from my

perspective back then.
Q I can understand that. That's all I have.
MS. CHAMPION: Thank you. We can now go back to Karen Mirabella.
MS. MIRABELLA: Thank you.
EXAMINATION
BY MS. MIRABELLA:
Q Mr. Marshall, when you became ill and started to realize that you cash flow had decreased because you were no longer doing tax preparation, did you have enough funds to stay afloat, like most individuals or families have a two to six month buffer that you can stay afloat if something happens. Did you not think that you would just, you know, become well or when you became well, just resume you tax business and just continue the process? Like, what made you say, I need to file for bankruptcy at this point?
A Many people filed judgments against me. In order to preserve what assets I have, and in fairness to the people that didn't file the judgments, which is a bulk of people, I had to file reorganization bankruptcy, because, otherwise, the people that filed the judgments would just seize money out before anybody else is my understanding.
Q Okay. And based on your knowledge of the definition of Ponzi scheme, do you consider this a Ponzi scheme, do you consider this a Ponzi scheme?

A I do not.

Q Okay. No further questions. Thank you.

MS. CHAMPION: Okay. This is Erin Champion again. I just have a couple of housekeeping items, and one question for you, Mr. Marshall. Since you filed the bankruptcy case on April 20th, have you been able to keep up with those post-petition obligations or bills that are coming due?

MR. MARSHALL: Yes.

MS. CHAMPION: So you haven't fallen behind on anything?

MR. MARSHALL: No.

MS. CHAMPION: That's fine, okay. And you understand that you have a requirement to file monthly operating reports that would include bank statements on all of the information about the income that you took in and the disbursements that you made each month, correct?

MR. MARSHALL: Yes, we filed the one that was -- that ended April 30th. We filed it by May 21st, I think it was the date. And I'm not sure if I'm doing it or if the financial guys are doing the next one, but we'll have that filed on time by June 21st.

MS. CHAMPION: Okay, great. Okay, so I just want to thank everybody for participating today. It's been a long meeting, but I appreciate everybody who has joined the call, participating, asking very important, valuable questions.

Thank you to you, Mr. Marshall and Counsel, for appearing and asking our questions. I think, at this point, we have gotten through what we needed to today. I am going to keep the meeting open and adjourn it, at this point, for control purposes to June 26th at 10:00 a.m. It would be the same conference line, if the meeting does go forward. You know, any individual concerned that they won't get notice, just you can email me, which -- okay -- so, also, if you are interested in getting a recorded copy of the 341 meeting, you can email me that request, as well. So, I'll give you my email address now and my telephone number, so if you can, you know, write it down, you have it in front of you, you can make that request.

So, you can contact me at my email address, which is Erin.Champion@USDOJ.Gov, and that's E-R-I-N, dot, Champion, C-H-A-M-P-I-O-N, at U-S-D-O-J, dot, Gov. Feel free to also call my direct line in my office. That number is (315)793-8127. We will get back to you as soon as we can. We get a lot of calls, as you can imagine, but we will get back to you about any information that you want, as far as administrative procedures or with respect to the 341 meeting.

So, again, this is the only official recorded meeting, so if you want a copy, email me. I gave you the email address, but just to be sure, I'll give it to you one more time. It's Erin.Champion@USDOJ.Gov. I will probably have some document requests of my own, Mr. Marshall, for your attorney,

and I will reach out separately to him. And then I will also be in touch whether we need to have a continued 341 on the 26th, but, at this point, I am going to just adjourn it to that date and time for control purposes.

So, with that, again, everybody, thank you, and you have my information. If you need any additional information, you can give me a call or email me. So, we can conclude today's portion of the meeting.

Thank you.

* * * * *

C E R T I F I C A T I O N

I, JACQUELINE MULLICA, court approved transcriber, certify that the foregoing is a correct transcript from the official electronic sound recording of the proceedings in the above-entitled matter, and to the best of my ability.

/s/ Jacqueline Mullica

JACQUELINE MULLICA

J&J COURT TRANSCRIBERS, INC. DATE: June 12, 2023

Exhibit 2

Fill in this information to identify the case:

Debtor 1 M. Burton Marshall

Debtor 2 (Spouse, if filing)

United States Bankruptcy Court for the: Northern District of New York

Case number 23-60263-6-rel

RECEIVED & FILED
MAY 10 2023
OFFICE OF THE BANKRUPTCY CLERK
UTICA, NY

Official Form 410

Proof of Claim

04/22

Read the instructions before filling out this form. This form is for making a claim for payment in a bankruptcy case. Do not use this form to make a request for payment of an administrative expense. Make such a request according to 11 U.S.C. § 503.

Filers must leave out or redact information that is entitled to privacy on this form or on any attached documents. Attach redacted copies of any documents that support the claim, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, judgments, mortgages, and security agreements. Do not send original documents; they may be destroyed after scanning. If the documents are not available, explain in an attachment.

A person who files a fraudulent claim could be fined up to $500,000, imprisoned for up to 5 years, or both. 18 U.S.C. §§ 152, 157, and 3571.

Fill in all the information about the claim as of the date the case was filed. That date is on the notice of bankruptcy (Form 309) that you received.

Part 1: Identify the Claim

1. **Who is the current creditor?**
   Kirk T. Lallier
   Name of the current creditor (the person or entity to be paid for this claim)
   Other names the creditor used with the debtor

2. **Has this claim been acquired from someone else?**
   ☑ No
   ☐ Yes. From whom?

3. **Where should notices and payments to the creditor be sent?**
   Federal Rule of Bankruptcy Procedure (FRBP) 2002(g)

   Where should notices to the creditor be sent?
   Kirk T. Lallier
   Name
   1779 Reservoir Road
   Number Street
   Cassville NY 13318
   City State ZIP Code
   Contact phone 315-527-5352
   Contact email lallierk230@gmail.com

   Where should payments to the creditor be sent? (if different)
   Kirk T. Lallier
   Name
   1779 Reservoir Road
   Number Street
   Cassville NY 13318
   City State ZIP Code
   Contact phone 315-527-5352
   Contact email lallierk230@gmail.com

   Uniform claim identifier for electronic payments in chapter 13 (if you use one):

4. **Does this claim amend one already filed?**
   ☑ No
   ☐ Yes. Claim number on court claims registry (if known) _____ Filed on ___/___/____ MM / DD / YYYY

5. **Do you know if anyone else has filed a proof of claim for this claim?**
   ☑ No
   ☐ Yes. Who made the earlier filing?

Part 2: Give Information About the Claim as of the Date the Case Was Filed

6. **Do you have any number you use to identify the debtor?**
☑ No
☐ Yes. Last 4 digits of the debtor's account or any number you use to identify the debtor: ____ ____ ____ ____

7. **How much is the claim?** $ 35,851.17 **Does this amount include interest or other charges?**
☐ No
☑ Yes. Attach statement itemizing interest, fees, expenses, or other charges required by Bankruptcy Rule 3001(c)(2)(A).

8. **What is the basis of the claim?**
Examples: Goods sold, money loaned, lease, services performed, personal injury or wrongful death, or credit card.
Attach redacted copies of any documents supporting the claim required by Bankruptcy Rule 3001(c).
Limit disclosing information that is entitled to privacy, such as health care information.

Promissory Note # 4939 (money loaned)

9. **Is all or part of the claim secured?**
☑ No
☐ Yes. The claim is secured by a lien on property.

Nature of property:
☐ Real estate. If the claim is secured by the debtor's principal residence, file a *Mortgage Proof of Claim Attachment* (Official Form 410-A) with this *Proof of Claim*.
☐ Motor vehicle
☐ Other. Describe: _____

Basis for perfection: _____
Attach redacted copies of documents, if any, that show evidence of perfection of a security interest (for example, a mortgage, lien, certificate of title, financing statement, or other document that shows the lien has been filed or recorded.)

Value of property: $ _____
Amount of the claim that is secured: $ _____
Amount of the claim that is unsecured: $ 35,851.17 (The sum of the secured and unsecured amounts should match the amount in line 7.)

Amount necessary to cure any default as of the date of the petition: $ 35,851.17

Annual Interest Rate (when case was filed) 8.00 %
☑ Fixed
☐ Variable

10. **Is this claim based on a lease?**
☑ No
☐ Yes. Amount necessary to cure any default as of the date of the petition. $ _____

11. **Is this claim subject to a right of setoff?**
☑ No
☐ Yes. Identify the property: _____

12. Is all or part of the claim entitled to priority under 11 U.S.C. § 507(a)?

A claim may be partly priority and partly nonpriority. For example, in some categories, the law limits the amount entitled to priority.

☑ No

☐ Yes. *Check one:*

	Amount entitled to priority
☐ Domestic support obligations (including alimony and child support) under 11 U.S.C. § 507(a)(1)(A) or (a)(1)(B).	$_____
☐ Up to $3,350* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use. 11 U.S.C. § 507(a)(7).	$_____
☐ Wages, salaries, or commissions (up to $15,150*) earned within 180 days before the bankruptcy petition is filed or the debtor's business ends, whichever is earlier. 11 U.S.C. § 507(a)(4).	$_____
☐ Taxes or penalties owed to governmental units. 11 U.S.C. § 507(a)(8).	$_____
☐ Contributions to an employee benefit plan. 11 U.S.C. § 507(a)(5).	$_____
☐ Other. Specify subsection of 11 U.S.C. § 507(a)(__) that applies.	$_____

* Amounts are subject to adjustment on 4/01/25 and every 3 years after that for cases begun on or after the date of adjustment.

Part 3: Sign Below

The person completing this proof of claim must sign and date it. FRBP 9011(b).

If you file this claim electronically, FRBP 5005(a)(2) authorizes courts to establish local rules specifying what a signature is.

A person who files a fraudulent claim could be fined up to $500,000, imprisoned for up to 5 years, or both. 18 U.S.C. §§ 152, 157, and 3571.

Check the appropriate box:

☑ I am the creditor.
☐ I am the creditor's attorney or authorized agent.
☐ I am the trustee, or the debtor, or their authorized agent. Bankruptcy Rule 3004.
☐ I am a guarantor, surety, endorser, or other codebtor. Bankruptcy Rule 3005.

I understand that an authorized signature on this *Proof of Claim* serves as an acknowledgment that when calculating the amount of the claim, the creditor gave the debtor credit for any payments received toward the debt.

I have examined the information in this *Proof of Claim* and have a reasonable belief that the information is true and correct.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on date 05/06/2023
MM / DD / YYYY

Kirk T. Lallier
Signature

Print the name of the person who is completing and signing this claim:

Name: Kirk (First name) T (Middle name) Lallier (Last name)

Title: _____

Company: _____
Identify the corporate servicer as the company if the authorized agent is a servicer.

Address: 1779 Reservoir Road
Number Street
Cassville NY 13318
City State ZIP Code

Contact phone 315-527-5352 Email lallierk230@gmail.com

Hamilton, N.Y. October 25th 20 21 $ 25,000.00

~ On demand ~ after date I Promise

to pay to the order of Kirk Lallier and Arthur Krawczenko

Twenty Five Thousand Dollars and No/100 Dollars

Terms: Interest @ 8% Per Annum PLUS: Monthly interest updates

30-day Notice For Withdrawal

No Penalty For Early Withdrawal

M. Burton Marshall
PO Box 89, Hamilton, N.Y. 13346
Phone (315) 824-2811 or (800) 642-6625

PLEASE DO NOT DESTROY
YOU WILL BE REQUIRED
TO RETURN THIS NOTE
WHEN IT HAS BEEN
PAID IN FULL

M. BURTON MARSHALL
PO Box 89, 11 Maple Ave.
Hamilton, New York 13346-0089
PHONE (315)824-2811
FAX LINE (315)824-1621
TOLL FREE 1-800-642-6625
email: denise@mbmarshall.com

EIGHT PERCENT PROMMISSORY NOTE

When an individual lends money to the "8% PROMISSORY NOTE", that individual is lending money to M. Burton Marshall.

Mr. Marshall issues to the lender a promissory note for the amount of the loan at eight percent (8%) per annum. These funds can accumulate interest, or some investors prefer a periodic check until the loan is paid in full.

For an accumulation plan, the interest is updated every time a payment is made, a deposit is made, a distribution is taken, or you ask for the interest to be brought up-to-date. When monthly payments are made the interest is automatically updated at that time.

Also, there are some individuals who prefer to receive a check monthly for the interest earned, leaving the principal intact.

Funds can be added to the promissory note at any time. Thirty (30) days notice is required for withdrawal. There is no penalty for early withdrawal.

If you would like to see what your money is being used for and would like to tour current construction projects, please let us know.

These funds are used primarily to purchase property; refurbish rental houses; and pay normal and ordinary expenses of rental property such as repairs, maintenance, utilities, debt service, insurance, real estate taxes, etc., in the Hamilton, New York area. All properties are within 6 miles of Burt's office.

If you have any further questions, please call Burt.

RENTALS
Apartments # Houses # Commercial # Storage

/ Button Va shall 25
PO Box 89
' Vac e Ave
[illegible] NY 13346

Transaction Summary for Note # 4939

K rk T Lallier
1779 Reservoir Rd
Cassv lle NY 13318-1207

ate	Description	Interest	Deposit	Withdrawal	Balance
)/25/202'	New Funds Ck# 1858 & R# 3895		$25,000.00		$25,000.00
' 25/202'	3' days interest @ .08 (10/25/2021 - 11/25/2021)	$169.86			$25,169.86
2 25/202'	3) days interes: @ .08 (11/25/2021 - 12/25/2021)	$165.50			$25,335.36
25 2022	3' days interes: @ .08 (12/25/2021 - 1/25/2022)	$172.14			$25,507.50
25 2022	3' days interest @ .08 (1/25/2022 - 2/25/2022)	$173.31			$25,680.81
25 2022	23 days interest @ .08 (2/25/2022 - 3/25/2022)	$157.60			$25,838.41
/25/2022	31 days interest @ .08 (3/25/2022 - 4/25/2022)	$175.56			$26,013.97
/'1/2022	1 3 days interest @ .08 (4/25/2022 - 5/11/2022)	$91.23			$26,105.20
/'1/2022	New Funds Ck# 1895 & R# 3929 (cash)		$5,350.00		$31,455.20
/25/2022	14 days interest @ .09 (5/11/2022 - 5/25/2022)	$96.52			$31,551.72
/25/2022	31 days interest @ .08 (5/25/2022 - 6/25/2022)	$214.38			$31,766.10
/25/2022	30 days interest @ .08 (6/25/2022 - 7/25/2022)	$208.87			$31,974.97
)/1/2022	7 days interest @ .08 (7/25/2022 - 8/1/2022)	$49.06			$32,024.03
)/' /2022	To: Kirk Lallier RE: Distribution Note# 4939			$2,000.00	$30,024.03
)/25/2022	24 days interest @ .08 (8/1/2022 - 8/25/2022)	$157.93			$30,181.96
)/25/2022	31 days interest @ .08 (8/25/2022 - 9/25/2022)	$205.07			$30,387.03
10/25/2022	30 days interest @ .08 (9/25/2022 - 10/25/2022)	$199.81			$30,586.84
11/2/2022	8 days interest @ .08 (10/25/2022 - 11/2/2022)	$53.63			$30,640.47
11/2/2022	New Funds Ck# 1927		$1,600.00		$32,240.47
11/25/2022	23 days interest @ .08 (11/2/2022 - 11/25/2022)	$162.53			$32,403.00
12/25/2022	30 days interest @ .08 (11/25/2022 - 12/25/2022)	$213.06			$32,616.06
1/5/2023	11 days interest @ .08 (12/25/2022 - 1/5/2023)	$78.64			$32,694.70
1/5/2023	New Funds Ck# 1936 R #34516 (cash)		$3,000.00		$35,694.70
1/25/2023	20 days interest @ .08 (1/5/2023 - 1/25/2023)	$156.47			$35,851.17

Fill in this information to identify the case:

Debtor 1 M. Burton Marshall

Debtor 2 (Spouse, if filing)

United States Bankruptcy Court for the: Northern District of New York

Case number 23-60263-6-rel

RECEIVED & FILED
MAY 11 2023
OFFICE OF THE BANKRUPTCY CLERK
UTICA, NY

Official Form 410

Proof of Claim

04/22

Read the instructions before filling out this form. This form is for making a claim for payment in a bankruptcy case. Do not use this form to make a request for payment of an administrative expense. Make such a request according to 11 U.S.C. § 503.

Filers must leave out or redact information that is entitled to privacy on this form or on any attached documents. Attach redacted copies of any documents that support the claim, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, judgments, mortgages, and security agreements. Do not send original documents; they may be destroyed after scanning. If the documents are not available, explain in an attachment.

A person who files a fraudulent claim could be fined up to $500,000, imprisoned for up to 5 years, or both. 18 U.S.C. §§ 152, 157, and 3571.

Fill in all the information about the claim as of the date the case was filed. That date is on the notice of bankruptcy (Form 309) that you received.

Part 1: Identify the Claim

1. **Who is the current creditor?**
   Jean L. Hewitt
   Name of the current creditor (the person or entity to be paid for this claim)
   Other names the creditor used with the debtor

2. **Has this claim been acquired from someone else?**
   ☑ No
   ☐ Yes. From whom?

3. **Where should notices and payments to the creditor be sent?**
   Federal Rule of Bankruptcy Procedure (FRBP) 2002(g)

   Where should notices to the creditor be sent?
   JEAN L. HEWITT
   Name
   2874 STATE Route 12B
   Number Street
   HAMILTON NY 13346
   City State ZIP Code
   Contact phone 315-228-2043
   Contact email

   Where should payments to the creditor be sent? (if different)
   Name
   Number Street
   City State ZIP Code
   Contact phone
   Contact email

   Uniform claim identifier for electronic payments in chapter 13 (if you use one):

4. **Does this claim amend one already filed?**
   ☑ No
   ☐ Yes. Claim number on court claims registry (if known) ____ Filed on ____ MM / DD / YYYY

5. **Do you know if anyone else has filed a proof of claim for this claim?**
   ☑ No
   ☐ Yes. Who made the earlier filing?

Part 2: Give Information About the Claim as of the Date the Case Was Filed

6. Do you have any number you use to identify the debtor?
☐ No
☑ Yes. Last 4 digits of the debtor's account or any number you use to identify the debtor: 4 8 1 4

7. How much is the claim? $ 13,792.08
Does this amount include interest or other charges?
☐ No
☑ Yes. Attach statement itemizing interest, fees, expenses, or other charges required by Bankruptcy Rule 3001(c)(2)(A).

8. What is the basis of the claim?
Examples: Goods sold, money loaned, lease, services performed, personal injury or wrongful death, or credit card.
Attach redacted copies of any documents supporting the claim required by Bankruptcy Rule 3001(c).
Limit disclosing information that is entitled to privacy, such as health care information.
Promissory Note #3005 + #3006

9. Is all or part of the claim secured?
☑ No
☐ Yes. The claim is secured by a lien on property.
Nature of property:
☐ Real estate. If the claim is secured by the debtor's principal residence, file a *Mortgage Proof of Claim Attachment* (Official Form 410-A) with this *Proof of Claim*.
☐ Motor vehicle
☐ Other. Describe: _____
Basis for perfection: _____
Attach redacted copies of documents, if any, that show evidence of perfection of a security interest (for example, a mortgage, lien, certificate of title, financing statement, or other document that shows the lien has been filed or recorded.)
Value of property: $_____
Amount of the claim that is secured: $_____
Amount of the claim that is unsecured: $_____ (The sum of the secured and unsecured amounts should match the amount in line 7.)
Amount necessary to cure any default as of the date of the petition: $_____
Annual Interest Rate (when case was filed)_____%
☐ Fixed
☐ Variable

10. Is this claim based on a lease?
☑ No
☐ Yes. Amount necessary to cure any default as of the date of the petition. $_____

11. Is this claim subject to a right of setoff?
☑ No
☐ Yes. Identify the property: _____

12. Is all or part of the claim entitled to priority under 11 U.S.C. § 507(a)?

A claim may be partly priority and partly nonpriority. For example, in some categories, the law limits the amount entitled to priority.

☑ No

☐ Yes. *Check one:*

	Amount entitled to priority
☐ Domestic support obligations (including alimony and child support) under 11 U.S.C. § 507(a)(1)(A) or (a)(1)(B).	$
☐ Up to $3,350* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use. 11 U.S.C. § 507(a)(7).	$
☐ Wages, salaries, or commissions (up to $15,150*) earned within 180 days before the bankruptcy petition is filed or the debtor's business ends, whichever is earlier. 11 U.S.C. § 507(a)(4).	$
☐ Taxes or penalties owed to governmental units. 11 U.S.C. § 507(a)(8).	$
☐ Contributions to an employee benefit plan. 11 U.S.C. § 507(a)(5).	$
☐ Other. Specify subsection of 11 U.S.C. § 507(a)(__) that applies.	$

* Amounts are subject to adjustment on 4/01/25 and every 3 years after that for cases begun on or after the date of adjustment.

Part 3: Sign Below

The person completing this proof of claim must sign and date it. FRBP 9011(b).

If you file this claim electronically, FRBP 5005(a)(2) authorizes courts to establish local rules specifying what a signature is.

A person who files a fraudulent claim could be fined up to $500,000, imprisoned for up to 5 years, or both. 18 U.S.C. §§ 152, 157, and 3571.

Check the appropriate box:

☑ I am the creditor.
☐ I am the creditor's attorney or authorized agent.
☐ I am the trustee, or the debtor, or their authorized agent. Bankruptcy Rule 3004.
☐ I am a guarantor, surety, endorser, or other codebtor. Bankruptcy Rule 3005.

I understand that an authorized signature on this *Proof of Claim* serves as an acknowledgment that when calculating the amount of the claim, the creditor gave the debtor credit for any payments received toward the debt.

I have examined the information in this *Proof of Claim* and have a reasonable belief that the information is true and correct.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on date 05/08/2023
MM / DD / YYYY

Jean L. Hewitt
Signature

Print the name of the person who is completing and signing this claim:

Name: JEAN (First name) L. (Middle name) HEWITT (Last name)

Title:

Company:
Identify the corporate servicer as the company if the authorized agent is a servicer.

Address: 2874 (Number) State Route 12B (Street)
HAMILTON (City) NY (State) 13346 (ZIP Code)

Contact phone: 315-228-2043 Email: N/A

Proof of Claim Form 410
Case No. 23-60263-6-rel

Current Creditor: Jean L. Hewitt

Part 2:

Question 7.

Interest was added annually by the Debtor prior to filing Bankruptcy.

M. BURTON MARSHALL
PO Box 89, 11 Maple Ave.
Hamilton, New York 13346-0089
PHONE (315) 824-2811
FAX LINE (315) 824-1621
TOLL FREE 1-800-642-6625
email: taxman@dreamscape.com

EIGHT PERCENT FUND

When an individual lends money to the "8% FUND", that individual is lending money to M. Burton Marshall.

These funds are used primarily to purchase and/ or refurbish rental houses in the Hamilton, New York area. All properties are within 6 miles of Burt's office.

Mr. Marshall issues to the lender a promissory note for the amount of the loan at eight percent (8%) per annum. These funds can be treated as a savings account and earn interest, or some investors prefer a periodic check until the loan is paid in full.

For a savings account plan, the interest is updated every time a payment is made, a deposit is made, a distribution is taken, or you ask for the interest to be brought up-to-date. When monthly payments are made, the interest is automatically updated at that time.

Also, there are some individuals who prefer to receive a check monthly for the interest earned, leaving the principal intact.

Funds can be added to the promissory note at any time. Thirty (30) days notice is required for withdrawal. There is no penalty for early withdrawal.

If you have any further questions, please phone M. Burton Marshall at 315-824-2811 or 800-642-6625.

Certified Financial Planner • Certified Insurance Counselor
Enrolled to Practice before the Internal Revenue Service

3004 Hamilton, N.Y., OCTOBER 8 20 09 $ 2500.00

ONE YEAR after date I Promise

to pay to the order of JEAN L. HEWITT AND THERESA J. LOLLMAN, JTWROS

TWO THOUSAND FIVE HUNDRED DOLLARS AND NO/100 Dollars

M. Burton Marshall
PO Box 89, Hamilton, N.Y. 13346
Phone (315) 824-2811 or (800) 642-6625

PLEASE DO NOT DESTROY
YOU WILL BE REQUIRED
TO RETURN THIS NOTE
WHEN IT HAS BEEN
PAID IN FULL

Terms:

PLUS: Interest @ 8% Per Annum

30-day Notice For Withdrawal

No Penalty For Early Withdrawal

3005 Hamilton, N.Y., OCTOBER 8 20 09 $ 2500 00

ONE YEAR after date I Promise

to pay to the order of JEAN L. HEWITT AND JAMES R. LOLLMAN, JTWROS

TWO THOUSAND FIVE HUNDRED DOLLARS AND NO/100 Dollars

M. Burton Marshall
PO Box 89, Hamilton, N.Y. 13346
Phone (315) 824-2811 or (800) 642-6625

PLEASE DO NOT DESTROY
YOU WILL BE REQUIRED
TO RETURN THIS NOTE
WHEN IT HAS BEEN
PAID IN FULL

Terms:

PLUS: Interest @ 8% Per Annum

30-day Notice For Withdrawal

No Penalty For Early Withdrawal

(2)

Case 23-60263-6-pgr Doc 106-2 Filed 06/27/23 Entered 06/27/23 10:42:37 Desc Exhibit 2 Page 13 of 21

AMERICAN BANKRUPTCY INSTITUTE

(3)

M. BURTON MARSHALL
PO Box 89, 11 Maple Ave.
Hamilton, New York 13346-0089
PHONE (315) 824-2811
FAX LINE (315) 824-1621
TOLL FREE 1-800-642-6625
email: taxman@dreamscape.com

September 3, 2010

Ms. Jean Hewitt
73 Lebanon Street
Hamilton NY 13346

Re: Promissory Note #3005 and
Promissory Note #3006.

Dear Jean:

We have brought the interest up to date on both of the notes you have here. Enclosed please find the following documents:

1. Addendum to Note #3005 showing the interest of $180.82 added to the note
2. Photocopy of the summary sheet for Note #3005 for your records
3. Addendum to Note #3006 showing the interest of $180.82 added to the note
4. Photocopy of the summary sheet for Note #3006 for your records.

Sincerely yours,

Lettie J Nelson

Lettie J. Nelson
Office Manager

Encs.

March 18. 2023

Dear Note Holder:

We are providing this update along with the payment of 1/2 of 1% of the principal balance of your note.

Some of our note holders have requested clarification of how we have calculated the principal against which the payment is being made. For purposes of this payment, we have calculated the principal balance as of the date of your last transaction. For instance, if the last time you received a payment was on June 30, 2021, your principal will have been calculated as of that date, and the enclosed payment represents 1/2 of 1% of that amount.

Also, your notes continue to accrue interest even though regular payments have been interrupted.

I am pleased to inform you that I have been released from the hospital and I am recuperating at home. While I will be slowly ramping up my workload, it will be quite some time before I am back in the office full time.

Currently I am working on updating the cash flow projections from each of my businesses so that a repayment program can be developed and shared with all of you. Toward that goal, we continue our efforts to solicit participation on a committee of note holders. We will be contacting several of the note holders with the largest note amounts within the next several days.

As you have previously been advised, our attorneys at Barclay Damon LLP have established a designated email account to field inquiries regarding this situation. We encourage you to continue to use this email account for any questions or comments you may have: Bmarshallinfo@barclaydamon.com

On the back of this letter, you will find a statement of your account reflecting the enclosed payment.

Jeff Dove of Barclay Damon LLP will continue to act as the contact person for all questions and concerns regarding promissory notes and will be establishing a committee of note holders in the upcoming days.

Thank you,

Burt Marshall

5

M Burton Marshall 3005
PO Box 89
11 Maple Ave
Hamilton NY 13346

Disbursement Summary for Note # 3005

Jean L Hewitt
2874 State Route 12B
Hamilton NY 13346-3400

ID	Date	Batch	Previous Balance	Rate	Disbursement	New Balance
473	3/16/2023	First	$6,930.69	.005	$34.65	$6,896.04

The most recent Note transaction date was 1/9/2023 with a balance of $ 6930.69. This is the amount used to start figuring the Disbursements.
See the other side of this page for additional information.

March 18, 2023

Dear Note Holder:

We are providing this update along with the payment of 1/2 of 1% of the principal balance of your note.

Some of our note holders have requested clarification of how we have calculated the principal against which the payment is being made. For purposes of this payment, we have calculated the principal balance as of the date of your last transaction. For instance, if the last time you received a payment was on June 30, 2021, your principal will have been calculated as of that date, and the enclosed payment represents 1/2 of 1% of that amount.

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On the back of this letter, you will find a statement of your account reflecting the enclosed payment.

Jeff Dove of Barclay Damon LLP will continue to act as the contact person for all questions and concerns regarding promissory notes and will be establishing a committee of note holders in the upcoming days.

Thank you,

Burt Marshall

M Burton Marshall 3006
PO Box 89
11 Maple Ave
Hamilton NY 13346

Disbursement Summary for Note # 3006

Jean L. Hewitt
2874 State Route 12B
Hamilton NY 13346-3400

ID	Date	Batch	Previous Balance	Rate	Disbursement	New Balance
472	3/16/2023	First	$6,930.69	.005	$34.65	$6,896.04

The most recent Note transaction date was 1/9/2023 with a balance of $ 6930.69. This is the amount used to start figuring the Disbursements.
See the other side of this page for additional information.

Printed 2/16/2023 2:26:24 PM

March 18, 2023

Dear Note Holder:

We are providing this update along with the payment of 1/2 of 1% of the principal balance of your note.

Some of our note holders have requested clarification of how we have calculated the principal against which the payment is being made. For purposes of this payment, we have calculated the principal balance as of the date of your last transaction. For instance, if the last time you received a payment was on June 30, 2021, your principal will have been calculated as of that date, and the enclosed payment represents 1/2 of 1% of that amount.

Also, your notes continue to accrue interest even though regular payments have been interrupted.

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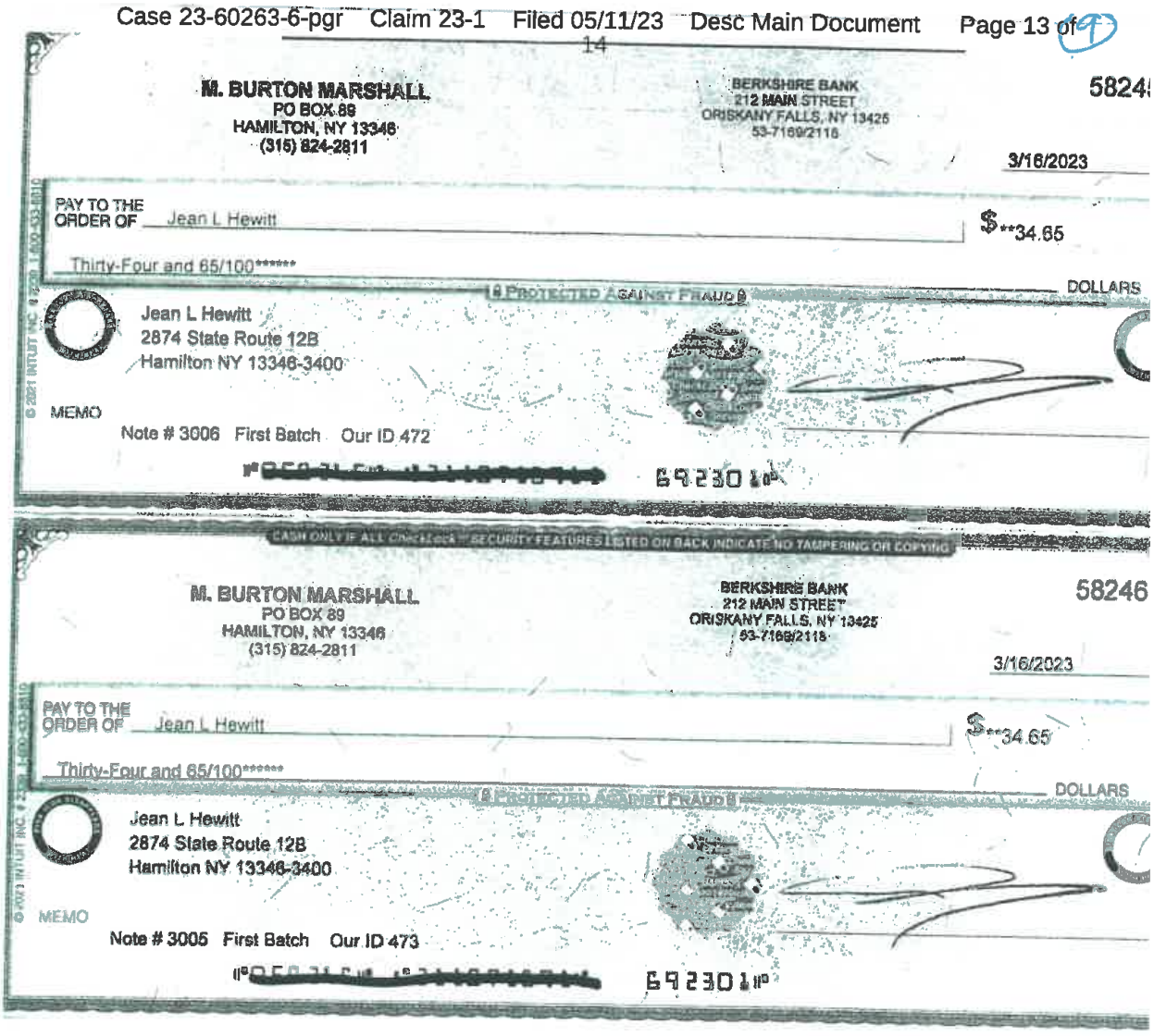
As you have previously been advised, our attorneys at Barclay Damon LLP have established a designated email account to field inquiries regarding this situation. We encourage you to continue to use this email account for any questions or comments you may have: Bmarshallinfo@barclaydamon.com

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Thank you,

Burt Marshall



M. BURTON MARSHALL
PO BOX 89
HAMILTON, NY 13346
(315) 824-2811

BERKSHIRE BANK
212 MAIN STREET
ORISKANY FALLS, NY 13425
53-7169/2116

58245

3/16/2023

PAY TO THE ORDER OF Jean L Hewitt $**34.65

Thirty-Four and 65/100******

DOLLARS

Protected Against Fraud

Jean L Hewitt
2874 State Route 12B
Hamilton NY 13346-3400

MEMO

Note # 3006 First Batch Our ID 472

69230

CASH ONLY IF ALL CHECK SECURITY FEATURES LISTED ON BACK INDICATE NO TAMPERING OR COPYING

M. BURTON MARSHALL
PO BOX 89
HAMILTON, NY 13346
(315) 824-2811

BERKSHIRE BANK
212 MAIN STREET
ORISKANY FALLS, NY 13425
53-7169/2116

58246

3/16/2023

PAY TO THE ORDER OF Jean L Hewitt $**34.65

Thirty-Four and 65/100******

DOLLARS

Protected Against Fraud

Jean L Hewitt
2874 State Route 12B
Hamilton NY 13346-3400

MEMO

Note # 3005 First Batch Our ID 473

69230

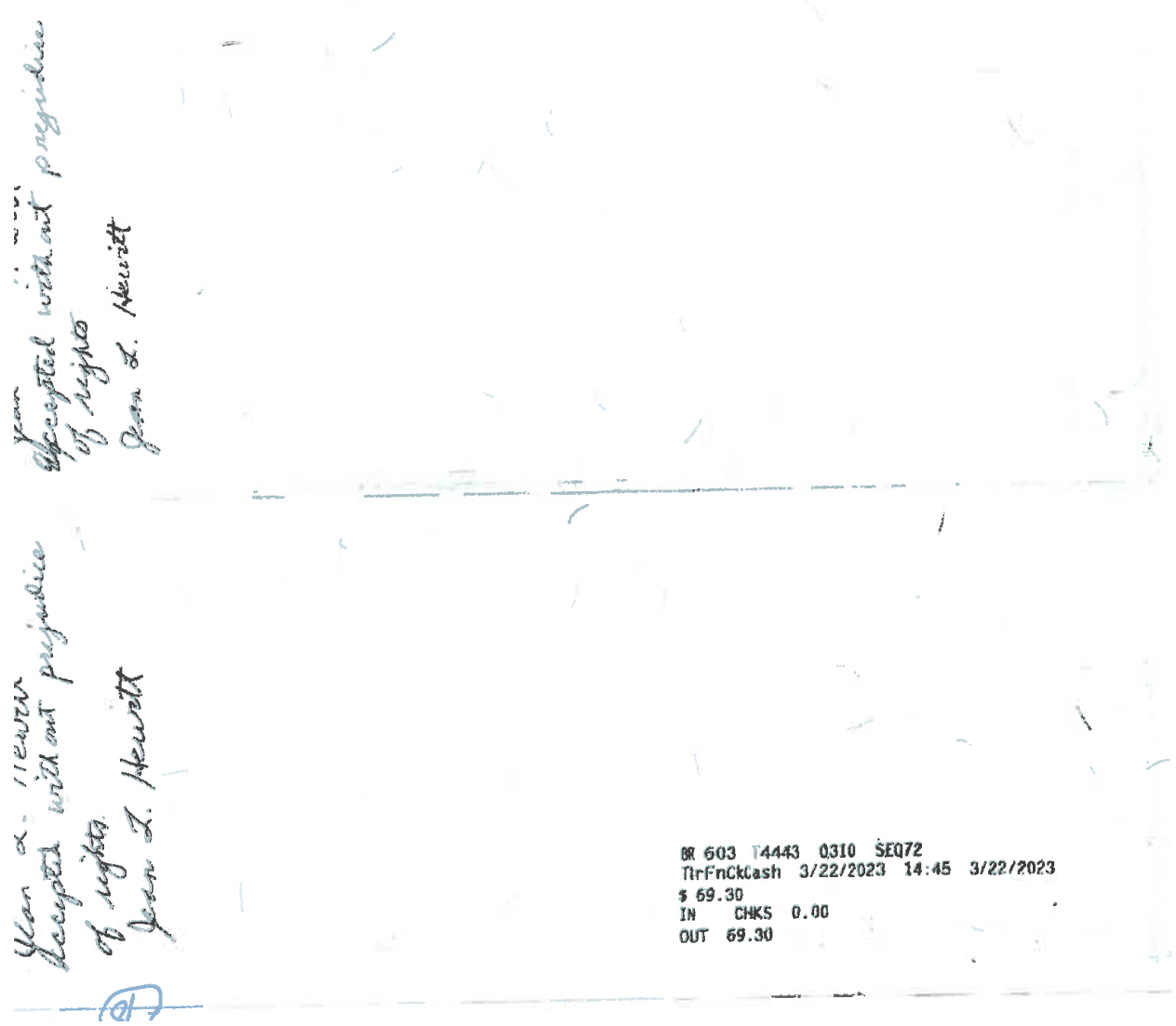

Jean K. Hewitt
Accepted with out prejudice
All rights
Jean K. Hewitt
BR 603 T4443 0310 SE072
TlrFnCkCash 3/22/2023 14:45 3/22/2023
$ 69.30
IN CHKS 0.00
OUT 69.30

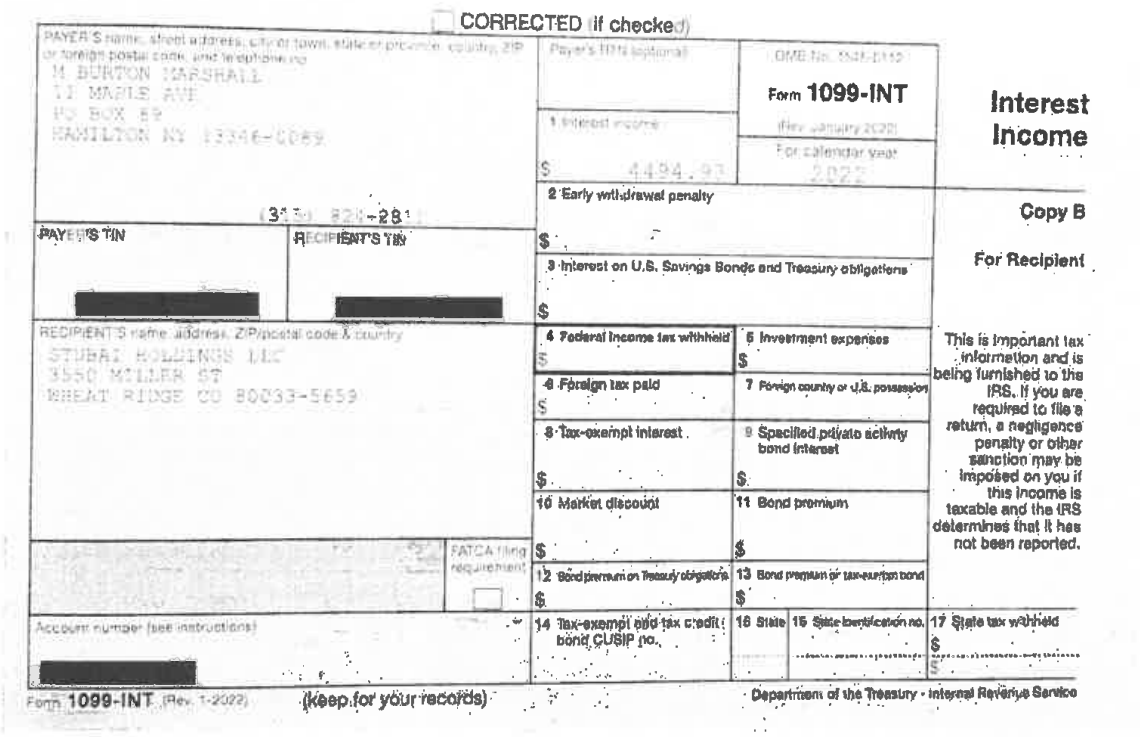
Exhibit 3

☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.	Payer's RTN (optional)	OMB No. 1545-0112	Interest Income
M BURTON MARSHALL 11 MAPLE AVE PO BOX 89 HAMILTON NY 13346-0089 (315) 824-2811	1 Interest income $ 2040.86	Form 1099-INT (Rev. January 2022) For calendar year 2022	
PAYER'S TIN [redacted]	RECIPIENT'S TIN [redacted]	2 Early withdrawal penalty $	Copy B For Recipient
		3 Interest on U.S. Savings Bonds and Treasury obligations $	
RECIPIENT'S name, address, ZIP/postal code & country JAMES W PEPTIS GEORGANA J PEPTIS 1457 BLUE HERON DR ENGLEWOOD FL 34224-4705	4 Federal income tax withheld $	5 Investment expenses $	This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
	6 Foreign tax paid $	7 Foreign country or U.S. possession	
	8 Tax-exempt interest $	9 Specified private activity bond interest $	
	10 Market discount $	11 Bond premium $	
FATCA filing requirement ☐	12 Bond premium on Treasury obligations $	13 Bond premium on tax-exempt bond $	
Account number (see instructions) [redacted]	14 Tax-exempt and tax credit bond CUSIP no.	15 State	16 State identification no. / 17 State tax withheld $ $

Form 1099-INT (Rev. 1-2022) (keep for your records) Department of the Treasury - Internal Revenue Service

Note 4562 - Stubai Holdings



CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 69
HAMILTON NY 13346-0069

(315) 824-2811

PAYER'S TIN [redacted]

RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
STUBAI HOLDINGS LLC
3550 MILLER ST
WHEAT RIDGE CO 80033-5659

FATCA filing requirement ☐

Account number (see instructions) [redacted]

Payer's TIN (optional)

OMB No. 1545-0112

Form 1099-INT (Rev. January 2022)

For calendar year 2022

1 Interest income: $ 4494.93

2 Early withdrawal penalty: $

3 Interest on U.S. Savings Bonds and Treasury obligations: $

4 Federal income tax withheld: $

5 Investment expenses: $

6 Foreign tax paid: $

7 Foreign country or U.S. possession

8 Tax-exempt interest: $

9 Specified private activity bond interest: $

10 Market discount: $

11 Bond premium: $

12 Bond premium on Treasury obligations: $

13 Bond premium on tax-exempt bond: $

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld: $ $

Interest Income

Copy B

For Recipient

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Form 1099-INT (Rev. 1-2022) (keep for your records) Department of the Treasury - Internal Revenue Service

Form 1099-INT

☐ CORRECTED (if checked)

Keep for your records

PAYER'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone no.

M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2013

Form 1099-INT

Interest Income

38-2099803

Department of the Treasury — IRS

1 Interest income

$ 3479.48

Copy B

For Recipient

2 Early withdrawal penalty

$

3 Interest on U.S. Savings Bonds and Treas. obligations

$

PAYER'S federal identification number

RECIPIENT'S identification number

RECIPIENT'S name, address, country, and ZIP or foreign postal code

STEPHEN G SPUDIE
676 MASON RD
WATERVILLE NY 13480

4 Federal income tax withheld

$

5 Investment expenses

$

6 Foreign tax paid

$

7 Foreign country or U.S. possession

8 Tax-exempt interest

$

9 Specified private activity bond interest

$

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Account number (see instructions)

[redacted]

10 Tax-exempt bond CUSIP no.

11 State

12 State ID no.

13 State tax withheld

$

$

Form 1099-INT ☐ CORRECTED (if checked) (keep for your records)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2014

Form 1099-INT

Interest Income

38-2899503

Department of the Treasury — IRS

1 Interest income
$ 8832.43

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

Copy B

For Recipient

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

PAYER'S federal identification number | RECIPIENT'S identification number

RECIPIENT'S name, address, ZIP/postal code & country
STEPHEN G SPUDIE
676 MASON RD
WATERVILLE NY 13480

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

Account number (see instructions)

12 Tax-exempt bond CUSIP no.

13 State | 14 State ID no.

15 State tax withheld
$
$

Form 1099-INT | CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2015

Form 1099-INT

Interest Income

38-1088603
Dept. of Treasury — IRS

Copy B

For Recipient

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

PAYER'S federal identification number	RECIPIENT'S identification number
	[redacted]

RECIPIENT'S name, address, ZIP/postal code & country

STEPHEN G SPUDIE
676 MASON RD
WATERVILLE NY 13480

1 Interest income	$ 10781.14
2 Early withdrawal penalty	$
3 Interest on U.S. Savings Bonds and Treas. obligations	$
4 Federal income tax withheld	$
5 Investment expenses	$
6 Foreign tax paid	$
7 Foreign country or U.S. possession	
8 Tax-exempt interest	$
9 Specified private activity bond interest	$
10 Market discount	$
11 Bond premium	$
12	
13 Bond premium on tax-exempt bond	$
FATCA filing requirement ☐	
14 Tax-exempt and tax credit bond CUSIP no.	
15 State	16 State ID no.
17 State tax withheld	$ $

Account number (see instructions)

1

5 B99INTB NTF 2578207 BINTREC Copyright 2015 Greatland/Nelco - Forms Software Only

Form 1099-INT ☐ CORRECTED (if checked) (keep for your records)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional) | OMB No. 1545-0112 | 2016 | Form 1099-INT

Interest Income

88-2088888 Dept. of Treasury — IRS

1 Interest income: $ 11316.77

2 Early withdrawal penalty: $

3 Interest on U.S. Savings Bonds and Treas. obligations: $

PAYER'S federal identification number | RECIPIENT'S identification number

RECIPIENT'S name, address, ZIP/postal code & country

STEPHEN G SPUDIE
676 MASON RD
WATERVILLE NY 13480

4 Federal income tax withheld: $

5 Investment expenses: $

6 Foreign tax paid: $

7 Foreign country or U.S. possession

8 Tax-exempt interest: $

9 Specified private activity bond interest: $

10 Market discount: $

11 Bond premium: $

FATCA filing requirement ☐

12 Bond premium on Treasury obligations: $

13 Bond premium on tax-exempt bond: $

Account number (see instructions) [redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State | 16 State ID no.

17 State tax withheld: $ $

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For Recipient

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Form 1099-INT ☐ CORRECTED (if checked) (keep for your records)

Interest Income

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112
2017
Form 1099-INT

Dept. of Treasury — IRS

1 Interest income
$ 12201.45

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

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For Recipient

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PAYER'S federal identification number | RECIPIENT'S identification number

RECIPIENT'S name, address, ZIP/postal code & country
STEPHEN G SPUDIE
676 MASON RD
WATERVILLE NY 13480

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

Account number (see instructions)
[redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State ID no.

17 State tax withheld
$
$

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☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2018

Form 1099-INT

Interest Income

1 Interest income
$ 12830.85

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

Copy B
For Recipient

PAYER'S TIN

RECIPIENT'S TIN

RECIPIENT'S name, address, ZIP/postal code & country
STEPHEN G SPUDIE
676 MASON RD
WATERVILLE NY 13480

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Account number (see instructions)
[redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$
$

Form 1099-INT (keep for your records)

Department of the Treasury - Internal Revenue Service

BSGNTB 6 Dec.

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2019

Form 1099-INT

Interest Income

1 Interest income
$ 13994.66

2 Early withdrawal penalty
$

Copy B

For Recipient

PAYER'S TIN

RECIPIENT'S TIN

3 Interest on U.S. Savings Bonds and Treas. obligations
$

RECIPIENT'S name, address, ZIP/postal code & country
STEPHEN SPUDIE
676 MASON RD
WATERVILLE NY 13480-2308

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Account number (see instructions)
[redacted]

14 Tax-exempt and tax credit bond CUSIP no.

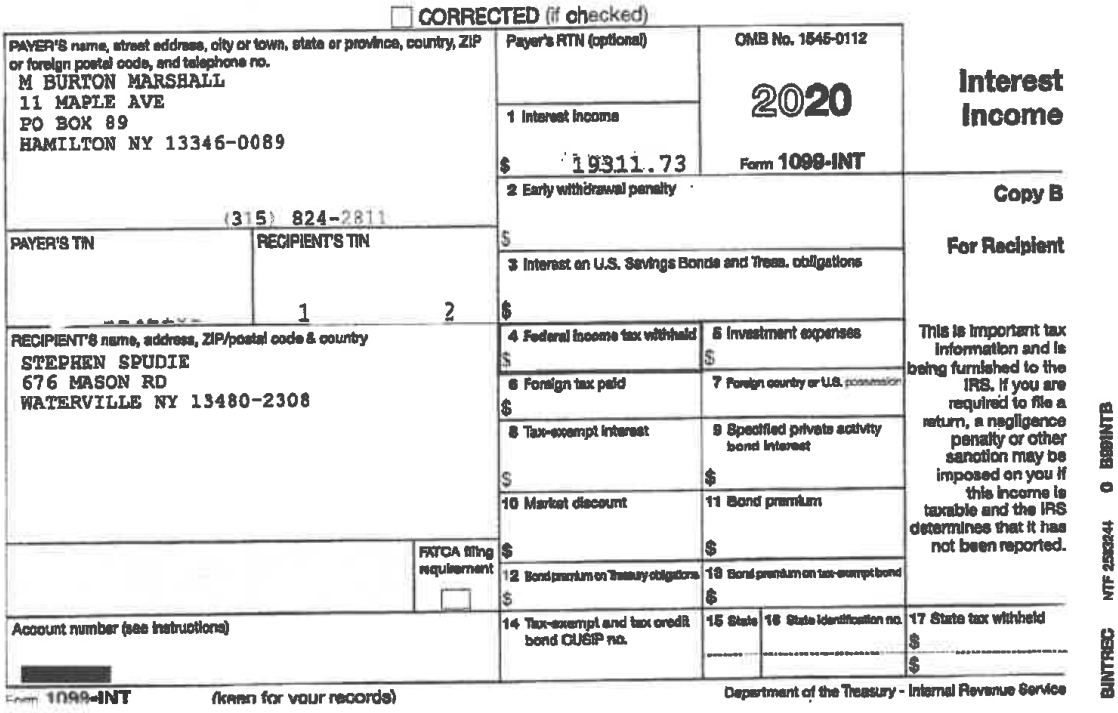
15 State

16 State identification no.

17 State tax withheld
$
$

Form 1099-INT (keep for your records)

Department of the Treasury - Internal Revenue Service



☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2020

Form 1099-INT

Interest Income

1 Interest income
$ 19311.73

2 Early withdrawal penalty
$

Copy B

For Recipient

PAYER'S TIN

RECIPIENT'S TIN
1 2

3 Interest on U.S. Savings Bonds and Treas. obligations
$

RECIPIENT'S name, address, ZIP/postal code & country
STEPHEN SPUDIE
676 MASON RD
WATERVILLE NY 13480-2308

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Account number (see instructions)
[redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$
$

Form 1099-INT (Keep for your records)

Department of the Treasury - Internal Revenue Service

BUNTREC NTF 253244 0 B99INTB

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2021

Form 1099-INT

Interest Income

Copy B

For Recipient

1 Interest income
$ 13755.84

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

PAYER'S TIN

RECIPIENT'S TIN

RECIPIENT'S name, address, ZIP/postal code & country
STEPHEN SPUDIE
676 MASON RD
WATERVILLE NY 13480-2308

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

Account number (see instructions)
[redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

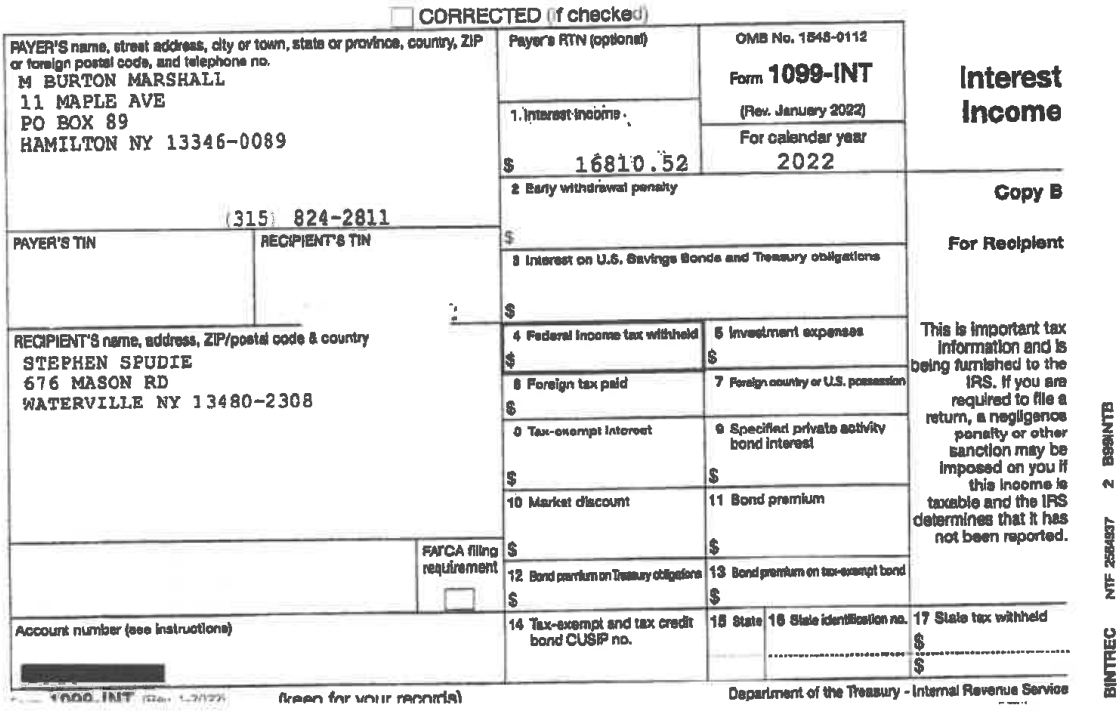
17 State tax withheld
$
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Form 1099-INT (keep for your records)

Department of the Treasury - Internal Revenue Service

BMTREC NTF 2934054 1 B99INTB



☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112
Form 1099-INT
(Rev. January 2022)
For calendar year 2022

Interest Income

1. Interest income
$ 16810.52

2 Early withdrawal penalty
$

Copy B
For Recipient

PAYER'S TIN

RECIPIENT'S TIN

3 Interest on U.S. Savings Bonds and Treasury obligations
$

RECIPIENT'S name, address, ZIP/postal code & country
STEPHEN SPUDIE
676 MASON RD
WATERVILLE NY 13480-2308

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Account number (see instructions)
[redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State | 16 State identification no. | 17 State tax withheld
$
$

1099-INT (Rev. 1-2022) (keep for your records) Department of the Treasury - Internal Revenue Service

BINTREC NTF 2584837 2 BSBINTB

CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2018

Form 1099-INT

Interest Income

1 Interest income
$ 2025.59

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

PAYER'S TIN [redacted]

RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
LOVELY LIVING TRUST
5112 BUYEA RD
CAZENOVIA NY 13035-9773

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

Account number (see instructions)
[redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$
$

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For Recipient

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Form 1099-INT (keep for your records)

Department of the Treasury - Internal Revenue Service

—

CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country. ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2019

Form 1099-INT

Interest Income

1 Interest income
$ 5715.70

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

PAYER'S TIN [redacted]

RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
LOVELY LIVING TRUST
5112 BUYEA RD
CAZENOVIA NY 13035-9773

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

Account number (see instructions)
[redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$
$

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Form 1099-INT (keep for your records)

Department of the Treasury - Internal Revenue Service

CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2020

Form 1099-INT

Interest Income

1 Interest income: $ 6839.78

2 Early withdrawal penalty: $

3 Interest on U.S. Savings Bonds and Treas. obligations: $

PAYER'S TIN [redacted]

RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
LOVELY LIVING TRUST
5112 BUYEA RD
CAZENOVIA NY 13035-9773

4 Federal income tax withheld: $

5 Investment expenses: $

6 Foreign tax paid: $

7 Foreign country or U.S. possession

8 Tax-exempt interest: $

9 Specified private activity bond interest: $

10 Market discount: $

11 Bond premium: $

FATCA filing requirement

12 Bond premium on Treasury obligations: $

13 Bond premium on tax-exempt bond: $

Account number (see instructions)
2020

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld: $ $

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For Recipient

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Form 1099-INT (keep for your records)

Department of the Treasury - Internal Revenue Service

BINTREC NTF 2583244 0 $99INTB

CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2021

Form 1099-INT

Interest Income

1 Interest income: $ 7384.36

2 Early withdrawal penalty: $

3 Interest on U.S. Savings Bonds and Treas. obligations: $

PAYER'S TIN [redacted]

RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
LOVELY LIVING TRUST
5112 BUYEA RD
CAZENOVIA NY 13035-9773

4 Federal income tax withheld: $

5 Investment expenses: $

6 Foreign tax paid: $

7 Foreign country or U.S. possession

8 Tax-exempt interest: $

9 Specified private activity bond interest: $

10 Market discount: $

11 Bond premium: $

FATCA filing requirement

12 Bond premium on Treasury obligations: $

13 Bond premium on tax-exempt bond: $

Account number (see instructions)
2021

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld: $ $

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For Recipient

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Form 1099-INT (keep for your records)

Department of the Treasury - Internal Revenue Service

☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112
Form **1099-INT**
(Rev. January 2022)
For calendar year 2022

Interest Income

1 Interest income
$ 7000.08

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treasury obligations
$

Copy B
For Recipient

PAYER'S TIN [redacted]

RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
LOVELY LIVING TRUST
5112 BUYEA RD
CAZENOVIA NY 13035-9773

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Account number (see instructions)
[redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$
$

Form **1099-INT** (Rev. 1-2022) (keep for your records) Department of the Treasury - Internal Revenue Service

[redacted]

Form 1099-INT ☐ CORRECTED (if checked) (keep for your records)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2014

Form 1099-INT

Interest Income

38-2098809

Department of the Treasury -- IRS

1 Interest income
$ 10400.00

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

Copy B

For Recipient

PAYER'S federal identification number [redacted]

RECIPIENT'S identification number [redacted]

RECIPIENT'S name, address, ZIP/postal code & country

ARCHIE DIABLE
16491 S E 80TH AVE
SUMMERFIELD FL 34491

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Account number (see instructions)

12 Tax-exempt bond CUSIP no.

13 State

14 State ID no.

15 State tax withheld
$
$

[redacted]

Form 1099-INT ☐ CORRECTED (if checked) (keep for your records)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2015

Form 1099-INT

Interest Income

38-2009803
Dept. of Treasury — IRS

Copy B

For Recipient

1 Interest income
$ 5579.01

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

PAYER'S federal identification number | RECIPIENT'S identification number

[redacted]

RECIPIENT'S name, address, ZIP/postal code & country
ARCHIE DIABLE
16491 SE 80TH AVE
SUMMERFIELD FL 34491

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12

13 Bond premium on tax-exempt bond
$

Account number (see instructions)
1

14 Tax-exempt and tax credit bond CUSIP no.

15 State | 16 State ID no.

17 State tax withheld
$
$

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

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[redacted]

Form 1099-INT ☐ CORRECTED (if checked) _____ (keep for your records)

Interest Income

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2016

Form 1099-INT

38-2099803
Dept. of Treasury — IRS

1 Interest income
$ 2406.60

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

PAYER'S federal identification number [redacted]

RECIPIENT'S identification number [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
ARCHIE DIABLE
THE DIABLE FAMILY TRUST
16491 SE 80TH AVE
SUMMERFIELD FL 34491

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

Account number (see instructions)
1

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State ID no.

17 State tax withheld
$
$

Copy B

For Recipient

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[redacted]

Form 1099-INT CORRECTED (if checked) (keep for your records)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2017

Form 1099-INT

Interest Income

Dept. of Treasury -- IRS

Copy B

For Recipient

1 Interest income
$ 2400.03

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

PAYER'S federal identification number | RECIPIENT'S identification number

[redacted]

RECIPIENT'S name, address, ZIP/postal code & country
ARCHIE DIABLE
THE DIABLE FAMILY TRUST
16491 SE 80TH AVE
SUMMERFIELD FL 34491

4 Federal income tax with held
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

Account number (see instructions)

[redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State | 16 State ID no. | 17 State tax with held
$
$

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

[redacted]

1-29-19

☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2018

Form 1099-INT

Interest Income

1 Interest income
$ 2400.03

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

Copy B

For Recipient

PAYER'S TIN [redacted]

RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code, country
ARCHIE DIABLE
THE DIABLE FAMILY TRUST
16491 SE 80TH AVE
SUMMERFIELD FL 34491

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

FATCA filing requirement ☐

Account number (see instructions)
[redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Form 1099-INT (keep for your records)

Department of the Treasury - Internal Revenue Service

BINTREC NTF 2sheiss0 8 B99INTB

[redacted]

[redacted]

☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2019

Form 1099-INT

Interest Income

Copy B

For Recipient

1 Interest income
$ 4092.16

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

PAYER'S TIN [redacted]

RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
ARCHIE DIABLE
JOANIE DIABLE
THE DIABLE FAMILY TRUST
16491 SE 80TH AVE
SUMMERFIELD FL 34491-5322

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you. If this income is taxable and the IRS determines that it has not been reported.

Account number (see instructions)
[redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$
$

Form 1099-INT (keep for your records)

Department of the Treasury - Internal Revenue Service

BINTREC NTF 2352696 9 B99INTB

[redacted]

☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2020

Form 1099-INT

Interest Income

1 Interest income
$ 7496.43

2 Early withdrawal penalty
$

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For Recipient

PAYER'S TIN [redacted]

RECIPIENT'S TIN [redacted]

3 Interest on U.S. Savings Bonds and Treas. obligations
$

RECIPIENT'S name, address, ZIP/postal code & country
ARCHIE DIABLE
JOANIE DIABLE
16491 SE 80TH AVE
SUMMERFIELD FL 34491-5322

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Account number (see instructions) [redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$
$

Form 1099-INT (keep for your records)

Department of the Treasury - Internal Revenue Service

[redacted]

[redacted]

☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2021

Form 1099-INT

Interest Income

1 Interest income
$ 7999.97

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

Copy B

For Recipient

PAYER'S TIN [redacted]

RECIPIENT'S TIN [redacted]50[redacted]

RECIPIENT'S name, address, ZIP/postal code & country
ARCHIE DIABLE
JOANIE DIABLE
16491 SE 80TH AVE
SUMMERFIELD FL 34491-5322

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

Account number (see instructions)
[redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Form 1099-INT (keep for your records)

Department of the Treasury – Internal Revenue Service

[redacted]

☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112
Form **1099-INT**
(Rev. January 2022)
For calendar year 2022

Interest Income

1 Interest income
$ 7999.97

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treasury obligations
$

Copy B
For Recipient

PAYER'S TIN [redacted]

RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
ARCHIE DIABLE
JOANIE DIABLE
16491 SE 80TH AVE
SUMMERFIELD FL 34491-5322

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

Account number (see instructions) [redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Form 1099-INT (Rev. 1-2022) (keep for your records)

Department of the Treasury - Internal Revenue Service

BINTREC NTF 2584927 2 B99INTB

[redacted]

Form 1099-INT CORRECTED (if checked) (keep for your records)

PAYER'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional) | OMB No. 1545-0112 | 2013 | **Interest Income**

1 Interest income: $ 8784.25 | Form 1099-INT | Department of the Treasury -- IRS

2 Early withdrawal penalty: $

3 Interest on U.S. Savings Bonds and Treas. obligations: $

4 Federal income tax withheld: $ | 5 Investment expenses: $

6 Foreign tax paid: $ | 7 Foreign country or U.S. possession

8 Tax-exempt interest: $ | 9 Specified private activity bond interest: $

10 Tax-exempt bond CUSIP no. | 11 State | 12 State ID no. | 13 State tax withheld: $

PAYER'S federal identification number: [redacted] | RECIPIENT'S identification number: [redacted]

RECIPIENT'S name, address, country, and ZIP or foreign postal code
ARCHIE DIABLE
16491 S E 80TH AVE
SUMMERFIELD FL 34491

Account number (see instructions)
3

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For Recipient

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

3 B99INTB NTF 2577636A BINTREC Copyright 2013 Greatland/Nelco - Forms Software Only

[redacted]

Form 1099-INT ☐ CORRECTED (if checked) (Keep for your records)

PAYER'S name, street address, city, state, ZIP code, and telephone no.

M BURTON MARSHALL
PO BOX 89
11 MAPLE AVE
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2012

Form 1099-INT

Interest Income

Department of the Treasury — IRS

1 Interest income
$ 4652.28

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Tax-exempt bond CUSIP no.

11 State

12 State ID no.

13 State tax withheld
$

PAYER'S federal identification number [redacted]

RECIPIENT'S name, address, and ZIP code

ARCHIE DIABLE
16491 S E 80TH AVE
SUMMERFIELD FL 34491

Account number (see instructions) [redacted]

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For Recipient

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

2 - 599INTB ATF2576199 BINTREC Copyright 2012 Greatland/Nelco - Forms Software Only

Form 1099-INT CORRECTED (if checked) (Keep for your records)

PAYER'S name, street address, city, state, ZIP code, and telephone no.
M BURTON MARSHALL
PO BOX 89
11 MAPLE AVE
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112
2011
Form 1099-INT
Interest Income
Department of the Treasury -- IRS

PAYER'S federal identification number [redacted]

RECIPIENT'S name, address, and ZIP code
ARCHIE DIABLE
16491 S E 80TH AVE
SUMMERFIELD FL 34491

1 Interest income: $ 1591.14
2 Early withdrawal penalty: $
3 Interest on U.S. Savings Bonds and Treas. obligations: $
4 Federal income tax withheld: $
5 Investment expenses: $
6 Foreign tax paid: $
7 Foreign country or U.S. possession
8 Tax-exempt interest: $
9 Specified private activity bond interest: $
10 Tax-exempt bond CUSIP no. (see instructions)

Copy B
For Recipient

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

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[redacted]

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M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2021

Form 1099-INT

Interest Income

1 Interest income
$ 2719.71

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

PAYER'S TIN [redacted]

RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
MICHAEL P SPELLICY
ANJANETTE A SPELLICY
82 ZION DR
SMYRNA DE 19977-6800

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

Account number (see instructions)
[redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$
$

Form 1099-INT (keep for your records)

Department of the Treasury - Internal Revenue Service

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For Recipient

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☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112

2019

Form 1099-INT

Interest Income

1 Interest income
$ 1763.55

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

PAYER'S TIN [redacted]

RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
MICHAEL SPELLICY
ANJANETTE A SPELLICY
7667 PURDY RD
MADISON NY 13402-9795

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

Account number (see instructions)
2019

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$
$

Form 1099-INT (keep for your records)

Department of the Treasury - Internal Revenue Service

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For Recipient

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

BINTREC NTF 2552E98 9 B99INT8

☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112
Form 1099-INT
(Rev. January 2022)
For calendar year 2022

Interest Income

1 Interest income
$ 3104.13

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treasury obligations
$

PAYER'S TIN [redacted]

RECIPIENT'S TIN [redacted]3

RECIPIENT'S name, address, ZIP/postal code & country
MICHAEL P SPELLICY
ANJANETTE A SPELLICY
82 ZION DR
SMYRNA DE 19977-6800

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

Account number (see instructions)
[redacted]3

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$
$

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For Recipient

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Form 1099-INT (Rev. 1-2022) (keep for your records)

Department of the Treasury - Internal Revenue Service

Form 1099-INT ☐ CORRECTED (if checked) (keep for your records)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

PAYER'S federal identification number | RECIPIENT'S identification number
[redacted]

RECIPIENT'S name, address, ZIP/postal code & country
MARGARET A PAVELA
500 BIRCHALL LN 308
HOOVER AL 35226

FATCA filing requirement ☐

Account number (see instructions)
[redacted]

Payer's RTN (optional) | OMB No. 1545-0112
2017
Form 1099-INT

1 Interest income
$ 13726.63

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

14 Tax-exempt and tax credit bond CUSIP no.

15 State | 16 State ID no.

17 State tax withheld
$
$

Interest Income

Dept. of Treasury - IRS

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For Recipient

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☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089

(315) 824-2811

PAYER'S TIN | RECIPIENT'S TIN
[redacted]

RECIPIENT'S name, address, ZIP/postal code & country
MARGARET A PAVELA
500 BIRCHALL LN APT 308
HOOVER AL 35226

FATCA filing requirement ☐

Account number (see instructions)
[redacted]

Payer's RTN (optional) | OMB No. 1545-0112
2018
Form 1099-INT

1 Interest income
$ 13847.98

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

14 Tax-exempt and tax credit bond CUSIP no.

15 State | 16 State identification no.

17 State tax withheld
$
$

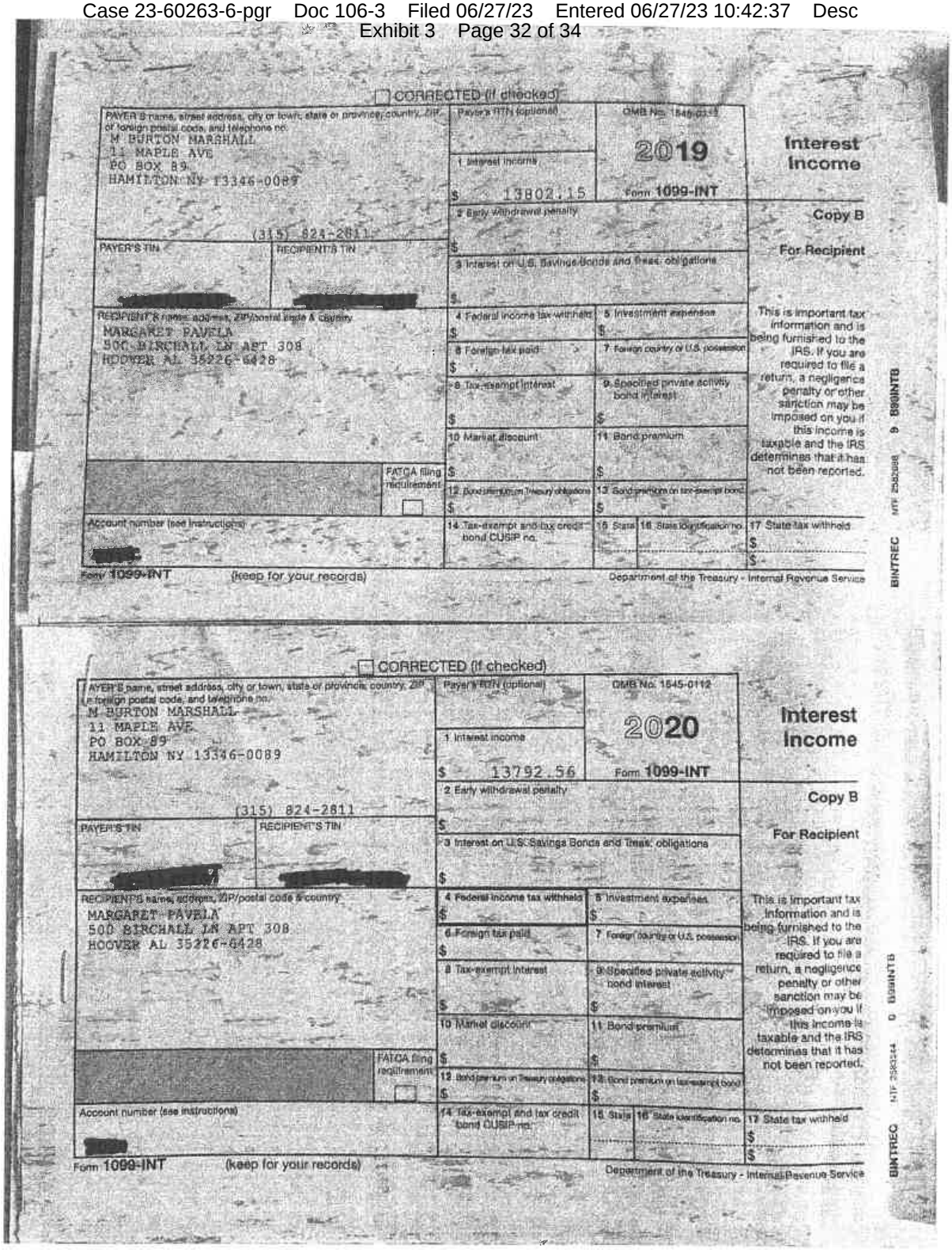
Interest Income

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For Recipient

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Form 1099-INT (keep for your records) Department of the Treasury - Internal Revenue Service



☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

PAYER'S TIN [redacted] | RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
MARGARET PAVELA
500 BIRCHALL LN APT 308
HOOVER AL 35226-6428

Account number (see instructions) [redacted]

FATCA filing requirement ☐

Payer's RTN (optional)

OMB No. 1545-0112

2019

Form **1099-INT**

Interest Income

1 Interest income: $ 13802.15

2 Early withdrawal penalty: $

3 Interest on U.S. Savings Bonds and Treas. obligations: $

4 Federal income tax withheld: $

5 Investment expenses: $

6 Foreign tax paid: $

7 Foreign country or U.S. possession

8 Tax-exempt interest: $

9 Specified private activity bond interest: $

10 Market discount: $

11 Bond premium: $

12 Bond premium on Treasury obligations: $

13 Bond premium on tax-exempt bond: $

14 Tax-exempt and tax credit bond CUSIP no.

15 State | 16 State identification no.

17 State tax withheld: $ | $

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For Recipient

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Form **1099-INT** (keep for your records)

Department of the Treasury - Internal Revenue Service

BINTREC MTF 2582088 9 890INTB

☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

PAYER'S TIN [redacted] | RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
MARGARET PAVELA
500 BIRCHALL LN APT 308
HOOVER AL 35226-6428

Account number (see instructions) [redacted]

FATCA filing requirement ☐

Payer's RTN (optional)

OMB No. 1545-0112

2020

Form **1099-INT**

Interest Income

1 Interest income: $ 13792.56

2 Early withdrawal penalty: $

3 Interest on U.S. Savings Bonds and Treas. obligations: $

4 Federal income tax withheld: $

5 Investment expenses: $

6 Foreign tax paid: $

7 Foreign country or U.S. possession

8 Tax-exempt interest: $

9 Specified private activity bond interest: $

10 Market discount: $

11 Bond premium: $

12 Bond premium on Treasury obligations: $

13 Bond premium on tax-exempt bond: $

14 Tax-exempt and tax credit bond CUSIP no.

15 State | 16 State identification no.

17 State tax withheld: $ | $

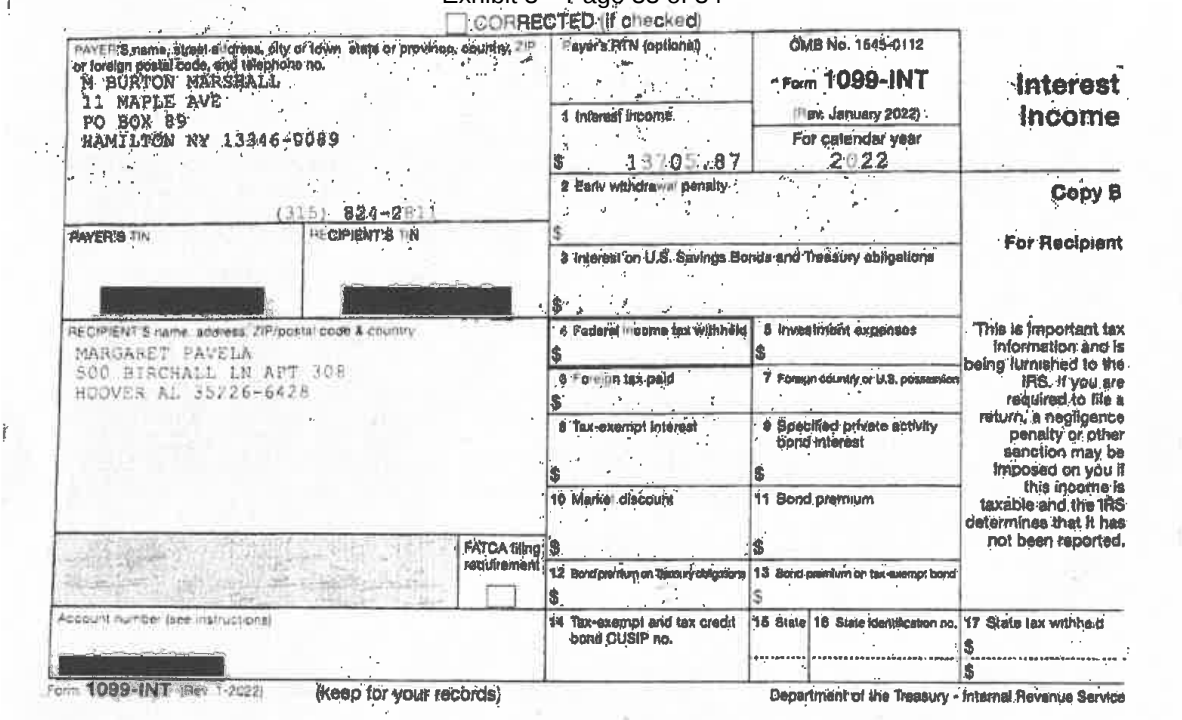
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For Recipient

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Form **1099-INT** (keep for your records)

Department of the Treasury - Internal Revenue Service

BINTREC MTF 2582044 0 890INTB



☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112
Form 1099-INT
(Rev. January 2022)
For calendar year 2022

Interest Income

1 Interest income
$ 1305.87

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treasury obligations
$

Copy B
For Recipient

PAYER'S TIN [redacted]
RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
MARGARET PAVELA
500 BIRCHALL LN APT 308
HOOVER AL 35226-6428

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Account number (see instructions) [redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$
$

Form 1099-INT (Rev. 1-2022) (keep for your records)

Department of the Treasury - Internal Revenue Service

☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112
2021
Form 1099-INT

Interest Income

1 Interest income
$ 1370.76

2 Early withdrawal penalty
$

3 Interest on U.S. Savings Bonds and Treas. obligations
$

Copy B
For Recipient

PAYER'S TIN [redacted]
RECIPIENT'S TIN [redacted]

RECIPIENT'S name, address, ZIP/postal code & country
MARGARET PAVELA
500 BIRCHALL LN APT 308
HOOVER AL 35226-6428

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Account number (see instructions) [redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$
$

Form 1099-INT (keep for your records)

Department of the Treasury - Internal Revenue Service

1INTREC NTF 2584054 1 B99INTB

☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
M BURTON MARSHALL
11 MAPLE AVE
PO BOX 89
HAMILTON NY 13346-0089
(315) 824-2811

Payer's RTN (optional)

OMB No. 1545-0112
Form **1099-INT**
(Rev. January 2022)
For calendar year
2022

Interest Income

1 Interest income
$ 14383.22

2 Early withdrawal penalty
$

Copy B
For Recipient

PAYER'S TIN [redacted]
RECIPIENT'S TIN [redacted]

3 Interest on U.S. Savings Bonds and Treasury obligations
$

RECIPIENT'S name, address, ZIP/postal code & country
BERT MCCULLOCH
2629 DAREN DR
ENDWELL NY 13760-7228

4 Federal income tax withheld
$

5 Investment expenses
$

6 Foreign tax paid
$

7 Foreign country or U.S. possession

8 Tax-exempt interest
$

9 Specified private activity bond interest
$

10 Market discount
$

11 Bond premium
$

FATCA filing requirement ☐

12 Bond premium on Treasury obligations
$

13 Bond premium on tax-exempt bond
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Account number (see instructions) [redacted]

14 Tax-exempt and tax credit bond CUSIP no.

15 State

16 State identification no.

17 State tax withheld
$
$

Form 1099-INT (Rev. 1-2022) (keep for your records)

Department of the Treasury - Internal Revenue Service

BINTREC NTF 2584537 2 B99INTB

Case 23-60263-6-pgr Doc 137 Filed 07/18/23 Entered 07/18/23 17:10:45 Desc Main Document Page 1 of 16 Docket #137 Date Filed: 07/18/2023

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK
(UTICA DIVISION)

Hearing Date: July 25, 2023
Hearing Time: 1:00 p.m.
Hearing Location: Utica, New York

In re:

M. BURTON MARSHALL
a/k/a BURT MARSHALL
a/k/a MILES BURTON MARSHALL

Debtor.

Main Case No. 23-60263-6-PGR

Chapter 11

DEBTOR'S PARTIAL OBJECTION TO THE UNITED STATE TRUSTEE'S MOTION UNDER 11 U.S.C. §1104(a) TO APPOINT A CHAPTER 11 TRUSTEE OR, IN THE ALTERNATIVE, TO APPOINT AN EXAMINER UNDER § 1104(c)

M. Burton Marshall a/k/a Burt Marshall a/k/a Miles Burton Marshall, the above-captioned debtor and debtor in possession (the "Debtor"), by and through his counsel, as and for his Partial Objection (the "Objection") to the United States Trustee's Motion Under 11 U.S.C. § 1104(a) to appoint a Chapter 11 Trustee or, in the alternative, to appoint an Examiner under 11 U.S.C. § 1104(c) and reservation of rights ("Motion") respectfully represents to the Court as follows:

JURISDICTION

1. The Court has jurisdiction over this Motion pursuant to 28 U.S.C. §§ 157 and 1334.

2. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2).

3. Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

SUMMARY OF ARGUMENT

4. The United States Trustee ("UST") has failed to meet his burden in establishing cause for the appointment of a Chapter 11 Trustee. The UST submits unsubstantiated allegations and incomplete summaries from a transcript regarding the alleged past conduct of the Debtor, but ignores the fact that the Debtor has been removed from management of the Debtor's businesses. Simply stated, the Debtor is not currently managing the business and allegations concerning his past conduct are irrelevant to appointment of a trustee under Section 1104(a)(1) of the Bankruptcy

Code. While the UST has correctly pointed out that the appointment of an examiner is mandated if a section 1104 trustee is not appointed, the Debtor submits that the Court should await the results of the investigation being undertaken by the financial advisors retained by the Official Committee of Unsecured Creditors (the "Committee") before defining the scope of such an examiner's investigation. The Debtor, through his proposed financial advisors and chief restructuring advisor, the Algon Capital, Inc. d/b/a Algon Group ("Algon") has been fully transparent, has cooperated with all document demands and has worked tirelessly to produce voluminous financial information and records to the Committee and the UST.

BACKGROUND

5. On April 20, 2023 (the "Petition Date"), the Debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code with the United States Bankruptcy Court for the Northern District of New York (the "Court"), commencing the Debtor's Chapter 11 case (this "Chapter 11 Case").

6. The Debtor's business are operated as sole proprietorships, through "doing business as" ("dba") designations in the areas of tax preparation services, storage services, printing services, and rental services. The Debtor's six dba's include: M&M Press, Marshall Tax Service, Marshall Moving, Marshall Storage, Marshall Maintenance, and Marshall Rentals.

7. In addition, the Debtor owns 100% of the stock of an insurance agency, Miles B. Marshall, Inc. This corporation did not seek bankruptcy relief.

8. The Debtor owns over one hundred rental properties containing over 240 residential units through M. Burton Marshall d/b/a Marshall Rentals. The Debtor holds approximately 249 tenant security deposits in segregated accounts. Nineteen of the properties are subject to

mortgages, and fourteen of those mortgages contain an assignment of rents provision, pledging rent received from tenants as additional collateral.

9. The Debtor's rental properties range from a two-family building to a seven-unit building.

10. The Debtor is also a tax preparer.

11. The Debtor also owns a printing business as well as a storage rental business.

12. The Debtor's Chapter 11 case was largely precipitated by his recent hospitalization for a serious heart condition requiring two (2) surgeries. As a result of being out of the office, the Debtor estimated a loss of approximately $600,000 in revenue related to his tax return preparation business. As news of his illness circulated, he experienced an increase in requests by his unsecured noteholders for payments of principal and/or interest, requests that the cash flow from the business could not support.

STATUTORY STANDARDS AND BURDEN OF PROOF

A. Section 1104 (a) – Appointment of a Chapter 11 Trustee

13. Chapter 11 allows a debtor to continue to manage and operate his business and any property of his estate. 11 U.S.C. § 1107; see *In re Adelphia Commc'ns Corp.*, 336 B.R. 610, 665 (Bankr. S.D.N.Y.). However, a debtor-in-possession is obligated to perform all of the obligations of a trustee identified in Bankruptcy Code section 1106, see 11 U.S.C. § 1107, and owes fiduciary duties to his estate and creditors. *In re Smart World Techs., LLC*, 423 F.3d 166, 175 (2d Cir. 2005).

14. While there is a presumption that a debtor should be permitted to remain in possession of its business, that presumption is not absolute. *In re Ionosphere Clubs, Inc*., 113 B.R. 164, 167 (Bankr. S.D.N.Y. 1990); *In re Ashley River Consulting, LLC*, 2015 Bankr. LEXIS 1008 (Bankr. S.D.N.Y. 2015). The willingness to allow a Debtor to remain in possession of its assets is

predicated upon the assumption that the Debtor will perform its fiduciary obligations. *In re Centennial Textiles* 227 B.R. 606, 612 (Bankr. S.D.N.Y. 1998).

15. Section 1104(a)(1) of the Bankruptcy Code requires a court to appoint a Chapter 11 Trustee upon a clear and convincing demonstration of "cause." Sufficient cause for appointment of a trustee under section 1104(a)(1) includes fraud, dishonesty, incompetence, or gross mismanagement of the debtor's affairs **by current management**. *In re Sillerman*, 605 B.R. 631 (Bankr. S.D.N.Y. 2019. *See also, In re Mako, Inc.*, 102 B.R. 809, 811-12 (Bankr. E.D. Okla. 1988); *In re Fisher & Son, Inc.*, 70 B.R. 7, 8 (Bankr. S.D. Ohio 1986). What constitutes "cause" under section 1104(a)(1) is determined on a case-by-case basis. *In re Sharon Steel Corp.*, 871 F.2d 1217, 1226 (3rd Cir. 1989); *In re General Oil Distributors, Inc.*, 42 B.R. 402, 409. Courts have ordered the appointment of a Chapter 11 Trustee under section 1104(a)(1) in cases involving conflicts of interests, misuse of assets and funds, inadequate recordkeeping and reporting, lack of appropriate cost controls, nonpayment of taxes or conduct constituting fraud or dishonesty. *In re Clinton Centrifuge, Inc.*, 85 B.R. 980, 985. Courts have recognized, however, that some degree of mismanagement exists in practically every insolvency case. *In re Ionosphere Clubs, Inc.*, 113 B.R. 164, 168; *In re Mako, Inc.,* 102 B.R. 809, 812; *In re Anchorage Boat Sales, Inc.*, 4 B.R. 635, 645 (Bankr. E.D.N.Y. 1980). To constitute "gross mismanagement" under section 1104(a)(1), something more than simple mismanagement must exist. *In re Mako, Inc.*, 102 B.R. 809, 812; *In re Anchorage Boat Sales, Inc.*, 4 B.R. 635, 645. "The philosophy of chapter 11 is to give the debtor a 'second chance' and, consistent with such philosophy, current management should be permitted to identify and correct [any] past mistakes." *In re Ionosphere Clubs, Inc.*, 113 B.R. 164, 168. *See also*, *In re General Oil Distributors, Inc.*, 42 B.R. 402, 409 (Bankr. E.D.N.Y. 1984). To justify appointment of a trustee under section 1104(a)(1), some aggravated wrong, extreme

ineptitude or impropriety must be demonstrated. *In re Mako, Inc.*, 102 B.R. 809, 812; *In re Anchorage Boat Sales, Inc.*, 4 B.R. 635, 645.

B. Standard of Proof

16. The Second Circuit has annunciated the standard for the appointment of a Chapter 11 Trustee. The UST has the burden of showing by clear and convincing evidence that the appointment of a trustee is warranted. *Adams v. Marwil* 564 F.3d 541 (2nd Cir. 2009). *See also, In re Sillerman*, 605 B.R. 631. The "[s]tandard for § 1104 appointment is very high . . . ."*Adams v. Marwil* at 546 *quoting In re Smart World*, 423 F.3d at 176; *see also,* 7 Collier on Bankruptcy, P 1104.02[2][a] (noting that appointment of a trustee in a Chapter 11 case is an "extraordinary" remedy)". The movant has the burden of showing by "clear and convincing evidence" that the appointment of a trustee is warranted. *Adams v. Marwil* at 546 *quoting In re Adelphia Commc'ns Corp*., 336 B.R. 610, 656 (Bankr. S.D.N.Y. 2006).

17. In determining whether a §1104 appointment is warranted, the bankruptcy court must bear in mind that the appointment of a trustee "may impose a substantial financial burden on a hard pressed debtor seeking relief under the Bankruptcy Code," by incurring the expenditure of "substantial administrative expenses" caused by further delay in the bankruptcy proceedings. *Id.* at 547 *citing Midlantic Nat'l Bank v. Anchorage Boat Sales, Inc*. 4 B.R. 635, 644 (Bankr. S.D.N.Y. 1980). Thus, the standard to appoint a Chapter 11 Trustee is a very high standard. The mere allegations lodged by the UST do not meet this standard.

C. Section 1104 (c) - Appointment of an Examiner

18. As acknowledged above, if the Court does not appoint an 1104 Trustee, the appointment of an examiner is mandatory. The Court retains discretion to define the scope of the examiner's investigations. As the Debtor, through Algon, has already provided volumes of information to both the UST and the Committee. The Committee's financial advisors are

performing an extensive forensic investigation into the businesses of the Debtor. Accordingly, the Debtor submits that the Court should await the results of that investigation before appointing the examiner and defining the scope of their investigation.

I. Cause does Not Exist to Appoint a Chapter 11 Trustee for the Debtor Under 11 U.S.C. §1104(a)(1)

19. The UST has failed to establish, by clear and convincing evidence, that cause exists to appoint a Chapter 11 Trustee in this case.

20. The Bankruptcy Code requires a debtor to continue to run the debtor's day-to-to day operations and make the necessary changes to the business to provide for a successful organization. Courts have repeatedly found the appointment of a Chapter 11 Trustee to be an extraordinary remedy. *In re Euro-American Lodging Corp.*, 365 B.R. 421, 426 (Bankr. S.D.N.Y. 2007). One court has even said "it is settled that the appointment of a trustee should be the exception, rather than the rule." *In re Sharon Steel Corp.* 871 F.2d 1217, 1225 (3d Cir. 1989). There is a strong presumption that a debtor should remain in possession absent the showing of a need for the appointment of a trustee. *In re Ionosphere Clubs, Inc.* 113 B.R. 164, 167 (Bankr. S.D.N.Y. 1990).

21. The UST largely relies on unsubstantiated allegations and partial testimony of the Debtor about **the Debtor's** pre-petition activities, to support his Motion. Such reliance is misplaced, however, as it fails to address the activities of Algon as current management of the businesses, and in any event, is insufficient to meet the heightened standard for appointment of a Chapter 11 Trustee. Moreover, when the Court considers that facts laid out by the Debtor (*infra)*, which include his post-petition activities, the Court should find a Chapter 11 Trustee is not warranted.

22. The Debtor will demonstrate to the Court that Algon is impartial, has assumed full control of the businesses, thus rendering the UST's allegations irrelevant and insufficient to warrant the appointment of an 1104 Trustee.

Retention of New Management Post-Petition

23. The failure to prove that Algon has participated in questionable conduct alleged by the UST warrants denial of the UST's Motion. *See, In re 1031 Tax Group LLC,* 374 B.R. 79 (S.D.N.Y. 2007).

24. Even if all the allegations against the Debtor were true, and the Debtor does not concede that they are, the post-petition actions taken by the Debtor, particularly including the ceding of authority over the businesses to Algon, demonstrate he has properly fulfilled the obligations of a debtor-in-possession.

25. Actions taken by the Debtor since the Petition Date include:

a) Debtor disclosures required under Section 521 (ECF #1, 3,4, 6);

b) Debtor filed various first day motions to ensure uninterrupted service, operations and use of cash collateral (ECF #10, 11, 12 and 13);

c) Debtor, with Algon, filed his monthly operating report (ECF #115);

d) Debtor filed motions to retain professionals, including a financial advisor, as set forth in Section 327 (ECF #55, 71, 72);

e) Debtor, with Algon and counsel, hosted Committee counsel at the Debtor's offices in Hamilton for an informal informational meeting to answer questions posed by Committee counsel;

f) Debtor, with Algon, appeared and was examined for approximately 2 hours at the first meeting of creditors;

g) Debtor, with Algon, appeared and was examined for approximately 2 hours at the continued meeting of creditors;

h) Debtor stipulated to extend the deadline under Section 523 to the date of confirmation (ECF #105, 111, 123, 124);

i) Debtor, through Algon, prepared a 13 week cash flow projection;

j) Debtor, through Algon, opened additional segregated financial accounts;

k) Debtor ceded signatory authorization to Algon on financial accounts;

l) Algon participated at the initial 341 meeting and the adjourned 341 meeting;

m) Debtor, through Algon, responded to all UST requests for documents and uploaded all documents to the UST secure share file site;

n) Debtor, through Algon responded (and continues to respond) to all Committee requests for documents and created a secure share file where all requested documents were uploaded;

o) Debtor, through Algon, is exploring the valuation and sale of real property, the insurance business and self-storage businesses;

p) Debtor authorized Algon Group to manage the rental properties including the authority to enter into a contract with a property management group;

q) Algon has met with and continues to meet with the Committee's financial advisors;

r) There have been no motions to compel as the Debtor voluntarily complied with requests made of him (see ECF docket generally);

s) The Debtor has complied with the Court's orders and the Bankruptcy Code;

t) The Debtor has made material and relevant disclosures to the Court;

u) In response to a request by the Committee, the Debtor agreed to have the locks changed at his office building, was not provided with a key, and can only be in the premises when others are on site; and

v) The Debtor is current with all post-petition obligations, including his taxes and employee taxes and withholdings.

Disputes with the UST are insufficient grounds to satisfy cause

26. Disputes with the UST's office are insufficient to warrant the appointment of a Chapter 11 Trustee and to rebut the presumption that a debtor should remain in possession. The UST noted in his Motion that he filed an objection to the cash management motion and that said objection remains pending. While the objection remains pending, it is the Debtor's position that his accounts do not exceed the FDIC amount and therefore his depository bank is not required to

be on the UST approved list. The UST approved list exists for protection of amounts in excess of the FDIC insured limit.

27. The disagreement between the Debtor and the UST is insufficient to establish cause for the appointment of a Chapter 11 Trustee.

Factors weighing against the Imposition of a Chapter 11 Trustee

28. The UST relies on *In re Ashley River Consulting, LLC*, 2015 Bankr. Lexis 1008 (Bankr. S.D.N.Y. 2015). In that case, the Court appointed a Chapter 11 Trustee. *Ashley River* is significantly different than the case at hand. In *Ashley River*, there was a finding and an arbitration award which found that the principals and owners of the debtor violated an operating agreement. The *Ashley River* principals engaged in making payments not in the budget, failed to disclose assets in an affiliate corporate, and diverted funds. A charging lien was filed and the debtor filed for bankruptcy relief in response to enforcement proceeding. While in bankruptcy, the court considered several factors in determining whether a Chapter 11 Trustee should be appointed. Factors that influenced the court included: (1) no official unsecured creditors' committee was appointed; (2) no joint administration was requested or ordered; (3) there was a pending motion for dismissal alleging the case was filed in bad faith; (4) in opposing the dismissal motion, the debtor filed opposition which disclosed omitted and missing assets; (5) a punitive award was a result of the court's determination that there was fraud; (6) the debtor had ulterior motives; (7) debtor failed to timely file monthly operating reports which prompted the UST to file a motion to dismiss or convert the case; (8) the only appraiser/oversight was the debtor's professional (and the operating agreement contemplated more than one appraisal); and (9) the debtor defaulted in its debtor-in-possession responsibilities.

29. The "[w]illingness of courts to leave debtors in possession 'is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee.'" *In re Circulatory Ctrs. of Am., LLC*, 579 B.R.752, 760 (Bankr. W.D.P.A. 2017). A debtor-in-possession's inability or unwillingness to discharge its fiduciary responsibilities necessitates the appointment of an independent trustee who can. *In re Marvel Entertainment Group*, 140 F.3d 463, 474 (3d Cir. 1988).

30. The UST merely relies on insufficient speculation that the Debtor may do something bad in the future to satisfy his heightened burden of proof. The UST ignores that Algon is effectively the new management of the Debtor.

31. On a "[m]otion for appointment of a trustee, the focus is on the debtor's current activities, not past misconduct." *Ashley* at 29 *quoting In re Sletteland,* 260 B.R. 657,672 (Bankr. S.D.N.Y. 2011) *citing* 7 Collier on Bankruptcy ¶1104.02[3][c][i] (15th ed.).

32. Here, the Debtor has taken steps to timely and properly fulfill his duties.

33. The Debtor is seeking the appointment of Algon. Algon seeks to provide the following services to the Debtor: (i) perform a financial review of the Debtor (review and assessment of financial information, cash flow projects and developing, and implementing restructuring plans), (ii) performing required analysis of amounts due to creditors including classification of principal, accrued interest, and history of repayment, (iii) develop and execute a strategic plan to maximize the value of the Debtor's assets, lead communications and negotiations with the Committee, (iv) serve as the Debtor's representative for his bankruptcy proceedings, (v) authority to manage and execute agreements, contracts and leases as well as negotiate with interested parties, (vi) assist in preparation of monthly operating reports, and (vii) develop strategies alternatives in connection with a plan of reorganization.

34. Since the Petition Date, the involvement of Algon has been significant. Algon reviewed the data records, made records available (summaries and back up documents) to both the UST and Committee's professionals, is working on valuation of properties and is overseeing the rental properties, tracking cash flow, and is a required signatory on the financial accounts. The Debtor has ceded all authority over the businesses to Algon. Thus, the role of a chapter 11 Trustee in monitoring the progress of the chapter 11 and in supervising the Debtor is unnecessary as the Debtor has no activities to supervise. The actions taken by the Debtor do not warrant the appointment of a Chapter 11 Trustee and in fact militate against it. Algon operates as new management and should be permitted to continue in this role. The appointment of a Chapter 11 Trustee would cost the estate significantly more money than leaving Algon in place as there will be a duplication of the work already performed by the Algon. Additionally a Chapter 11 Trustee would retain its own counsel, also duplicating the efforts to date of Barclay Damon.

35. The knowledge of the businesses developed by Algon is critical to the proper and successful functioning of the businesses which cannot be replaced adequately by a Chapter 11 Trustee. Algon's qualifications and experience are not challenged. Algon has and will continue to generate accurate financial information, assist in determining impartially an appropriate business direction for the businesses and ultimately effectuate a successful reorganization of the Debtor.

36. The UST also alleges that the Debtor may not prosecute chapter 5 causes of action. There is no basis for this allegation. In fact, the Debtor provided a complete list of 44 pre-petition transfers[1] in the Statement of Financial Affairs and the transfers are reflected in the bank records produced to the UST and the Committee. At no time has the Debtor indicated an unwillingness to

[1] One transaction disclosed on the Statement of Financial affairs includes the distribution to all noteholders.

perform any of the duties required by him as a Debtor-In-Possession, and Algon is fully prepared to pursue avoidance actions, in consultation with the Committee.

37. To address the allegations, the Debtor and Algon have taken extensive measures to address any concerns, which include compliance with Section 521, appearance at all 341 Meetings, turnover of summaries and underlying records to the UST, turnover of summaries and underlying records to the Committee, meetings with Committee's financial advisors, completion and filing of monthly operating reports and opening of additional accounts. While there may be complaints against the debtor pre-petition, none are lodged post-petition.

38. UST cites to other cases in other fields of the law to suggest a lower standard should be followed by the Court. However, an examination of those cases which reject the heightened standard, are clearly distinguishable from this case. Equating the award of attorney fees to a successful plaintiff with the extraordinary relief of depriving a debtor of the ability to remain in control of his own financial affairs is clearly erroneous. Extraordinary relief requires a heightened standard.

39. The UST's assertion that a finding of fraud is amply supported by the record is inaccurate. (ECF #7). While the Debtor does state that he has used personal borrowings in the operation of business, he has also used income from his businesses and other sources of income to repay his personal borrowings over the last 30 years. That statement alone is insufficient to make a finding of fraud, certainly does not rise to the level for imposition of a Chapter 11 Trustee, and does not implicate current management.

40. The Debtor stated that his bankruptcy was precipitated by his recent hospitalization, loss of revenue and increased demands from noteholders. ECF #7.

41. In support of the UST allegation of fraud, he states the Debtor admitted to paying existing noteholders by borrowing from future noteholders and cites to the transcript pp. 44-45. *See*, Motion Exhibit 1. A closer examination of those pages reveals that the Debtor testified that he put all money in one account (he referenced the Burt Marshall account). The Debtor deposited the monies received from his dbas: M&M Press, Marshall Tax Service, Marshall Moving, Marshall Storage, Marshall Maintenance and Marshall Rentals. The Debtor also deposited the money he received from social security. The Debtor also deposited money including commissions he earned from his insurance business, a separate corporate entity.

42. The Debtor stated "Again, all the monies coming in, effectively, went into the Burt Marshall account. So my wages went into that account. My Social Security check was in that account. All of the rents go into that account. All of the money from M&M Press was in the account. People lend me new money, it goes into that account. So, all the money goes into that pot, if you will." Trustee's Motion Exhibit 1 - Transcript pp. 44-45. The Assistant UST then asked "So, the new money, then, that you were getting by borrowing money from individuals could have been paying out money you owed to others individuals, correct?" *Id* at 45. To which the Debtor replied, "It could have been partially used for that, yes." *Id*.

43. In suggesting there are other factors for a finding of fraud, the UST fails to recognize any of the steps the Debtor, through Algon, has taken in the 3 months since the filing of this case. The transparency and actions taken by the Debtor and Algon to date demonstrate that the UST cannot meet its heightened burden to displace the Debtor and appoint a Chapter 11 Trustee.

44. This case is similar to *In re 1031 Tax Group LLC*, 374 B.R. 78 (Bankr. S.D.N.Y. 2007) because, like this case, the debtor hired restructuring professionals. In *1031 Tax Group*, the

court denied the UST motion to appoint a Chapter 11 Trustee because new management was brought into the case.

45. Here, the Debtor hired a financial advisor long before the UST filed his Motion. Bringing in new management like Algon, particularly with the scope of authority granted to Algon, weighs in favor of denial of the Motion.

46. The UST cannot demonstrate that the Debtor failed to comply with the Bankruptcy Code, failed to make required filings, failed to file required reports with the Court, failed to abide by orders of the Court, failed to file tax return, failed to discharge his fiduciary duties, conflicts of interest exists, concealed assets or failed to disclose material assets nor has the debtor attempted to retain a professional without court authority. There is no evidence that the Debtor engaged in any of the above circumstance which are factors the Court should weigh in determining if the UST has met the heightened standard of proof to support the imposition of a Chapter 11 Trustee.

47. The UST has not demonstrated any conflict of interest with a party in interest that would demonstrate an inability to perform his duties. *See, In re Vascular Access Ctrs. L.P.,* 611 B.R. 742 (E.D.P.A. 2020) (due to conflicts of interests, a Chapter 11 Trustee was necessary).

48. Thus, the Debtor's retention of Algon coupled with his willingness to be totally transparent weighs against the appointment of a Chapter 11 Trustee.

The Cost of a Chapter 11 Trustee and their professionals cannot be supported in this case and would result in a substantial burden detrimental to the estate.

49. The cost accompanying the appointment of a Chapter 11 Trustee and their professionals would impose a substantial financial burden on the estate. In *In re Bergeron*, the evidence before the court suggested that the costs accompanying the appointment of a Chapter 11 Trustee would impose a substantial financial burden on the debtor and the estate that exceeded any benefit. *In re Bergeron*, 2013 Bankr. LEXIS 4556 (Bank. E.D.N.C. 2013). This coupled with the

UST failure to demonstrate by clear and convincing evidence that a Chapter 11 Trustee should be appointed, warrants the denial of the Motion at this time.

50. In *Bergeron*, the movant contended that the debtors pre-petition conduct, which included hiding assets from a judgment creditor, resulting in contempt of court fines and imprisonment, warranted the appointment of an 1104 trustee. The *Bergeron* court stated under §1104(a)(1), the "determination of cause … is within the discretion of the court and due consideration must be given to the various interests involved in the bankruptcy proceeding." *Bergeron citing Dalkon Shield Claimants v. A.H. Ronins Co.,* 828 F.2d 239, 242 (4th Cir. 1987) *quoting In re gen. Oil Dists., Inc.*, 42 B.R. 402, 409 (Bankr. E.D.N.Y. 1984). In considering all the varying interests in the proceeding, that court noted that the allegations concerned the debtor's pre-petition conduct and not his post-petition conduct. The court denied the motion, in part because "[s]peculation that a debtor may do something in the future does not overcome the strong presumption that the debtor should be permitted to remain in possession in a chapter 11 case or justify the additional costs of a trustee." *Bergeron at *24, citing Sletteland, 260 B.R. at 672.*

51. Here, any alleged wrong doing is said to have occurred pre-petition, not post-petition, and was prior to the retention of Algon.

CONCLUSION

The UST has failed to meet his burden under 11 U.S.C. § 1104(a)(1) to demonstrate cause for the appointment of a Chapter 11 Trustee. The Debtor's actions have been transparent, and he has ceded all authority over the businesses to Algon, and there are no allegations of any kind pertaining to either the Debtor's or Algon's post-petition conduct. At a minimum, the Court should require the UST to prove his allegations by competent evidence.

WHEREFORE, the Debtor respectfully requests that the Court deny the UST's Motion for the appointment of a Chapter 11 Trustee, withhold appointing an examiner or defining the scope of an examiner's investigation until the Committee's financial advisors have completed their investigation and grant further relief as the Court may deem just and proper.

Dated: July 18, 2023
Syracuse, New York

BARCLAY DAMON LLP
Counsel for Debtor and Debtor-In-Possession

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THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

M. BURTON MARSHALL
a/k/a BURT MARSHALL,
a/k/a MILES BURTON MARSHALL,

Case No. 23-60263-PGR
Chapter 11

Debtor.

JOINDER OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO THE UNITED STATES TRUSTEE'S MOTION UNDER 11 U.S.C. § 1104(a) TO APPOINT A CHAPTER 11 TRUSTEE OR, IN THE ALTERNATIVE, TO APPOINT AN EXAMINER UNDER 11 U.S.C. § 1104(c)

The Official Committee of Unsecured Creditors (the "Committee") appointed in the chapter 11 case of M. Burton Marshall a/k/a Burt Marshall a/k/a Miles Burton Marshall (the "Debtor"), by and through its undersigned counsel, hereby submits this joinder (this "Joinder") in support of the motion filed by the Office of the United States Trustee for the Northern District of New York (the "US Trustee"), for entry of an Order under § 1104(a) of title 11 of the United States Code, 11 U.S.C. §§101 *et seq*. (as amended, the "Bankruptcy Code"), directing the appointment of a chapter 11 trustee for the Debtor or, in the alternative, directing the appointment of an examiner under § 1104(c) of the Bankruptcy Code (the "1104 Trustee Motion") [Docket No. 106]. In support of this Joinder, the Committee respectfully represents as follows:

PRELIMINARY STATEMENT

1. By the 1104 Trustee Motion, the US Trustee seeks the appointment of a trustee pursuant to § 1104(a) of the Bankruptcy Code (a "Chapter 11 Trustee") to replace the Debtor's management, remove the Debtor as a debtor in possession, and take control over the Debtor's

business operations. The US Trustee's primary argument for the appointment of a Chapter 11 Trustee for "cause" pursuant to 1104(a)(1) is that the Debtor, for nearly forty years, conducted a Ponzi-like scheme through which he would convince the local community to invest in his real estate operations for a promised return of 8%, and would pay the 8% interest with funds from new investors. The US Trustee also contends that at no time during the operations of the Debtor's business did he generate enough money to service the debt without the ability to borrow new money.

2. As set forth in the 1104 Trustee Motion, the US Trustee asserts serious allegations concerning the Debtor's questionable and unorthodox prepetition business practices. Specifically, based upon the Debtor's testimony during the section 341 meeting of creditors, the US Trustee asserts allegations of fraud that it submits strongly supports the appointment of a Chapter 11 Trustee. Not surprisingly, the Committee also has serious concerns regarding these allegations and believes the Debtor should not be able to remain in possession of his assets and in control of his business operations in light of the alleged fraud. Moreover, as a result of the Debtor's inability to adequately explain his prepetition business practices when questioned during the section 341 meeting of creditors, the Committee does not believe that the Debtor is qualified to remain in control of administering the estate and therefore supports the 1104 Trustee Motion.

3. Separately from the Court's ability to appoint a Chapter 11 Trustee for cause under section 1104(a)(1), the appointment may also be ordered if such result is in the best interest of creditors pursuant to section 1104(a)(2) of the Bankruptcy Code. The Committee independently represents the interests of approximately a thousand unsecured creditors holding more than $90 million of claims in this chapter 11 case, the overwhelming majority of whom are individuals, including friends, neighbors, and family investors who invested their funds with the Debtor based

on a personal relationship with the Debtor. Furthermore, creditors in this case have, through their own letters, pleadings and statements before the Court, expressed their desire for the Debtor's assets to be managed by a third party. In addition, other creditors have explicitly appeared in this case either *pro se* or by counsel to express their support of the US Trustee's 1104 Trustee Motion.

4. The Committee is charged with the duty of maximizing recoveries for all creditors, but here, because of the Debtor's questionable business practices and current financial situation, the Committee is also charged with investigating such business practices with the goal of recovering additional funds for the benefit of creditors. Although the Committee understands that the removal of the Debtor as a debtor in possession and the resulting appointment of a Chapter 11 Trustee may increase costs to the estate and cause disruption to the administration of the Debtor's case, the Committee nevertheless believes that, on balance, the appointment of a Chapter 11 Trustee pursuant to section 1104 of the Bankruptcy Code is warranted.

5. Accordingly, the Committee respectfully submits that the appointment of a Chapter 11 Trustee who will act as a neutral third-party fiduciary is in the best interests of the creditors.

BACKGROUND

6. On April 20, 2023 (the "Petition Date"), the Debtor commenced this chapter 11 case by filing a voluntary petition for relief under chapter 11 of the Bankruptcy Code. The Debtor remains in possession of its assets and continues to operate its business as debtor in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

7. Additional information regarding the Debtor's businesses and the events leading up to the Petition Date can be found in the Declaration of M. Burton Marshall Pursuant to Local Bankruptcy Rule 2015-2 [Docket No. 7].

8. On May 9, 2023, US Trustee formed the Committee in this chapter 11 case [Docket No. 52], appointing the following parties as members of the Committee: (i) Mark Brennan; (ii) East Schuyler Cemetery; (iii) Kevin Fuller; (iv) Cheryl A. Hallam; (v) Robyn G. Lamb; (vi) Kevin Sharpe; and (vii) Charles J. Wharton.

JURISDICTION

9. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334.

10. This is a core proceeding pursuant to 28 U.S.C. § 157(b).

11. Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

APPOINTMENT OF A CHAPTER 11 TRUSTEE IS WARRANTED

12. The 1104 Trustee Motion contains extensive background facts intended to establish that "cause" exists under section 1104(a) of the Bankruptcy Code to appoint a Chapter 11 Trustee.

13. Section 1104(a) of the Bankruptcy Code provides that at the request of a party in interest, and after notice and a hearing, the court shall appoint a trustee:

> (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or
>
> (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

A. A Chapter 11 Trustee May be Appointed for Cause.

14. The US Trustee argues in the 1104 Trustee Motion that a Chapter 11 Trustee should be appointed for cause because, among other reasons, "the Debtor admitted, under oath, that, for

over thirty years, he borrowed millions of dollars, promising a return of 8%, only to use the newly borrowed funds to service existing debts and to finance his personal expenses." *See* 1104 Trustee Motion at page 1. The 1104 Trustee Motion further provides that a finding of fraud is amply supported by the record because the Debtor admits in his declaration pursuant to Local Bankruptcy Rule 2015-2 that, for over thirty years, he financed his businesses with personal borrowings pursuant to unsecured, thirty-day demand notes. *See* 1104 Trustee Motion at page 6.

15. Courts consider the appointment or election of a Chapter 11 Trustee to be an "extraordinary remedy." *Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery*, 330 F.3d 548, 577 (3d Cir. 2003). Consistent with this view, there is the "strong presumption" that debtors-in-possession should be afforded a fair opportunity to reorganize. This presumption is based on the general assumption that the debtor-in-possession is better suited to control the business and manage the reorganization process for the benefit of creditors and the estate. S*ee In re Marvel Entm't Grp.*, 140 F.3d 463, 471 (3d Cir. 1998) (citing *In re V. Savino Oil & Heating Co.*, 99 B.R. 518, 524 (Bankr. E.D.N.Y. 1989)).

16. Here, the US Trustee argues that "cause" exists by relying on the Debtor's own admissions of fraudulent business practices, and such admissions appear to clearly demonstrate the Debtor's fraudulent scheme. Therefore, the Committee submits that the "strong presumption" requirement is satisfied and that the 1104 Trustee Motion may be granted for cause under section 1104(a)(1).

B. **The Appointment of a Trustee is in the Best Interest of Creditors.**

17. The Committee further submits that the appointment of a Chapter 11 Trustee would be in the best interest of the creditors pursuant to section 1104(a)(2) of the Bankruptcy Code. While section 1104(a)(1) requires a showing of "cause" through a showing of fraud, dishonesty,

incompetence, or gross mismanagement, section 1104(a)(2) does not require any showing of wrongdoing on the part of the debtor. *In re China Fishery Grp. Ltd. (Cayman)*, Case No. 16-11895 (JLG), 2016 WL 6875903, at *14 (Bankr. S.D.N.Y. Oct. 28, 2016) ("There are no hard and fast rules governing the application of [section 1104(a)(2)] except that unlike under subsection (a)(1), 'it is not necessary to find fault on the part of the debtor' to appoint a Chapter 11 trustee pursuant to subsection (a)(2).") (internal citation omitted).

18. If cause does not exist, a court may appoint a Chapter 11 Trustee if doing so is in the interests of creditors, equity security holders, and other interests of the estate, commonly referred to as the "best interests" test. 11 U.S.C. § 1104(a)(2). In making this determination, courts consider a number a factors, including: "(i) the trustworthiness of the debtor; (ii) the debtor in possession's past and present performance and prospects of the debtor's rehabilitation; (iii) the confidence—or lack thereof—of the business community and of the creditors in present management; and (iv) the benefits derived by the appointment of a trustee, balanced against the cost of appointment." *In re Euro-American Lodging Corp.*, 365 B.R. 421, 427 (Bankr. S.D.N.Y. 2007) (quoting *In re Ionosphere*, 113 B.R. at 168) (internal citations omitted). Here, the Committee strongly believes that, when all relevant factors are considered, the appointment of a Chapter 11 Trustee is in the best interest of creditors. The Debtor may argue that an evidentiary hearing is required prior to the Court's determination, but the Committee respectfully submits that a Chapter 11 Trustee may be appointed in the Court's discretion because such appointment is in the best interest of creditors based on the extraordinary circumstances set forth herein and in the 1104 Trustee Motion without any further findings.

19. The best interests test to analyze the appointment of a trustee pursuant to section 1104(a)(2) of the Bankruptcy Code provides the Court with broad discretion to appoint a Chapter

11 Trustee when such appointment would be in the best interests of creditors, without any showing of fraud, mismanagement, or other finding of fault or cause, although those factors may also be considered under the best interests test. The discretionary nature of this test "involves to some extent weighing equities." *In re Marvel Entm't Grp.*, 140 F.3d 463, 471 (3d Cir. 1998). As stated above, the balance of interests here weighs in favor of appointing a trustee.

20. Moreover, the Committee recognizes that the appointment of a Chapter 11 Trustee may result in the incurrence of additional administrative costs to the estate and may cause some delay in the administration of this estate. However, based on the serious allegations concerning the Debtor's prepetition business practices, the Committee believes that the risk of future mismanagement far outweighs the potential for increased costs and delays that may be associated with the appointment of a Chapter 11 Trustee. *See In re Blue Stone Real Estate, Constr. & Dev. Corp.*, 392 B.R. 897, 904-05 (Bankr. M.D. Fla. 2008) ("The court may order appointment [of a Chapter 11 Trustee] only if the protection afforded by a trustee is needed and expenses of a trustee would not be disproportionately higher than the value of the protection afforded.") (citing House Report No. 95-595, 95th Cong., 1st Sess. (1977), U.S. Code Cong. & Admin. News 1978, at 5963, 6358) (emphasis added). Here, despite additional costs and potential delay, the Committee has lost all confidence in the Debtor and believes that the interests of the chapter 11 estate would be best served with the appointment of a Chapter 11 Trustee.

21. Therefore, given the Debtor's questionable business practices, as set forth above, and to serve the best interest of all creditors, the Committee respectfully requests that the Court use its discretion to grant the 1104 Trustee Motion without further hearing and appoint a Chapter 11 Trustee in this case.

WHEREFORE, the Committee respectfully requests that the Court issue an order granting the 1104 Trustee Motion filed by the US Trustee, directing the US Trustee to appoint a Chapter 11 Trustee, and granting such other and further relief as the Court deems just and proper.

Dated: July 18, 2023
Syracuse, New York

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Case 23-60263-6-pgr Doc 199 Filed 08/30/23 Entered 08/30/23 19:36:46 Desc Main Document Page 1 of 16 Docket #199 Date Filed: 08/30/2023

Hearing: September 6, 2023 at 10:00 a.m.

THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

M. BURTON MARSHALL
a/k/a BURT MARSHALL,
a/k/a MILES BURTON MARSHALL,

Case No. 23-60263-PGR
Chapter 11

Debtor.

PRE-HEARING STATEMENT OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS IN SUPPORT OF THE UNITED STATES TRUSTEE'S MOTION UNDER 11 U.S.C. § 1104(a) TO APPOINT A CHAPTER 11 TRUSTEE OR, IN THE ALTERNATIVE, TO APPOINT AN EXAMINER UNDER 11 U.S.C. § 1104(c), AND MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT AND RESERVATION OF RIGHTS (DOCKET NO. 106)

The Official Committee of Unsecured Creditors (the "Committee") appointed in the chapter 11 case of M. Burton Marshall a/k/a Burt Marshall a/k/a Miles Burton Marshall (the "Debtor"), by and through its undersigned counsel, hereby submits this pretrial statement ("Pretrial Statement") in support of the motion filed by the Office of the United States Trustee for the Northern District of New York (the "U.S. Trustee"), for entry of an Order under § 1104(a) of title 11 of the United States Code, 11 U.S.C. §§101 *et seq*. (as amended, the "Bankruptcy Code"), directing the appointment of a chapter 11 trustee for the Debtor or, in the alternative, directing the appointment of an examiner under § 1104(c) of the Bankruptcy Code [Docket No. 106] (the "1104 Trustee Motion") and the joinder thereto filed by the Committee [Docket No. 140] (the "Joinder"), and respectfully states as follows:

INTRODUCTION

1. This Pretrial Statement is filed pursuant to the Court's Scheduling Order dated August 8, 2023 [Docket No. 167] (the "Scheduling Order") in preparation for this Court's hearing

on September 6, 2023 at 10:00 a.m. Through the 1104 Motion and the Joinder, the U.S. Trustee and Committee seek the appointment of a trustee pursuant to section 1104(a) of the Bankruptcy Code (an "1104 Trustee") to replace the Debtor's management, remove the Debtor as a debtor in possession, and take control over the Debtor's business operations.

2. The Committee refers the Court to the Joint Pretrial Statement filed by the Committee and U.S. Trustee contemporaneously herewith [Docket No. 196] for the following requirements of the Scheduling Order:

a. contested issues of fact;

b. exhibit list; and

c. witness list and description of expected testimony.

3. On July 25, 2023, the Court held a hearing with respect to the 1104 Trustee Motion, and reserved decision. On July 28, 2023, the Court issued its *Memorandum-Decision and Order Determining Need for Evidentiary Hearing Regarding U.S. Trustee's Motion to Appoint a Trustee*, *In re Marshall,* Case No. 23-60263-PGR, 2023 WL 4851158, (Bankr. N.D.N.Y. July 28, 2023) [Docket No. 160] (the "July 28 Decision"), which among other things, determined that there was a need for an evidentiary hearing, and identified the following key issues with respect to whether cause exists for purposes of section 1104(a)(1):

> (a) whether there has actually been a change in management and (if so) whether there is (b) cause for concern regarding Algon's management and (c) whether sufficient safeguards can be established to ensure the Debtor remains divested of control and deprived of any opportunity to engage in fraud, dishonesty, incompetence, or gross mismanagement.

See July 28 Decision, p. 17.

4. The Committee respectfully submits that the evidence will show that Algon's involvement as financial advisor to the Debtor has not resulted in an effective change in

management of the Debtor. In fact, the Committee asserts that the Debtor still has control of his assets and the opportunity to engage in fraud, dishonesty, incompetence, or gross mismanagement. Further, while an effective change in management and removal of prior officers or managers may be effective in chapter 11 cases involving a business entity, they are wholly inappropriate here, in an individual chapter 11 case where fraud has been alleged. Here, policing any such safeguards would be left to Algon, and Algon owes a duty of confidentiality to the Debtor. *See* Debtor's Exhibits 3 and 4. Furthermore, Algon does not have control of all of the Debtor's assets and to date, has not reported to the Committee or the Court that any new assets have been discovered. Accordingly, the Committee believes that cause exists to appoint an 1104 Trustee.

5. Additionally, with respect to section 1104(a)(2), the Court recognized that "if the Debtor remained in control, the elements of trustworthiness and past performance would toll heavily, if not dispositively, in favor of appointing an 1104 trustee", but that the evidentiary record is "not well developed with respect to several other factors in the §1104 (a)(2) analysis." *See id.*, at p. 18-20. The Committee respectfully submits that the evidence will show that all of the factors of section 1104(a)(2) support the appointment of an 1104 Trustee in the best interest of the creditors, the safeguards put in place to date are ineffective to divest the Debtor of control of the business, and that there are no possible safeguards that would allow the Debtor to effectively be removed from control over estate assets without the appointment of an 1104 Trustee.

6. Of particular concern for the Committee is the hesitancy that Algon has exhibited in investigating potential fraud and responding to Committee information and document requests concerning same, as well as Algon's hesitancy to market and sell the Debtor's insurance business in the months that have passed since the Petition Date when the insurance business has been

characterized by Algon as a "shrinking ice cube."[1] The Committee respectfully submits that an independent 1104 Trustee with a fiduciary obligation to the estate would work more cooperatively with the Committee, with the interest of the estate at the forefront, which will result in a significant cost savings and ultimately, a more significant recovery for the noteholders.

7. Finally, on August 15, 2023, the Court held a hearing on *the Application by Debtor-In-Possession for Authority to Employ Algon Capital, LLC d/b/a Algon Group as Financial Advisors Effective as of May 22, 2023* [Docket No. 72] ("Algon Retention Application"), and the *Supplemental Statement Pursuant to Bankruptcy Rule 2014 and 11 U.S.C. § 327(e)* [Docket No. 134] (the "Supplemental Statement"), and determined by text order that the parameters of the evidentiary hearing should be expanded to include the issues raised in connection with the Algon Retention and objections thereto. [Docket No. 188].

CONTESTED LEGAL ISSUES

8. The Committee has identified the following contested issues of law:

a. A sole proprietorship and individual Debtor are not separate entities and therefore, the Debtor cannot divest management of sole proprietorships to a financial advisor or other third party.

b. A financial advisor employed by the Debtor cannot act as an independent fiduciary of a chapter 11 estate and Algon should not be appointed as financial advisor to the Debtor pursuant to the terms of the Supplemental Statement.

c. The appointment of a trustee pursuant to section 1104(a)(2) of the Bankruptcy Code is in the best interest of creditors in this case. The creditors' interests

[1] The Committee respectfully submits that the testimony will show that Algon did not begin marketing the insurance business for sale until August 11, 2023, well after the 1104 Trustee Motion was filed.

would be best served by a disinterested fiduciary, and transparency and common interests between an 1104 Trustee and the creditors would yield greater efficiency and ultimately a greater recovery for unsecured creditors.

LEGAL SUPPORT FOR CONTESTED ISSUES

I. The Debtor, as an Individual, Cannot Divest Himself of Management Authority and Control of His Assets.

9. The Debtor is an individual, not a corporation. The fact that the Debtor operates various businesses as a sole proprietor is irrelevant for purposes of whether Algon is current management, as a "sole proprietorship is not a 'person' for purposes of the Bankruptcy Code because it is neither an individual, nor a partnership, nor a corporation." *In re CA Fin. Sols.*, Case No. 19-00676 (RJF), 2019 WL 2869566, at *6 (Bankr. D. Haw. July 1, 2019); *In re KRSM Properties, LLC*, 318 B.R. 712, 717 (B.A.P. 9th Cir. 2004)(holding that because "it is not a "person," a sole proprietorship is ineligible to be a debtor in bankruptcy.").

10. Accordingly, although there are various businesses that must be operated in this case prior to the sale of such businesses, this is still an individual bankruptcy case. As such, if the Debtor is divested of control as debtor-in-possession, someone must be granted authority by this Court to make decisions on behalf of the Debtor. The Committee respectfully submits that Algon, who is a proposed professional for the Debtor, cannot serve as current management in an attempt to abrogate the existence of cause to appoint a trustee under section 1104(a)(1). *In re Casco Bay Lines, Inc.*, 17 B.R. 946, 952 (B.A.P. 1st Cir. 1982)("When a trustee is appointed, that control, or possession, is transferred to the trustee who assumes the decision-making function previously held by the debtor's management").

11. Furthermore, Algon has not exerted control over all of the Debtor's assets, including the Debtor's purported postpetition "income" from his own business operations, which

are property of the estate pursuant to section 1115 of the Bankruptcy Code. During the Debtor's adjourned 341 meeting on June 26, 2023, the Debtor confirmed the opening of an additional bank account for deposit of this postpetition "income". *See* Exhibit B, at p. 40. Such account has not been disclosed to the Court or included on the Debtor's Monthly Operating Reports.

12. In *Casco Bay*, the Court ordered that the debtor's management be removed from control of the debtor's business due to their "appropriation and wrongful use of corporate assets for their individual benefit." *See id.*, at 949. The bankruptcy court further ordered that the debtor's former owner be hired to act as "operating officer of the debtor," with joint authority to sign checks along with debtor's counsel. *See id.* In that case, the debtor's prior owner died a month later, leaving the debtor's counsel as the sole party in control of the debtor,[2] which prompted the bankruptcy court to order the appointment of an 1104 trustee. *See id.*

13. On appeal, the Bankruptcy Appellate Panel for the First Circuit held that the bankruptcy court had no statutory authority to approve "new management", and that once a court determines that debtor's management must be removed from control, the only permissible option under the Bankruptcy Code is for the court to order the appointment of a chapter 11 trustee. *See id.*, at 952. The Bankruptcy Appellate Panel for the First Circuit added:

> a Chapter 11 reorganization contemplates only two possible scenarios for control of the debtor's business operations: a debtor in possession, or a debtor out of possession. The latter situation contemplates and mandates the appointment of a trustee... [E]ither the debtor must be in control, or the court will authorize the appointment of a trustee to take control of the debtor's affairs. Furthermore, the phrase "in possession" not only means physical possession, but actual control over decisions regarding conduct of the business. In sum, the debtor, to be in possession, must have some form of control over its business destiny and be able to make the day to day business decisions required of its operation. The court

[2] The bankruptcy court was particularly concerned that the debtor's counsel who was left in charge was without a "recognizable client", and "functioning as a de facto trustee, acting as his own counsel, and he [could not] qualify in either capacity." *See id.*, at 951.

> observed that the appointment of a trustee is the only statutorily authorized alternative to a debtor in possession.

See id., at 952 (citations and quotations omitted).

14. Like in *Casco Bay*, here Mr. Marshall has been somewhat removed from control over business operations, albeit by his own consent, in an attempt to avoid the appointment of an 1104 Trustee. Thus, without a debtor-in-possession, the Court must order the appointment of a trustee, and Algon, as a proposed professional of the Debtor, cannot serve in that capacity.

15. Similarly, unless it is consensual among the parties, section 105 does not provide the Court with authority to appoint an estate fiduciary as a workaround for a chapter 11 trustee under section 1104. *In re Adelphia Commc'ns Corp.*, 336 B.R. 610, 664 (Bankr. S.D.N.Y.), aff'd, 342 B.R. 122 (S.D.N.Y. 2006)("Using section 105(a) to appoint a fiduciary to act as a trustee shorn of the name, but with few other substantive differences, would be the exact kind of wrongful judicial action that the Second Circuit has forbidden. Section 1104 already provides for two kinds of fiduciaries, trustees and examiners."); *Matter of Gaslight Club, Inc.*, 782 F.2d 767, 771 (7th Cir. 1986) ("Sections 105(a) and 1107(a) of the Bankruptcy Code provide adequate authority for the bankruptcy court to approve the replacement of the person designated to perform the duties and exercise the rights of the debtor in possession if the creditors' committee, the person presently in control and the majority and controlling shareholder of the debtor agree to this course of action.").

16. Moreover, a case cited by the Debtor for the proposition that management could be replaced as "responsible person", *Real Estate Partners*, is inapposite. As an initial matter, in *Real Estate Partners*, the debtor was a corporate debtor and no official committee had been appointed. *In re Real Est. Partners, Inc.*, Case No. SA 07-13239 TA, 2007 WL 7025114, at *2 (Bankr. C.D. Cal. Nov. 20, 2007), *aff'd,* No. SA CV 07-1440 ODW, 2009 WL 3246619 (C.D. Cal. Oct. 5, 2009).

17. Further, certain creditors in *Real Estate Partners* weighed in on the issue through pleadings, but none opposed the appointment a responsible person in lieu of an 1104 Trustee as requested be the U.S. Trustee. As such, the court reasoned that "[i]f there were any legitimate concern about "taint" the Court would have expected it to have been expressed by these [creditor] groups."). *See id.*, at 5.

II. Algon is Employed by the Debtor and Cannot Act as an Independent Fiduciary of the Chapter 11 Estate

18. One of the critical factors in determining whether current management is tainted by prior management is "whether prior management still has vestiges of control". *In re Real Est. Partners, Inc.*, No. SA 07-13239 TA, 2007 WL 7025114, at *4 (Bankr. C.D. Cal. Nov. 20, 2007), *aff'd*, No. SA CV 07-1440 ODW, 2009 WL 3246619 (C.D. Cal. Oct. 5, 2009).

19. Here, the testimony will show that despite all of the safeguards that are already allegedly in place, the Debtor still has control of various aspects of the businesses, as well as at least one bank account, and has failed to disclose assets that are property of the estate.

20. Additionally, the testimony will show that despite Algon's expanded role, there are still significant errors and omissions in both the schedules and monthly operating reports, which represents additional cause for an 1104 Trustee. *In re Vaughan*, 429 B.R. 14, 28 (Bankr. D.N.M. 2010)("A failure to provide accurate schedules to the court has been deemed sufficient "cause" under § 1104(a)(1) to appoint a trustee."); *In re V. Savino Oil & Heating Co., Inc.*, 99 B.R. 518, 526 (Bankr. E.D.N.Y. 1989) ("Where, as here, the Debtor fails to disclose material and relevant information to the Court and creditors, a Chapter 11 trustee is required").

21. Put simply, from the Committee's perspective, it appears as though Algon is still working *for the Debtor*, and not for the noteholders. As such, the Committee believes that Algon

is not sufficiently independent from the Debtor and his counsel to be free from "taint" of prior management.

a. The Debtor has not Met his Burden to Show that Algon is Disinterested and Without Conflict.

22. As this Court astutely observed, courts should apply heightened scrutiny "where, as here, new management was selected by tainted former management." Further, the burden of proof shifts to the "debtor, or other parties opposing appointment, 'to demonstrate that the new management is unconflicted by any association with the tainted members of the governing body that made the selection or appointment.'" *See id.* (quoting *In re The 1031 Tax Grp., LLC*, 374 B.R. 78, 88 (Bankr. S.D.N.Y. 2007)).

23. In fact, the existence of one or more conflicts of interest can establish cause under section 1104(a)(1). "The list of wrongs constituting "cause" that warrants the appointment of a trustee is not exhaustive; some other "[f]actors relevant to the appointment of a trustee under § 1104(a)(1) include: conflicts of interest, including inappropriate relations between corporate parents and the subsidiaries; misuse of assets and funds; inadequate record keeping and reporting; various instances of conduct found to establish fraud or dishonesty; and lack of credibility and creditor confidence." *In re Sillerman*, 605 B.R. 631, 648 (Bankr. S.D.N.Y. 2019).

24. As set forth above, the Committee respectfully submits that Algon has an uncurable conflict of interest in that they rely on the Debtor and Debtor's counsel to carry out their services. As such, the Committee has a lack of confidence in Algon's ability to perform independently as an independent 1104 Trustee would.

b. Algon Cannot Serve as an Independent Fiduciary to the Estate.

25. Even if Algon could be considered current management, and that they were free of taint from prior management, Algon would still need to demonstrate that they are serving as an estate fiduciary and that they are able to carry out their duties to the chapter 11 estate stakeholders.

26. The notion that a debtor-in-possession should remain in control of its assets, is "premised on an expectation that current management can be depended upon to carry out the fiduciary responsibilities of a trustee." *In re V. Savino Oil*, at 526; *see also Wabash Valley Power Ass'n, Inc. v. Rural Electrification Admin.*, 903 F.2d 445, 451 (7th Cir. 1990) (suggesting that where the interests of the debtor are being promoted over those of the creditors, a trustee may be appropriate particularly where "the clash of interests between creditors and its current management is so obvious").

27. As set forth above, Algon is a professional of the Debtor and not only owes a duty to the Debtor through the terms of its retention, but generally takes direction from both the Debtor and Debtor's counsel.

c. Algon's Proposed Fee Structure is Excessive in Light of the Economics of this Chapter 11 Case.

28. Despite numerous requests from the Committee, Algon has refused to provide the Committee with detailed information regarding the tasks that have been performed and the associated accrued fees for the full duration of their engagement. To date, the Committee has only received an extremely simplified report for the period of May 22, 2023 through June 30, 2023 (approximately five weeks) that is devoid of any detail regarding the actual work that has been performed by Algon. *See* Exhibit S. The report provided to the Committee, excluding the months of July and August, only reflects the aggregate time spent by Algon professionals and the aggregate fees incurred, which are in the excessive sum of $338,418.00. *See id.* Algon has not been

transparent with the Committee and the Committee cannot review and assess the appropriateness of Algon's accrued fees. The Committee submits that Algon's fees are unjustifiably excessive and will usurp a substantial portion of the estate's funds that would otherwise be available for distribution to the unsecured creditors.

29. Additionally, none of the Debtor's 13-week cash budgets provide for estimated payments of professional fees and therefore, do not accurately reflect the Debtor's application of available cash. *See* Debtor's Exhibits 6 and 7. In fact, if Algon accounted for its professional fees in the 13-week cash budgets, it would clearly show that the Debtor's weekly cash flow cannot support Algon's monthly fees, let alone the fees of other professionals. To that point, Algon is not only seeking to be paid hourly rates of approximately $695 per hour but is also seeking to be paid a guaranteed monthly fee of $40,000, and a fixed payment of 5% of the all the funds available for net distribution to creditors. Under this fee structure, it is conceivable that Algon's fees on annual basis could total in excess of $3.5 million.

30. The Committee submits that Algon's fee structure is excessive, unjustified, and completely out of balance with the economics of this case, which involves businesses with combined gross monthly revenue less than $300,000. As proposed, Algon's fees will severely reduce the distribution to the unsecured creditors, who have already suffered overwhelming financial harm on account of the Debtor's conduct.

d. There Has Been Limited Progress Made in the Administration of the Debtor's Chapter 11 Case to Date.

31. Although Algon has expended a substantial amount of time and has incurred a significant amount of fees, Algon has done little for the administration of the Debtor's estate. Algon has failed to properly pursue the sale of the Debtor's various assets, including the Debtor's

payroll company, self-storage business, real estate holdings, and the Debtor's insurance business, Miles B. Marshall, Inc.

32. Algon has been involved in the Debtor's case since May 2023, and it was not until very recently that Algon provided the Committee with any information regarding its proposed sales process concerning the Debtor's insurance business, which Algon advised the Committee over a month ago was rapidly losing value because of the Debtor's filing for bankruptcy and the resulting loss of clients.

33. Additionally, Algon also just recently advised the Committee that the liquidation of the Debtor's payroll company will not generate a significant return for creditors because the rates charged to the Debtor's clients are under market value and the business is essentially losing money every month. As a result, the net recovery to the estate from the sale of the payroll business will be approximately equal to if not less than the amount of Algon's guaranteed monthly payment of $40,000. This fact alone, demonstrates that Algon is not the proper fit for this case and, if allowed to remain in this case, will not provide a benefit to the unsecured creditors.

34. As for the Debtor's real estate portfolio, other than retaining a property manager to manage the Debtor's approximate 100 properties (the "Real Properties") at additional cost to the estate, Algon has not done much to advance the administration of the Real Properties. Algon has not provided the Committee with its analysis of the value of the Real Properties, nor has Algon provided the Committee with concrete recommendations for a sale process that would maximize value for creditors, which would typically consist of comprehensive bidding and marketing procedures. Moreover, without a direct request for information from the Committee, through its professionals, Algon does not share information on the administration of the Debtor's assets with the Committee.

e. Algon Has not Been Transparent with the Committee and its Professionals.

35. The Committee's financial advisors, HKA Global, LLC. ("HKA"), have advised the Committee that there has been a lack of cooperation and transparency from Algon in connection with HKA's investigation of the Debtor's financial affairs and the production of documents and information requested by HKA. In fact, when presented with a request for information from HKA, Algon customarily indicates that it must seek authorization from the Debtor's counsel, which raises serious concerns of an apparent conflict of interest. *See* Exhibit Q. The Committee respectfully submits that testimony will show that even basic requests for information are met with opposition and delay, even when such requests concern the preservation of and search for assets of the estate.

III. Appointment of an 1104 Trustee is in the Best Interest of the Creditors Pursuant to Section 1104(a)(2) of the Bankruptcy Code.

36. In determining whether appointment of an 1104 Trustee is warranted under section 1104(a)(2), courts generally consider:

> (i) the trustworthiness of the debtor;
>
> (ii) the debtor in possession's past and present performance and prospects of the debtor's rehabilitation;
>
> (iii) the confidence—or lack thereof—of the business community and of the creditors in present management; and
>
> (iv) the benefits derived by the appointment of a trustee, balanced against the cost of appointment.

See July 28 Decision, at 18 (citing *1031 Tax Grp.*, 374 B.R. at 91).

37. The Committee respectfully submits that the likelihood of reorganization with Algon is significantly less than with an 1104 Trustee. The Committee members lack confidence

and trust in the Debtor and his professionals, including Algon. The Committee represents the interests of over 900 unsecured noteholders who were defrauded by the Debtor. When Algon's actions to date have hindered rather than assisted in the Committee's investigation, which will be demonstrated though testimony, the Committee cannot place its confidence and trust in Algon.

38. The lack of collaboration and cooperation in the Committee's investigation is yet another reason to appoint an 1104 Trustee. *In re V. Savino Oil & Heating Co., Inc.*, 99 B.R. 518, 527 (Bankr. E.D.N.Y. 1989) ("Where, as here, it appears that no meaningful progress towards reorganization is possible because of deep rooted animosities between a Debtor and major creditors, an independent reorganization trustee may well be necessary to insulate the reorganization process from paralytic conflict.").

39. In fact, the Committee believes that the appointment of an 1104 Trustee will result in significant cost savings due to the cooperation and alignment of interests alone, to say nothing of the savings that will result from paying the statutory fees of a trustee rather than Algon's exorbitant fees. *In re Hotel Assocs., Inc.*, 3 B.R. 343, 346 (Bankr. E.D. Pa. 1980) (holding that a chapter 11 trustee "will seek to benefit all the creditors and will bring a refreshing air of objectivity and impartiality to a business which has been operated by and for the benefit of its primary creditor.").

40. Pursuant to the Committee's calculations, assuming the net distribution to creditors is $20 million, an 1104 Trustee's fees including reasonably estimated real estate broker fees would total $1,499,600. Under the same net distribution amount, Algon's monthly flat fee and success fee alone would total $1,480,000—this amount does not include fees for hourly services which could total hundreds of thousands or even millions of dollars.

41. The Committee prepared the following hypothetical analysis to compare the proposed Algon fee structure to a potential distribution scenario involving an 1104 Trustee and real estate broker:

Distribution Amount	**$20,000,000.00**	
Trustee Commission Due Under 11 USC § 326	**Distribution Amount**	**Commission Amount**
$0.00 - $5,000 (25%)	$5,000.00	$1,250.00
$5,001 - $50,000 (10%)	$50,000.00	$5,000.00
$50,001 - $1,000,000 (5%)	$1,000,000.00	$50,000.00
$1,000,001 + (3%)	$18,945,000.00	$568,350.00
Trustee	**$20,000,000.00**	**$624,600.00**

Real Estate Broker	**Contingent Percentages**	**Commission Amount**
$10,000,000	3.50%	$350,000.00
Next $5,000,000	4.50%	$225,000.00
Next $10,000,000	5.00%	$250,000.00
Above $25,000,000	6.00%	$0.00
Retainer		$50,000.00
	Real Estate Broker	**$875,000.00**
	Trustee + Real Estate Broker	**$1,499,600.00**

Algon Fee Structure		
5% Success Fee	($20,000,000 x 5%)	$1,000,000.00
Annual Flat Fee Due Troy	($40,000 x 12)	$480,000.00
Hourly Rates at $695 per hour	(($695x200) x 12)	$1,668,000.00
	Total	**$3,148,000.00**

42. For all of the reasons set forth herein, and the additional exhibits and testimony that will be presented at the evidentiary hearing, the Committee respectfully submits that allowing Algon to be retained and continue in management of the Debtor's assets and businesses is not in the best interests of creditors. Furthermore, Algon's excessive proposed fee structure and lack of disinterestedness, when considered together, create an environment in which the appointment of an 1104 Trustee is both economically prudent and will create the necessary transparency and accountability for a successful outcome in this chapter 11 case.

WHEREFORE, the Committee respectfully submits this Pretrial Statement and requests that the Court enter order directing the U.S. Trustee to appoint an 1104 Trustee, and granting such other and further relief as the Court deems just and proper.

Dated: August 30, 2023
Syracuse, New York

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Examining the Examiner: Waiver of the Attorney-Client Privilege and the Outer Limits of an Examiner's Powers in Bankruptcy

Jeffery A. Deller, Esq.[1]

I. INTRODUCTION

Until recently, the role of examiners in Chapter 11 bankruptcies was relatively minor. The wave of accounting scandals, corporate misconduct, and the resulting Chapter 11 bankruptcies of Enron and WorldCom in recent years have made the appointment of an examiner in contentious bankruptcies the flavor of the day.[2] Against this backdrop, this article discusses the traditional role of an examiner in bankruptcy proceedings, as well as the current state of an examiner's duties in a Chapter 11 bankruptcy.[3] Towards this end, the role of a bankruptcy trustee will be examined and contrasted with the duties of an examiner. This article will discuss how the differences between the powers and duties of a trustee and those of an examiner can become blurred in complex

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1. Mr. Deller is a shareholder in the Pittsburgh law firm of Klett Rooney Lieber & Schorling, P.C., and he is the Vice Chair of the American Bar Association's Business Bankruptcy Sub-Committee on Trustees and Examiners. Mr. Deller's practice includes representing debtors and creditors in insolvency related matters, such as out-of-court restructurings and bankruptcy litigation. The author is grateful to the insightful comments provided by attorneys Michael Rhodes and Sam Toney during the process of writing this article.

2. Loomis, *Court-Approved Examiners Become More Common as Scandal Taints Chapter 11*, N.Y.L.J., Aug. 15, 2002.

3. There are two general forms of bankruptcy proceedings. The first general form is liquidation bankruptcy or straight bankruptcy, whose statutory origins are Chapter 7 of the Bankruptcy Code. *See* 11 U.S.C. §§ 701- 766 (2004). In a typical Chapter 7 liquidation, a bankruptcy trustee is appointed to collect and liquidate all non-exempt property for the benefit of creditors. The second general form of bankruptcy proceedings are rehabilitative bankruptcies -- also known as reorganizations or restructurings. The rehabilitation bankruptcy provisions of the Bankruptcy Code are found at Chapters 9, 11, 12, and 13 of the Bankruptcy Code. *See* 11 U.S.C. §§ 901-946; 1101-1174; 1201-1231; 1301-1330 (2004). Professor David Epstein has described "rehabilitation" bankruptcy as bankruptcy cases wherein "creditors look to future earnings of the debtor . . . to satisfy their claims. The debtor generally retains its assets and makes payments to creditors, usually from postpetition earnings, pursuant to a court-approved plan." *See* Epstein et al, *Bankruptcy* at § 1-5 (West 1993). Rehabilitation cases under Chapter 9 are for municipalities. Rehabilitation cases under Chapters 12 and 13 are for farmers and individual consumer debtors with regular income, respectively. Chapter 11 is rehabilitation or reorganization for corporations and, in some instances, for individuals who are not eligible for any meaningful Chapter 12 or 13 relief.

reorganization cases. This article will explore this issue in the context of whether an examiner has the power to waive the attorney-client privilege of a debtor in bankruptcy. As this paper demonstrates, the powers of bankruptcy examiners are often illusory.

II. POWERS AND DUTIES OF TRUSTEES AND EXAMINERS

It is widely recognized that the appointment of a trustee or examiner in a Chapter 11[4] bankruptcy is an extremely rare event.[5] The reason behind this rarity is that in a Chapter 11 environment, there is a strong presumption that the debtor should remain in possession of its assets.[6] Consistent with this presumption, clear and convincing evidence of "cause" for any such appointment must be demonstrated before a trustee or examiner can be appointed by

4. Unlike Chapter 11, a trustee is appointed automatically under Chapter 7 of the Bankruptcy Code to wind-up and liquidate the affairs of the debtor. *See* 11 U.S.C. § 701 and 702. The governmental entity that has oversight for trustees appointed in bankruptcy (both in Chapter 11 and Chapter 7) is the United States Department of Justice through the office of the United States Trustee. Pursuant to Section 701 of the Bankruptcy Code, "Promptly after the order for relief under [Chapter 7], the United States Trustee shall appoint one disinterested person . . . as interim trustee." *See* 11 U.S.C. § 701(a). The Bankruptcy Code further provides that the interim trustee may become trustee if either (a) the interim trustee is duly elected by unsecured creditors holding at least 20 percent of allowed, undisputed, fixed, liquidated unsecured claims, or (b) no other trustee is elected by the creditors at the meeting of creditors. *See* 11 U.S.C. § 702.

5. In re Cardinal Industries, Inc., 109 B.R. 755 (Bankr. S.D. Ohio 1990). Prior to the adoption of the Bankruptcy Code in 1978, the appointment of a trustee was more routine in reorganization cases. In fact, the precurser to the Bankruptcy Code, known as the Bankruptcy Act or Chandler Act, expressly contemplated the appointment of a bankruptcy trustee in some instances. For example, under the Bankruptcy Act, corporate debtors desirous of reorganizing their affairs could file for protection under Chapters X or XI of the Bankruptcy Act. "Under Chapter X of the prior Bankruptcy Act, the bankruptcy court was required to appoint one or more trustees upon approval of a Chapter X petition if the liquidated, non-contingent debts in the case exceeded $250,000 or more." *See* LAWRENCE P. KING ET AL., COLLIER ON BANKRUPTCY at ¶ 1104.LH[1][a] (15th ed. 2004) [hereinafter KING]. If the corporation's debts were less than $250,000, the court had the discretion to either appoint one or more trustees or to continue the debtor in possession. *Id.* Under Chapter XI of the Bankruptcy Act, the court was permitted to appoint a trustee for cause shown. *Id.* However, as Chapter XI relief did not sufficiently enable corporate debtors to restructure secured debt or significantly impair the interests of equity holders, Chapter XI of the Bankruptcy Act was often an unworkable solution to large corporate debtors. *Id.* Moreover, as Chapter X's mandatory trustee provisions were equally unappealing, corporate debtors found themselves reluctant to commence a case under Chapter X. *Id.* To avoid the bugaboo associated with the trustee provisions of Chapter X, and the limitations imposed on large corporate debtors in Chapter XI, Congress re-wrote the rehabilitative provisions of bankruptcy when it adopted the Bankruptcy Code. *Id.* at ¶ 1104.LH[1][b]-[e]. For an outstanding history of bankruptcy law in the United States, *see* DAVID A. SKEEL, DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA (Princeton University Press 2001).

6. Committee of Dalkon Shield Claimants v. A.H. Robbins Co., Inc., 828 F.2d 239 (4th Cir. 1987); In the Matter of Cajun Electric Power Cooperative, Inc., 69 F.3d 746 (5th Cir. 1995), *rehearing granted and result reversed*, 74 F.3d 599 (5th Cir. 1996).

the court.[7] Absent a strong showing that the appointment of a trustee or examiner is both warranted and in the best interest of creditors, courts will permit a debtor in Chapter 11 to remain "in possession" of its assets and business operations.[8]

In reorganization cases, the general presumption is that allowing the debtor's current management to retain control of the corporation makes a Chapter 11 reorganization more attractive to debtors than a Chapter 7 liquidation.[9] As a result, the rationale goes, recovery for creditors is maximized and preservation of jobs is enhanced due to the fact that the Chapter 11 debtor does not have to waste resources responding to turnover in management.[10]

In addition, examiners provide an awesome vehicle for investigating legal and equitable claims and causes of action that may exist against various third-parties.[11] Unlike a Chapter 11 trustee, however, examiners traditionally do not take over the day-to-day control of a business enterprise; rather, such activities are usually left to the business' personnel, who are running the debtor-in-possession's operations.[12] Consequently, the appointment of an examiner may be a more attractive vehicle in some Chapter 11 contexts as there is little, if any, business interruption occasioned by the appointment of an examiner.[13]

A. *Appointment, Powers, and Duties of Chapter 11 Trustees*

Ordinarily, when a debtor files a Chapter 11 bankruptcy it becomes a "debtor-in-possession," and the current officers, directors, and managers of the debtor remain in place.[14] These officers, directors, and managers generally are not displaced as a result of a Chapter 11 bankruptcy filing and continue to operate the business of the debtor, subject to fiduciary duties imposed by applicable

7. In re Sharon Steel Corp., 871 F.2d 1217, 1226 (3d Cir. 1989).
8. *See e.g.*, In re Ionosphere Clubs, Inc., 113 B.R. 164 (Bankr. S.D.N.Y. 1990).
9. *See* KING, *supra* note 5 at ¶ 1104.02[1].
10. *Id.*
11. *See* In re Big Rivers Electric Corp., 284 B.R. 580, 585 (W.D. Ky. 2002) (highlighting examiner's broad investigatory duties); *see also* First Interim Report of Neal Batson, Court Appointed Examiner, In re Enron Corp., N0. 01-16034 at 1-5 (Bankr. S.D.N.Y.) (Sept. 21, 2001) (summarizing investigative duties of the Enron examiner).
12. *See* 11 U.S.C. § 1106(b), which omits from an examiner's duties the duty to possess the debtor's assets or operate its business.
13. *See* KING, *supra* note 5 at ¶ 1104.03[1].
14. *See* CFTC v. Weintraub, 471 U.S. 343, 355 (1985); In re Pease, 195 B.R. 431, 433 (Bankr. D.Neb. 1996) ("Upon the commencement of a Chapter 11 bankruptcy case, the debtor becomes a 'debtor in possession' with a fiduciary duty to creditors."); *see also* 11 U.S.C. § 1107 (describing the rights, powers, and duties of a debtor-in-possession).

bankruptcy and non-bankruptcy law.[15] Indeed, the willingness to leave a Chapter 11 debtor "in possession" of property of the bankruptcy estate is premised on the assumption that officers, directors, and employees of the debtor can be depended upon to carry out the fiduciary responsibilities of a trustee.[16] Of course, one important fiduciary duty[17] omitted from the duties statutorily imposed by the Bankruptcy Code upon a debtor-in-possession is the duty of investigating its own acts, conduct, and affairs.[18] As a result of this omission, litigation seeking the appointment of a bankruptcy trustee often arises in a context[19] in which creditors con-

15. *See supra* note 15.

16. *Weintraub*, 471 U.S. at 355.

17. Justice Cardozo wrote that many "forms of conduct permissible in a workday world for those acting at arms' length, are forbidden to those bound by fiduciary ties." Meinhard v. Salmon, 164 N.E. 545, 546 (1928). According to Justice Cardozo, the concept of "fiduciary duty" is "something stricter than the morals of the marketplace." *Id.* To Justice Cardozo, fiduciary duty is "the punctilio of an honor most sensitive." *Id.* In a bankruptcy proceeding, the fiduciary duty of a debtor-in-possession (and trustee) flows primarily to the creditors of the bankruptcy estate. *See* John T. Roache, Note, *The Fiduciary Obligations of a Debtor in Possession*, 1993 U. ILL. L. REV. 133, 144 (1993). These duties include the duties of loyalty, care, and good faith. *See* Ramesh K.S. Rao et al., *Fiduciary Duty a la Lyonais: An Economic Perspective on Corporate Governance in a Financially Distressed Firm*, 22 J. Corp. L. 53, 60-61 (1996); Richard M. Cieri et al., *The Fiduciary Duties of Directors of Financially Troubled Companies*, 3 J. Bankr. L. & Prac. 405, 406 (1994). These duties encompass the duty to conserve assets and to maximize distribution to creditors, United States v. Aldrich, 795 F.2d 727, 730 (9th Cir. 1986) and In re Microwave Prods. of Am., 102 B.R. 666, 671 (Bankr. W.D. Tenn. 1989), and to avoid self-dealing and conflicts of interest. *See e.g.*, In re Ben Franklin Retail Stores, Inc., 225 B.R. 646 (Bankr. N.D. Ill. 1998), *aff'd in part and rev'd in part*, 2000 WL 28266 (N.D. Ill. 2000); In re Bellvue Place Assoc., 171 B.R. 615, 623-24 (Bankr. N.D. Ill. 1994). In the Chapter 11 context, when the conduct of the debtor-in-possession becomes so egregious as to rise to the level of illegal or fraudulent conduct, courts have held that debtor's counsel must take corrective measures or face losing fees. In re Smitty's Truck Stop, Inc., 210 B.R. 844 (10th Cir. 1997)(the failure to investigate and disclose conflicting claims to funds paid to an attorney as a retainer requires disgorgement of the retainer and denial of fees); In re Wild Horse Enterprises, Inc., 136 B.R. 830 (Bankr. C.D. Cal. 1991)(debtor's attorney is a fiduciary to the estate and has a duty to remind the debtor of duties under the Bankruptcy Code); FDIC v. O'Melveny & Meyers, 969 F.2d 744 (9th Cir. 1992)(securities case where court held that attorney has duty to avoid public harm when it is discovered that client is engaging in fraud), *rev'd on other grounds*, 512 U.S. 79 (1994); In re Harp, 166 B.R. 740 (Bankr. N.D. Ala. 1993)(lawyers representing debtors-in-possession are charged with responsibilities of insuring that when the interest of the bankruptcy estate conflicts with the interest of the debtor's principal, that the interest of the bankruptcy estate prevail).

18. *See* 11 U.S.C. § 1107(a) (2004).

19. Litigation relating to breaches of fiduciary duty can occur outside of a bankruptcy context as well. As a general proposition, officers and directors of a solvent corporation have fiduciary duties to stockholders rather than creditors. *See e.g.*, Koehler v. Black River Falls Iron Co., 67 U.S. 715 (1862); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). However, when a corporation becomes insolvent, or as it slides into bankruptcy, the fiduciary duties of the corporation's officers and directors shift from the stockholders to the creditors. FDIC v. Sea Pines Co., 692 F.2d 973, 977 (4th Cir. 1982). As described by the United States Court of Appeals for the Fourth Circuit:

tend that officers, directors, and employees of a debtor-in-possession have breached their respective fiduciary duties either prior or subsequent to a bankruptcy filing.[20]

In this context, Section 1104(a) of the Bankruptcy Code sets forth the grounds for appointment of a trustee in a Chapter 11

> The law by the great weight of authority seems to be settled that when a corporation becomes insolvent, or in a failing condition, the officers and directors no longer represent the stockholders, but by the fact of insolvency, become trustees for the creditors, and that they cannot by transfer of its property or payment of cash, prefer themselves or other creditors.

Davis v. Woolf, 147 F.2d 629, 633 (4th Cir. 1945); *see also*, Alexander et al. v. Hillman, 296 U.S. 222 (1935).

20. *See* KING supra note 5 at ¶ 1104.02[3][b]. Officers and directors of corporations usually hide behind the "business judgment" defense to claims that they breached their respective duties. Case law is somewhat mixed as to whether the business judgment defense is viable when officers and directors are looking at breach of duty claims that arise *out of*, or relate *to*, conduct occurring during the administration of a bankruptcy estate. For example, in one case, the United States Bankruptcy Court for the Northern District of Florida held that a bankruptcy fiduciary did not breach its duty when the complained of conduct fell within the sound business judgment of the debtor and was made in good faith and on a reasonable basis. In the Matter of Southern BioTech, Inc., 37 B.R. 318 (Bankr. N.D. Fla. 1983). Other courts have rejected the sound business judgment rule in the bankruptcy context, and have held bankruptcy fiduciaries to the standard of "reasonable care and due diligence." For example, the Ninth Circuit Court of Appeals wrote in the case of *In re Ridgen*:

> The dissent voices some reservations and concern about our discussion of the fiduciary duty of the bankruptcy trustee. The dissent maintains that the nature of the trustee's duty varies depending upon whether he or she is acting on behalf of the individual debtor or corporate debtor. In the latter case, the dissent maintains that the trustee's role is in the nature of a corporate manager and that his actions should therefore be measured by the business judgment rule rather than by the fiduciary standard of reasonable care and due diligence. To support this contention the dissent relies on the recent Supreme Court decision in [*CFTC v. Weintraub*, 471 U.S. 343 (1985)]. The Supreme Court in *Weintraub* held that the trustee in bankruptcy of a debtor corporation, rather than the corporation's directors, had the power to waive the debtor corporation's attorney-client privilege. . . . *Weintraub*'s holding is limited. Nowhere does the Supreme Court in *Weintraub* state that as a general rule the conduct of the trustee of a corporate debtor is analyzed under the business judgment rule. *Weintraub* does contain some language discussing the nature of the role of the trustee of a corporate debtor. The Supreme Court, in an effort to support its holding in that case . . ., discussed the way in which the trustee plays a role most analogous to that of a solvent corporation's management. Nonetheless, we do not believe that *Weintraub* compels or requires us to reformulate the standard by which we judge the conduct of a trustee in the context of corporate debtors generally. In the absence of a clear statement from the Supreme Court that the business judgment rule now applies whenever analyzing the conduct of a corporate debtor's trustee, we are unwilling to adopt such a rule. . . . The majority in this case remains convinced. . . that the reasonable care and due diligence standard is the one by which we judge the conduct of the trustee, regardless of whether the debtor is an individual or a corporation.

In re Ridgen, 795 F.2d 727, 731 n. 1 (9th Cir. 1986). The Ninth Circuit went further in *Ridgen* and held that reasonable care and due diligence is exercised appropriately when "an ordinarily prudent person would exercise [the same degree of care and due diligence] in similar circumstances." *Id.* at 730.

bankruptcy proceeding. Specifically, Sections 1104(a)(1) and (2) of the Bankruptcy Code authorize the appointment of a trustee for "cause," and provide as follows:

> [O]n request of a party in interest . . . the court shall order the appointment of a trustee:
>
> (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or
>
> (2) if such appointment is in the interest of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities or the amount of assets or liabilities of the debtor.[21]

Under this section of the Bankruptcy Code, examples of "cause" expressly include fraud, dishonesty, and gross mismanagement of the debtor.[22] The examples of "cause" set forth in Section 1104(a)(1), however, do not comprise an exhaustive list.[23] For example, the existence of a conflict of interest among the debtor's existing management may constitute "cause" for the appointment of a trustee.[24] The lack of creditor confidence in the debtor's management may also constitute "cause" for the appointment of a trustee.[25] No matter what "cause" is alleged, where such "cause" is proven[26] to exist, a court must order the appointment of a trustee

21. 11 U.S.C. § 1104(a).

22. 11 U.S.C. § 1104(a)(1). *See also In re Sharon Steel Corp.*, 871 F.2d at 1227 and the cases cited therein.

23. *See* 11 U.S.C. § 102(3) ("'includes' and 'including' are not limiting"); In re Lilley, 91 F.3d 491, 494 (3d Cir. 1996).

24. *See, e.g.*, In re Cajun Elec. Power Coop., Inc., 191 B.R. 659, 661 (M.D. La. 1995); *aff'd*, 74 F.3d 599 (5th Cir. 1996), *cert. denied*, 117 S.Ct. 51 (1996); In re Fiesta Homes of Georgia, Inc., 125 B.R. 321, 325 (Bankr. S.D.Ga. 1990); In re L.S. Good & Co., 8 B.R. 312, 315 (Bankr. N.D.W.Va. 1980).

25. In re Madison Management Group, Inc., 137 B.R. 275, 281 (Bankr. N.D. Ill. 1992); Cardinal Industries, 109 B.R. at 765.

26. With respect to whether the appointment of a trustee is in the best interest of creditors and other parties-in-interest, courts "eschew rigid absoluteness and look to the practical realities and necessities" of the case. *In re Madison Management Group, Inc.*, 137 B.R. at 282 (citing *In re Hotel Associates, Inc.*, 3 B.R. 343, 345 (Bankr. E.D. Pa. 1980)). Among the factors considered are (i) the trustworthiness related to the management of the debtor, and (ii) the benefits derived by the appointment of a trustee, balanced against the cost of appointment. *In re Madison Management Group, Inc.*, 137 B.R. at 282 (citations omitted).

if the appointment is in the best interest of creditors and other parties-in-interest in the case.[27]

Once appointed, the powers and duties of a Chapter 11 trustee are quite vast,[28] as a trustee assumes the same fiduciary duties to creditors as a debtor-in-possession,[29] plus some additional ones.[30] The additional duties assumed by a bankruptcy trustee include the duty to "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor."[31]

Upon the appointment of a trustee,[32] all property of the debtor passes to an estate represented by the trustee.[33] Thus the debtor and its management team are simply no longer in control of the business operations of the Chapter 11 debtor.[34] Under the Bank-

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27. *See* 11 U.S.C. § 1104(a); In re Sharon Steel Corp., 871 F.2d at 1226; In re Nicolet, Inc., 80 B.R. 733, 738 (Bankr. E.D. Pa. 1987).

28. *Weintraub*, 471 U.S. at 352.

29. The debtor-in-possession is accountable for all property received, examines claims and objects to improper claims, furnishes information regarding the administration of the estate if such information is requested by interested parties, files monthly operating reports, files monthly operating reports, files tax returns, files a plan of reorganization or recommends conversion or dismissal of the case if no plan is filed. *See* 11 U.S.C. §§ 704, 1106 and 1107. The debtor in possession also is authorized to operate its business. 11 U.S.C. § 1108.

30. *See* 11 U.S.C. §§ 704, 1106 and 1107.

31. *See* 11 U.S.C. § 1106(3). Another additional duty is the duty to "collect and reduce to money the property of the estate for which such trustee serves, and to close such estate as expeditiously as is compatible with the best interests of parties in interest." 11 U.S.C. § 704(1). Section 1109 of the Bankruptcy Code appears to define the term "party-in-interest" as "including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, and equity security holder, or any indenture trustee." 11 U.S.C. § 1109(b).

32. As in Chapter 7, trustees in Chapter 11 may also be elected by creditors if the court deems it appropriate to order the appointment of a trustee. *See* 11 U.S.C. § 1104(b). The Bankruptcy Code provides that "on the request of a party in interest made not later than 30 days after the court orders the appointment of a trustee ..., the United States trustee shall convene a meeting of creditors for the purpose of electing one disinterested person to serve as trustee in the case." *Id.* For a discussion of who constitutes a "disinterested person" under the Bankruptcy Code, *see* Kurt F. Gwynne, *Employment of Turnaround Management Companies, "Disinterestedness" Issues Under the Bankruptcy Code, and Issues Under Delaware General Corporation Law*, 10 AM. BANKR. INST. L. REV. 673 (2002).

33. 11 U.S.C. § 542(a).

34. *See* 11 U.S.C. §§ 323, 541, and 1106. It can be argued that the trustee appointment provisions of Section 1104 of the Bankruptcy Code are by no means the only manner by which a change of corporate governance of a debtor-in-possession may be properly effectuated in bankruptcy. Under Sections 1107 and 1108 of the Bankruptcy Code, a Chapter 11 debtor-in-possession is free to manage its assets and operate its business, subject to general bankruptcy court oversight. For example, a Chapter 11 debtor-in-possession is free to "enter into such transactions" in the ordinary course of business without first obtaining prior court approval. *See* 11 U.S.C. § 363(c)(1). Where the debtor desires to enter into transactions that are outside the ordinary course of business, the debtor-in-possession is permitted to enter into them after first obtaining court approval upon notice and hearing. *See* 11 U.S.C. § 363(b). Examples of transactions that would require prior court approval

ruptcy Code, the trustee is accountable for all property received and has the duty to maximize the value of the estate.[35] The trustee, therefore, is not only directed to investigate the debtor's financial affairs, but he or she also is empowered to sue officers, directors, and other third-parties to recover, on behalf of the estate, fraudulent or preferential transfers of the debtor's property.[36] Without the necessity of bankruptcy court approval, a Chapter 11 trustee is also empowered to operate the debtor's business and sell, use, and lease property of the bankruptcy estate in the ordinary course[37] of business.[38]

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include a debtor-in-possession's retention, payment, or replacement of non-ordinary course professionals. *See* In re Pannebaker Custom Cabinet Corp., 198 B.R. 453 (Bankr. M.D. Pa. 1996); In re Bartley Lindsay Co., 137 B.R. 305, 309 (D. Minn. 1991); *see also* 11 U.S.C. §§ 327(a) and (b). Some courts have utilized Sections 327, 363, 1107, and 1108 of the Bankruptcy Code to authorize the appointment of a "responsible officer" or "person in control" of a Chapter 11 debtor's assets and operations. *See* In the Matter of FSC Corp., 38 B.R. 346, 349 (Bankr. W.D. Pa. 1983); *accord* In re Harper Industries, Inc., 18 B.R. 773, 775 (Bankr. S.D. Ohio 1982). For example, in *FSC Corp.*, the United States Bankruptcy Court for the Western District of Pennsylvania upheld the appointment of a responsible officer to perform the duties of a debtor-in-possession when all of the debtor's officers and directors had resigned, thereby leaving the debtor with no management. While the lack of a board of directors could have been cause for the appointment of a trustee under 11 U.S.C. § 1104, the bankruptcy court in *FSC* nevertheless upheld the appointment of a responsible officer because (a) the parties who had a financial stake in the outcome of the case consented to the appointment and (b) Sections 226 and 303 of Delaware Corporation Law authorized a court of competent jurisdiction to appoint a custodian or "other representative" to act for the corporation's board of directors. *See FSC Corp.*, 38 B.R. at 349-51; *see also* In re Gaslight Club, Inc., 782 F.2d 767, 772 (7th Cir. 1986)(replacement person in control authorized where creditors with financial stake consented and nothing under applicable state law precluded the replacement of management); In re Boileau, 736 F.2d 503, 505-06 (9th Cir. 1984)(same); In re Harper Industries, Inc., 18 B.R. at 775 (same); In re Freedlander, Inc., 86 B.R. 66, 68 (Bankr. E.D. Va. 1988)(substitution of management is permissible where there is a consensus that management should be replaced).

35. *See* 11 U.S.C. §§ 704(1), 704(2) and 1106(a)(1); In re Washington Group, Inc., 476 F.Supp. 246, 250 (M.D.N.C. 1979).

36. *Id.*

37. The phrase "ordinary course of business" is not defined in the Bankruptcy Code. Many courts have applied a two-part test to determine whether a transaction is in the ordinary course of business. First, in the "vertical dimension" or "creditor expectation" test, the court analyzes the transaction from the vantage point of a hypothetical creditor and inquires whether the transaction subjects a creditor to economic risks of a nature different from those the creditor accepted when it initially contracted with the debtor. Second, the "horizontal dimension" test determines whether, from an industry-wide perspective, the transaction is of the sort commonly undertaken by companies in that industry. For a discussion of these tests, *see* In re Roth American, Inc., 975 F.2d 949, 953 (3d Cir. 1992); and In re Glosser Bros., 124 B.R. 664, 667 (Bankr. W.D. Pa. 1991).

38. *See* 11 U.S.C. §§ 363(b), 363 (c)(1) and 1106(3). Sections 363(b)(1) and 363(c)(1) of the Bankruptcy Code provide that a trustee or debtor-in-possession may use, sell or lease property of the estate without prior court approval only so long as the transaction contemplated by the trustee or debtor-in-possession is "in the ordinary course of business." *See* 11 U.S.C. §§ 363(b)(1) and (c)(1). If the trustee's or debtor's transaction is outside the ordinary course of business, the transaction may be avoided. *See* 11 U.S.C. § 549. Thus, where a

B. Appointment, Powers, and Duties of Examiners

All of the expansive powers reposed in a Chapter 11 trustee, along with their correlating benefits, do not come without a price. From a practical perspective, the appointment of a Chapter 11 trustee may cause business operations to be interrupted to some degree as a result of the installation of new management.[39] In addition, the debtor and Chapter 11 trustee lose one of the fundamental protections afforded to Chapter 11 debtors, namely the exclusive right to propose a plan and solicit support for a plan of reorganization during the first 120 days of a bankruptcy case.[40] As

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transaction is ordinary, as opposed to extraordinary, a trustee or debtor-in-possession may freely enter into the desired transaction without the need of affording interested parties notice or opportunity for a hearing. The purpose behind such a rule was stated succinctly by the United States District Court for the Southern District Court in the case of In re James A. Phillips, Inc., 29 B.R. 391 (S.D.N.Y. 1983). The Court in the *Phillips, Inc.* case, wrote:

> [T]he apparent purpose of requiring notice only where the use of property is extraordinary is to assure interested persons of an opportunity to be heard concerning transactions different from those that might be expected to take place so long as the debtor in possession is allowed to continue normal business operations under 11 U.S.C. §§ 1107(a) and 1108. The touchstone of 'ordinariness' is thus the interested parties' reasonable expectation of what transactions the debtor in possession is likely to enter in the course of business. So long as the transactions conducted are consistent with these expectations, creditors have no right to notice and hearing, because their objections to such transactions relate to the bankrupt's chapter 11 status, not the particular transactions themselves. Where the debtor in possession is merely exercising the privileges of its chapter 11 status, which include the right to operate the bankrupt business, there is no general right to notice and hearing concerning particular transactions.

In re James A. Phillips, Inc., 29 B.R. at 394.

39. For example, the appointment of a bankruptcy trustee may trigger an event of default under the debtor's post-petition credit facility, which in-turn could impair the debtor-in-possession's ability to finance its operations in Chapter 11.

40. *See* 11 U.S.C. § 1121(c)(1). Section 1121 of the Bankruptcy Code augments the concept of a "debtor-in-possession" and provides for an initial "exclusivity" period of 120 days after the commencement of a Chapter 11 case during which a debtor has the exclusive right to file a plan of reorganization; if the debtor files a plan within such 120-day period, it has an additional 60 days thereafter to solicit acceptance of its plan, during which time no other party may file a plan. *See* 11 U.S.C. § 1121(b), (c). While Section 1121 of the Bankruptcy Code has only a 120 day time limitation, the Bankruptcy Code does afford debtors-in-possession with flexibility in that the Bankruptcy Code expressly authorizes the court to extend the exclusivity period for "cause," after notice and hearing. 11 U.S.C. § 1121(d). Whether cause exists to extend the exclusive periods is at the discretion of the court based upon the facts and circumstances of each particular case. *See* First American Bank of New York v. Southwest Gloves & Safety Equip., Inc., 64 B.R. 963 (D. Del. 1986). Although the term "cause" is not defined in the Bankruptcy Code, the legislative history indicates that it is intended to be a flexible standard. *See* H.R. REP. NO. 95-595 at 231 (1977), *reprinted* in 1978 U.S.C.C.A.N. 5963; *In re* AMKO Plastics, Inc., 197 B.R. 74, 77 (Bankr. S.D. Ohio 1996)("[T]he legislative intent . . . [is] to promote maximum flexibility."); *In re Clamp-All Corp.*, 233 B.R. 198, 207 (Bankr. D. Mass. 1999); *In re* All Seasons, Inc., 121 B.R. 1002, 1004 (Bankr. N.D. Ind. 1990). A flexible standard is necessary "in order to allow the debtor

a result, once a Chapter 11 trustee is appointed, creditors lacking fiduciary duties to all creditors may come forward and propose their own plan and attempt to take control of the reorganization process.[41] Congress recognized these risks, and crafted in Section 1104 of the Bankruptcy Code an alternative to the appointment of a trustee, wherein something less than a full-fledged trustee is warranted.[42] In these unique circumstances, the vehicle utilized by Congress in Section 1104 of the Bankruptcy Code is called an "examiner."[43]

The process for the appointment of an examiner is the same for the appointment of a trustee,[44] with one notable exception.[45] In

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to reach an agreement." H.R. REP. No. 95-595, 95th Cong., 1st Sess. 231-32 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6191. A flexible standard thus provides the debtor with reasonable opportunity to stabilize its business operations at the outset of the case, to negotiate with creditors an effective plan of reorganization, and to prepare the necessary financial and non-financial information that must be disclosed to creditors. *See In re* Newark Airport/Hotel, 156 B.R. 444, 451 (Bankr. D.N.J. 1993); *In re* McLean Indus., 87 B.R. 830, 833-34 (Bankr. S.D.N.Y. 1987). In determining whether to extend a debtor's exclusive periods, courts assess the totality of circumstances and consider a variety of factors. *See, e.g., In re* Dow Corning Corp., 208 B.R. 661, 664 (Bankr. E.D. Mich. 1997); *In re* Express One Int'l Inc., 194 B.R. 98, 100 (Bankr. E.D. Tex. 1996); *McLean*, 87 B.R. at 834. The following factors are relevant to a court's decision to extend a debtor-in-possession's exclusive periods: whether (a) the debtor's case is sizeable and complex; (b) there is good faith progress towards rehabilitation and development of a consensual plan of reorganization; (c) the debtor is not seeking to use its exclusivity to pressure creditors into accepting a plan they find unacceptable; and (d) the debtor is generally making required post petition payments as they come due and is effectively managing its business and preserving the value of its assets. *See id. In re Express One*, 194 B.R. at 100; In the Matter of Interco, Inc., 137 B.R. 999, 1001 (Bankr. E.D. Mo. 1992). The Bankruptcy Code also contains provisions that protect creditors from a debtor-in-possession's abuse of the exclusivity afforded to it. Specifically, Section 1121(d) of the Bankruptcy Code provides that "after notice and a hearing, the court may for cause reduce or increase the 120-day" exclusivity period. 11 U.S.C. § 1121(d). The leading case in this area is the case of *In re* Texaco, Inc., 81 B.R. 806 (Bankr. S.D.N.Y. 1988). In *Texaco*, the United States Bankruptcy Court held that the party seeking to reduce or extend the exclusivity period carries the burden of proving that "cause" exists to do so. One court has even described that burden as being "heavy." *See Interco Inc., supra.* In those cases where the exclusivity period was reduced, factors such as gross mismanagement of the debtor's operations or acrimonious feuding between the debtor's principals serving as a major obstacle to a successful reorganization were regarded as "cause" for the reduction of the exclusivity period. *See e.g., In re* Texas Extrusion Corp., 68 B.R. 712 (Bankr. N.D. Tex. 1986). Courts have also held that plan exclusivity provisions should not be employed as a tactical device to put pressure on parties to yield to a plan the movant considers to be unsatisfactory. *Texaco*, 81 B.R. at 812. In a reorganization context, it has been held that the mere fact that a party would like to take part in the plan formulation and negotiation process is insufficient to constitute "cause" for terminating exclusivity. *See In re* Eagle-Picher Indus., Inc., 176 B.R. 143 (Bankr. S.D. Ohio 1994). It has also been held that "cause" is not shown merely where the movant desires to file its own plan. *Id.*

41. *See, e.g., In re* Allegheny Int'l, Inc., 118 B.R. 282 (Bankr. W.D. Pa. 1990), as a textbook case in which the plan process in bankruptcy was, albeit unsuccessfully, used as a tool to undertake a hostile takeover of a debtor-in-possession.

42. 11 U.S.C. § 1104(c).

43. *Id.*

44. The process is that a party in interest, or the court on its own motion, must move for the appointment of an examiner and demonstrate that (a) "cause" exists for the ap-

looking at the plain language of Section 1104(c) of the Bankruptcy Code, it appears that Congress intended the automatic appointment of an examiner in instances where (a) the debtor's obligations to an insider exceed $5,000,000; and (b) creditors desire the appointment of an examiner to investigate the conduct, assets, and liabilities of the debtor.[46]

Hence, the frequently asked question is: "Is Section 1104(c)(2) relief automatic or does the bankruptcy court have some discretion in fashioning relief?" Courts are split on how Section 1104(c)(2) operates.[47] The Sixth Circuit Court of Appeals, following the majority rule, concluded that when the statutory requirements of 11 U.S.C. § 1104(c)(2) are met, the court has no discretion and must order the appointment of an examiner because the statute is clear on its face.[48] The United States Bankruptcy Court for the Middle District of Florida, however, reached a different result and concluded that the appointment of an examiner is nonetheless discretionary even if the movant demonstrates that insider claims exceed $5 million.[49]

Once appointed, the question often posed by parties-in-interest to examiners is, "What are your powers and duties?" While the

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pointment; and (b) the appointment is in the best interest of creditors and other parties in interest. *See* 11 U.S.C. § 1104(c).

45. Under the Bankruptcy Act, an examiner could only be appointed in cases where no bankruptcy trustee was appointed, as Chapter X did not contemplate the appointment of both a trustee and an examiner. *See* KING, *supra* note 5, at ¶ 1104.LH[2][a]; *see also Gochenour v. Cleveland Terminals Bldg. Cor.*, 118 F.2d 89 (6th Cir. 1941), for a description of the use of examiners in bankruptcy under the Bankruptcy Act.

46. *See* 11 U.S.C. § 1104(c)(2). The term "insider" is defined in Section 101(31) of the Bankruptcy Code, and such term includes, but is not limited to, any relative of an individual debtor and any officer, director or person in control of a corporate debtor. *See* 11 U.S.C. § 101(31).

47. *Compare In re* Revco D.S., Inc., 898 F.2d 498 (6th Cir. 1990)(appointment of examiner mandatory where provisions of Section 1104(c)(2) are met); *In re* Mechem Fin. of Ohio, Inc., 92 B.R. 760 (Bankr. N.D. Ohio 1988)(same); *In re* the Bible Speaks, 74 B.R. 511 (Bankr. D. Mass. 1987); *In re* 1243 20th Street, Inc., 6 B.R. 683 (Bankr. D. D.C. 1980)(same); *In re* Lenihan, 4 B.R. 209 (Bankr. D. R.I. 1980)(same); *with In re* Rutenberg, 158 B.R. 230 (M.D. Fla. 1993)(appointment not mandatory even if requirements of Section 1104(c)(2) met); *In re* Shelter Res. Corp., 35 B.R. 304 (N.D. Ohio 1983)(same). In any event, even if the applications of Section 1104(c)(2) are met, a party-in-interest may waive his or her right to seek the appointment of an examiner by sheer delay in submitting such a request to the court. *In re* Bradlees Stores, Inc., 209 B.R. 36, 39 (Bankr. S.D.N.Y. 1997); *see also In re* Schepps Food Stores, Inc. 148 B.R. 27, 30-31 (S.D. Tex. 1992)(holding that creditor waived right to examiner where request was made just before plan confirmation hearing and would disrupt proceedings).

48. *Revco*, 898 F.2d at 500.

49. *Rutenberg*, 158 B.R. at 233 (although the case in question met the statutory provisions of 11 U.S.C. § 1104(c)(2), the appointment of an examiner was rejected on the basis that such appointment would delay the administration of the case).

powers and duties of a Chapter 11 trustee are generally broad, the powers and duties of an examiner may be subject to some restrictions, thereby affording a Chapter 11 debtor some autonomy in its restructuring.[50]

The limited operational impact of an examiner in bankruptcy is consistent with the limited purpose of the appointment of an examiner in the first instance. In *In re Gilman Servs., Inc.*, the Bankruptcy Court for the District of Massachusetts held,

> The primary function of an examiner is to investigate the debtor's actions, financial condition, as is appropriate under the particular circumstances of the case including any allegations of fraud, dishonesty or gross mismanagement of the debtor by current or former management. . . .
>
> Even though § 1104 provides for the appointment of an examiner to investigate allegations of fraud, dishonesty, and gross mismanagement, mere allegations of misconduct will not suffice; there must be a factual basis supporting the need for an independent investigation.[51]

The *Gilman* Court's description of the purpose of an examiner in bankruptcy is consistent with conclusions reached by other bankruptcy courts throughout the country. For instance, the United States Bankruptcy Court for the Southern District of Ohio observed in *In the Matter of Baldwin United Corp.*,

> An Examiner's legal status is unlike that of any other court-appointed officer which comes to mind. He is first and foremost disinterested and non adversarial. The benefits of his investigative efforts flow solely to the debtor and to its creditors and shareholders, but he answers solely to the Court. [A]n examiner constitutes a Court fiduciary and is amendable to no other purpose or interested party.[52]

Similarly, in *In re Ionosphere Clubs, Inc.*, the United States Bankruptcy Court for the Southern District of New York held,

> The purpose of an examiner's investigation in bankruptcy is to discover whatever assets may exist for the estate of the

50. *See* KING, *supra* note 5 at ¶ 1104.03.
51. 46 B.R. 322, 327 (Bankr. D. Mass. 1985).
52. 46 B.R. 314, 316 (Bankr. S.D. Ohio 1985).

> bankrupt, just as one purpose for the appointment of a trustee is so that a trustee may use statutory powers conferred by the Bankruptcy Code to collect all property belonging to the debtor for the benefit of the debtor's creditors. The bankruptcy code gives a trustee more power than a solvent debtor to collect property belonging to the estate. Bankruptcy Rule 2004 likewise gives the Examiner scope to investigate which is broader than that of civil discovery under Rule 26. . .
>
> The investigation of an examiner in bankruptcy, unlike civil discovery under Rule 26(c), is supposed to be a 'fishing expedition,' as exploratory and groping as appears proper to the Examiner . . . .[53]

The limited nature[54] of an examiner's role is highlighted by the plain language of Section 1106 of the Bankruptcy Code.[55] Under Section 1106(b), and unless the bankruptcy court orders otherwise, a bankruptcy examiner is a fiduciary charged with the duty of investigating[56] the "acts, conduct, assets, liabilities, and finan-

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53. 156 B.R. 414, 432 (S.D.N.Y. 1993).

54. *See In re* American Bulk Transp., Inc., 8 B.R. 337, 340 (Bankr. D. Kan. 1980).

55. *See* 11 U.S.C. § 1106(b)(setting forth the duties of trustees and examiners).

56. As set forth above, the primary function of an examiner appointed pursuant to 11 U.S.C. § 1104(c) is to investigate the debtor's actions, financial condition, and, as is appropriate under the particular circumstances of the case, any allegations of fraud, dishonesty, or gross mismanagement of the debtor. *Gilman Servs., Inc.*, 46 B.R. at 327. An examiner acts as an independent party to review, without monetary interest, transactions and documents. An examiner is first and foremost a disinterested party and is nonadversarial. The benefits of an examiner's investigative efforts therefore flow solely to the debtor and the debtor's creditors and equity holders. *Baldwin United Corp.*, 46 B.R. at 316. Once an examiner collects the requisite information, he or she then disseminates the information to the creditors of the bankruptcy estate in a nonadversarial context by filing a report with the bankruptcy court. Towards this end, the examiner is:

> [A] fact-finder in the colloquial sense of the term. The Examiner discovers facts for the benefit of the creditors as directed by the Court. He does not, however, issue judicial "findings of fact" as a court does under F.R.B.P. 7052. It follows then, that while the Examiner may be appointed by the Court, he is so appointed to assist the parties other than the Court. He is not an extension of the Court.

In re Apex Oil Co., 101 B.R. 92, 99 (Bankr. E.D. Mo. 1989). The conclusions of an examiner, therefore, "do not have the binding effect on the Court or parties of those of a special master, arbitrator or magistrate." *Ionosphere Clubs, Inc.*, 156 B.R at 432 (quoting *Baldwin United Corp.*, 46 B.R. at 316). Accordingly, because an examiner does not make an "adjudicatory determination of substantive rights," an examiner's findings have no binding effect on the debtor or its creditors in the absence of a bankruptcy court expressly adopting the examiner's conclusions. As a practical matter, however, a bankruptcy court will probably give great deference to the conclusions drawn by any examiner that it appoints. FED. R. EVID. 702 might also apply to permit the introduction of an examiner's report into evidence as an "expert opinion" to the extent the appropriate legal foundation is made by the party proffering the evidence.

cial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan."[57]

While Section 1106(b) generally provides for a limited role of an examiner in Chapter 11, Section 1106(b) does not contain an absolute express prohibition to the bankruptcy court expanding an examiner's duties beyond conducting a mere investigation. The plain language of Section 1106(b) even contemplates that an examiner appointed by the Court "shall perform . . . any other duties of the trustee that the court orders the debtor in possession not to perform."[58] The issue raised by this catch-all provision therefore is

57. *See* 11 U.S.C. § 1106(b). Because an examiner must also, "as soon as practicable, file a 'statement of any investigation' and 'transmit a copy or a summary of any such statement to any creditors' committee or equity security holders' committee,' to any indenture trustee, and to such other entity as the court designates," *see* 11 U.S.C. § 1106(a)(4),(as adopted and incorporated by 11 U.S.C. § 1106(b)), an issue exists as to whether a court-appointed examiner is protected from discovery by some sort of quasi-immunity. This issue comes up from time to time, as the investigation that an examiner does in the course of a bankruptcy proceeding usually uncovers an abundance of information which third party litigants would like to use to their own benefit. The *Enron* case is a good example of a situation wherein various parties-in-interest had litigation claims and contended that the examiner possessed documents and information relevant to the prosecution or defense of such actions. The examiner in *Enron*, however, obtained limited immunity from third-party discovery before any discovery was propounded upon the examiner in that case. Why? There are compelling interests in allowing an examiner to be immune from discovery in connection with his or her work. From a practical perspective, finding individuals to work as examiners in complex cases like *Enron* might become increasingly difficult if the examiner would be subject to a barrage of discovery requests at the conclusion of the examiner's tenure. Essentially, no one would want to be placed in involuntary servitude to the bankruptcy estate. Providing an examiner with limited immunity from discovery is consistent with the notion that an examiner is a disinterested third party and an officer of the court. *Big Rivers Elec. Corp.*, 213 B.R. at 977 (recognizing that an examiner is an independent third party and an officer of the court); *Interco Inc.*, 127 B.R. at 638 (the examiner's role is by its nature disinterested and non-adversarial). Third party litigants and those involved in the underlying bankruptcy, however, do have compelling arguments for requesting information from the examiner to be used in subsequent litigation. In fact, such parties' due process rights are paramount to an examiner's convenience so long as the examiner suffers no undue harm or burden for its efforts in responding to discovery requests. Accordingly, access to the examiner's documents and information appears to be appropriate when the proponent of discovery has no other available means of obtaining relevant documents and information from other known sources. This conclusion appears to be consistent with the traditional view that an examiner is independent and should not be used by third party litigants to fuel their litigation. *Baldwin United Corp.*, 46 B.R. at 316.

58. 11 U.S.C. § 1106(b). Section 1106(a)(3) and (a)(4) of the Bankruptcy Code requires the trustee to "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business, the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan." The "other duties" referred in Section 1106(a) of the Bankruptcy Code include the duty to account for estate property, 11 U.S.C. § 704(2); the duty to examine and object to claims, 11 U.S.C. § 704(5); the duty to furnish information to parties-in-interest, 11 U.S.C. § 704(7); the duty to file financial reports and tax returns, 11 U.S.C. § 704(8); the duty to make a

whether an examiner may be morphed into a quasi-trustee, without implicating some of the adverse consequences triggered by the appointment of a trustee. The answer to this question is somewhat mixed.

From the outset, it should be recognized that an examiner's duties cannot be morphed if a bankruptcy trustee has been appointed. Section 1104(b) of the Bankruptcy Code appears to contemplate that an examiner cannot be appointed if a trustee is already in place.[59] This "don't tread on me" approach is consistent with the prudential concern of not limiting a trustee's powers and duties, as the appointment of a bankruptcy trustee under the Bankruptcy Code completely ousts the debtor's officers and directors.[60]

The expansion of an examiner's duties under the Bankruptcy Code is not to be inferred or taken lightly. Expansion of an examiner's duties may be accomplished only by an express order of the bankruptcy court, and such order must plainly set forth both the duties that the examiner is to perform and the duties that the debtor is to abstain from performing.[61]

In instances where an examiner's duties have been expanded, the majority of the case law appears to indicate that the inflation of the duty balloon occurs in the context of liquidating assets of the bankruptcy estate, including pursuing causes of action identified in an examiner's report and soliciting bids for the sale of assets under circumstances wherein the debtor did not aggressively pursue the liquidation of such asserts.[62] Alternatively, courts have also cloaked examiners with the duty of facilitating the plan confirmation process in instances where the reorganization process

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final report with respect to the administration of the estate, 11 U.S.C. § 704(9); the duty to file schedules of assets and liabilities and statements of financial affairs, 11 U.S.C. 1106(a)(2); the duty to file a plan or recommend conversion or dismissal of the case, 11 U.S.C. § 1106(a)(5); the duty to furnish information to governmental taxing bodies, 11 U.S.C. § 1106(a)(6); and the duty to file post-confirmation reports, 11 U.S.C. § 1106(a)(7).

59. *See* 11 U.S.C. § 1104(c)(providing that the appointment of an examiner can only occur where cause is shown and where "the court does not order the appointment of a trustee").

60. *See* KING, *supra* note 5 at ¶ 1106.05[1](noting that Section 1106(b) of the Bankruptcy Code should "not be viewed as a means by which the court can essentially remove the debtor in possession from control of the estate without appointing a trustee").

61. *See* 11 U.S.C. § 1106(b).

62. *In re* Patton's Busy Bee Disposal Serv., Inc., 182 B.R. 681 (Bankr. W.D.N.Y. 1995); *see also In re* John Peterson Motors, Inc., 47 B.R. 551 (Bankr. D. Minn. 1985); *In re* Carnegie Int'l Corp., 51 B.R. 252 (Bankr. S.D. Ind. 1984).

has broken down.[63] By way of illustration, the court in *In re Public Serv. Co. of New Hampshire* appointed an examiner to mediate and break a deadlock in plan negotiations and to assist the court at disclosure statement hearings relating to competing plans.[64]

III. THE EXAMINER AND THE ATTORNEY-CLIENT PRIVILEGE

The ability of a court to grant an examiner quasi-trustee powers and duties under Section 1106 of the Bankruptcy Code has allowed courts to expand the scope of an examiner's role in Chapter 11 beyond that of a mere investigator in order to meet the individual needs of each case.[65] The ability to inflate the role of an examiner appears to have practical utility in the bankruptcy context, particularly due to the fact that Chapter 11 cases have grown in size, complexity, and volume.[66] The growing number of accounting scandals and cases of executive misconduct will lead to examiners continuing to play a pivotal role in complex Chapter 11 cases.[67]

However, an examiner's inflated power and duty balloon may be popped in certain circumstances.[68] The outer-limits of an examiner's powers and duties can be illustrated through an examination of whether the examiner has the power to waive a debtor's attorney-client privilege. Perhaps one of the most publicized Chapter 11 cases involving the scope of an examiner is *In re Enron Corporation*,[69] in which the United States Bankruptcy Court for the Southern District of New York authorized the appointment of

63. *See, e.g., In re* Enron Corp., 279 B.R. 671, 678-82 (Bankr. S.D.N.Y. 2002)(examiner's role expanded to facilitate reorganization plan); *In re* Keene Corp., 205 B.R 690, 694 (Bankr. S.D.N.Y. 1997)(examiner appointed with power to mediate and supervise reorganization negotiations); *In re* UNR Indus., 72 B.R. 789, 795-96 (Bankr. N.D. Ill. 1987)(examiner appointed to mediate and facilitate impasses in negotiating a reorganization plan).

64. 99 B.R. 177, 182-83 (Bankr. D. N.H. 1989); *see also In re* Great Barrington Fair & Amusement, Inc., 53 B.R. 241, 244 (Bankr. D. Mass. 1985).

65. *See, e.g., Enron Corp.*, 279 B.R. at 678-82 (appointing examiner with expanded powers to facilitate plan of reorganization); *Apex Oil Co.*, 111 B.R. at 240 (examiner appointed with expanded power to resolve claims); Williamson v. Roppollo, 114 B.R. 127 (W.D. La. 1990)(examiner with expanded powers to pursue avoidance actions); *In re* World Indus. Ctrs., *Ltd.*, 992 F.2d 1220 (9th Cir. 1993)(unpublished decision)(examiner appointed with expanded power to sell estate property); *Balser v. Dep't of Justice*, 327 F.3d 903, 905-06 (9th Cir. 2003)(examiner appointed with expanded power to manage rental properties and sell assets).

66. Kaplan, *The Role of the Examiner: Some Observations*, 4 BANKR. DEV. J. 439 (1987).

67. *See* Loomis, *supra* note 2.

68. *In re* Int'l Distrib. Ctrs, Inc., 74 B.R. 221 (S.D.N.Y. 1987)(rejecting powerful examiner as a "pseudo-trustee").

69. No. 01-16034, 2002 WL 32151530 (Bankr. S.D.N.Y. 2002).

an examiner to investigate various questionable balance sheet transactions between the debtor and its affiliates.[70] The order appointing an examiner in *Enron* (hereinafter "the Enron Order") was fairly broad in terms of the investigative duties reposed in the examiner appointed in that case.[71] To facilitate the examiner's investigation, and to aid the examiner in uncovering claims and causes of action against various parties (including, without limitation, the debtor's present and former officers, attorneys, and accountants), the Enron Order also went so far as to grant the examiner the power to waive the debtor's attorney-client privilege.[72]

The power granted in the Enron Order that permitted the examiner to exercise control over and to waive the attorney-client privilege is controversial and raises many questions, including: "Does an examiner have an interest in the attorney-client privilege in order to waive it?"

There is no specific provision in the Bankruptcy Code that grants an examiner an interest in the debtor's privileges, let alone conferring upon an examiner the ability to waive those privileges. Indeed, examiners are not even mentioned as being parties-in-interest under the Bankruptcy Code.[73]

Proponents of granting an examiner the power to waive the debtor's privileges point to Section 1106(b) of the Bankruptcy Code as a source of this power.[74] Section 1106(b) of the Bankruptcy Code, however, may not be as expansionist as the proponents contend.[75]

The United States Supreme Court held in *CFTC v. Weintraub* that a trustee in bankruptcy has the power to waive a corporate

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70. *Id.* at *1.

71. *Id.*

72. *See* Enron Order at 3. The waiver provisions of the Enron Order provided that the examiner "shall have the power to waive" the attorney-client privilege on an "issue-by-issue basis" with respect to pre-petition communications relating to matters that the examiner was to investigate. In the Enron Order, the court further instructed that the examiner was to act "in the best interest of the debtor's estates" in connection with any decision to waive the attorney-client privilege, and that the debtors' and creditors' committees could make objections to such a waiver.

73. *See* 11 U.S.C. § 1109(b). The notion that an examiner is not a party-in-interest is consistent with the fact that an examiner's role in bankruptcy is generally limited to being a neutral and independent investigator.

74. *Cf., Baldwin United Corp.*, 46 B.R. at 315 (holding that examiner shall have the same privilege rights as trustee so that examiner may perform its statutorily mandated duties).

75. In *Norwest Bank Worthington v. Ahlers*, the United States Supreme Court concluded that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." 485 U.S. 197, 206 (1988).

debtor's attorney-client privilege with respect to pre-bankruptcy communications.[76] The *CFTC v. Weintraub* case appears to provide practical support for conferring upon an examiner the power to waive the attorney-client privilege.[77]

In *Weintraub*, the United States Supreme Court noted the proposition that the trustee in bankruptcy plays the role most closely analogous to that of a solvent corporation's management.[78] The Supreme Court reasoned that conferring upon a trustee the power to waive the privilege is consistent with the fact "that the debtor's directors retain virtually no management powers, [and, as a result,] they should not exercise the traditional management function of controlling the corporation's attorney-client privilege."[79] The Supreme Court went on to explain,

> It would be extremely difficult for the trustee to investigate the conduct of prior management if the former management were allowed to control the attorney-client privilege and therefore control access to the corporation's legal files.[80]

The *Weintraub* Court therefore held that vesting control of the debtor corporation's attorney-client privilege in the trustee was appropriate[81] and did not in any way conflict with the careful design of the Bankruptcy Code.[82]

The Supreme Court's second line of reasoning in *Weintraub* asserted that trustees need to be able to control the attorney-client privilege in order to conduct a thorough investigation and thereby discover "hidden assets" or "looting schemes."[83] Essentially, the Supreme Court appears to have held in this instance that wresting control of the privilege away from persons who may have engaged in, or have knowledge of, tortious conduct is in the best interest of creditors. In fact, some cases have suggested that the

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76. *Weintraub*, 471 U.S. at 358.
77. *Id.*
78. *Id.* at 353.
79. *Id.*
80. *Id.*
81. *Weintraub*, 471 U.S. at 355. Wresting control of the attorney-client privilege does not translate into a trustee's unfettered right to waive it. As the Supreme Court in *Weintraub* noted," The propriety of the trustee's waiver of the attorney-client privilege in a particular case can, of course, be challenged in the bankruptcy court on the ground that it violates the trustee's fiduciary duties." *Id.* at n.7.
82. *Id.* at 354.
83. *Id.*

debtor or trustee has the fiduciary duty to waive the privilege in these circumstances.[84]

IV. Does an Examiner Really Have Standing to Waive the Debtor's Attorney-Client Privilege?

The fiduciary duty argument conferring standing upon an examiner to waive an attorney-client privilege does have some curb appeal, and perhaps some basis in Sections 105 and 1106(b) of the Bankruptcy Code.[85] This argument, however, is also prone to attack.

Challenges to an examiner's power to waive the debtor's attorney-client privilege may cite to the plain language of the Bankruptcy Code as support for the proposition that an examiner's power to waive privileges is illusory. Specifically, a fair reading of the fundamental premise of the Supreme Court's decision in *Weintraub* is that the attorney-client privilege is property of the estate,[86] which a bankruptcy trustee owns and controls as a matter

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84. *See Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970). *Garner* is the seminal case reflecting the fiduciary exception to retaining the attorney-client privilege. In *Garner*, a number of shareholders brought a derivative suit against a corporation alleging various counts of fraud and corporate misconduct. When the shareholders sought information and documentation from the company's former counsel, who later became an officer of the company, both the counsel and the company claimed that the information and documentation were protected by the privilege. The Fifth Circuit Court of Appeals held that the privilege did not apply because the corporation owed a fiduciary duty to the shareholders and the privilege should not deny the beneficiary access to information or documentation created or obtained, at least in part, for the shareholders' benefit. According to the Court in *Garner*, courts are to consider the applicability of the attorney-client privilege in a particularized context. In instances wherein the client asserting the privilege is an entity that in the performance of its functions acts wholly or partly in the interests of others, and those others or some of them seek access to the subject matter of the communications, courts are to conclude:

> The representative and the represented have a mutuality of interest in the representative's freely seeking advice when needed and putting it to use when received. This is not to say that management does not have allowable judgment in putting advice to use. But management judgment must stand on its merits, not behind an ironclad veil of secrecy which under all circumstances preserves it from being questioned by those for whom it is, at least in part, exercised.

Garner, 430 F.2d at 1101.

85. *See generally* 11 U.S.C. §§ 105, 1106(b). Section 105 of the Bankruptcy Code authorizes the bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." *See* 11 U.S.C. § 105(a). Certainly, the entry of an order providing an examiner with access to privileged materials, and to waive applicable privileges, is consistent with an examiner's duty to investigate the acts, conduct, assets, liabilities, and financial condition of the debtor and the operation of the debtor's business.

86. The phrase "property of the estate" is defined in section 541 of the Bankruptcy Code, and includes "all legal or equitable interests of the debtor in property as of the com-

of law once he or she is appointed.[87] According to *Weintraub*, management of the debtor is "ousted" by the appointment of a trustee, and all such property of the estate then passes to the trustee duly appointed by the court.[88] Towards this end, *Weintraub* may be construed narrowly and be applicable only in contexts of bankruptcy trustees (who have vast powers) as opposed to bankruptcy examiners (whose powers are limited).

The Bankruptcy Code is consistent with a narrow application of *Weintraub*. Section 363 of the Bankruptcy Code authorizes a bankruptcy trustee to sell, use or lease property of the bankruptcy estate both in the ordinary course of business, and (subject to prior order of the court) outside the ordinary course of business.[89] Arguably, the waiver of the attorney-client privilege is a "use" of property of the estate as contemplated in Section 363(b) of the Bankruptcy Code.[90] As a result, it is important to note that Section 363 of the Bankruptcy Code permits no one, other than the debtor or trustee, to use, sell, or lease property of the estate.[91] Consequently, to the extent that the waiver of the attorney-client privilege constitutes a "use" of "property of the estate," the Bankruptcy Code does not appear to authorize or empower an examiner to waive the privilege.[92]

The legal concept of "property of the bankruptcy estate" is quite broad, and, pursuant to Section 541 of the Bankruptcy Code, includes all legal and equitable interests of the debtor as of the commencement of the bankruptcy case.[93] The question of whether the debtor's attorney-client privilege constitutes property of the debtor's bankruptcy estate is an issue that has been confounding

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mencement of the case" and any such interest acquired "after the commencement of the case." 11 U.S.C. § 541(a).

87. *See Weintraub*, 471 U.S. at 349-353.

88. *Id.* at 352-353 (citing Bankruptcy Code Sections 323, 541, 363, 704 and 1106).

89. *See* 11 U.S.C. § 363(b).

90. The *Weintraub* opinion suggests that creditors may object to the waiver of any estate privileges. *See supra* note 81. Implicit in such a conclusion is that the waiver is a non-ordinary course transaction for which creditors and other parties in interest are entitled to notice and an opportunity to be heard.

91. *Id.* The United States Supreme Court has held that when the "statute's language is plain, the sole function of courts is to enforce it according to its terms." United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241 (1989) (citing Caminetti v. United States, 242 U.S. 470, 485 (1917)).

92. *See* Hartford Underwriters Ins. Co. *v.* Union Planters Bank, N.A., 530 U.S. 1 (2000)(holding that only the trustee or debtor-in-possession may assert Section 506(c) surcharge claims because Section 506(c) of the Bankruptcy Code does not repose the authority of prosecuting such claims in third-parties).

93. *See* 11 U.S.C. Section 541.

legal scholars for many years.[94] Some commentators suggest that characterizing the attorney-client privilege as alienable property is "morally repugnant" since the privilege is personal in nature.[95]

Authority exists in support of the proposition that the right to invoke the attorney-client privilege is both transferable and has some indicia of property. For example, in *Swidler & Berlin and James Hamilton v. United States*,[96] the United States Supreme Court held that as a matter of federal common law the attorney-client privilege survives the death of its holder for the benefit of the holder's estate.[97] Similarly, in the commercial context, some courts have acknowledged that the attorney-client privilege can be transferred along with the debtor's personal property.[98] In the corporate context, the United States Supreme Court in *Weintraub* even appears to implicitly embrace the concept that the attorney-client privilege constitutes a legal and/or equitable property interest of a debtor in bankruptcy.[99]

Critics of the "privilege as property" theory contend that construing the attorney-client privilege as a legal or equitable interest of the debtor falling within the ambit of Section 541 of the Bankruptcy Code is "unsound."[100] Undoubtedly, the purpose of the attorney-client privilege "is to encourage full and frank communication between attorneys and their clients and thereby promote

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94. For an outstanding discussion of the issue, *see* Laura B. Bartell, *The Implied Waiver Solution to the Problem of Privileges in the Individual Bankruptcy Case*, 20 BANKR. DEV. J. 25 (2003) and Neil E. Herman, *Who Controls the Attorney-Client Privilege in Bankruptcy*, 13 HOFSTRA L. REV. 549 (1985).

95. Bartell, *The Implied Waiver Solution to the Problem of Privileges in the Individual Bankruptcy Case*, 20 BANKR. DEV. J. at 42 n 97.

96. 524 U.S. 399 (1998).

97. *Swidler & Berlin*, 524 U.S. at 404-405.

98. *See, e.g.*, American Metrocomm Corp. et al. v. Duane Morris & Heckscher *(In re American Metrocomm Corp.*, 274 B.R. 641, 654 n.10 (Bankr. D. Del. 2002)(where assignee of litigation claims also acquired shared privilege rights); Grace Children's Prods, Inc. v. Regalo Int'l LLC, Civ. A. 97-6885, 1999 WL 553478 at *3, 4 (E.D. Pa. July 29, 1999)(holding that the right to assert or waive the attorney-client privilege also passes with the majority of a corporation's assets in an asset sale); Rhode Island Depositors Ecocomic Protection Corp. v. Mapleroot Dev. Corp., 710 A.2d 167 (R.I. 1998)(stating that "DEPCO expressly purchased all of the receiver's personal and intangible rights with respect to this borrower. Such rights would include the receiver's right to assert any attorney client privilege that formerly belonged to [the borrower]"); *In re* Amjoe, Bankr. L.Rep. (CCH) P 66, 131 (M.D. Fla. 1976)(suggesting that the attorney-client privilege is connected to other property of the estate, and if that other property passes to the trustee, the attorney-client privilege should pass with it); *contra In re* Grand Jury Subpoenas *89-3 & 89-4*, 734 F.Supp. 1207, 1211 n.3 (E.D. Va.), *aff'd in part, vacated in part*, 902 F.2d 244 (4th Cir. 1990).

99. *Weintraub*, 471 U.S. at 348-351.

100. *See, e.g.* Herman, *Who Controls the Attorney-Client Privilege in Bankruptcy*, 13 HOFSTRA L. REV. at 583.

broader public interests in the observance of law and administration of justice."[101] Critics contend that if the attorney-client privilege is construed as a property interest passing to a bankruptcy trustee automatically upon the commencement of a Chapter 7 bankruptcy case or upon the appointment of a trustee in a Chapter 11 case, such a construction will have a chilling effect upon the attorney-client relationship.[102] According to such critics, the chilling effect is predictable because any "rational individual would not divulge sensitive information to an attorney who might be forced to reveal the information if the individual suffers a financial reversal."[103]

The arguments of the critics of the "privilege as property" theory appear to be misplaced to a certain degree. With respect to the corporate context, the *Weintraub* decision (which indirectly adopted the "privilege as property" theory) is nearly twenty years old, and corporate entities still seek out and obtain corporate counsel just as they did prior to that decision. Irrespective of the *Weintraub* decision, corporate decision makers outside of a bankruptcy context have always been subject to the risk that successor managers of the corporation's affairs would waive the attorney-client privilege to the extent that such a waiver is either in the corporation's best interest or is consistent with the fiduciary duties of the corporation's officers and directors. Under these circumstances, the *Weintraub* decision and the concept of "privilege as property" has no chilling effect on the attorney-client privilege in the corporate context. As a matter of fact, the *Weintraub* decision and the privilege as property theory merely restate the obvious (i.e. -- that corporate entities are inanimate objects whose then current managers control the invocation and waiver of the attorney-client privilege).

With respect to the individual debtor context, critics of the "privilege as property" approach contend that characterizing the attorney-client privilege as a property interest has "untoward consequences."[104] Citing to the fact that the fiduciary duties of a bankruptcy trustee flow to creditors, and not to the interests of the individual debtor,[105] critics argue that a bankruptcy trustee "will

101. Upjohn Co. v. United States, 449 U.S., 389 (1981).
102. *Id.*
103. *Id.*
104. Bartell, *The Implied Waiver Solution to the Problem of Privilege in the Individual Bankruptcy Case*, 20 BANKR. DEV. J. at 43-45.
105. *Id.*

not, and should not act in the best interests of the debtor in deciding whether to waive the privilege, but will pursue his [or her] statutory obligations to collect property of the estate and investigate the financial affairs of the debtor."[106] Consequently, an untoward corollary highlighted by critics of the "privilege as property" theory is the fact that individual debtors' pre-bankruptcy communications subsequently may operate to open a Pandora's Box of criminal and/or civil liability to the detriment of the unsuspecting debtor.[107]

It can be argued that the critics' fears of the "privilege as property" theory in the individual debtor context also are somewhat misguided. As an initial matter, the attorney-client privilege is not without exception, as the law of virtually every jurisdictions will not allow clients and lawyers to communicate with impunity about future crimes or intentional torts such as fraud.[108] Even outside of bankruptcy, an individual consumer debtor may find his or her privilege impliedly waived if the circumstances fall within the crime/fraud exception to the attorney-client privilege.

Also, the individual debtor does have resources available to avoid the forfeiture of the privilege. To the extent that the individual debtor's interest in retaining the privilege is paramount to all of his or her other interests, the debtor is always free not to seek bankruptcy protection in the first instance and to deal with his or her creditors in a non-bankruptcy context. To the extent that the individual debtor is in need of a fresh start and has no choice but to seek bankruptcy protection (or, alternatively, if the individual debtor finds himself or herself subject to an involuntary bankruptcy proceeding), the debtor can attempt to shield the privilege, and augment his or her "fresh start" in bankruptcy, by declaring his or her interest in the attorney-client privilege as being exempt from property of the estate pursuant to Section 522 of the Bankruptcy Code.[109]

Exempting the attorney-client privilege under Section 522 of the Bankruptcy Code from property of the estate does have practical

106. *Id.*

107. *Id.* at 49.

108. *See* § 82 at 613-14 RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS (1998); *see e.g. In re* Grand Jury Subpenas, 144 F.3d 653, 660 (10th Cir.), *cert. denied*, 525 U.S. 966 (1998).

109. *See* 11 U.S.C. § 522(d)(5) (2004) (providing an individual debtor with a "wild-card" exemption to the extent of $8,725 of an unused homestead exemption in bankruptcy); *see also* 11 U.S.C. § 542(a) (2004) (providing that an entity holding exempt property does not have to turnover such exempt property to the bankruptcy trustee).

concerns. For example, how does one value the exemption to insure that the statutory amount of exemptions are met? If the content of the privileged communication is not disclosed, can a court ever determine whether the "asset" has been appropriately exempted by the debtor? Surely, this result is unworkable and is something that Congress did not contemplate when it drafted the property of the estate provisions of the Bankruptcy Code.

Despite a debtor's ability to claim exemptions under Section 522 of the Bankruptcy Code, the statutory framework of the Bankruptcy Code is such that debtors do not enjoy an expectation of confidentiality where the attorney-client privilege implicates tangible assets and choses of action which could be liquidated for the benefit of creditors.[110] The provisions of Section 521 of the Bankruptcy Code impose upon the debtor the absolute duty to "cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties" under the Bankruptcy Code.[111] Such duties of a debtor to cooperate include surrendering to the bankruptcy trustee "any recorded information, including books, documents, records, and papers, relating to property of the estate."[112] Based on Section 521 of the Bankruptcy Code and the broad concept of "property of the estate" utilized in Section 541 of the Bankruptcy Code, it is conceivable to conclude that Congress envisioned a scheme whereby the attorney-client privilege of an individual debtor would submit, in appropriate situations, to the needs of the bankruptcy trustee, so that the trustee may carry through with his or her duties under the Bankruptcy Code.[113] In addition, the "as necessary" language utilized in Section 521 of the Bankruptcy Code also suggests that the bankruptcy trustee's claim to privileged materials is tempered by necessity. Courts therefore should balance the interests of the bankruptcy estate in general against the harm caused to the individual debtor when framing an order directing the turnover of privileged materials.[114]

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110. It should also be recognized that the mere fact that a trustee may succeed to the debtor's interest in the attorney-client privilege does not necessarily mean that the privilege is waived. In fact, Section 542 of the Bankruptcy Code appears to preserve the privilege unless expressly waived by the trustee as the Bankruptcy Code provides that the transfer of documents and information by attorneys to the trustee is "[s]ubject to applicable privileges. . . .." 11 U.S.C. § 542(e).

111. *See* 11 U.S.C. § 521(3).

112. *See* 11 U.S.C. § 521(4).

113. *In re* Miller, 247 B.R. 704, 710 (Bankr. N.D. Ohio 2000).

114. *Id.* The analysis pursuant to Section 521 of the Bankruptcy Code is consistent with Rule 501 of the Federal Rules of Evidence. Federal Rule of Evidence. 501 provides that the attorney-client privilege "shall be governed by the principles of the common law as they

No matter how the attorney-client privilege is viewed from a bankruptcy perspective, it is important to recognize that the right to assert or to waive privileges in and of itself is either property of the bankruptcy estate or it is not. Authority certainly exists (most notably the *Weintraub* decision) in support of the theory that a debtor's attorney-client privilege should be construed as property of the bankruptcy estate.[115] If the privilege constitutes property of the bankruptcy estate, Section 363 of the Bankruptcy Code authorizes only the debtor or trustee to sell, use, or lease such property, and no-one else (including an examiner in bankruptcy) is authorized to do so. Conversely, if the debtor's attorney-client privilege does not constitute property of the bankruptcy estate, there is absolutely nothing in the Bankruptcy Code that empowers anyone other than the debtor to waive the privilege. Moreover, a debtor's obligation to cooperate and turn over records flows only to a bankruptcy trustee under Section 521 of the Bankruptcy Code. Under these circumstances, waivers in favor of examiners, like the one procured in *Enron*, appear to be suspect.

Additional statutory prohibitions on an examiner's power to waive an attorney-client privilege can be found in Sections 321(b) and 1106 of the Bankruptcy Code.[116] As to the former, Section 321(b) of the Bankruptcy Code prohibits an examiner from serving as a trustee in the same bankruptcy case.[117] Bankruptcy courts have relied upon this statute to prohibit examiners from being morphed into quasi-trustees.[118]

For example, in *In re International Distributions Centers, Inc.*, the United States District Court for the Southern District of New York vacated an order of the bankruptcy court delegating the powers and duties of a trustee to an examiner.[119] The District Court, looking at the substantive powers afforded to the examiner in that case (as opposed to mere titles bestowed upon officers of the court), concluded that the powers granted to the examiner at

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may be interpreted by the courts of the United States in the light of reason and experience." This analysis also is consistent with Section 542 of the Bankruptcy Code. 11 U.S.C. § 542. Section 542(a) provides that property of "inconsequential value or benefit" to the bankruptcy estate need not be turned over to the bankruptcy trustee. *See* 11 U.S.C. § 542(a).

115. *See also Citibank, N.A. v. Andros*, 666 F.2d 1192, 1194-1196 (8th Cir. 1981).

116. *See* 11 U.S.C. §§ 321(b) and 1106(b).

117. 11 U.S.C. § 321(b).

118. *See In re* Int'l Distributions Centers, Inc., 74 B.R. 221 (1977).

119. *Id.*

issue intruded upon the powers conferred upon a trustee.[120] In vacating the bankruptcy court's order, the Court in *International Distributions Centers, Inc.* held that it is an abuse of discretion to appoint pseudo-trustees cloaked with powers of a trustee when Section 321 of the Bankruptcy Code prohibits an examiner from being both trustee and examiner in the same bankruptcy case.[121]

The conclusion reached in the *In re International Distributions Centers, Inc.* case is supported by Section 1106 of the Bankruptcy Code and case-law interpreting this statute. In looking at Section 1106 of the Bankruptcy Code, this section describes the powers and duties of trustees and examiners.[122] As it relates to trustees, Section 1106(b) sets forth both the "powers" *and* the "duties" of trustees in bankruptcy. Conversely, when Section 1106 addresses examiners, Section 1106 only imposes "duties" upon examiners and bestows no "powers" whatsoever.[123] This distinction between "powers" and duties" in Section 1106 of the Bankruptcy Code served to deflate an examiner's efforts to prosecute certain adversary proceedings in the case of *In re Patton's Busy Bee Disposal Service, Inc.*. In *Patton's Busy Bee*, the Bankruptcy Court for the Western District of New York wrote:

> . . . [T]he parties fail to distinguish the concepts of duty and responsibility from the concepts of power and authority. The existence of an obligation does not necessarily command the use of any particular means to fulfill that obligation. For example, the duty to safeguard an interest does not necessarily empower the obligor to commence an action. Rather, a plaintiff must possess authority to employ litigation as an appropriate exercise of responsibility. For such creatures of this Court as examiners and trustees, this authority must derive from the Bankruptcy Code itself or from an order of this Court.
>
> The Bankruptcy Code carefully defines the responsibilities and powers of a trustee. Section 1106(a) sets forth seven duties of a trustee. Apart from this provision are grants of authority contained in section 323. . . . In contrast, the Code assigns far more limited responsibility to an examiner and con-

120. *Id.* at 223.
121. *Id* at 224.
122. 11 U.S.C. § 1106 (2004).
123. *Compare* 11 U.S.C. § 1106(a) *with* 11 U.S.C. § 1106(b).

tains no clear authorization for the examiner's commencement of an adversary proceeding.[124]

The Bankruptcy Code and case law set forth above suggests that the ability of an examiner to have its powers morphed to include powers traditionally vested solely with a bankruptcy trustee (such as waiver of the attorney-client privilege) is far from certain.[125] Precedent and statutory provisions under the Bankruptcy Code both support and work against affording an examiner the power to waive the attorney-client privilege.[126] While the practical and prudential reasons for permitting an examiner to waive the attorney-client privilege are frequently present in most cases (such as the trustee case in *Weintraub*), Congress has not yet specifically empowered examiners to waive attorney-client privileges that constitute either property of the bankruptcy estate under Section 541 of the Bankruptcy Code or records turned over to bankruptcy trustees pursuant to Section 521 of the Bankruptcy Code. This legal issue has been further complicated by the United States Supreme Court's decision in *Hartford Underwriters Insurance Company v. Union Planters Bank, N.A.*, which contains a narrow view of which persons may exercise powers traditionally held by the debtor or trustee.[127]

In *Hartford Underwriters*, a unanimous United States Supreme Court reaffirmed the well-established precept of statutory construction that provides that where the language of a statute is clear and unambiguous, "the sole function of the courts . . . is to enforce [the statute] according to its terms."[128] In *Hartford Underwriters*, the United States Supreme Court followed this precept of statutory construction in the context of a case in which an administrative creditor, in its own right, sought to recover its post-petition claim against the debtor's secured lender pursuant to the "surcharge" provisions of Section 506(c) of the Bankruptcy Code.[129]

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124. *In re Patton's Busy Bee*, 182 B.R. at 685-86.

125. Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548, 578 (3d Cir. 2003).

126. *Id.* at 577-78 (noting that language of Section 1106 of the Bankruptcy Code has been interpreted to afford courts with the authority to expand an examiner's power to sue, and also noting that such a construction is suspect).

127. *See Hartford Underwriters,* 530 U.S. at 2.

128. *Id.*

129. *Id.* Section 506(c) of the Bankruptcy Code states, "The Trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holders of such claim." 11 U.S.C. § 506(c) (2004).

Because the administrative creditor in *Hartford Underwriters* pursued the surcharge claim in its own right without express consent of the court, and because Section 506(c) of the Bankruptcy Code unambiguously provides that "[t]he trustee may" pursue such surcharge claims, the United States Supreme Court rejected the unilateral right of an unpaid administrative creditor to prosecute a surcharge claim under Section 506(c) of the Bankruptcy Code.[130]

Hartford Underwriters' narrow view of which persons may exercise powers traditionally owned by the debtor or trustee arguably restricts the ability of a bankruptcy examiner to waive the attorney-client privilege of a debtor-in-possession. It is difficult to harmonize this narrow view espoused by *Hartford Underwriters* with the fundamental purpose of the Bankruptcy Code (i.e., maximizing the estate and distributions to creditors) in the absence of some statutory enactment by Congress or Supreme Court precedent that permits persons other than the debtor or trustee to waive the debtor's attorney-client privilege in bankruptcy.[131]

All may not be lost, however. In *Hartford Underwriters*, the United States Supreme Court left open the issue of whether the concept of "derivative standing" is legally cognizable in a bankruptcy setting when a bankruptcy trustee or debtor-in-possession refuses to enforce legal claims or causes of action for the benefit of creditors.[132] While the United States Supreme Court has yet to tackle the derivative standing issue, several Federal Courts of Appeals have recently been heard on the issue and have recognized

130. *See Hartford Underwriters*, 530 U.S. at 2.

131. In *In re* Boileau, 736 F.2d 503 (9th Cir. 1984), the Ninth Circuit Court of Appeals affirmed an order that permitted an examiner to waive the debtor's attorney-client privilege. Under the unique facts if the case, the *Boileau* Court stated, "Our holding is not to be understood as a ruling on the authority of an examiner to waive the attorney-client privilege." *Id.* at 506.

132. Specifically, the United States Supreme Court wrote:

> We do not address whether a bankruptcy court can allow other interested parties to act in the trustee's stead in pursuing recovery under § 506(c). Amici . . . draw our attention to the practice of some courts of allowing creditors or creditors' committees a derivative right to bring avoidance actions when the trustee refuses to do so, even though the applicable Code provisions, see 11 U.S.C. §§ 544, 545, 547(b), 548(a), 549, mention only the trustee. *See, e.g., In re* Gibson Group, Inc., 66 F.3d 1436, 1438 (C.A.6 1995). Whatever the validity of that practice, it has no analogous application here, since petitioner did not ask the trustee to pursue payment under § 506(c) and did not seek permission from the Bankruptcy Court to take such action in the trustee's stead. Petitioner asserted an independent right to use § 506(c), which is what we reject today.

Hartford Underwriters, 530 U.S. at 13 n. 5.

the general equitable concept of "derivative standing"[133] in instances where a bankruptcy trustee or debtor-in-possession wrongfully fails to prosecute lawsuits for the benefit of creditors.[134] These cases are indeed persuasive. To the extent that they are applicable to the issue of whether an examiner's power may, on a derivative basis, be expanded to include the ability to waive the debtor's attorney-client privilege, these cases are also consistent with the goals and aims of Sections 1104 and 1106 of the Bankruptcy Code, namely, to eliminate the proverbial problem of the "fox guarding the henhouse."[135]

Notwithstanding the apparent benefits of recognizing the concept of "derivative standing" in bankruptcy, recent case law in this area nonetheless casts some doubt on whether an examiner can have its powers morphed into the various powers normally re-

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133. Bankruptcy courts have long been recognized as courts of equity. Local Loan Co. v. Hunt, 292 U.S. 234 (1934); Pepper v. Litton, 308 U.S. 295 (1939). The concept of derivative standing is consistent with the equitable jurisdiction of the bankruptcy courts, as derivative standing permits the beneficial owners (i.e., the creditors) of the legal claim or cause of action to exercise such rights in the name of the party who holds a mere nominal interest (i.e., the trustee or debtor-in-possession) in the legal claim or cause of action. *See e.g.*, Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., Inc., 267 F.3d 340, 349 (2001)(noting that creditors are the beneficiary of claims prosecuted by trustee or debtor-in-possession). Because the concept of derivative standing is consistent with the equitable jurisdiction of the bankruptcy court, derivative standing has long been recognized in bankruptcy, *see e.g.*, Glenny v. Langdon, 98 U.S. 20, 27 (1878)(derivative standing "is founded upon the enlarged principles of equity"); McDaniel v. Stroud, 106 F. 486, 489 (4th Cir. 1901)("the court would, in the first instance, have directed the trustee to allow the use of his name to conduct the appeal if it was thought necessary"); *In re* Stern, 144 F. 956, 958 (8th Cir. 1906)("if [the trustee] refuses to oppose a claim or to move for its reconsideration when he ought to do so, he may be compelled to act or to permit the objecting creditors to act in his name"); Ohio Valley Bank Co. v. Mack, 163 F. 155, 156 (6th Cir. 1906)("when the trustee refuses to appeal . . . the better practice would be to order the trustee to appeal or to allow the dissatisfied creditor to appeal in his name"); SEC v. United States Realty & Improvement *Co.*, 310 U.S. 434, 457-58 (1940)(recognizing creditors derivative rights to challenge claims filed by other creditors in a Chapter XI proceeding). Such a mechanism was not abrogated by the Bankruptcy Code. Midatlantic Nat'l Bank v. New Jersey Dep't of Envtl. Prot., 474 U.S. 494, 501 (1986)("The normal rule of statutory construction is that if Congress intends for legislation to change interpretation of a judicially created concept, it makes that intent specific . . . .The Court has followed this rule with particular care in construing the scope of bankruptcy codification.").

134. *See Cybergenics, supra.*; *see also* Commodore Int'l, Ltd. v. Gould, 262 F.3d 96 (2d Cir. 2001).

135. For example, if the debtor's insiders and professionals are permitted to hide behind the cloud of secrecy that is attendant to the attorney-client privilege, how will an examiner be able to complete fully his or her mandate? The answer to this hypothetical suggests that if the plain language of the Bankruptcy Code prohibits an examiner from fulfilling his or her duties, the result may be deemed "absurd" and the statute should be interpreted to avoid any absurd result. *Lamie v. United States Trustee*, 540 U.S. 526, 534 (2001)(the sole function of the court is to enforce the statute according to its terms if the statute is plain and does not lead to an absurd result).

served to a bankruptcy trustee.[136] Simply stated, the largest stumbling block to this endeavor is the plain language of the Bankruptcy Code itself. As a starting point, and as set forth above, a preliminary problem with giving an examiner the equal rights and powers of a trustee is the fact that the Bankruptcy Code fails to provide an examiner with "party-in-interest" status.[137] As a result, the ability of an examiner to appear and be heard on any issue in Chapter 11 may be in doubt.

An examiner's chameleon-like character is also thwarted by the provisions of Section 1106 of the Bankruptcy Code.[138] In the context of its holding that an examiner in bankruptcy lacks the power to prosecute estate causes of action on a derivative basis, the United States Court of Appeals for the Third Circuit in *Official Committee of Unsecured Creditors of Cybergenics Corporation v. Chinery* wrote,

> . . . [W]e harbor doubts about [an examiner's] ability to substitute for derivative suit. One concern is that, like a trustee, an examiner would incur direct costs through its fees, so that extent of this remedy is inferior to the alternative of derivative suit by a creditors' committee.[139]

> The more serious problem, however, is that it is less than obvious that Section 1106(b) actually *does* permit examiners to initiate actions on the debtor's behalf. The full text of that section states:

> An examiner appointed under section 1104(d) of this title shall perform the duties specified in paragraphs (3) and (4) of subsection (a) of this section, and, except to the extent that the court orders otherwise, any other duties of the trustee

136. *Cybergenics*, 330 F.3d at 577-78.

137. *See* 11 U.S.C. § 1109(b). The fact that an examiner is not a party-in-interest in bankruptcy is consistent with the concept that an examiner is a disinterested neutral. *See supra* note 57. Because an examiner is a neutral party, arguably it is improper to afford an examiner derivative standing, as such standing erodes the examiner's neutrality. *Id.*

138. *See* 11 U.S.C. § 1106(a) and (b) (describing the powers of trustees and only the duties of examiners).

139. Unlike an examiner, a creditors' committee is a party-in-interest under 11 U.S.C. § 1109 of the Bankruptcy Code. *See* 11 U.S.C. § 1109(b). Some courts have relied on this section of the Bankruptcy Code to confer standing upon creditors' committees to prosecute various lawsuits such as preference actions and fraudulent conveyance claims when a debtor-in-possession or Chapter 11 trustee fails to initiate the action and the claims are shown to be colorable. *See e.g.*, *In re* STN Enterprises, 779 F.2d 901 (2d Cir. 1985).

that the court orders the debtor in possession not to perform.[140]

> Although this catch-all language is expansive, it is subject to the interpretive canon *ejusdem generis*, which states that "where general words follow specific words in a statutory enumeration, the general words are construed to embrace only objects similar to those enumerated by the preceding specific words." [citation omitted]. [Paragraphs] (3) and (4) [of Section 1106(a)] allow the examiner to "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business and any other [relevant] matter," and also to "file a statement of investigation." 11 U.S.C. §§ 1106(a)(3)-(4). Critically, these sections permit only investigating and reporting on that investigation, they stop far short of authorizing examiners to litigate based on their findings.[141]

As the Third Circuit's holding in *Cybergenics* illustrates, an examiners' ability to have its powers expanded to encompass powers normally reserved for trustees is indeed questionable under the current status of the law -- both in the attorney-client privilege waiver context and outside of it. Examiners therefore will continue to find that their powers may be legitimately questioned in any bankruptcy context until such time the outer limits of an examiner's powers are fully and finally defined by Congress or the United States Supreme Court. The end result is that the confusion attenuated by the Bankruptcy Code and existing case law does nothing but add to the costs of administering a bankruptcy estate[142] and, in some instances, cloaks an examiner in a cloud of uncertainty.

V. CONCLUSION

Bankruptcy examiners remain a useful alternative to the appointment of a trustee in some Chapter 11 cases. The utility of

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140. 11 U.S.C. § 1106(b).

141. *Cybergenics*, 330 F.3d at 578.

142. *See In re* Mirant Corporation et al, Case No. 03-46590 (Bankr. N.D. Texas 2003), in which the Bankruptcy Court appointed an examiner with expanded powers only to have various parties-in-interest litigate and file motions for reconsideration as to whether expanding the powers of an examiner is proper under the Bankruptcy Code. *Id.*

examiners includes the fact that an examiner is a disinterested officer of the court who has the unquestionable duty to investigate the acts, conduct, assets, liabilities, and financial condition of the debtor and the operation of the debtor's business. The utility of examiners in bankruptcy also includes the fact that an examiner is duty bound to submit a public report to the court for the benefit of all creditors. It is generally recognized that the court appointment of examiners with expanded powers is an inventive, efficient, and valuable method of identifying assets, promoting a reorganization under Chapter 11, and maximizing distributions to creditors. The expandable powers bestowed upon examiners, however, are far from unfettered, as some courts have expressly rejected the notion of expanding an examiner's powers to include powers normally reserved for bankruptcy trustees (such as the power to waive the debtor's attorney-client privilege). Until the outer limits of an examiner's powers are fully and finally defined by Congress or the United States Supreme Court, examiners will continue to find their powers to be illusory.

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

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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]

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[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

[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

[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

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

[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:

> [1] 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.

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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

[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:



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

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[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.

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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." <dietderichа@sullcrom.com>, Joe Bankman <joebankman@fx.us>, Joe Bankman <joebankman@gmail.com>, zz[Ex]-sam <sam@fx.us>
Cc: "Glueckstein, Brian D." <gluecksteinb@sullcrom.com>, "sam@fx.com" <sam@fx.com>, zzexd-cyrus <cyrus@fx.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

[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

[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

[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

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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

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[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.

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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.

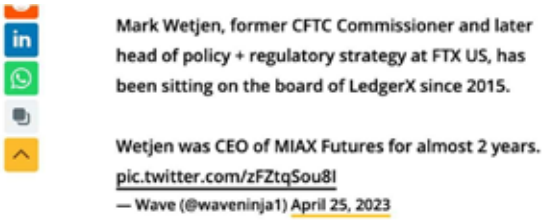
[267] As of this writing, FTX seeks to sell the Swiss and Greek entities to a debtor-parent in a transaction that appears to amount to moving coins from one pocket to the other, with no obvious benefit for creditors. *See* Bidder 1's Objection to Motion of Debtors for Entry of an Order (1) Authorizing 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]



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) S&C and LedgerX

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.

[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.

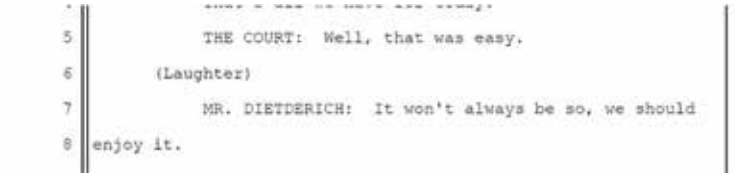
[279] Section 5.3 of the LedgerX sale agreement provides that (except for claims against the prebankruptcy insiders), "the Seller and each of its affiliated Debtors hereby sells, transfers and conveys to the Buyer any and all claims, liabilities and causes of action that such person has or may have against (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."



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

[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

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[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.

[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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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re FTX TRADING LTD., *et al.*,[1] Debtors.	: : : : : : : : : : :	Chapter 11 Case No. 22-bk-11068 (JTD) (Jointly Administered)

REPORT OF ROBERT J. CLEARY, EXAMINER

[1] The last four digits of FTX Trading Ltd.'s and Alameda Research LLC's tax identification numbers are 3288 and 4063, respectively. Due to the large number of debtor entities in these bankruptcy cases, a complete list of the Debtors and the last four digits of their federal tax identification numbers is not provided herein. A complete list of such information may be obtained on the website of the Debtors' claims and noticing agent at https://cases.ra.kroll.com/FTX. The principal place of business of Debtor Emergent Fidelity Technologies Ltd is Unit 3B, Bryson's Commercial Complex, Friars Hill Road, St. John's, Antigua and Barbuda.

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DEFINED TERMS

ADAM	Association of Digital Asset Markets
Additional S&C Materials	Materials and allegations put forward by former employees, third-party observers, and other parties in interest concerning S&C's conflicts of interest, including the Friedberg Declaration; *Garrison v. Sullivan & Cromwell, LLP*, No. 24-cv-20630 (S. D. Fla.) (KMM), Dkt. No. 1; Jonathan C. Lipson & David A. Skeel, *FTX'd: Conflicting Public and Private Interests in Chapter 11* (Mar. 13, 2024), U of Penn, Inst. for Law & Econ Research Paper No. 24-08, https://ssrn.com/abstract=4760736, *archived at* https://perma.cc/CGQ6-CUY5; and *Vara v. FTX Trading (In re FTX Trading)*, No. 23-2297 (3d Cir.), Dkt. No. 27
Alameda	Alameda Research LLC and other entities in the "Alameda Silo," as set forth in the Ray First Day Declaration
Alameda Ventures	Clifton Bay Investments LLC, f/k/a Alameda Research Ventures LLC, and related entities.
AlixPartners	AlixPartners, LLP
Alvarez & Marsal	Alvarez & Marsal Holdings, LLC, an investigatory firm retained by S&C
AMT	Anderson Mōri & Tomotsune
bankruptcy cases	The jointly administered chapter 11 proceedings of FTX Trading, and certain of its affiliates captioned *In re FTX Trading Ltd.*, No. 22-bk-11068 (Bankr. D. Del) (JTD)
Bankruptcy Court	The United States Bankruptcy Court for the District of Delaware
Bankruptcy Code	Title 11 of the United States Code
Bankruptcy Rule(s)	Federal Rules of Bankruptcy Procedure
BDO	BDO USA LLP
Binance	Binance Holdings Ltd. and its affiliates
BlockFi	BlockFi International Ltd and BlockFi, Inc.
BlockFi SEC Settlement	Public settlement reached between BlockFi and the SEC
Bracewell	Bracewell LLP
Brian Simms	Brian Simms KC, Bahamas counsel to FTX Group and JPL
CEO	Chief Executive Officer
CFTC	Commodity Futures Trading Commission

Clement T. Maynard & Co	Bahamas counsel to FTX Group
Coinbase	A cryptocurrency exchange at which the FTX Group maintained accounts
Consensus Law	A law firm operated by Pavel Pogodin that was retained by FTX Group after it represented a whistleblower
Consultants	Sports, media, and corporate partnership consultants engaged by the FTX Group
Cottonwood Grove	Cottonwood Grove Limited
CRO	Chief Restructuring Officer
Crypto.com	A cryptocurrency exchange at which the Debtors maintained accounts
CZ	Changpeng Zhao, the founder of cryptocurrency exchange Binance
DAAG	Digital Assets DA AG, renamed FTX Europe after its acquisition by the FTX Group
Debtors	FTX Trading, Ltd. and its affiliated entities that are debtors in the Chapter 11 bankruptcy cases
Deck	Deck Technologies, a political data analytics company
Deltec	Deltec International Group
Deltec Bank	Deltec Bank & Trust Co. Ltd.
Dietderich Declaration	*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*, Dkt. No. 270-3
Dkt. No.	Citations to "Dkt. No." without a case name or number refer to docket entries in *In re FTX Trading Ltd.*, No. 22-bk-11068 (Bankr. D. Del) (JTD)
DOJ	U.S. Department of Justice
Embed	A securities clearing and custody business acquired by the FTX Group
Emergent	Emergent Fidelity Technologies Ltd.
Evolve Bank	Evolve Bank & Trust, a bank where Wise held an FBO account
Examination	The Examiner's methods and procedures underlying this Report
FBO	For Benefit Of

FCA	U.K. Financial Conduct Authority
FDM	FTX Digital Markets Ltd.
FEC	Federal Election Commission
Fenwick	Fenwick & West, LLP
FinCEN	Financial Crimes Enforcement Network
First Ray Report	The First Interim Report of John J. Ray III to the Independent Directors on Control Failures at the FTX Exchanges, Dkt. No. 1242-1
Friedberg Declaration	*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*, Dkt. No. 530
FTI	FTI Consulting, Inc.
FTT	The exchange token for FTX.com
FTX Foundation	A non-profit that made charitable contributions with funds from FTX Group, later known as FTX Philanthropy
FTX Group	FTX Trading Ltd., West Realm Shires Services Inc., d/b/a FTX.US, Alameda Research LLC, and their directly and indirectly owned subsidiaries and affiliates
FTX Philanthropy	A non-profit that made charitable contributions with funds from FTX Group, previously known as FTX Foundation
FTX Trading	FTX Trading Ltd.
FTX Ventures	FTX Ventures, Ltd.
FTX.com	A cryptocurrency exchange operated by FTX Trading
FTX.US	An exchange for spot trading of cryptocurrency and other digital assets in the United States operated by the FTX Group, and controlled by WRS
GAAS	Generally Accepted Auditing Standards
GAP	Guarding Against Pandemics, a political action committee
Gate.io	A cryptocurrency exchange at which Debtors maintained accounts
Genesis Block	Genesis Block Ltd., a cryptocurrency trading firm
HiveEx	Hive Empire Trading Pty Ltd.
Hogan	Hogan Lovells International LLP

Holland & Knight	Holland & Knight LLP
Inca	Inca Digital, Inc.
JOLs	Joint Official Liquidators of FTX Digital Markets Ltd. appointed in the Bahamas
JPLs	Joint Provisional Liquidators of FTX Digital Markets Ltd. appointed in the Bahamas
K5	K5 Global and related entities
KuCoin	A cryptocurrency exchange at which Debtors maintained accounts
Landis	Landis Rath & Cobb LLP
Latona	Latona Biosciences Group
LayerZero	LayerZero Labs Ltd.
LedgerX	LedgerX LLC
Lennox Patton	Bahamas counsel to the FTX Group
LHI	Ledger Holdings, Inc., a holding company for LedgerX
Liquid	A Japanese cryptocurrency exchange operated as FTX Japan after its acquisition by the FTX Group
LPTCC	Limited Purpose Trust Company Charter
M 7 Holdings	M 7 Holdings, LLC
M Group	M Group Strategic Communications, a public relations firm
MAPS	The token for Maps.me
Mazars	Mazars LLP
MEXC	A cryptocurrency exchange at which Debtors maintained accounts
MIAX	Miami International Holdings, Inc.
MicroLedgers	MicroLedgers Co. Ltd.
Barbara Miller	Barbara Miller d/b/a BGM Consultants
Mirana	Mirana Corp., the investment arm of Bybit, a cryptocurrency exchange
Modulo	Modulo Capital
MoFo	Morrison & Foerster LLP
Moonstone Bank	Farmington State Bank d/b/a Moonstone Bank
Moore Stephens	Moore Stephens CPA Limited

MR Holdings and Varin Strategies	MR Holdings, Varin Strategies (d/b/a Compliers Consulting)
MTG	Mind the Gap, a political action committee
Nardello	Nardello & Co., an investigative firm retained by S&C
NFT	A non-fungible token, a type of cryptocurrency token designed to be uniquely identifiable
North Dimension	North Dimension Inc. and related entities
Norton Hall	Norton Hall Ltd.
OKCoin	A cryptocurrency exchange at which Debtors maintained accounts, sometimes referred to as OKX
Omnibus Authority	Document appointing John J. Ray III as CEO of the FTX Group
Orrick	Orrick Herrington & Sutcliffe LLP
Other FTX-Affiliated Tokens	SRM, OXY, and MAPS
OXY	The token for the Oxygen Protocol
Paul Hastings	Paul Hastings LLP, counsel to the Unsecured Creditors' Committee
Petition Date	The dates that the bankruptcy cases were commenced, November 11 and 14, 2022
Poloniex	A cryptocurrency exchange at which the Debtors maintained accounts
Prime Trust	Prime Trust LLC
ProCo	ProCo Global (d/b/a Chartwell Compliance)
Professionals	A group of 195 law firms, auditors, accountants, financial consultants, and other professionals engaged by the FTX Group between 2017 and 2022
PwC AG	PricewaterhouseCoopers AG
PwC LLP	Pricewaterhouse Coopers LLP
Pyth Network	Pyth Network, a pricing data aggregator, and associated entities including Pyth Data Association, the minter of the PYTH token
Quinn Emanuel	Quinn Emanuel Urquhart & Sullivan, LLP, conflicts counsel to the Debtors
R&M	Rivers & Moorehead
Ray Employment Declaration	*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*, Dkt. No. 270-2
Ray First Day Declaration	Declaration of John J. Ray III in Support of Chapter 11 Petitions and First Day Pleadings, Dkt. No. 24
Redwood	Redwood Valuation Partners
RFA	Rich Feuer Anderson
RLA	Robert Lee & Associates
Robinhood	Robinhood Markets, Inc.
Robinhood Shares	Approximately $500 million worth of shares of Robinhood acquired by Bankman-Fried
Robinhood Transaction	Acquisition of Robinhood Shares by Bankman-Fried
S&C Employment Application	*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*, Dkt. No. 270
SBF Criminal Case, Dkt. No.	Citations to "SBF Criminal Case, Dkt. No." refer to docket entries in *United States v. Bankman-Fried*, No. 22-cr-00673 (S.D.N.Y.) (LAK)
SCB	Securities Commission of the Bahamas
Scope Order	*Order (I)(A) Establishing the Scope, Cost, Degree, and Duration of the Examination and (B) Granting Related Relief; and (II) Permitting the Filing of Certain Information Regarding Potential Parties in Interest Under Seal*, Dkt. No. 9883
SEC	U.S. Securities and Exchange Commission
Second Ray Report	The Second Interim Report of John J. Ray III to the Independent Directors: The Commingling and Misuse of Customer Deposits at FTX.com, Dkt. No. 1704-1
Sheth	Alpen Sheth d/b/a Canopy Labs LLC
Signature	Signature Bank
Silver Miller	Silver Miller Law
Silvergate	Silvergate Bank
Simmons & Simmons	Simmons & Simmons JWS Pte. Ltd
Skadden	Skadden Arps Slate Meagher & Flom LLP
SRM	The exchange token for the Serum exchange

Supplemental Dietderich Declaration	*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*, Dkt. No. 510
Supplemental Ray Employment Declaration	*Supplemental Declaration of John J. Ray III in Support of Debtors' Applications for Orders Authorizing the Retention and Employment of Sullivan & Cromwell LLP, Alix Partners LLP and Quinn Emanuel Urquhart & Sullivan, LLP*, Dkt. No. 511
TaxBit	TaxBit Inc., a tax and accounting firm
Teknos	Teknos Associates LLP
TigerWit	TigerWit Holdings Ltd./ TigerWit Limited (UK)
Unsecured Creditors' Committee	The official committee of unsecured creditors in the Debtors' bankruptcy cases
Upbit	A cryptocurrency exchange at which Debtors maintained accounts
U.S. Trustee Objection	*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* Nunc Pro Tunc *to the Petition Date*, Dkt. No. 496
USAO-SDNY	The United States Attorney's Office for the Southern District of New York
Venture Book	A fund created by FTX Group to invest in companies and tokens
Voyager Digital	Voyager Digital Holdings, Inc., and its debtor affiliates
Willkie	Willkie Farr & Gallagher LLP
Winter Objection	Collectively: (i) *Objection 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*, Dkt. No. 369; and (ii) *Amended Objection 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*, Dkt. No. 459
Wise	A payment processor used by non-Debtor FTX Philanthropy
WRS	West Realm Shires Inc.
WRSS	West Realm Shires Services Inc.
XReg	XReg Consulting Ltd.

EXECUTIVE SUMMARY

This is the Report of Examiner Robert J. Cleary in the Chapter 11 bankruptcy cases of FTX Trading, Ltd. ("FTX Trading") and certain of its affiliates (collectively, the "FTX Group" or the "Debtors"),[2] No. 22-bk-11068 (Bankr. D. Del) (JTD).

Part One of the Report sets out the history of the bankruptcy cases, the background of the Examiner's appointment, and the scope of the Examiner's duties. Pursuant to the Bankruptcy Court's order of March 20, 2024, the Examiner was tasked with compiling and summarizing the completed and ongoing investigations, and the findings thereof, into the FTX Group by the Debtors' counsel, by the Unsecured Creditors' Committee, and by any third parties (including government agencies), and making recommendations for additional investigations. The Examiner was further instructed to address three specific issues: (1) whether the Bankruptcy Court correctly ruled on the Debtors' application to employ Sullivan & Cromwell LLP[3] as counsel despite alleged conflicts of interest; (2) whether existing and ongoing investigations adequately addressed fraud by the former and current employees of the Debtors; and (3) whether the investigations have adequately addressed the Debtors' use of its cryptocurrency token FTT to inflate the value of FTX Group entities. Part One concludes with a discussion of the methodology the Examiner has used to accomplish these assigned tasks.

Part Two addresses the Debtors' engagement of S&C. It sets out the legal framework governing the retention of professionals in bankruptcy cases—with particular attention to how that framework has been applied by the United States Court of Appeals for the Third Circuit—and analyzes the Bankruptcy Court's ruling on the Debtors' application to engage S&C. It also

[2] This Report generally refers to these entities as the "FTX Group" when describing prepetition conduct or events, and as the "Debtors" when describing postpetition conduct or events.

[3] This Report will refer to Sullivan & Cromwell LLP as "S&C."

describes an investigation into S&C's prepetition representation of the FTX Group conducted by the Debtors' conflicts counsel, Quinn Emanuel Urquhart & Sullivan, LLP,[4] as well as allegations made by interested parties regarding S&C's conduct. Ultimately, Part Two concludes that the Examiner did not identify any error in the Bankruptcy Court's decision authorizing the Debtors to retain S&C. However, the Examiner recommends two additional investigations into S&C-related issues: an investigation into S&C's representation of Samuel Bankman-Fried ("Bankman-Fried")[5] in connection with his purchase of shares of Robinhood Markets, Inc., and an inquiry into the postpetition sale of LedgerX that specifically addresses any potential claims the Debtors may have against non-released shareholders in the LedgerX parent company, LHI.

Part Three assesses the adequacy of investigations into prepetition fraud by prepetition employees of the FTX Group, and whether any employees involved in that fraud remain employed by the Debtors. This Part describes the extensive investigative work by the Debtors' counsel and government agencies. Part Three then surveys the results of investigations by government agencies and the Debtors' counsel into fraudulent conduct, including any perpetrated by Bankman-Fried, the co-founder of FTX.com and Alameda and the former CEO of FTX.com; by FTX Group executives Bankman-Fried, Caroline Ellison, Nishad Singh, Zixiao ("Gary") Wang, and Ryan Salame; by the FTX Group's in-house legal and compliance teams; and by other FTX Group employees. It also addresses several instances in which current or former FTX Group employees made whistleblower complaints, circumstances in which the FTX Group sought to resolve those whistleblower complaints by making payments, and other instances when the FTX Group made payments to departing employees that were not clearly tied to known

[4] This Report will refer to Quinn Emanuel Urquhart & Sullivan, LLP as "Quinn Emanuel."

[5] This Report refers to Samuel Bankman-Fried as "Bankman-Fried." When other individuals with the surnames "Bankman-Fried," "Bankman," or "Fried" are referenced, the Report uses their first and last names.

whistleblower complaints. The Examiner concludes that no further investigation is warranted by him, as the ongoing and completed investigations have established the facts surrounding fraud by former employees of the FTX Group and demonstrated with sufficient confidence that current employees of the Debtors were not likely complicit in the prepetition fraud.

Part Four evaluates the adequacy of investigations into whether FTX Group entities manipulated cryptocurrency tokens or used cryptocurrency tokens they controlled to inappropriately inflate the value of FTX Group entities. This Part reviews investigations into the use of four cryptocurrency tokens that may have been employed for these purposes: FTT, SRM, MAPS, and OXY. It summarizes the investigations into instances of manipulation that have been conducted by the Debtors' counsel and governmental units. Ultimately, the Examiner concludes that these investigations have been sufficient to identify the significant instances of manipulation and the individuals who were principally involved, and that additional investigation into this subject by him is not necessary.

Part Five addresses investigations into prepetition conduct by professional service firms engaged by the FTX Group, including law firms, accounting firms, auditing firms, valuation firms, and other consultants. It summarizes completed and ongoing investigations conducted by the Debtors' counsel into potential misconduct by these professional services firms. The Examiner concludes that these investigations have been thorough and complete, such that there are no areas in which further investigation by the Examiner would be productive.

Part Six addresses other investigations into the prepetition conduct of the FTX Group and affiliated individuals and how those investigations have led, or could lead, to recovery of assets for the Debtors' estates. Investigations addressed in this section include inquiries into (1) corporate acquisitions by the FTX Group, (2) Bankman-Fried's family members, (3) charitable

and political contributions by the FTX Group and affiliated individuals, (4) cryptocurrency tokens that the FTX Group held at third-party exchanges, (5) the collapse of FTX.US, (6) miscellaneous investigations, (7) political contributions by the FTX Group and affiliated individuals, (8) payments to foreign officials, and (9) the FTX Group's Venture Book. The Examiner concludes that the completed and ongoing investigations into these issues have largely been sufficient to establish the facts concerning the FTX Group's conduct and to identify potential areas for asset recovery. However, he recommends one additional project to be undertaken by him: an investigation into potential misconduct at FTX.US.

Part Seven summarizes other adversary proceedings brought by the Debtors that are not addressed in other Parts.

Finally, Part Eight outlines the expected duration and proposed budget for the Examiner's recommended investigations.

PART 1: BACKGROUND AND METHODOLOGY

Part One of this Report sets out the relevant history of these bankruptcy cases, the scope of the Examiner's investigation, and the Examiner's methodology.

I. The Examiner's Appointment and Assigned Duties

On November 11, 2022, many FTX Group entities filed for Chapter 11 bankruptcy in the United States District Court for the District of Delaware (the "Bankruptcy Court"), and West Realm Shires Inc. ("WRS") followed on November 14 (together, the "Petition Date"). On December 1, 2022, the United States Trustee for Region 3 (the "U.S. Trustee") moved for appointment of an examiner pursuant to section 1104(c) of title 11 of the United States Code (the "Bankruptcy Code").[6] The Debtors,[7] the Official Committee of Unsecured Creditors ("Unsecured Creditors' Committee"),[8] and the Bahamas-based Joint Provisional Liquidators ("JPLs") of FTX Digital Markets Ltd.[9] ("FDM") opposed the U.S. Trustee's motion. The

[6] *In re FTX Trading Ltd.*, No. 22-bk-11068 (Bankr. D. Del) (JTD), Dkt. No. 176. Further citations in this Report to a docket number, without an accompanying case name or number, are to docket entries in *In re FTX Trading Ltd.*, No. 22-bk-11068 (Bankr. D. Del) (JTD).

[7] Dkt. No. 573.

[8] Dkt. No. 571.

[9] Dkt. No. 572. In Bahamian insolvency law, provisional liquidators are appointed by the court to act as agents of a company placed into provisional liquidation before a winding up order has been entered. Provisional liquidators are empowered to take various actions to maintain the value of the company. Once a winding up order has been entered, the official liquidators conduct the winding up of a company, including collecting, realizing, and distributing assets.

On November 10, 2023, the SCB "presented a winding up petition against [FDM] and suspended its license to operate" as a digital asset business in the Bahamas. *See Third Interim Report and Accounts of the Joint Provisional Liquidators to the Supreme Court of the Commonwealth of the Bahamas*, Joint Provisional Liquidators of FTX Digit. Mkts., at 4 (Nov. 9, 2023), https://www.pwc.com/bs/en/services/business-restructuring-ftx-digital-markets/assets/third-update-from-the-jpls-10-nov-2023.pdf, *archived at* https://perma.cc/4N9U-3ZBJ. The Supreme Court of the Bahamas subsequently ordered FDM be placed into provisional liquidation and appointed Brian Simms KC of Lennox Paton, Kevin Cambridge of PricewaterhouseCoopers Advisory (The Bahamas) Limited, and Peter Graves of PricewaterhouseCoopers Limited as the JPLs. *See id.* About a year later, pursuant to the Supreme Court of the Bahamas' November 10, 2023 order, the Bahamian court ordered FDM be wound up, and the JPLs were appointed as Joint Official Liquidators ("JOLs"). *See FTX Digital Markets Ltd. (In Official Liquidation)*, PWC, https://www.pwc.com/bs/en/services/business-restructuring-ftx-digital-markets.html, *archived at* https://perma.cc/98G4-EQHF.

Bankruptcy Court held a hearing on the U.S. Trustee's motion on February 6, 2023,[10] and subsequently denied the motion for appointment of an examiner.[11]

The U.S. Trustee appealed the Bankruptcy Court's order to the United States Court of Appeals for the Third Circuit,[12] which reversed.[13] The Third Circuit explained that section 1104(c) instructs that a bankruptcy court "'shall' appoint an examiner if the terms of the statute have been met," which is an "obligatory command to appoint an examiner."[14] The Third Circuit remanded the case to the Bankruptcy Court "with instructions to order the appointment of an examiner[]."[15]

On remand, the Bankruptcy Court held a hearing,[16] and subsequently directed the U.S. Trustee to appoint an examiner.[17] The U.S. Trustee appointed Robert J. Cleary as the Examiner,[18] and in an order dated March 20, 2024, the Bankruptcy Court approved that appointment.[19]

On March 20, 2024, the Bankruptcy Court also issued an order concerning the scope of the Examiner's investigation (the "Scope Order").[20] The Scope Order instructed the Examiner to issue a report that:

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[10] Dkt. No. 622.

[11] Dkt. No. 746.

[12] Before appealing the Bankruptcy Court's order, the U.S. Trustee successfully moved in the United States District Court for the District of Delaware for an order certifying a direct appeal to the Third Circuit. *Vara v. FTX Trading Ltd. (In re FTX Trading Ltd.)*, No. 22-bk-11068 (JTD), 2023 WL 3721527 (D. Del. May 30, 2023).

[13] *In re FTX Trading Ltd.*, 91 F.4th 148 (3d Cir. 2024).

[14] *Id*. at 153.

[15] *Id*. at 157.

[16] Dkt. No. 6366.

[17] Dkt. No. 7909.

[18] Dkt. No. 8048.

[19] Dkt. No. 9882.

[20] Dkt. No. 9883 (the "Scope Order").

> (i) summarizes the investigations of the Debtors conducted by the Debtors, the [Unsecured Creditors'] Committee, and any third parties (including any governmental units, to the extent such information is made available to the Examiner) which are pending or have concluded (the 'Investigations'), (ii) summarizes the findings or status of such Investigations, and (iii) makes recommendations for additional investigations.[21]

The Bankruptcy Court also directed the Examiner to undertake the following tasks, which the Third Circuit expressly enumerated in its opinion:

> a. An examination of the Court's ruling on the Debtors' application to employ Sullivan & Cromwell (respectively, "S&C" and the "Employment Application"), including whether there are potential conflicts of interest involving S&C which were not adequately addressed by the Court's hearing and ruling on the Employment Application;[22]
>
> b. An examination of whether the Investigations adequately addressed fraud by the Debtors' employees and whether employees involved in such fraud are still working for the Debtors; [23] and
>
> c. An examination of whether the Investigations adequately addressed the Debtors' use of its cryptocurrency, FTT, to inflate the value of FTX and Alameda Research.[24]

In accordance with the Bankruptcy Court's instructions, this Report addresses each of these topics.

II. The Examiner's Methodology

The Scope Order tasked the Examiner with assessing and summarizing the completed and ongoing investigations undertaken by counsel for the Debtors and counsel for the Unsecured

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[21] *Id*. at ¶ 2.

[22] *Id.* at ¶ 3(a); *see also In re FTX*, 91 F.4th at 157 ("This requirement of disinterest 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.").

[23] Scope Order at ¶ 3(b); *see also In re FTX*, 91 F.4th at 157 ("Moreover, the U.S. Trustee raised the concern that, given the reports of widespread fraud, officers or employees who may have engaged in wrongdoing could remain at FTX Group.").

[24] Scope Order at ¶ 3(c); *see also In re FTX*, 91 F.4th at 157 ("[A]n investigation into FTX Group's use of its own cryptocurrency tokens, FTTs, to inflate the value of FTX and Alameda Research could bring this practice under further scrutiny, thereby alerting potential investors to undisclosed credit risks in other cryptocurrency companies.").

Creditors' Committee, as well as their findings. The Examiner requested initial briefings from the Debtors' primary counsel, S&C, and its conflicts counsel, Quinn Emanuel, as well as from Paul Hastings LLP,[25] counsel for the Unsecured Creditors' Committee. All three law firms provided timely, complete, and very helpful cooperation, beginning with comprehensive briefings. The law firms produced relevant investigative documentation, including memoranda of investigations and interviews, reports of financial data analyses, and other documents. Members of the Examiner's team reviewed and analyzed these investigative documents. When the Examiner's team had follow-up questions, members of the team requested additional information and investigative documents from the three law firms and discussed issues of interest with them. The law firms supplied virtually all of the information requested. In a few limited instances, the law firms declined to produce requested materials to the Examiner. Whenever a law firm withheld requested materials, it provided a reasonable justification for doing so, and there was no negative impact on the Examiner's work. In total, the Examiner's team (1) reviewed hundreds of investigative documents and reports prepared by or at the direction of the three law firms, and (2) had dozens of discussions with attorneys at these firms who participated in the investigations.

The Scope Order also instructed the Examiner to summarize investigations conducted by third parties, including governmental units, as well as their findings. In accordance with this instruction, members of the Examiner's team conferred with representatives of each of the many government agencies that have investigated the Debtors, including the United States Attorney's Office for the Southern District of New York ("USAO-SDNY"), the U.S. Securities and Exchange Commission ("SEC"), the Commodity Futures Trading Commission ("CFTC"), the

[25] This Report will refer to Paul Hastings LLP as "Paul Hastings."

United States Department of Justice ("DOJ"), a committee of the United States House of Representatives, state securities regulators, and a money transmitter regulator. Each governmental unit reported on the status of its respective investigations, to the extent that doing so was possible without compromising non-public investigations. Members of the Examiner's team also undertook a comprehensive review of (1) civil complaints against the FTX Group and associated individuals, (2) criminal information and indictments filed against individuals affiliated with the FTX Group, and (3) the transcripts of Bankman-Fried's criminal trial and sentencing, and related filings.[26] Finally, the Examiner's team reviewed testimony and other materials from Congressional hearings into the collapse of the FTX Group.

The Examiner also gathered information from sources other than the Debtors, the Unsecured Creditors' Committee, and the government. Members of the Examiner's team received information from counsel for certain senior FTX Group executives (Caroline Ellison, Gary Wang, and Nishad Singh) via attorney proffers. Members of the Examiner's team also spoke with John Ray, current Chief Executive Officer ("CEO") of the Debtors, and Adam Moskowitz and David Boies, counsel for the plaintiff class in an ongoing multidistrict litigation against the Debtors and affiliated individuals and entities.[27] The Examiner reviewed unsolicited written materials provided by Bankman-Fried. The team conferred with Bahamas counsel for the JOLs. Finally, the Examiner received and considered unsolicited information from several individuals and law firms. In some instances, the Examiner's team followed up with additional

[26] A review of the USAO-SDNY investigations and prosecutions involving senior FTX Group executives, as well as the SEC and CFTC complaints, is addressed throughout this Report. The Examiner also understands that certain state securities regulators, including the Wisconsin Department of Financial Institutions, Division of Securities, have filed proofs of claim outlining an investigation into FTX.US "for offering and selling unregistered securities in the form of its Earn program." *See* Claim No. 72749, *In re West Realm Shires Inc.*, No. 22-bk-11183 (Bankr. D. Del.) (JTD).

[27] *In re: FTX Cryptocurrency Exchange Collapse Litigation*, No. 23-md-03076 (S.D. Fla) (KMM). Moskowitz is also lead counsel in a separate lawsuit against S&C stemming from the collapse of the FTX Group.

questions, but only did so when the providers of unsolicited information identified themselves. The Examiner did not communicate with individuals who did not reveal their identities, nor did he respond to every named individual or entity who provided unsolicited information.

As noted above, the Examiner was guided by the Scope Order, which framed the Examiner's task as summarizing and assessing investigations completed by others rather than conducting a *de novo* investigation into issues concerning the collapse of the FTX Group. Many percipient witnesses were previously interviewed by the Debtors' counsel and/or the government. Because of the limited scope of the Examiner's assigned tasks, the Examiner generally did not interview percipient witnesses. Similarly, the Examiner did not review primary source documents that were already reviewed by the Debtors' counsel and/or the government, except in some limited circumstances or to the extent that these documents were excerpted or quoted in investigative work product prepared by others.

Bankruptcy examiners are appointed to conduct "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."[28] However, examiners do not have free rein to investigate any matter of potential private or public interest related to a debtor. Rather, "[t]he Examiner performs his duties at the request of the Court,"[29] and the Court "direct[s] the examiner's investigation."[30] Accordingly, the Examiner did not investigate every matter related to the Debtors that has attracted public or press attention. Nor did he investigate every known

[28] 11 U.S.C. § 1104(c).

[29] *In re New Century TRS Holdings, Inc.*, 407 B.R. 558, 566 (Bankr. D. Del. 2009).

[30] *In re FTX*, 91 F.4th at 156 (quoting 5 William L. Norton III, *Norton Bankruptcy Law and Practice* § 99:25 (3d ed. 2023)).

complaint regarding the prepetition conduct of the FTX Group or the postpetition course of these bankruptcy cases. Instead, the Examiner investigated only the matters assigned to him by the Scope Order. This Report should not be interpreted as a comment on any issues beyond the Examiner's remit.

Throughout the Report, names of certain individuals and entities are anonymized.[31]

[31] Dkt. No. 15271, at 2.

PART 2: EMPLOYMENT OF S&C

I. Overview

As set forth in the Scope Order, the Examiner was tasked with reporting on "the Court's ruling on the Debtors' application to employ [S&C], including whether there are potential conflicts of interest involving S&C which were not adequately addressed by the Court's hearing and ruling on the Employment Application."[32] The Examiner has reviewed in detail the record before the Court regarding S&C's employment and considered whether facts outside the record should have been brought to the Court's attention.

The second section of this Part reviews the bankruptcy conflict rules that govern a court's consideration of a professional's retention application. The following section describes (1) the record that was before the Court on the S&C Employment Application (as defined below), and (2) the hearing held by the Court, and then analyzes the Court's ruling. The fourth and fifth sections discuss investigations and other assessments of S&C's alleged conflicts by other law firms, academics, and other parties in interest. Finally, the sixth section makes recommendations for further investigative work related to S&C's retention as the Debtors' primary counsel in these bankruptcy cases.

In sum, the Examiner has concluded that, in light of the record before the Court, there was no error in the Court's decision concerning the Debtors' retention of S&C. However, after a review of investigations and other analyses of S&C, the Examiner has found that there were some additional facts relevant to S&C's conflicts or disinterestedness that were not before the Court when it ruled on the S&C Employment Application. None of the additional facts reviewed to date suggests that S&C was in fact conflicted from representing the Debtors, or that the

[32] Scope Order at ¶ 3(a).

Court's decision was compromised by the lack of such information. However, the Examiner sets forth below two recommendations for limited further investigation concerning facts that were not before the Court. These recommendations are in the public interest as they are made with the goal of ensuring that material questions that have been raised by observers of these cases are fully and completely vetted and answered.

II. Rules Governing the Retention of Professionals

a. Section 327 of the Bankruptcy Code

Bankruptcy Code section 327(a) provides that, with court approval, a debtor may employ attorneys that "do not hold or represent an interest adverse to the estate, and that are disinterested persons."[33] The term "disinterested person" is defined as:

> [A] person that (A) is not a creditor, an equity security holder, or an insider; (B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and (C) does 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.[34]

Therefore, both the first and second prong of section 327(a) prohibit a debtor's lawyer from holding an interest adverse to the bankruptcy estate. The Third Circuit has observed that, while the two prongs of section 327(a) are "formally distinct," they "effectively collapse into a single test."[35] But because the Bankruptcy Code does not define the term "adverse interest," the language is left open to interpretation by the courts.

The Bankruptcy Code does include other guidance on the application of section 327(a). Under section 1107(b), a professional is not automatically disqualified under section 327 solely

[33] 11 U.S.C. § 327(a).

[34] 11 U.S.C. § 101(14).

[35] *In re Boy Scouts of Am.*, 35 F.4th 149, 157 (3d Cir. 2022) (citing *In re BH & P, Inc.*, 949 F.2d 1300, 1314 (3d Cir. 1991)).

because that professional represented the debtor on prior occasions. Similarly, under section 327(c), a professional is not disqualified solely because of that professional's employment by, or representation of, a creditor.

b. Bankruptcy Rule 2014

Rule 2014 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") enforces the provisions of section 327(a) by requiring disclosure of a professional's relationships with parties in interest. Bankruptcy Rule 2014 requires that an application to retain a professional under section 327 be accompanied by a "verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee."[36]

Courts have held that "Bankruptcy Rule 2014 requires that the attorney seeking employment disclose to the Court all connections with parties in interest in the case, rather than furnishing only those which appear to implicate 'disinterestedness' or 'adverse interest' concerns under section 327(a)."[37] The Third Circuit has further emphasized that the obligation to disclose possible conflicts of interest "belongs to the party who seeks employment by the estate" because it is not the bankruptcy court's obligation "to search the record for possible conflicts of interest," and that "negligence does not excuse the failure to disclose a possible conflict of interest[]."[38] But a bankruptcy court's "discretion in determining whether to disqualify counsel for inadequate

[36] Fed. R. Bankr. P. 2014(a).

[37] *In re eToys, Inc.*, 331 B.R. 176, 190 (Bankr. D. Del. 2005) (emphasis in original); *see also In re Blue Ridge Limousine & Tour Serv., Inc*., No. 12-bk-17551 (BFK), 2014 WL 4101595 (Bankr. E.D. Va. Aug. 20, 2014); *In re Harris Agency, LLC*, 451 B.R. 378 (Bankr. E.D. Pa.), *aff'd sub nom. Paul J. Winterhalter, P.C. v. Off. of the U.S. Tr. (In re The Harris Agency, LLC),* 462 B.R. 514 (E.D. Pa. 2011).

[38] *In re BH & P, Inc.*, 949 F.2d at 1317-18 (alterations and internal citations omitted).

disclosure is broad" and "[a] [B]ankruptcy [C]ourt may excuse the original failure to disclose because complete disclosure is for the Court's benefit so that it can scrutinize any adverse interests of the attorney."[39]

c. Application of the Law

In the Third Circuit, conflicts under section 327 fall into three categories: "(1) actual conflicts of interest, (2) potential conflicts of interest, and (3) appearances of conflict."[40] Actual conflicts of interest result in per se disqualification of professionals, potential conflicts of interest are left to the bankruptcy court's discretion to determine if they are disqualifying, and appearances of conflicts alone cannot lead to disqualification.[41] Because only actual or potential conflicts of interest can be disqualifying, this section of the Report focuses on the case law regarding those types of conflicts.

1. Actual Conflicts

The term "actual conflict of interest" is not defined in the Bankruptcy Code; however, the Third Circuit has stated that "[p]ragmatically, a conflict is actual when the specific facts before the bankruptcy court suggest that it is likely that a professional will be placed in a position permitting it to favor one interest over an impermissibly conflicting interest."[42] The Third Circuit has observed that the determination of a "conflict as 'potential' or 'actual' . . . [is] committed to the bankruptcy court's sound exercise of discretion."[43] Indeed, courts in the Third

[39] *Magten Asset Mgmt. Corp. v. Paul Hastings Janofsky & Walker LLP (In re Northwestern Corp.)*, 346 B.R. 84, 89 (D. Del. 2006) (quoting *First Interstate Bank of Nev., N.A. v. CIC Inv. Corp. (In re CIC Inv. Corp.)*, 175 B.R. 52, 54 (B.A.P. 9th Cir. 1994)).

[40] *In re Boy Scouts of Am.*, 35 F.4th at 157 (citing *In re Marvel Ent. Grp., Inc.*, 140 F.3d 463, 476 (3d Cir. 1998)).

[41] *Id.* at 157-58.

[42] *Id.* (internal quotations omitted) (quoting *In re Pillowtex, Inc.*, 304 F.3d 246, 251 (3d Cir. 2002)).

[43] *In re Marvel Ent. Grp., Inc.*, 140 F.3d at 476.

Circuit "have been accorded considerable latitude in using their judgment and discretion in determining whether an actual conflict exists in light of the particular facts of each case."[44]

That said, the Third Circuit has also stated that while "a bankruptcy court enjoys considerable discretion in evaluating whether professionals suffer from conflicts . . . [it] does not enjoy the discretion to bypass the requirements of the Bankruptcy Code."[45] Accordingly, courts rigorously adhere to the statutory requirement that a disinterested person cannot be an officer within two years before the petition date,[46] and courts strictly prohibit a creditor from serving as a debtor's professional.[47]

In addition, the Third Circuit has held that, while prior representation of a debtor does not by itself merit disqualification, receipt of a preferential transfer under section 547(b) of the Bankruptcy Code constitutes an actual conflict of interest requiring disqualification of the professional.[48] This is due to the fact that "receipt of a preference creates a conflict with unpaid creditors because a payment by an insolvent debtor to one creditor is necessarily paid at the

[44] *In re BH & P, Inc.*, 949 F.2d at 1315 (quoting *In re Star Broad., Inc.*, 81 B.R. 835, 844 (Bankr. D.N.J. 1988)).

[45] *In re Pillowtex, Inc.*, 304 F.3d at 253 n.5, 254 (citing *U.S. Tr. v. Price Waterhouse*, 19 F.3d 138 (3d Cir.1994) for the proposition that "based on the language of the Code, a bankruptcy court that approves the retention of a prepetition creditor of the estate necessarily abuses its discretion"—as under section 101(14), a "disinterested person" must be a person who "is not a creditor").

[46] *In re Essential Therapeutics, Inc.*, 295 B.R. 203, 211 (Bankr. D. Del. 2003) (holding that an individual who served as secretary for the debtors was not disinterested even though he only performed ministerial tasks because the proposed representation was contrary to the clear and unambiguous language of the statute).

[47] *See Price Waterhouse*, 19 F.3d at 142 (finding that an accounting firm that was also one of the twenty largest creditors of the estate was not disinterested even though the accounting firm promised not to participate in the case or vote its claim in the plan process).

[48] *In re First Jersey Secs., Inc.*, 180 F.3d 504, 509 (3d Cir.1999).

expense of another creditor."[49] At the time of retention, then, courts will determine if a prepetition payment is preferential.[50]

2. Potential Conflicts

When a professional has a potential conflict of interest, a bankruptcy court has wide discretion to approve or reject the professional's retention based on the court's assessment of the totality of the circumstances in light of the specific facts of the case.[51] Most courts look to the materiality of the potentially disqualifying facts and balance them against the potential advantages to the estate of having the professional in question represent the debtor.[52]

(i) Professional's Prepetition Work for a Debtor

As noted above, "[p]rior representation of the debtor does not, by itself, merit disqualification" of a professional under section 327.[53] But such prior representation does constitute a potential conflict of interest. Accordingly, courts will evaluate the nature of the prior representation to determine if a disqualifying conflict exists under section 327.[54]

Most courts have held that customary prepetition bankruptcy services—i.e., preliminary work performed to prepare a bankruptcy filing—do not, standing alone, require

[49] *In re Fleming Cos., Inc.*, 305 B.R. 389, 393 (Bankr. D. Del. 2004) (citing *In re Pillowtex, Inc.*, 304 F.3d at 252).

[50] *In re Pillowtex, Inc.*, 304 F.3d at 248 (finding that, even though counsel agreed to (1) return any preference payments it might have received, and (2) waive any claim resulting from the preference payments, the firm could not continue with its representation until the court determined whether a preference existed).

[51] *In re Marvel Ent. Grp., Inc.*, 140 F.3d at 477; *see also In re BH & P, Inc.*, 949 F.2d at 1315 ("[C]ourts have generally declined to formulate bright-line rules concerning the criteria for disqualification but have favored instead an approach which gives the bankruptcy court discretion to evaluate each case on its facts, taking all circumstances into account.").

[52] *In re Boy Scouts of Am.*, 35 F.4th at 161 ("Because Sidley's representation of BSA did not prejudice Century but disqualifying it would have been a significant detriment to BSA, it was well within the Court's discretion to determine that the drastic remedy of disqualification was unnecessary").

[53] *In re Fleming Cos., Inc.*, 305 B.R. at 393 (noting that "neither of the parties involved in the prior transaction ha[d] complained about [counsel's] representation," the objecting creditor was "not a creditor of either party at the time the transaction took place," and that counsel had "disclosed its involvement in the transaction to the satisfaction of the United States Trustee").

[54] *Waldron v. Adams & Reese, L.L.P. (In re Am. Int'l Refinery, Inc.)*, 676 F.3d 455, 464 (5th Cir. 2012).

disqualification under section 327(a).[55] Relatedly, a firm's receipt of a retainer prepetition does not automatically disqualify it under section 327, despite its status as a creditor.[56] Circuit courts have highlighted that "[a]ll professionals become 'creditors' when they perform services for which the estate must pay. When the services are performed, the professional is not thereupon disqualified as not disinterested."[57] Ultimately, whether a professional who has received a retainer is disinterested will depend on the totality of the circumstances.[58]

Courts have determined that a disqualifying potential conflict does exist if the debtor's attorney is required to review her own legal work during the bankruptcy case. For example, where an attorney provided prepetition advice on transactions that would be scrutinized postpetition, the attorney could be disqualified from serving as the debtors' counsel because as "a participant in those decisions, it was impossible for [counsel] to review those decisions with disinterestedness."[59]

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[55] *See In re Hall*, 520 B.R. 116, 121 (Bankr. D. Kan. 2014) (citing *In re Watson*, 94 B.R. 111, 114 (Bankr. S.D. Ohio 1988), *reconsideration denied*, 102 B.R. 112 (Bankr. S.D. Ohio 1989)); *In re Creative Rest. Mgmt., Inc*., 139 B.R. 902, 918 (Bankr. W.D. Mo. 1992) ("Each case in which counsel performed pre-bankruptcy services must be evaluated based on the facts presented. Where, as here, the services were overwhelmingly related to a bankruptcy which was being contemplated throughout the period, no such basis for removal exists").

[56] *Rus, Miliband & Smith, APC v. Yoo (In re Dick Cepek, Inc.)*, 339 B.R. 730, 739 (B.A.P. 9th Cir. 2006) ("The professional's status as a secured creditor by virtue of the retainer does not disqualify the professional from being retained by the estate as required by section 327 of the Code.") (quoting 3 Collier on Bankruptcy ¶ 328.02[4] (15th ed. 2005)).

[57] *Id.* at 739 n.10; *In re Martin*, 817 F.2d 175, 180 (1st Cir.1987) (noting that, despite section 327's apparent bar against the employment of any attorney who is a creditor, any attorney who provides legal services to a debtor "becomes a creditor of the estate just as soon as any compensable time is spent on account. Thus, to interpret the law in such an inelastic way would virtually eliminate any possibility of legal assistance for a debtor in possession").

[58] *See In re Insilco Techs., Inc.*, 291 B.R. 628, 634 (Bankr. D. Del. 2003) (listing factors to be considered, including whether "terms of an engagement agreement reflect normal business terms . . . whether the parties involved are sophisticated business entities with equal bargaining power who engaged in an arms-length negotiation[] [and] . . .whether the retention, as proposed, is in the best interests of the estate . . .").

[59] *DeAngelis v. Geisenberger (In re Ressler Hardwoods & Flooring, Inc.)*, No. 1:08-bk-01878MDF, 2010 WL 2342497, at *7 (Bankr. M.D. Pa. June 8, 2010); *aff'd sub nom. Geisenberger v. DeAngelis*, No. 1:10-CV-01660, 2011 WL 4458779 (M.D. Pa. Sept. 23, 2011); *see also In re Granite Sheet Metal Works, Inc.*, 159 B.R. 840 (Bankr. S.D. Ill. 1993) (holding that while representation of the debtor prepetition is not, in itself, a basis for disqualification, and even simultaneous representation of the debtor and its controlling shareholder may be permissible, counsel for the debtor was involved in a prepetition stock redemption transaction that would need to be scrutinized postpetition

In contrast, courts have held that disqualification is not necessary if there is no evidence that counsel's prepetition work for the debtor was improper or would influence counsel's postpetition representation of the debtor.[60] For example, in one Delaware case, the court determined that disqualification of a debtor's proposed counsel under section 327 was not warranted, despite counsel's representation of the debtor and its subsidiary in a prepetition transaction. This was because (1) neither of the parties in the transaction had complained about the representation, (2) the complaining creditor was not a creditor of either party at the time of the transaction, and (3) the debtor's counsel had disclosed its involvement in the transaction to the satisfaction of the U.S. Trustee.[61]

Courts also look to other factors to evaluate the significance of a professional's prepetition work. These factors include the revenue earned by the professional from the prior representation and whether it was a material percentage of the firm's overall revenue,[62] whether the party was a significant client of the firm, whether the prior representation would influence the firm to not engage in its best representation of the debtor, and whether the firm had adequately and sufficiently disclosed the relationship.[63]

(ii) Professional's Relationship with a Debtor's Principals

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and that counsel, who played an instrumental role in that transaction, might have difficulty conducting the necessary review).

[60] *See, e.g.*, *In re Am. Int'l Refinery, Inc.*, 676 F.3d at 465 (noting that there was "no evidence in the record indicating that A&R's advice on the treatment of these claims was clouded"); *In re Caesars Ent. Operating Co., Inc.*, 561 B.R. 420, 433 (Bankr. N.D. Ill. 2015).

[61] *In re Northwestern Corp.*, 346 B.R. at 88.

[62] *See In re Filenes Basement, Inc.*, 239 B.R. 850, 853 (Bankr. D. Mass. 1999) ("The billings to any one client or the aggregate group is not material to the Firm;s revenues. Individually, no client represented more than 1% of the Firm's total billings, and the aggregate group represented less than 1.1% of the total billings, of the Firm for calendar year 1998."); *In re Rockaway Bedding, Inc.*, No. 04-bk-14898, 2007 WL 1461319, at *3 (Bankr. D.N.J. May 14, 2007) ("PNC Bank represented less than 1% of Duane Morris LLP's 2006 annual gross revenue.").

[63] *See Kennedy v. Skadden, Arps, Slate, Meagher & Flom LLP (In re Radnor Holdings Corp.)*, 528 B.R. 245 (D. Del. 2014), *aff'd sub. nom. In re Radnor Holdings Corp.*, 629 F. App'x 277 (3d Cir. 2015).

In some circumstances, a professional's representation of other parties closely related to the debtor, such as the debtor's directors, officers, or principal stakeholders, may give rise to a disqualifying conflict.[64] These types of representations "are not a disqualifying conflict per se" but they may become disqualifying "when adverse interests either exist *or are likely* to develop."[65]

In one Third Circuit case, a debtor's law firm simultaneously represented the debtor and the debtor's sole shareholder, president, and CEO, who had personally guaranteed the debtor's secured debts. The Third Circuit ruled that there was no significant risk of an adverse interest developing because the debtor's assets far exceeded the value of secured claims, such that it was substantially certain that all secured claims would be satisfied and the CEO would likely never be called upon to satisfy her guarantees.[66] Therefore, the court determined that despite there being a potential conflict, the possibility that this conflict would become an actual conflict was remote.[67] Similarly, in a bankruptcy case in the Southern District of New York, the debtor's proposed counsel had represented a corporate director prepetition. Proposed counsel was allowed to represent the debtor in the bankruptcy case because the prior representation had

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[64] *See Rome v. Braunstein*, 19 F.3d 54 (1st Cir. 1994) (denying fee application of debtor's counsel that previously represented both sole shareholder, president of the debtor and certain of his other family members); *In re EZ links Golf, LLC*, 317 B.R. 858 (Bankr. D. Colo. 2004) (denying retention of debtor's proposed counsel because it had close ties and consequential relationships with parties that were inseparable with the debtor).

[65] *In re Jade Mgmt. Services*, 386 F. App'x 145, 149 (3d Cir. 2010) (emphasis in original) (quoting *In re Plaza Hotel Corp.*, 111 B.R. 882, 890 (Bankr. E.D. Cal. 1990); *see also In re Angelika Films 57th Inc.*, 227 B.R. 29, 40 (Bankr. S.D.N.Y. 1998), *aff'd sub. nom. Tenzer Greenblatt LLP v. Silverman (In re Angelika Films 57th, Inc.),* 246 B.R. 176 (S.D.N.Y. 2000).

[66] *In re Jade Mgmt Servs.*, 386 F. App'x at 149; *but see Parker v. Frazier (In re Freedom Solar Ctr., Inc.),* 776 F.2d 14 (1st Cir. 1985) (reversing lower court's order permitting attorney to continue to represent debtor, debtor's sole shareholder, and a new corporation organized by shareholder where shareholder might be liable for preferential transfers); *In re Grabill Corp.*, 113 B.R. 966, 969 (Bankr. N.D. Ill. 1990), *aff'd sub nom. Grabill Corp. v. Pelliccioni*, 135 B.R. 835 (N.D. Ill. 1991), *aff'd sub nom. In re Grabill Corp.*, 983 F.2d 773 (7th Cir. 1993) ("Representation of more than one person or entity in a matter which ends up in bankruptcy court is fraught with ethical quagmires . . . temporary alliances forged between parties on a matter one day, frequently dissolve shortly thereafter when battle is joined on another matter arising in that same case.").

[67] *In re Jade Mgmt. Servs.*, 386 F. App'x at 149.

terminated before the petition date, and there were no allegations that the prepetition work substantially related to any claims asserted in the bankruptcy cases.[68] Therefore, the bankruptcy court held that the debtor's proposed counsel was not disqualified under section 327(a).

In contrast to the cases cited above, courts have disqualified counsel based on longstanding relationships and close connections between a debtor's counsel and its principals, when counsel acted in the principals' interests to the detriment of the debtor.[69]

When a professional does not represent an insider, yet has a relationship with an insider, courts evaluate the materiality of the relationship to determine whether a conflict exists. In one case, the court stated that a firm's former attorney being an insider of the debtor "alone might not cause [us] to find material adversity" requiring disqualification of the firm.[70] Moreover, courts have acknowledged that the specialized nature of bankruptcy practice means that relationships between professionals and others involved in a bankruptcy case are "inevitable."[71] And, therefore, even close familial relationships may not require disqualification. One court examining a familial relationship between debtor's counsel and the debtor explained that the question presented by such a relationship is whether "counsel, as the debtors' nephew, possess[es] an interest such as would color the requisite independent and impartial judgment

[68] *In re Level 8 Apparel LLC*, No. 16-bk-13164 (JLG), 2023 WL 2940489, at *16 (Bankr. S.D.N.Y. Apr. 13, 2023).

[69] *In re Rusty Jones, Inc.*, 134 B.R. 321, 344 (Bankr. N.D. Ill. 1991) (finding a conflict of interest under section 327 when a partner at debtor's counsel had significant personal and business relationships with indirect controlling owners of the debtors, leading counsel to act on several occasions to further the goals of these owners to the detriment of the debtor's estate).

[70] *Petralex Stainless, Ltd. v. Bishop Tube Div. of Christiana Metals (In re Petralex Stainless, Ltd.)*, 78 B.R. 738, 746 (Bankr. E.D. Pa. 1987).

[71] *In re eToys, Inc.*, 331 B.R. at 195 (determining that the relationship between counsel for the unsecured creditors' committee and the individual hired to coordinate debtor's liquidation, which extended over many years and involved several bankruptcy cases was "not unusual" and "[i]n fact, given the specialized nature of the bankruptcy practice, it is inevitable.").

required to handle the case."[72] That court determined that the relationship "does not outweigh the value afforded by his experience and familiarity with the affairs of the debtors."[73]

Courts have held, however, that professionals will not be found to be disinterested due to close relationships with insiders of the debtor if it is not clear whether the professional will be acting in the best interest of the bankruptcy estate. In a case in which a debtor's counsel had many important and consequential connections with parties who were integral to and somewhat inseparable from the debtor, the court determined that the interrelationship of the parties meant that there were far too many areas where questions could arise as to whether debtor's counsel's action or inaction on behalf of the debtor was driven by what was in the best interest of the estate and its creditors or by what would be in the best interest of the individuals.[74]

(iii) Professional's Simultaneous Representation of Multiple Debtors

The majority of courts, including the Third Circuit, have held that the representation of multiple related debtors does not alone create a *per se* conflict of interest warranting disqualification under section 327.[75] The Second Circuit has explained that "[i]nterdebtor issues arise in most large multidebtor bankruptcy cases. [Therefore,] [r]equiring appointment of independent professionals to represent each individual debtor in all such cases, regardless of the factual circumstances, would burden estates with unjustified and insurmountable costs."[76]

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[72] *In re Covey*, 57 B.R. 665, 667 (Bankr. D.S.D. 1986).

[73] *Id.*

[74] *In re EZ Links Golf, LLC*, 317 B.R. at 864.

[75] *See In re BH & P, Inc.*, 949 F.2d at 1314 (holding that "the existence of interdebtor claims is . . . no longer an automatic ground for disqualification of counsel . . ."); *In re Adelphia Commc'ns Corp.*, 342 B.R. 122, 128 (S.D.N.Y. 2006) ("[P]resence of intercompany claims between debtors represented by the same counsel does not automatically warrant the disqualification of that counsel") (quoting *In re Adelphia Commc'ns Corp.*, 336 B.R. 610, 672-73 (Bankr. S.D.N.Y. 2006)); *In re Int'l Oil Co.*, 427 F.2d 186, 187 (2d Cir. 1970) (the existence of intercompany claims was not enough "to saddle these estates with the expense of separate trustees and trustees' attorneys").

[76] *In re Adelphia*, 342 B.R. at 128.

Instead, courts have determined that only the presence of an "actual" conflict, as opposed to a "potential" conflict, will prevent simultaneous representation of debtors.[77]

As with the analysis of all conflicts under section 327, a determination as to whether a single professional's representation of multiple debtors rises from a potential conflict to a disqualifying actual conflict is highly fact-specific. The Third Circuit has held that factors to be considered "include, but are not limited to, the nature of the disclosure of conflict made at the time of appointment, whether the interests of the related estates are parallel or conflicting, and the nature of the interdebtor claims made."[78] However, in addition to these factors, the Circuit has reiterated the general rule that bankruptcy "[c]ourts have been accorded considerable latitude in using their judgment and discretion in determining whether an actual conflict exists."[79]

When multiple debtors have intercompany claims against one another, many courts take a wait-and-see approach before deciding whether additional professionals are necessary.[80] Counsel will not necessarily be disqualified at the outset of a case due to the possibility that a conflict might arise. Should conflicts surface, then conflicts counsel can be retained.[81]

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[77] *In re Glob. Marine, Inc.*, 108 B.R. 998, 1004 (Bankr. S.D. Tex. 1987) ("[T]here is a fundamental distinction between the 'potentially' conflicting interests that may arise in every instance of joint representation and an 'actual conflict of interest' as envisioned by § 327(c).").

[78] *In re BH & P Inc.*, 949 F.2d at 1316.

[79] *Id.* at 1315; *see In re Glob. Marine, Inc.*, 108 B.R. at 1004 (finding no actual conflict of interest that would require disqualification of bankruptcy counsel that represented multiple corporate debtor affiliates with a complex web of intercompany debts, who used each other's assets, and guaranteed each other's debts to third parties); *but see Quarles & Brady LLP v. Maxfield (In re Jennings)*, 199 F. App'x 845, 849 (11th Cir. 2006) (holding that an actual conflict arose where "one debtor depleted its assets despite another debtor's secured claim against those assets" forcing counsel "to advance two diametrically opposed goals" that "created an actual dispute") (internal quotation marks omitted).

[80] *In re Adelphia*, 342 B.R. at 128.

[81] *In re Wheatfield Bus. Park LLC*, 286 B.R. 412, 423 (Bankr. C.D. Cal. 2002) ("[I]f a potential conflict of interest arises because of a transaction between two affiliated business entities that are both debtors in bankruptcy cases, the appointment of special counsel to deal with that transaction may be sufficient to permit a single attorney or law firm to represent the related entities as their general bankruptcy counsel.")

d. The Role of Conflicts Counsel

When a debtor's primary counsel cannot handle a matter in a bankruptcy case due to a conflict of interest, courts will often allow the debtor to retain another law firm as conflicts counsel.[82] In certain circumstances, courts have held that a potential conflict can be avoided by the retention of conflicts counsel when a case begins.[83] In other instances, courts will wait to see how the case plays out before requiring the retention of conflicts counsel.[84]

The retention of conflicts counsel, however, is not a cure-all for every situation. Courts have held that conflicts counsel will not provide a solution to conflicts arising when the party with whom the professional has a relationship has a significant and pervasive role in the case.[85] Situations in which courts have held the appointment of conflicts counsel to be insufficient include those in which the professional has a conflict of interest with the debtor's largest creditor who was central to the reorganization,[86] or when the professional has a conflict with a debtor's major competitor with multiple claims, including more than half the total unsecured claims against the debtor.[87] Therefore, if the retention of conflicts counsel cannot ensure that a lawyer or law firm will provide the debtor with undivided loyalty, then that lawyer or law firm must be disqualified.

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[82] *See, e.g.*, *In re Enron Corp.*, No. 01-bk-16034(AJG), 2002 WL 32034346, at *11 (Bankr. S.D.N.Y. May 23, 2002), *aff'd sub. nom. Exco Res., Inc. v. Milbank, Tweed, Hadley & McCloy LLP (In re Enron Corp.)*, No. 02-cv-5638(BSJ), 2003 WL 223455 (S.D.N.Y. Feb. 3, 2003) (describing conflicts counsel as an "acceptable procedure[] to address conflict of interest issues . . . in numerous large bankruptcy cases.").

[83] *See, e.g.*, *In re J&M Dev. of Cass Cnty*, *Inc.*, No. 04-br-41065-JWV, 2004 WL 1146451, at *3 (Bankr. W.D. Mo. May 19, 2004) (citing *In re BH & P, Inc.*, 103 B.R. 556 (Bankr. D.N.J. 1989)), *remanded*, 119 B.R. 35 (D.N.J. 1990), *aff'd*, 949 F.2d 1300 (3d Cir. 1991)).

[84] *See, e.g.*, *Hassett v. McColley (In re O.P.M. Leasing Servs., Inc.)*, 16 B.R. 932, 939 (Bankr. S.D.N.Y.1982) (citing *Dresner, Gomberg & Co., Inc. v. Kilsheimer (In re G.E.C. Secs., Inc.*), 331 F.2d 655, 656 (2d Cir. 1964) and *Katz v. Kilshemer*, 327 F.2d 633, 636 (2d. Cir. 1964)).

[85] *See, e.g.*, *In re Amdura Corp.*, 121 B.R. 862 (Bankr. D. Colo. 1990).

[86] *In re Project Orange Assocs., LLC*, 431 B.R. 363, 375.

[87] *In re WM Distribution, Inc.*, 571 B.R. 866 (Bankr. D.N.M. 2017).

III. The Court's Ruling on the Debtors' Application to Employ S&C

a. Summary of the Record

On December 21, 2022, the Debtors filed an application to retain S&C as counsel (the "S&C Employment Application").[88] Objections to the S&C Employment Application were due on January 4, 2023. The hearing was initially scheduled for January 11, 2023, and then later adjourned to January 20, 2023. Attached as exhibits to the S&C Employment Application were declarations from CEO John Ray (the "Ray Employment Declaration") and S&C partner Andrew G. Dietderich (the "Dietderich Declaration"). The Ray Employment Declaration discusses the Debtors' decision to select S&C as counsel, as well as S&C's rate structure and cost supervision. The Dieterich Declaration contains, among other things, a short statement that "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 related to certain U.S. business lines."[89] For this work, S&C was paid $8,564,487 in total.[90] The S&C Employment Application and related declarations provide few specifics on the nature of S&C's prior work for the Debtors.

On January 4, 2023, one of the Debtors' customers and creditors filed an objection to the S&C Employment Application.[91] The objection was amended on January 10, 2023 (together, the "Winter Objection").[92] The Winter Objection asserts that S&C had an actual conflict of interest arising from: (1) S&C's relationship with Ryne Miller, described as General Counsel to

[88] Dkt. No. 270.

[89] Dkt. No. 270-3 at ¶ 16.

[90] *Id.*

[91] Dkt. No. 369.

[92] Dkt. No. 459.

FTX.US,[93] and Tim Wilson, described as General Counsel to FTX Ventures, Ltd. ("FTX Ventures"), both of whom were former S&C attorneys and, Winter argues, worked with S&C to mount an extreme pressure campaign so that Bankman-Fried would place the FTX Group into bankruptcy; (2) S&C's prepetition representations, which would allegedly need to be investigated and were not sufficiently disclosed; (3) S&C's preference exposure; and (4) S&C's representation of potential targets of investigations and litigation to be brought by the estates. One other creditor joined the Winter Objection.[94]

On January 13, 2023 (after an extension of the objection deadline), the U.S. Trustee filed an objection to the S&C Employment Application (the "U.S. Trustee Objection").[95] The U.S. Trustee Objection raises two concerns. First, the U.S. Trustee asserts that S&C's disclosures were "wholly insufficient to evaluate whether S&C satisfies the Bankruptcy Code's conflict-free and disinterestedness standards."[96] Second, the U.S. Trustee argues that the scope of S&C's retention should not include an investigation of the Debtors' downfall given S&C's close connection to "an insider" of the Debtors (likely a reference to Miller) and because such an investigation would be more appropriately tasked to an examiner.[97]

On January 17, 2023, Dietderich filed a supplemental declaration containing more robust disclosures than the initial Dietderich Declaration (the "Supplemental Dietderich Declaration").[98] The Supplemental Dietderich Declaration discusses how S&C was retained by the FTX Group

[93] The Examiner has seen references to both West Realm Shires Inc. and its subsidiary West Realm Shires Services Inc. as doing business as FTX.US.

[94] Dkt. No. 502.

[95] Dkt. No. 496.

[96] *Id.* at 2.

[97] *Id.*

[98] Dkt. No. 510.

and describes the days leading up to the Petition Date. Dietderich explicitly denies pressuring Bankman-Fried to commence the bankruptcy cases, as alleged in the Winter Objection. Dietderich also discusses the negotiation and execution of the document appointing Ray as CEO (the "Omnibus Authority"). Dietderich explains that Ray was one of several candidates identified by S&C for the position of Chief Restructuring Officer ("CRO"), but the Supplemental Dietderich Declaration does not explain why Ray was appointed CEO instead.

According to Dietderich, in the days leading up to the Petition Date, Dietderich and other S&C attorneys were in contact with various members of the FTX Group leadership, including Bankman-Fried (represented by his own counsel), Can Sun (General Counsel to FTX Trading Ltd.), and Zach Dexter (CEO of LedgerX LLC ("LedgerX")). At this time, Dietderich states that S&C was also taking direction from Miller and Wilson who, as mentioned, were both senior legal officers at the FTX Group and prior S&C attorneys. Notably, in the lead up to the bankruptcy filing, two FTX Group senior legal officers—Sun and Daniel Friedberg—resigned from their positions.[99]

The Supplemental Dietderich Declaration explains S&C's relationship with both Miller and Wilson, as well as two other former S&C associates with more junior roles at the FTX Group. Miller was an associate at S&C for several years before being elected to the partnership. He was a partner of the firm from January 2019 to July 2021, when he left to join the FTX Group. Wilson was an associate at S&C from September 2019 to April 2021. He did not leave S&C to join the FTX Group. Instead, he left S&C for another law firm that also did work for the

[99] *Id*. at ¶ 15. With respect to Sun, Dietderich testifies that he was in contact with Sun during November 8, but that Sun resigned later that same day.

FTX Group, Fenwick & West, LLP ("Fenwick").[100] The Supplemental Dietderich Declaration does not disclose (and Dietderich may not know) when Wilson joined the FTX Group.

Regarding S&C's prepetition work, the Supplemental Dietderich Declaration contains disclosures, referred to as a *Pillowtex* analysis,[101] regarding the fees received by S&C from the FTX Group for the one-year period prior to the Petition Date.[102] The purpose of this analysis is to determine whether S&C received a potentially avoidable transfer. Beyond the preference disclosures, Dietderich also asserts that S&C did not classify the FTX Group as "regular clients," which is a designation the firm uses for clients with whom it has a standing relationship.[103] In his declaration, Dietderich predicts that work for the FTX Group in 2022 would represent less than 1% of S&C's total revenues in 2022.[104]

As set forth in the Supplemental Dietderich Declaration, starting in July 2021, S&C opened 20 matters prepetition on behalf of the FTX Group. The most significant representation of the FTX Group, based on the fees generated, was S&C's representation of West Realm Shires Services Inc. ("WRSS") in its bid for substantially all of the assets of Voyager Digital Holdings, Inc. and its debtor affiliates ("Voyager Digital"). S&C was paid approximately $3,128,000 for this work.[105] S&C also received $1,513,000 for its representation of WRS in connection with its acquisition of LedgerX LLC. S&C also represented WRS in its formal request to the CFTC to modify WRS' registration as a derivative clearing organization so it could offer margined products directly to participants. S&C was paid approximately $662,000 for this

[100] *Id*. at ¶¶ 62-66.

[101] This analysis is so termed because it is based on the Third Circuit decision *In re Pillowtex, Inc*., 304 F.3d at 251.

[102] Dkt. No. 510 at ¶ 59.

[103] *Id.* at ¶ 40.

[104] *Id.* at ¶ 44.

[105] *Id*. at ¶ 48.

representation.[106] And S&C advised the FTX Group in connection with other investigations and inquiries from the CFTC. One involved inquiries concerning third-party crypto businesses, for which S&C received approximately $220,000.[107] There was one CFTC matter for which S&C received fees in excess of $1,000,000, which was in connection with the agency's investigation into the FTX Group's Know Your Customer policies and procedures, for which S&C received $1,405,000.[108]

The remaining matters disclosed in the Supplemental Dietderich Declaration were much smaller engagements. However, two of these comparatively small engagements merit further comment here because they were representations of individuals from the FTX Group's leadership on a personal basis. First, Dietderich discloses that S&C advised Bankman-Fried in his individual capacity in connection with Hart-Scott-Rodino Act compliance and public reporting obligations, "arising out of a position that had been established in the stock of Robinhood Markets, Inc."[109] Second, S&C provided tax and estate planning advice to Nishad Singh. The modest fees for both matters were paid for by Alameda Research LLC ("Alameda").[110]

The Supplemental Dietderich Declaration also discloses S&C's representation of certain parties included on the "interested parties list" that was provided to S&C by the Debtors for the purposes of preparing its disclosures pursuant to Bankruptcy Rule 2014. For example, the Supplemental Dietderich Declaration discloses that S&C represented BlockFi International Ltd.

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[106] *Id*. at ¶ 49.

[107] *Id.*

[108] *Id.* at ¶ 48.

[109] Dkt. No. 510 at ¶ 52.

[110] *Id.* at ¶ 51. The work for Singh amounted to $22,000 in fees. The work for Bankman-Fried amounted to $195,000 in fees.

and BlockFi, Inc. (collectively, "BlockFi") in a regulatory matter that resulted in a public settlement (the "BlockFi SEC Settlement").[111] It notes that, at the time the declaration was filed, the matter was substantially complete, and that S&C did not expect any further work.[112]

On the same day that the Supplemental Dietderich Declaration was filed, two additional declarations were filed. First, Ray filed a supplemental declaration (the "Supplemental Ray Employment Declaration").[113] The Supplemental Ray Employment Declaration provides additional background on Ray's decisions to retain S&C as primary legal counsel and to engage Quinn Emanuel to, among other things, serve as counsel on matters for which S&C is conflicted. Ray also clarified that, although Miller was still employed at the Debtors, he had no day-to-day responsibilities. Second, Alexa J. Kranzley, an S&C partner, filed a declaration attaching emails between S&C and the U.S. Trustee regarding S&C's Employment Application.[114] Those emails, collectively, demonstrate that there were extensive communications between S&C and the U.S. Trustee regarding the additional disclosures in the Supplemental Dietderich Declaration.

On January 17, 2023, the Unsecured Creditors' Committee filed a statement saying that it did not share the U.S. Trustee's concerns regarding the retention of S&C, particularly given S&C's additional disclosures. This statement also asserts that denial of the S&C Employment Application would cause "disruption and expense" that "would not be in the best interests of the estates."[115]

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[111] *Id.* at ¶ 76. BlockFi operates another crypto platform.

[112] *Id.*

[113] Dkt. No. 511.

[114] Dkt. No. 512.

[115] Dkt. No. 508 at ¶ 5.

On January 19, 2023, Dietderich filed a second supplemental declaration that contains minor additional disclosures as well as clarifications to the existing S&C disclosures.[116]

Also on January 19, 2023, Daniel Friedberg filed a declaration purportedly in support of the Winter Objection (the "Friedberg Declaration").[117] Among other things, Friedberg asserts that S&C had breached ethical obligations and overbilled the FTX Group for certain prepetition work;[118] that S&C had a conflict concerning its prepetition representation of both the "Alameda Group"[119] and BlockFi;[120] that S&C mistakenly filed FTX.US[121] into Chapter 11 when "the group appears to have been solvent";[122] and that S&C erred in making the "unexplainable decision to leave open withdrawals at FTX.US for several days and not secure the crypto assets of the entities *after* filing bankruptcy."[123]

The filing of the Friedberg Declaration prompted the objectors to file an emergency motion asking the Court to adjourn the January 20 hearing on the S&C Employment Application.[124] Characterizing the Friedberg Declaration as a "bombshell" and its allegations against S&C as "explosive," the objectors opined that "it is in the best interest of our clients and all stakeholders to have additional time to arrange testimony, secure a deposition and, otherwise,

[116] Dkt. No. 533.

[117] Dkt. No. 530.

[118] *Id.* at ¶¶ 48-55.

[119] This term is not defined in the declaration.

[120] *Id.* at ¶¶ 56-63. The declaration also does not include a definition of BlockFi.

[121] Defined in the declaration as WRSS, but, as noted *supra* note 93, the Examiner has also seen references to WRSS' parent entity, WRS, doing business as FTX.US.

[122] *Id.* at ¶ 64.

[123] *Id.* at ¶ 66 (emphasis in original).

[124] Dkt. No. 535.

get to the bottom of this unexpected development."[125] No other objections, statements, or declarations were filed in connection with the S&C Employment Application.

b. The Court Hearing

At the January 20 hearing, the Court denied the objectors' emergency motion to adjourn the hearing and declined to consider the Friedberg Declaration. The Court noted that Friedberg had filed neither a motion nor a joinder to a motion, and his declaration was not filed in support of anyone else's motion. As a result, the Court held that the Friedberg Declaration was "not . . . appropriate—procedurally it's not appropriate."[126] In addition, the Court concluded that the declaration was "full of hearsay, innuendo, speculation, rumors; certainly not something I would allow to be introduced into evidence in any event."[127] The Court also noted that Friedberg was not present in the courtroom. "He is simply trying to be a witness, I suppose, but witnesses are not allowed unless [they are] here live."[128]

Also at the hearing, counsel for the U.S. Trustee informed the Court that the U.S. Trustee's objection to the S&C Employment Application was resolved as a result of S&C's extensive additional disclosures.[129] An S&C partner, an attorney representing the Unsecured Creditors' Committee, and an attorney representing the objectors all addressed the Court on the merits of the S&C Employment Application.

Based on this record, the Court ruled that, despite the prepetition work performed by S&C, there was no evidence of an actual conflict and no potential conflict that would require

[125] Transcript at 17:20, 18:12, 19:6-9, Dkt. No. 558.

[126] *Id*. at 24:1-5.

[127] *Id*. at 24:6-9.

[128] *Id*. at 25:1-3.

[129] *Id*. at 9:5-10:8.

disqualification. The Court reached this conclusion because nothing in the extensive record before it indicated "any investigation would be required of those transactions with which [S&C] might have been involved" and, even if there were, the "[D]ebtors have retained conflict counsel."[130] The Court also noted that Ray and four independent directors were appointed "who are all consummate professionals, who were not involved in the company's collapse, and there's no evidence that Miller or Wilson are involved in the management of the [D]ebtors at this time."[131] Regarding the preference allegations, the Court ruled that "the payments made within the 90-day preference period constitute ordinary course payments" and therefore were not recoverable by the Debtors.[132] Accordingly, the Court overruled the Winter Objection and granted the S&C Employment Application. The Court's decision was not appealed by any party.

c. Analysis of Court's Ruling

As directed in the Scope Order, the Examiner reviewed the Court's ruling on the S&C Employment Application to determine whether there were any potential conflicts of interest involving S&C which were not adequately addressed.

At the time of the hearing on the S&C Employment Application, there were just two objections before the Court: The Winter Objection and a joinder to the Winter Objection. In light of the Friedberg Declaration's procedural and evidentiary deficiencies, the Examiner does not believe that the Court erred by disregarding the Friedberg Declaration.[133]

With respect to each of the objectors' arguments, the Court had "considerable latitude in using [its] judgment and discretion in determining whether an actual conflict exists 'in light of

[130] Transcript at 48:18-25, Dkt. No. 558.

[131] *Id*. at 50:3-8.

[132] *Id*. at 51:2-6.

[133] Nonetheless, the allegations contained in the Friedberg Declaration are addressed *infra*, at Section IV.

the particular facts of each case.'"[134] Likewise, the Court had "wide discretion . . . to approve or disapprove" S&C's retention based on the existence of a potential conflict.[135] Indeed, as noted above, potential conflicts are not *per se* disqualifying.[136] And any concerns about potential conflicts can be alleviated through the employment of conflicts counsel.[137]

The Court addressed and responded to each of the objectors' arguments. First, the objectors argued that S&C's prepetition work for the Debtors gave rise to potential conflicts. But, as discussed previously, if there is no evidence in the record that counsel's prepetition work for a debtor related to or would influence counsel's representation of the debtor, then disqualification for such work is not warranted.[138] The Court found that there was nothing in the record that would merit disqualification of S&C based on its prepetition work.[139] After carefully reviewing the record that was before the Court, the Examiner agrees with the Court's conclusion.

Second, the objectors cited S&C's relationship with Miller and Wilson. To be sure, the case law reveals that longstanding relationships with insiders can be disqualifying if it is unclear whether the professional will act in the best interest of the estate or the insider.[140] Here, however, the Court concluded that "there's no evidence that Miller or Wilson are involved in the management of the [D]ebtors at th[e] time [of the retention decision]" and that generally these

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[134] *In re BH & P, Inc.*, 949 F.2d at 1315 (quoting *In re Star Broad., Inc.*, 81 B.R. at 844).

[135] *In re Marvel Ent. Grp., Inc.*, 140 F.3d at 477; *see also In re BH & P, Inc.*, 949 F.2d at 1315.

[136] *In re Boy Scouts of Am.*, 35 F.4th at 157 (citing *In re Marvel Ent. Grp., Inc.*, 140 F.3d at 476).

[137] *See, e.g.*, *In re J&M Dev. of Cass Cnty., Inc.*, 2004 WL 1146451, at *3 (citing *In re BH & P, Inc.*, 103 B.R. at 564); Transcript at 48:22-24, Dkt. No. 588.

[138] *See, e.g.*, *In re Am. Int'l Refinery, Inc.*, 676 F.3d at 465; *In re Caesars Ent. Operating Co., Inc.*, 561 B.R. at 433.

[139] Transcript at 48:18-25, Dkt. No. 558.

[140] *In re Jade Mgmt. Servs.*, 386 F. App'x at 148; *see also In re Angelika Films 57th Inc.*, 227 B.R. at 40; *In re Rusty Jones, Inc.*, 134 B.R. at 344.

relationships posed no conflicts issues that would require disqualification.[141] Again, the Examiner has seen nothing in the record to question the Court's conclusion on this issue.

Finally, the Court addressed the objectors' arguments regarding S&C's receipt of a prepetition retainer and other payments within the 90-day preference period.[142] Receipt of a retainer does not automatically prevent a finding of disinterestedness, as "[a]ll professionals become 'creditors' when they perform services for which the estate must pay."[143] In addition, as noted above, the Court reviewed S&C's *Pillowtex* analysis and determined that the payments S&C received were within the ordinary course—a dispositive fact that was unchallenged by the objectors.[144] Once again, having carefully reviewed the record that was before the Court on this issue, the Examiner agrees that (1) the retainer paid to S&C prepetition, and (2) all other payments S&C received during the 90-day preference period provided no basis to disqualify S&C from representing the Debtors in these bankruptcy cases.

In light of the record before the Court, the Court's analysis of each of the objectors' arguments, and the wide discretion afforded to the Court in determining whether disqualifying conflicts exist, the Examiner has concluded that there was no error in the Court's decision concerning the Debtors' retention of S&C.

IV. Analysis of Other Investigations

In accordance with the directive from the Court, the Examiner has also sought to identify any facts relevant to S&C's alleged conflicts or disinterestedness that were not before the Court

[141] Transcript at 50:5-8, Dkt. No. 558.

[142] *Id*. at 50:19-21; 51:2-4.

[143] *In re Dick Cepek, Inc*., 339 B.R. at 739 n.10.

[144] Transcript at 50:24; 51:4, Dkt. No. 558. Pursuant to section 547 of the Bankruptcy Code, transfers made in the ordinary course of business are non-avoidable. *See* 11 U.S.C. §547(c)(2).

when it ruled on the S&C Employment Application. This section summarizes other investigations and discusses key findings regarding S&C's retention.

a. Quinn Emanuel Investigation

Quinn Emanuel conducted an investigation into S&C's prepetition work. Upon the instruction of Ray, Quinn Emanuel's mandate was to investigate facts relating to whether, and to what extent, attorneys at S&C may have advised on, possessed knowledge of, or been made aware of critical facts concerning these categories of misconduct:[145]

> (a) the alleged commingling of FTX Trading Ltd. ([] "FTX.com") customer deposits/funds with the corporate assets of Alameda [] and other [entities in the FTX Group]; (b) the alleged misappropriation of FTX.com customer deposits/funds to pay for various unauthorized personal and corporate expenditures; (c) the allegedly false and misleading statements and representations made to FTX.com's customers, specific FTX.com investors, FTX.com's outside auditors, lenders and creditors of Alameda [], the investing public generally, and Silvergate Bank; (d) an alleged bribe of over $40 million paid to Chinese government officials to unfreeze approximately $1 billion in cryptocurrency held in various trading accounts associated with Alameda; (e) an alleged lack of internal controls at FTX.com and [WRSS], among other FTX entities; and (f) an alleged conflict of interest that S&C maintained in connection with a potential acquisition of BlockFi [by WRSS].[146]

Quinn Emanuel conducted a thorough investigation. It ran targeted searches over approximately 320,000 documents, reviewed approximately 14,000 documents, and interviewed seven S&C partners who provided prepetition legal services to the Debtors.[147] When determining which S&C attorneys' documents to review, Quinn Emanuel looked for lawyers (1) with substantial prepetition documents, (2) who billed significant hours to the FTX Group

[145] Quinn Emanuel, *Report to CEO John Ray and the Independent Directors of the FTX Group Debtors Entities Regarding Sullivan & Cromwell LLP*, Feb. 2024 (the "Quinn Report on S&C"), at 1.

[146] *Id.* at 2.

[147] *Id*. at 4.

prepetition, or (3) who signed an engagement letter with the FTX Group.[148] Eight attorneys were identified as meeting at least two of the three criteria.[149] Quinn Emanuel chose not to interview one of these attorneys, though his emails were a part of the 14,000 documents reviewed.[150]

Significantly, however, Quinn Emanuel's investigative mandate had certain limitations. For instance, Quinn Emanuel was not asked to consider and, hence, did not investigate, the broader question of whether S&C had any conflicts of interest that might have disqualified it from serving as counsel under Bankruptcy Code section 327. This is because S&C's retention had already been approved by the Bankruptcy Court. As another limitation, Quinn Emanuel did not investigate S&C's representation of either Bankman-Fried or Singh as individuals because it was not charged with that responsibility. As one final limitation, Quinn Emanuel did not interview individuals outside of S&C, such as Miller, in connection with its investigation into S&C. Once again, this was because such interviews were beyond the scope of Quinn Emanuel's investigative mandate.

There were also constraints on Quinn Emanuel's ability to collect certain documents. At times, some S&C attorneys used Signal[151] to communicate with the FTX Group's employees, and often those communications were auto-deleted after a specific period of time. S&C produced various Signal communications, and the Examiner has reviewed all of those documents.[152] However, because of the use of Signal auto-deletion features, it is likely—and

[148] S&C Investigation Annotated Steps.

[149] *Id*.

[150] *Id*. Quinn Emanuel did not interview one S&C partner because his documents either were not relevant or entirely overlapped with other partners' emails. As a result, Quinn Emanuel did not believe that this additional interview would have revealed further relevant information.

[151] Signal is an encrypted messaging system that employees of the FTX Group frequently used for both internal and external communications. Among other features, Signal provided options for ephemeral messaging.

[152] S&C has represented that they produced all relevant Signal messages that they were able to retrieve.

indeed appears to be the case—that the production of these messages is not and potentially could never be complete.

Notwithstanding these impediments, Quinn Emanuel is comfortable with the scope of its review, including with respect to the Signal messages provided by S&C. In particular, Quinn Emanuel noted that, in the Bankman-Fried criminal proceedings, no additional e-mail, Signal or other communications with S&C were proffered by the prosecution or the defense.

Through its investigation, Quinn Emanuel did not find any evidence that S&C advised on, had knowledge of, or ignored red flags relating to the six areas of FTX Group malfeasance identified by Quinn Emanuel.

After reviewing the Quinn Emanuel investigation, the Examiner is satisfied with the process and methodology that the firm used, as well as the overall thoroughness of its review. While the scope of the investigation was, out of necessity, not all-encompassing, the Examiner has found no evidence suggesting that he cannot rely on Quinn Emanuel's conclusions.

b. Additional Materials Regarding S&C

The Examiner also reviewed and analyzed materials and allegations put forward by former employees, third-party observers, and other parties in interest concerning S&C's alleged conflicts of interest (the "Additional S&C Materials").[153]

The Additional S&C Materials contain many factual allegations. Some of them were before the Court when it ruled on the S&C Employment Application, such as S&C's relationship with Miller. For the reasons discussed above, the Examiner has concluded that the Court did not

[153] These materials include: Dkt. No. 530; *Garrison v. Sullivan & Cromwell, LLP*, No. 24-cv-20630 (S.D. Fla.) (KMM), Dkt. No. 1; Jonathan C. Lipson & David A. Skeel, *FTX'd: Conflicting Public and Private Interests in Chapter 11* (Mar. 13, 2024), U of Penn, Inst. for Law & Econ Research Paper No. 24-08, https://ssrn.com/abstract=4760736, *archived at* https://perma.cc/CGQ6-CUY5; and *Vara v. FTX Trading (In re FTX Trading)*, No. 23-2297 (3d Cir.), Dkt. No. 27.

err in determining that the facts before it did not require the disqualification of S&C from serving as Debtors' counsel under the applicable rules. Other allegations contained in the Additional S&C Materials appear to be conclusory, such as allegations regarding S&C's purported knowledge of unlawful conduct. These statements are both generally unsupported by specific factual evidence and contradicted by Quinn Emanuel's findings in its investigation.

The Examiner also disagrees with certain other allegations and conclusions in the Additional S&C Materials. For example, certain academics have argued that S&C's cooperation with prosecutors may have violated S&C's duties to the Debtors, wasted estate assets, or misled Bankman-Fried.[154] Specifically, these scholars allege that, prior to the Petition Date, S&C violated its duty of confidentiality, candor, and loyalty to its client by disclosing to prosecutors, without proper authorization from the FTX Group, that a crime had occurred at the company.[155] But the Examiner has not seen any email or other document in which S&C expressly disclosed a crime to prosecutors or regulators prepetition. The Examiner has seen communications disclosing to the government that FTX.US had discovered an anomaly on its balance sheet—that there were not enough assets to cover liabilities.[156] Those disclosures do not conclude that the anomaly amounted to, or was the result of, a crime.[157] Notably, these prepetition disclosures were made either by Miller himself or by S&C at the direction of Miller while he was still acting

[154] *See* Jonathan C. Lipson & David A. Skeel, *FTX'd: Conflicting Public and Private Interests in Chapter 11* (Mar. 13, 2024), U of Penn, Inst. for Law & Econ Research Paper No. 24-08, at 5, 6, 31, 42, 52, 53, https://ssrn.com/abstract=4760736, *archived at* https://perma.cc/CGQ6-CUY5; *Vara v. FTX Trading (In re FTX Trading)*, No. 23-2297 (3d Cir.), Dkt. No. 27, at 32-35.

[155] *See* Jonathan C. Lipson & David A. Skeel, *FTX'd: Conflicting Public and Private Interests in Chapter 11* (Mar. 13, 2024), U of Penn, Inst. for Law & Econ Research Paper No. 24-08, at 5, 6, 31, 42, 52, 53. https://ssrn.com/abstract=4760736, *archived at* https://perma.cc/CGQ6-CUY5; *Vara v. FTX Trading (In re FTX Trading)*, No. 23-2297 (3d Cir.), Dkt. No. 27, at 5.

[156] Further discussion of this anomaly, or "hole," is found *infra,* at Part 6, Section V.

[157] *See* emails from Ryne Miller to various regulators, Nov. 9, 2022, Quinn Emanuel Interview Documents, F10705-E035453307.

as General Counsel to FTX.US.[158] Regarding their allegations about S&C's ethical duties, the academics appear to conflate the FTX Group and Bankman-Fried, whereas in fact there is a distinction between a corporate client and its principals. At that time, S&C was representing the FTX Group, not Bankman-Fried. Significantly, Bankman-Fried was then separately represented by sophisticated, experienced counsel. Furthermore, the FTX Group's decision, in consultation with S&C, to make a swift and decisive self-disclosure concerning the balance sheet anomaly is consistent with the prudent and common strategy for companies to promptly self-disclose corporate misconduct, and may have helped preserve estate resources by enabling the company to earn cooperation credit.[159] Lastly, the Examiner has confirmed that, since Ray's appointment, S&C's continued cooperation with prosecutors has been at Ray's direction.

Other factual assertions in the Additional S&C Materials are not relevant to the Examiner's conflicts analysis. For example, some of those allegations criticize S&C's postpetition work, including the sales of certain cryptocurrency assets, and the decision to wind down certain operations rather than maintaining those businesses as going concerns.[160] But these business decisions were made by Ray and the independent directors, not S&C. And all asset sales were approved by the Court after notice to parties in interest—including the U.S. Trustee

[158] *See id.* The Examiner has also seen a Signal message where Miller informed various FTX Group executives, including Bankman-Fried, that he was reporting the financial anomaly to regulators and Bankman-Fried did not protest the decision. *See* Signal message from Ryne Miller to Gary Wang, Bankman-Fried, Joseph Bankman, Mark Wetjen, Zach Dexter, Nishad Singh, Nov. 9, 2022. Instead, Bankman-Fried apologized to the other chat participants and directed them to continue to rely on Miller for information related to FTX.US.

[159] *See Memorandum from the Office of the Deputy Attorney General*, U.S. Dep't of Justice (Sept. 15, 2022) (requiring companies to produce "on a timely basis" facts and evidence about misconduct in order to receive full cooperation credit) (emphasis in original). "Cooperation is a mitigating factor, by which a corporation—just like any other subject of a criminal investigation—can gain credit in a case that otherwise is appropriate for indictment and prosecution . . . Credit for cooperation takes many forms and is calculated differently based on the degree to which a corporation cooperates with the government's investigation and the commitment that the corporate demonstrates in doing so." U.S. Dep't of Just., Just. Manual § 9-28.700 (2024).

[160] *See e.g.,* Jonathan C. Lipson & David A. Skeel, *FTX'd: Conflicting Public and Private Interests in Chapter 11* (Mar. 13, 2024), U of Penn, Inst. for Law & Econ Research Paper No. 24-08, at 54-57, 59, https://ssrn.com/abstract=4760736, *archived at* https://perma.cc/CGQ6-CUY5.

and the Unsecured Creditors' Committee—and opportunity for hearings. For at least some of the sales, no objections were filed. The Examiner has seen no evidence that these postpetition business decisions were made by S&C. Moreover, the Examiner has uncovered no proof suggesting that these core business decisions were unreasonable or that the Court's approval of these transactions was flawed in any respect.

The Additional S&C Materials also criticize the amount of fees that S&C has been paid as Debtors' counsel. Even if that complaint were well grounded, it is irrelevant to this inquiry. The fees that S&C has incurred postpetition are not germane to the section 327 analysis, and a detailed assessment of these fees is not within the scope of the Examiner's review. Even so, the Examiner notes that S&C's fees are (1) publicly disclosed in monthly fee statements and quarterly fee applications that include detailed time records, and (2) subject to review by the Court, the U.S. Trustee, a court-appointed fee examiner, the Unsecured Creditors' Committee, and all other parties in interest. Other than some minor adjustments requested by the fee examiner or the U.S. Trustee, no objections have been filed by any party in interest in response to S&C's monthly fee statements or quarterly fee applications, and the quarterly applications all have been approved by the Court on an interim basis.

Notwithstanding the above, the Examiner has identified several categories of allegations within the Additional S&C Materials that merit further discussion.

V. Conflicts That S&C Allegedly Did Not Adequately Disclose To the Court

a. Representation of Bankman-Fried in Connection with His Purchase of Robinhood Stock

The Supplemental Dietderich Declaration discloses one instance where S&C represented Bankman-Fried prepetition in his individual capacity. In that declaration, Dietderich states that, "[u]nder the supervision of Dan Friedberg, the senior legal officer of the FTX [G]roup, and Ryne

Miller, General Counsel of FTX[.]US, S&C advised Mr. Sam Bankman-Fried in connection with Hart-Scott-Rodino compliance and public reporting obligations arising out of a position that had been established in the stock of Robinhood[.]"[161] S&C received fees and expenses for this matter of approximately $195,000. The payment was arranged and paid for by Alameda.[162] The Supplemental Dietderich Declaration further states that, other than this representation and one other individual representation of Singh, S&C did not represent or perform services for any of the Debtors' current or former officers or directors, including Bankman-Fried.[163]

A letter from the USAO-SDNY to U.S. District Court Judge Lewis Kaplan revealed that, through an entity called Emergent Fidelity Technologies Ltd., ("Emergent"), a special purpose entity owned primarily by Bankman-Fried, Bankman-Fried acquired approximately $500 million worth of shares of Robinhood Markets, Inc. (the "Robinhood Shares") using misappropriated FTX Group customer funds.[164] And because the prosecutors found no public connection between Emergent and the Debtors, they seized the Robinhood Shares after a showing of probable cause that they were the proceeds of wire fraud and property involved in money laundering.[165]

The Additional S&C Materials contain various allegations with respect to S&C's involvement in this acquisition of the Robinhood Shares (the "Robinhood Transaction"). Specifically, the materials assert that S&C acted as both personal counsel for Bankman-Fried and

[161] Dkt. No. 510 at ¶ 52.

[162] *Id.*

[163] *Id.* at ¶ 53.

[164] *United States v. Samuel Bankman-Fried* ("SBF Criminal Case"), No. 22-cr-00673 (S.D.N.Y.) (LAK), Dkt. No. 53; *see also* Robinhood Markets, Inc., (Form SC 13D) (May 12, 2022).

[165] SBF Criminal Case, Dkt. No. 53.

primary counsel for Emergent.[166] In contrast to the statement in the Supplemental Dietderich Declaration that S&C merely advised on "Hart-Scott-Rodino compliance and public reporting obligations,"[167] the Additional S&C Materials claim that S&C provided expertise and advice to both Bankman-Fried and Emergent regarding the structuring of the Robinhood Transaction itself.[168] Therefore, based on this work by S&C, the Additional S&C Materials allege that S&C knew how the Robinhood Shares were purchased and with what funds—in other words, that S&C was aware of the misappropriation of customer funds.[169]

The Examiner has seen no evidence that S&C acted as the primary counsel for Emergent or that S&C's advice regarding the Robinhood Transaction involved the structuring of the transaction itself. However, there does not appear to have been any independent examination into S&C's work on the Robinhood Transaction. The Quinn Emanuel investigation did not involve any review of S&C's representation of Bankman-Fried or Singh individually. But references to the Robinhood Transaction did arise during Quinn Emanuel's document review and interviews.[170] For instance, when he was interviewed by Quinn Emanuel, S&C Partner Mitch Eitel, explained that he and S&C represented Bankman-Fried in his personal capacity by advising on an SEC 13D filing and related Hart-Scott-Rodino compliance.[171] Quinn Emanuel

[166] *Garrison v. Sullivan & Cromwell, LLP*, No. 24-cv-20630 (S.D. Fla.) (KMM), Dkt. No. 1 at ¶ 176; Dkt. No. 530 at ¶ 16.

[167] Dkt. No. 510 at ¶ 52.

[168] *Garrison v. Sullivan & Cromwell, LLP*, No. 24-cv-20630 (S.D. Fla.) (KMM), Dkt. No. 1 at ¶ 198 ("This was, therefore, no simple transaction, and despite S&C's expertise and advice to Bankman-Fried on the transaction, the purchase was not arranged through sophisticated financial institutions but rather over the course of 29 separate trading days over a period of two months via Emergent.").

[169] *Id*. at ¶ 201 ("S&C represented at the same time both Emergent, the special purpose vehicle used to accomplish the share purchase (such that S&C knew how the shares were purchased and with what funds) and also Bankman-Fried who purchased the Robinhood shares.").

[170] This was confirmed to the Examiner during his meeting with Quinn Emanuel on April 1, 2024.

[171] Quinn Emanuel, *Memorandum re: Interview of Mitch Eitel*, July 28, 2023, at 3.

asked Eitel about an email chain in which Miller discussed various options for structuring a transaction to ensure that Alameda (which initially held some of the Robinhood Shares) would not be identified on the SEC 13D form. Indeed, Miller explicitly told S&C that "[w]e have a desire not to identify Alameda."[172] In his interview, Eitel explained to Quinn Emanuel that, in the private equity and hedge fund space, it is not unusual for companies to want to remain anonymous and, therefore, Miller's request did not seem aberrant.

Beyond this brief exchange in the Eitel interview, no investigation appears to have been done into the Robinhood Transaction and, in particular, there has been no larger review of S&C's role in the transaction. As a result, there are no findings regarding the extent to which, if at all, S&C (1) advised on the transaction itself, (2) had access to and received inside information regarding the transaction (or the FTX Group more generally), or (3) simultaneously advised Emergent and Bankman-Fried. While Quinn Emanuel did not otherwise find any evidence that S&C advised on, possessed knowledge of, or was made aware of facts relating to the FTX Group's misappropriation of customer funds, Quinn Emanuel's investigation did not include a full analysis of the Robinhood Transaction.

In fact, only S&C itself appears to have looked further into the Robinhood Transaction postpetition. S&C conducted this inquiry as part of its efforts to recover the Robinhood Shares for the benefit of the bankruptcy estates, as the stock represented one of the estates' largest monetizable assets.

Given that no prior investigation has been conducted into the Robinhood Transaction, the Examiner recommends an investigation into the details of this transaction to confirm that there were no conflicts of interest on account of S&C's work (see *infra,* at Section VIII).

[172] Email from R. Miller to J. Hearn, Apr. 20, 2022, Quinn Emanuel Interview Documents, F10705-E016516334.

b. LedgerX Transaction

Debtor Ledger Holdings, Inc. ("LHI") was a holding company for non-debtor LedgerX, which operated a CFTC-regulated Bitcoin options exchange and clearing house.[173] In October 2021, WRS purchased LedgerX through the acquisition of LHI's shares for approximately $300 million.[174] As noted above, the Supplemental Dietderich Declaration discloses that S&C represented WRS in this transaction.

In December 2022, the Debtors commenced a sale process for the LedgerX business.[175] In January 2023, the Debtors received six non-binding indications of interest for the purchase of LHI's interests in LedgerX, or portions thereof, ranging from $500,000 to $90 million.[176] In March 2023, two final bids were received.[177] The Debtors received a $35 million bid from M 7 Holdings, LLC ("M 7 Holdings"), a wholly-owned subsidiary of Miami International Holdings, Inc. ("MIAX"), and a $14 million bid from another bidder.[178] Notably, MIAX was a major shareholder of LHI up until the WRS acquisition.[179] In addition, various directors and officers of MIAX also served on the board of LHI until the time of the WRS acquisition.[180]

In May 2023, LHI was sold to M 7 Holdings in a deal that provided approximately $50 million in proceeds to the Debtors.[181] The sale agreement was (1) approved by the Debtors'

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[173] Dkt. No. 233 at ¶ 3.

[174] *Id.*; 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, *archived at* https://perma.cc/832F-96Q5.

[175] Dkt. No. 233.

[176] *See* Dkt. No. 1344 at ¶ 13; S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 104.

[177] *See* Dkt. No. 1344 at ¶ 14.

[178] *See id*. at ¶ 14; Dkt. No. 1342, at 2; S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 104.

[179] *See* Dkt. No. 1342, at 2.

[180] *See id.*

[181] *See* Dkt. No. 4862, at 26.

board, (2) subject to review and objection by parties in interest (with no objections received), and (3) approved by the Court. In order to obtain Court approval, the Debtors presented evidence that the sale transaction was the "highest or otherwise best bid," and because no one objected to the proposed sale this evidence was uncontested.[182] It is outside the scope of the Examiner's mandate to evaluate the appropriateness of this sale transaction. However, the Debtors' inability to obtain a sale price anywhere near the price that WRS paid for the assets less than two years earlier suggests that WRS overpaid for LHI in October 2021. As such, the prepetition transaction, which S&C advised on, could be the subject of an avoidance action. In fact, S&C appears, at least preliminarily, to have concluded as much because, in April 2023, it drafted a clawback complaint against the former shareholders of LHI that sold their interests to WRS.

The Court specifically contemplated the possibility that one or more of the transactions that S&C advised the Debtors on prepetition could become the subject of a postpetition investigation. The Court held that, if "any investigation would be required of those transactions with which Sullivan & Cromwell might have been involved . . . debtors have retained conflict counsel to conduct *any investigation* that might touch on those issues."[183] Thus, the Court approved S&C's retention on the basis that, if a postpetition investigation were required into any transaction that S&C was involved in, conflicts counsel would be retained for that work.[184] As a result, no later than when S&C determined that there might a potential clawback action, the investigation into WRS' prepetition purchase of LHI should have been handed over to Quinn Emanuel as conflicts counsel. Quinn Emanuel attorneys have confirmed that they were not involved in any such investigation.

[182] Dkt. No. 1344 at ¶ 17.

[183] Transcript at 48:19-24, Dkt. No. 558 (emphasis added).

[184] *Id*. at 48:18-25.

That being said, while S&C failed to turn over the investigative work related to WRS' prepetition purchase of LHI to Quinn Emanuel, it is unclear whether that has had any impact whatsoever on the estates. The May 2023 sale agreement between the Debtors, M 7 Holdings, and MIAX included the sale of the Debtors' claims against former shareholders of LHI associated with M 7 Holdings, including MIAX.[185] Therefore, the sale agreement essentially released those former LHI shareholders and reduced the amount of funds that could be recovered in any clawback claim.[186] Importantly, M 7 Holdings would not have agreed to purchase LedgerX absent the purchase of these claims.[187] Therefore, while it appears that S&C should have handed over this work to Quinn Emanuel, many of the claims that might have been pursued in an avoidance action were released, and the sale of claims was ultimately beneficial for the estates because, as was noted in the sale hearing, without it, the Debtors could not have consummated this sale of LedgerX.

Regarding the releases, it has also been asserted that the LedgerX sale included a release of any legal malpractice claims that LedgerX may have had against S&C, which would include any claims derived from what S&C allegedly knew about the fraud at the FTX Group.[188] The basis for this argument is that the sale released "directors, officers, employees, [and] agents" of

[185] *See* Dkt. No. 1342-1 § 5.3(a). As noted above, all parties had notice and opportunity to object to these releases, but no objections were filed. Notably, MIAX would not have entered into the purchase agreement absent the purchase of these claims. *See* Dkt. No. 1344 at ¶ 26; Transcript at 7:16-22, Dkt. No. 1436.

[186] Dkt. No. 1344 at ¶ 17 (describing the scope of the claims purchased and noting that it covers former shareholders that collectively received approximately 37% of the proceeds of WRS' acquisition).

[187] Transcript at 7:16-22, Dkt. No. 1436.

[188] Jonathan C. Lipson & David A. Skeel, *FTX'd: Conflicting Public and Private Interests in Chapter 11* (Mar. 13, 2024), U of Penn, Inst. for Law & Econ Research Paper No. 24-08, at 57, https://ssrn.com/abstract=4760736, *archived at* https://perma.cc/CGQ6-CUY5.

LedgerX, and S&C could be considered an "agent" of LedgerX.[189] However, it is not obvious that the term "agent" is meant to include a law firm or any other professional, because the rest of the phrase refers to directors, officers and employees. Furthermore, S&C was not acting as LedgerX's counsel in either the prepetition or postpetition sale transaction. Prepetition, S&C represented WRS. Postpetition, S&C represents the Debtors, but LedgerX is not a Debtor, and the sale transaction was a sale of debtor LHI's equity interests rather than a sale of non-debtor LedgerX's assets. Notably, in a meeting with the Examiner, S&C represented that it does not view itself as an "agent" that was released by this language. The Examiner expects that S&C would stand by this stated position.

Nonetheless, as noted above, the Examiner believes that S&C should have turned over to Quinn Emanuel, as conflicts counsel, the postpetition investigation into WRS' prepetition acquisition of LedgerX. Accordingly, the Examiner is recommending a further investigation. Specifically, the Examiner notes that not all claims against LHI's former shareholders were sold in the postpetition transaction.[190] The Debtors did retain the right to pursue claims against other former shareholders (i.e., those that are not associated with M 7 Holdings), and any investigation into these claims should not be conducted by S&C. Instead, the Examiner recommends he conduct an investigation into the potential claims against the non-released shareholders. This investigation will determine if there are any claims, including any avoidance action claims,

[189] *Id.*; Dkt. No. 1433 at ¶ S (defining "Released Parties" to include "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)").

[190] *See* Dkt. No. 1343 at ¶ 8 ("[T]he substantial majority of the potential causes of [action] held by the Debtors in relation to the LedgerX Business, including in connection with the acquisition of Seller by West Realm Shires Inc., will be preserved by the Debtors."); Dkt. No. 1344 at ¶ 17 (describing the scope of the claims purchased and noting that it covers former shareholders that collectively received approximately 37% of the proceeds of WRS' acquisition).

against the non-released shareholders. This investigation may also provide additional insight into how the LedgerX transactions unfolded (*see infra,* at Section VI).

c. BlockFi

As noted above, the Supplemental Dietderich Declaration discloses that S&C represented BlockFi in a regulatory matter, and that the representation resulted in the BlockFi SEC Settlement.[191] Although the Court was aware of this representation at the time of S&C's retention, and the representation was by then substantially complete, questions have been raised regarding this representation.[192]

For instance, the Friedberg Declaration, which the Court appropriately did not consider when ruling on the S&C Employment Application, makes allegations regarding the BlockFi representation. Specifically, Friedberg contends that an entity in the "Alameda Group" loaned $200 million to BlockFi with an option to purchase BlockFi.[193] Friedberg also alleges that, before the Petition Date, S&C provided "Alameda advice with respect to diligence on whether the option should be exercised."[194] In connection with this representation, Friedberg accused S&C of failing to advise the Alameda Group that no exemption under the Securities Act of 1933 could apply to Alameda's exercise of the purchase option.[195] Friedberg also claimed that, if S&C had advised Alameda on this issue, then Alameda "would not have entered into the loan agreement with BlockFi in the first place."[196]

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[191] Dkt. No. 510 at ¶ 76.

[192] *See, e.g., Garrison v. Sullivan & Cromwell, LLP*, No. 24-cv-20630 (S.D. Fla.) (KMM), Dkt. No. 1 at ¶¶ 11-16.

[193] Dkt. No. 530 at ¶ 57.

[194] *Id.* at ¶ 58

[195] *Id.* at ¶¶ 58-63.

[196] *Id.* at ¶ 63.

On its face, this argument is questionable because Friedberg never asserted that S&C advised Alameda on the underlying loan agreement, but rather only on the exercise of the purchase option. And Friedberg's allegations appear to be factually incorrect in several respects. Significantly, Quinn Emanuel's investigation confirmed that S&C did not represent either BlockFi or the FTX Group in connection with the loan agreement or the related purchase option.[197] In connection with his investigation, the Examiner has seen an email communication regarding the loan agreement that shows that another sophisticated law firm—not S&C—was representing the FTX Group in connection with that transaction.[198]

However, S&C did discuss the BlockFi SEC Settlement and related regulatory issues with the FTX Group,[199] a fact that does not appear to have been before the Court when it ruled on the S&C Employment Application. That said, because S&C had limited involvement in this transaction, and S&C was not acting as legal counsel to either party to the transaction, this fact likely would not have impacted the Court's ruling on S&C's disinterestedness. Accordingly, the Examiner does not recommend further investigation regarding this representation.

d. Events Leading Up to the Bankruptcy Filings

S&C did a substantial amount of work for the Debtors leading up to the Petition Date. For the reasons discussed above, (*see supra*, at Section II(c)(2)(i)), the work S&C did to prepare the Debtors for bankruptcy did not create an actual conflict of interest so long as the work was

[197] Quinn Report on S&C, at 8.

[198] *See* email from Can Sun to various Blockfi email addresses, attorneys at Davis, Polk & Wardwell LLP, and lawyers at Latham & Watkins LLP, dated June 24, 2022, with the subject line "RE: BlockFI <> FTX – Loan Agreement."

[199] Quinn Report on S&C, at 8.

not improper, illegal, or negligent.[200] However, some observers have alleged such impropriety and argued that (1) S&C hand-picked Ray as CEO to lead the Debtors' restructuring efforts because he is loyal to S&C, (2) S&C pressured Bankman-Fried to resign from his position at the company, (3) S&C induced Bankman-Fried to resign by lying to him, (4) Miller inappropriately pushed for the Debtors to file Chapter 11 in the United States so that S&C could act as counsel, and (5) S&C erred in deciding to include FTX.US but to exclude LedgerX from the Chapter 11 filings.[201] None of these allegations, to the extent they have any validity, were before the Court when it ruled on the S&C Employment Application.

Regarding Ray's appointment, on November 11, 2022, Bankman-Fried signed the Omnibus Authority pursuant to which Ray was appointed CEO. S&C had recommended Ray, someone who does have a professional relationship with an attorney at S&C.[202] But that fact did not create an actual conflict of interest.[203] The Examiner has seen no evidence that the relationship between Ray and that S&C attorney (1) reflects anything more than a history of professional engagements, or (2) was not fully disclosed to the Court. However, as noted above, Ray was initially proposed to serve as the Debtors' CRO. It is not clear why Ray was appointed CEO instead of CRO as originally planned, and it is not apparent who made that decision or why. Ray confirmed that he was not involved in these negotiations or the decision to appoint

[200] *See In re Hall*, 520 B.R. at 121 (citing *In re Watson*, 94 B.R. at 114); *In re Creative Rest. Mgmt., Inc*., 139 B.R. at 918; *see also, e.g.*, *In re Am. Int'l Refinery, Inc.*, 676 F.3d at 465; *In re Caesars Ent. Operating Co., Inc.*, 561 B.R. at 433.

[201] *Vara v. FTX Trading (In re FTX Trading)*, No. 23- 2297 (3d Cir.), Dkt. No. 27, at 28-29; Jonathan C. Lipson & David A. Skeel, *FTX'd: Conflicting Public and Private Interests in Chapter 11* (Mar. 13, 2024), U of Penn, Inst. for Law & Econ Research Paper No. 24-08, https://ssrn.com/abstract=4760736, *archived at* https://perma.cc/CGQ6-CUY5; *Garrison v. Sullivan & Cromwell, LLP*, No. 24-cv-20630 (S.D. Fla.) (KMM), Dkt. No. 1, at ¶ 32; Dkt. No. 530 at ¶¶ 33-37, 64.

[202] Dkt. No. 510 at ¶ 68.

[203] *In re eToys, Inc.*, 331 B.R. at 195.

him CEO instead of CRO. When the Examiner asked S&C attorneys about this decision, the S&C lawyers pointed to Bankman-Fried's inexperience with corporate restructurings, which is the reason why CROs are usually appointed. Nonetheless, as noted above, Bankman-Fried signed the Omnibus Authority and, in consultation with his counsel, chose to appoint Ray CEO.

In addition, S&C was not representing Bankman-Fried in the days leading up to the Petition Date. Bankman-Fried had retained other sophisticated counsel to represent him in his individual capacity.[204] Bankman-Fried's personal attorneys were involved in the drafting of the Omnibus Authority, were able to advise Bankman-Fried on the terms of the Omnibus Authority, and could explain to him the consequences of signing it. Although the Examiner has reviewed emails between S&C and Bankman-Fried where Bankman-Fried's personal counsel was not included, these appear to be typical communications between a lawyer and a corporate client's principal where the lawyer provides advice to the corporate client. In particular, these emails did not relate to the Omnibus Authority and do not appear to have pressured Bankman-Fried in any way to either resign from his position as CEO or commence the bankruptcy cases.[205] The Examiner has seen no evidence that S&C acted improperly in connection with Bankman-Fried's execution of the Omnibus Authority.

To the extent S&C advised the Debtors to file for bankruptcy in the United States, this advice appears sound. The United States has a well-developed Bankruptcy Code and system.

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[204] Dkt. No. 510 at ¶ 19; Jonathan C. Lipson & David A. Skeel, *FTX'd: Conflicting Public and Private Interests in Chapter 11* (Mar. 13, 2024), U of Penn, Inst. for Law & Econ Research Paper No. 24-08, at 29, 31, 32 (providing screenshots of emails that include Bankman-Fried's personal attorneys), https://ssrn.com/abstract=4760736, *archived at* https://perma.cc/CGQ6-CUY5.

[205] *See, e.g.*, Jonathan C. Lipson & David A. Skeel, *FTX'd: Conflicting Public and Private Interests in Chapter 11* (Mar. 13, 2024). U of Penn, Inst. for Law & Econ Research Paper No. 24-08, at 29, 31, 32 (providing four screenshots of emails from S&C attorneys to Bankman-Fried), https://ssrn.com/abstract=4760736, *archived at* https://perma.cc/CGQ6-CUY5.

For many reasons, corporations often prefer to file for bankruptcy relief in the United States.[206] To cite just one example, the Bankruptcy Code places an automatic and immediate worldwide moratorium on adverse creditor actions against debtors.[207] Many jurisdictions, including the Bahamas, do not offer debtors the same degree of protection.[208] Of course, there are times when filing for bankruptcy in the United States might not be feasible or advisable. But the Examiner has seen nothing to suggest that it would have been prudent for the Debtors to avoid filing these bankruptcy cases in the United States.

Finally, S&C has been criticized for excluding LedgerX from the bankruptcy filing and also for including LedgerX's parent company, FTX.US,[209] in the filing.[210] More specifically, S&C has been accused of (1) leaving LedgerX out of the bankruptcy filing in order to obtain a larger retainer, and (2) including FTX.US in the filing for the same reason.[211] In the first instance, S&C did not make any final decisions as to which entities would file for bankruptcy. While S&C provided advice, Ray and the directors made the final decision. Nonetheless, in light of these assertions, the Examiner has tried to reconstruct what was known when S&C was

[206] Steven Church & Jeremy Hill, *Bankruptcy-Friendly U.S. Extends Lead as Haven of Foreign Filers*, Bloomberg, (July 21, 2021), https://www.bloomberg.com/news/articles/2021-07-21/bankruptcy-friendly-u-s-extends-lead-as-haven-of-foreign-filers?embedded-checkout=true, *archived at* https://perma.cc/H8KG-SQEA (discussing major filings of foreign corporations and noting that it is commonly agreed that America has company-friendly bankruptcy rules).

[207] *See* 11 U.S.C. §362.

[208] *See* Companies (Winding Up Amendment) Act, § 192, 2011 (Act No. 53/2011) (Bah.), Official Gazette of the Bahamas, Section 192 (requiring parties to file a motion to stay proceedings).

[209] As noted elsewhere, the Examiner has seen both WRS and WRSS referred to as "FTX.US."

[210] Dkt. No. 530 at ¶¶ 33-37 (stating that Ryne Miller insisted on filing in the United States so that S&C could do the work but that FTX.US should not have been included in the bankruptcy filing).

[211] *Garrison v. Sullivan & Cromwell, LLP*, No. 24-cv-20630 (S. D. Fla.) (KMM), Dkt. No. 1 at ¶¶ 9, 33 (alleging that funds were moved to LedgerX in order to secure receipt of a retainer to S&C); Dkt. No. 530 at ¶ 36 (stating that FTX.US was included in the bankruptcy because it had the cash to pay S&C its retainer).

preparing the bankruptcy filings to determine if there was a sound basis for the advice to exclude LedgerX and to include FTX.US in the bankruptcy cases.

At the time of filing, Ray believed that LedgerX was solvent and a noteworthy exception to the Debtors' general lack of corporate controls.[212] As for FTX.US, the Examiner has seen evidence that, before the Petition Date, the Debtors' employees could not produce a reliable account of FTX.US' assets or customer balances, that certain employees believed there was a significant "hole" in the FTX.US balance sheet, and that those financial discrepancies were reported to regulators.[213] The Examiner has seen no evidence that calls into question the decision to leave LedgerX out of the bankruptcy filings but to include FTX.US.

e. Representations to Regulatory Authorities

The Supplemental Dietderich Declaration discloses that S&C had advised the Debtors prepetition on responses to certain information requests from U.S. regulatory authorities, including the CFTC.[214] But the Additional S&C Materials contain allegations that S&C made misrepresentations in these submissions and, moreover, that in working on the responses S&C became aware of the fraud at the FTX Group. For example, S&C advised LedgerX concerning a submission LedgerX made to the CFTC, stating that Alameda "has no . . . special or unique

[212] *See* The First Interim Report of John J. Ray III to the Independent Directors on Control Failures at the FTX Exchanges ("First Ray Report"), Dkt. No. 1242-1, at 11 (noting that LedgerX was an isolated exception to the Debtors' overall lack of independent or experienced finance, accounting, human resources, information security or cybersecurity personnel or leadership); Dkt. No. 24 ("Ray First Day Declaration"), at ¶ 13 ("Based on the information that I have reviewed at this time, LedgerX is solvent.").

[213] S&C, *Memorandum re: Interview of Ryne Miller*, Nov. 17, 2022 ("Miller Interview Memo") (discussing realization that there might be a hole in the FTX.US balance sheet); S&C, *12.9.2022: Tim Wilson Interview Notes*, Dec. 9, 2022, at 12-13 (recounting conversation with Bankman-Fried regarding $45 million hole in FTX.US balance sheet identified by other employees); S&C, *12.8.2022 Adrienne During Interview Notes*, Dec. 8, 2022 (the "During Interview Notes"), at 7-8 (recounting discussion of a $40 million hole); emails from Ryne Miller to various regulators, Nov. 9, 2022, Quinn Emanuel Interview Documents, F10705-E035453307; *see also infra,* at Part 6, Section V.

[214] Dkt. No. 510 at ¶ 50.

access to the exchange, to exchange data, or to any other feature of the exchange."[215] This statement by LedgerX was ultimately determined to be false, and thus it has been alleged that S&C's work in advising on this submission exposed it to the fraud at the FTX Group.[216] Prior investigations have concluded otherwise.

As previously discussed, Quinn Emanuel thoroughly investigated S&C's prepetition work to determine whether S&C either knew of or was willfully blind to the fraud at the FTX Group. This comprehensive investigation reviewed the legal advice and services S&C provided in connection with information requests from regulatory authorities, including the CFTC.[217] As part of this investigation, Quinn Emanuel analyzed communications and documents where S&C attorneys helped prepare responses to CFTC inquiries for the Debtors.[218] Quinn Emanuel found no evidence to suggest that S&C attorneys knew that any of the Debtors' submissions to regulators contained false or misleading statements. Beyond that, Quinn Emanuel found that S&C was not made aware of any facts that would have revealed to it the fraud at the FTX Group. Quinn Emanuel also asked S&C partners about their regulatory advice, and the latter confirmed that (1) the work they performed did not entail verifying the factual accuracy of statements made by the FTX Group; (2) at the time, they had no reason to question the veracity of the information they received from the Debtors; and (3) they relied upon the accuracy of these representations in rendering their legal advice.[219] From the investigations and source documents reviewed, the

[215] Quinn Emanuel, *FTX Responses to Clearing Policy Questions*, Aug. 16, 2022, F10705-E016384266.

[216] *See e.g.,* Jonathan C. Lipson & David A. Skeel, *FTX'd: Conflicting Public and Private Interests in Chapter 11* (Mar. 13, 2024), U of Penn, Inst. for Law & Econ Research Paper No. 24-08, at 27, https://ssrn.com/abstract=4760736, *archived at* https://perma.cc/CGQ6-CUY5.

[217] Quinn Report on S&C, at 2-3.

[218] *Id*. at 3, 6.

[219] *Id*.

Examiner has seen no evidence to suggest that S&C knew about the fraud at the FTX Group prepetition or that S&C ignored red flags that would have required the firm to investigate statements made by the Debtors.

Because neither Quinn Emanuel nor the Examiner have found any evidence that S&C knew that the FTX Group's representations to authorities were false, the disclosures contained in the Supplemental Dietderich Declaration were sufficient for the Court to rule on S&C's disinterestedness. This is so even though the Court may not have known that S&C helped prepare client statements to regulatory authorities that, unbeknownst to S&C, were false.[220] Accordingly, the Examiner is not recommending any further investigation into S&C's representation of the Debtors in connection with information requests from regulatory authorities.

f. Representations to Voyager Digital's Counsel

It is undeniable that the Debtors' descent into bankruptcy happened rapidly. As disclosed in the Supplemental Dietderich Declaration, in July 2022, S&C advised the Debtors on their contemplated purchase of the assets of Voyager Digital—a company operating a cryptocurrency trading platform—in connection with Voyager Digital's bankruptcy filing. On September 26, 2022, Voyager Digital announced that WRS had won a hard-fought auction to purchase all of Voyager Digital's assets.[221] An asset purchase agreement was executed the next day, and on

[220] ABA Model Rule of Professional Conduct 4.1 (truthfulness) provides that "[i]n the course of representing a client, a lawyer shall not knowingly make a false statement of material fact or law to a third person." ABA Model R. Prof'l Conduct 4.1, https://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_4_1_truthfulness_in_statements_to_others/, *archived at* https://perma.cc/MDW7-UGHP. The Model Rules have been adopted by most states, including Delaware and New York. *See* Del. Lawyers' R. Prof'l Conduct 4.1; N.Y. Lawyers' R. Prof'l Conduct 4.1 (emphasis added). The commentary to Rule 4.1 notes that "[a] misrepresentation can occur if the lawyer incorporates or affirms a statement of another person that the lawyer *knows is false*." *See* Comments to Del. Lawyers' R. Prof'l Conduct 4.1 (emphasis added).

[221] *See In re Voyager Digital Holdings, Inc.*, No. 22-bk-10943 (Bankr. S.D.N.Y.) (MEW), Dkt. No. 457.

October 20, 2022, the sale was approved by court order in Voyager Digital's bankruptcy case.[222] As the winning bidder, the FTX Group was considered financially sound at this time.

But less than two weeks later, on November 2, 2022, a Coindesk article revealed Alameda's significant holdings of FTT, the exchange token for the FTX exchange.[223] On November 6, 2022, Changpeng Zhao ("CZ"), the founder of cryptocurrency exchange Binance Holdings Ltd. (together with its affiliates, "Binance"), announced that Binance would be liquidating its sizeable FTT holdings, which caused a rapid sell off of FTT.[224] Early the next day, Bankman-Fried tweeted reassuringly that "FTX is fine," while Dietderich assured Voyager Digital's counsel via email that questions being raised about the FTX Group's liquidity was just "Binance silliness" because the FTX Group was "rock solid."[225] However, later that same day, the FTX Group was trying to obtain emergency funding.

The email sent by Dietderich to Voyager Digital's counsel on the morning of November 7 has garnered a lot of public attention. Significantly, however, Dietderich states in his Supplemental Declaration that he did not learn about the FTX Group's financial problems until

[222] *See id.* at 581.

[223] 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/, *archived at* https://perma.cc/8AQ4-RMXJ.

[224] CZ BNB (@cz_binance), X (formerly Twitter) (Nov. 6, 2022), https://twitter.com/cz_binance/status/1589283421704290306?lang=en, *archived at* https://perma.cc/68PH-SE3P ("As part of Binance's exit from FTX equity last year, Binance received roughly $2.1 billion USD equivalent in cash (BUSD and FTT). Due to recent revelations that have come to light, we have decided to liquidate any remaining FTT on our books."). Binance has since been sued for its part in the Debtors' collapse. *See Lahav v. Binance Holdings Ltd*, No. 23-cv-05038 (N.D. Cal.) (TLT), Dkt. No. 1.

[225] *See* email from A. Dietderich to D. Azman, dated Nov. 7, 2022, Quinn Emanuel Interview Documents, F10705-E005618689; Jody Godoy, *'FTX is fine' - tweets Sam Bankman-Fried may regret on the stand*, Reuters (Oct. 26, 2023), https://www.reuters.com/world/us/ftx-is-fine-tweets-sam-bankman-fried-may-regret-stand-2023-10-26/, *archived at* https://perma.cc/PWR5-QN9N.

the morning of November 8—a day after sending his email to Voyager Digital's counsel.[226] The Examiner has reviewed no evidence to the contrary.

When asked about his November 7 "rock solid" email in an interview conducted by Quinn Emanuel, Dietderich stated that, after the Voyager Digital auction closed, there was concern that Binance and CZ were putting out negative press statements in order to derail the FTX Group's purchase of Voyager Digital's assets.[227] Dietderich's statement appears to be supported by the fact that (1) Binance was also a bidder in the Voyager Digital auction,[228] and (2) Binance and the FTX Group were not only competitors in the crypto market, but their respective founders had a well-documented, contentious relationship.[229] For these reasons, the Examiner is not recommending that he conduct any further investigation into Dietderich's representations to Voyager Digital's counsel.

VI. Recommendations for Additional Investigations

In sum, following a detailed review of the Quinn Emanuel investigation and the Additional S&C Materials, the Examiner believes that further inquiry is warranted regarding two aspects of the allegations surrounding S&C's potential conflicts as Debtors' counsel.

The Examiner recommends that he be authorized to conduct an investigation into S&C's representation of Bankman-Fried in connection with his purchase of the Robinhood Shares. The investigation would focus on (1) the contours of that representation, and (2) what, if anything, S&C knew or should have known about the FTX Group's fraud based on that representation.

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[226] Dkt. No. 510 at ¶ 10.

[227] Quinn Emanuel, *Memorandum re: Interview of Andrew Dietderich*, July 27, 2023, at 5.

[228] *Id*.

[229] *See e.g.*, David Yaffe-Bellany, *How Sam Bankman-Fried's Crypto Empire Collapsed*, N.Y. Times (Nov. 14, 2022), https://www.nytimes.com/2022/11/14/technology/ftx-sam-bankman-fried-crypto-bankruptcy.html, *archived at* https://perma.cc/U5KV-YRCP (describing CZ as Bankman-Fried's "biggest rival").

Dietderich has stated that S&C's representation in connection with the Robinhood Transaction was limited to advising on Hart-Scott-Rodino compliance and public reporting obligations.[230] On the other hand, there are allegations in the Additional S&C Materials that S&C (1) advised on the structuring of the Robinhood Transaction itself; (2) had access to and received inside information regarding the transaction as a result of its representation; and (3) advised Emergent in connection with that transaction. (*See supra*, at Section V(a)). Further investigation into this transaction would be important to help determine whether there was a potentially disqualifying conflict that the Court should have been aware of when ruling on S&C's retention application. In addition, the investigation would discern more generally if S&C advised on, possessed knowledge of, or had been made aware of critical facts relating to the FTX Group's misconduct as a consequence of this representation. (*See infra*, at Part 8).

The Examiner also recommends that an investigation be conducted into the Debtors' potential claims against the former shareholders of LHI that sold their interests to WRS prepetition to the extent those claims were not released in the postpetition transaction. This investigation would determine whether an avoidance action is warranted with respect to these shareholders, which would be beneficial for the estates. Such an investigation would also be in the interest of the public and the Court as, in carrying out the investigation, the Examiner would gain additional insight into and report on how these transactions unfolded. (*See supra*, at Section V(b); *see also infra*, at Part 8).

[230] Dkt. No. 510 at ¶ 52.

PART 3: FRAUD BY CURRENT AND FORMER EMPLOYEES OF THE DEBTORS

As described in the Second Ray Report, "from the inception of the FTX.com exchange, the FTX Group commingled customer deposits and corporate funds, and misused them with abandon."[231] In its Scope Order, the Bankruptcy Court directed the Examiner to inquire into "whether the Investigations adequately addressed fraud by the Debtors' employees and whether employees involved in such fraud are still working for the Debtors."[232] This portion of the Examiner's Report answers these questions. For the reasons set forth below, the Examiner has determined that the completed and ongoing investigations by the Debtors, the Debtors' counsel, and government agencies into whether the Debtors' former and current employees were involved in fraud have been robust, thorough, and competently conducted. The Examiner does not believe that any further investigation into current or former employees by the Examiner is warranted at this time.

I. Overview of Investigative Work

As discussed further below, several government agencies—including the USAO-SDNY—investigated the fraud perpetrated by individuals affiliated with the FTX Group. These government investigations have principally focused on the fraudulent conduct of Bankman-Fried and other executives, including co-conspirators Ellison, Singh, and Wang, perpetrated on FTX Group customers, investors, and lenders. Ellison served as co-CEO and then sole CEO of Alameda, Singh served as Head of Engineering at FTX.com, and Wang co-founded FTX.com and Alameda and served as Chief Technical Officer of FTX.com. On November 2, 2023, following a month-long jury trial, Bankman-Fried was convicted of wire fraud and conspiracy to

[231] *See* The Second Interim Report of John J. Ray III to the Independent Directors: The Commingling and Misuse of Customer Deposits at FTX.com ("Second Ray Report"), Dkt. No. 1704-1, at 5.

[232] *See* Scope Order at ¶ 3(b).

commit wire fraud on FTX.com's customers; wire fraud and conspiracy to commit wire fraud on Alameda's lenders; conspiracy to commit securities fraud; conspiracy to commit commodities fraud; and conspiracy to commit money laundering.[233] Bankman-Fried was sentenced on March 28, 2024, to 25 years' imprisonment.[234]

Pursuant to cooperation agreements, Wang, Singh, and Ellison pleaded guilty to various crimes, including wire fraud and conspiracy to commit the same, conspiracy to commit commodities fraud, and conspiracy to commit securities fraud.[235] Ellison and Singh also pleaded guilty to conspiracy to commit money laundering, and Singh pleaded guilty to conspiracy to make unlawful political contributions and to defraud the Federal Election Commission ("FEC").[236] All three testified as cooperating witnesses at Bankman-Fried's trial.[237] Another former senior FTX Group executive, Ryan Salame, separately pleaded guilty to conspiracy to make unlawful political contributions and to defraud the FEC, and conspiracy to operate an unlicensed money transmitting business.[238] All four are awaiting sentencing.

Additionally, and as discussed further below, the Debtors' counsel extensively investigated the fraudulent activities of the FTX Group executives, particularly Bankman-Fried and his co-conspirators. The Debtors' counsel also thoroughly investigated the possible involvement of other former and current employees in fraudulent conduct at the FTX Group.

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[233] *See* Transcript at 3252:3-24, SBF Criminal Case, Dkt. No. 384; *see also* Press Release, U.S. Dep't of Just., *Statement of U.S. Attorney Damian Williams on the Conviction of Samuel Bankman-Fried*, U.S. Dep't of Just. (Nov. 2, 2023), https://www.justice.gov/usao-sdny/pr/statement-us-attorney-damian-williams-conviction-samuel-bankman-fried, *archived at* https://perma.cc/YL6Z-HEG3.

[234] *See* SBF Criminal Case, Dkt. No. 424.

[235] *See* SBF Criminal Case, Dkt. Nos. 6-9, 19, 21.

[236] *See* SBF Criminal Case, Dkt. Nos. 8-9, 19, 90-91, 102.

[237] *See* SBF Criminal Case, Dkt. Nos. 352, 356, 358, 360, 362, 366, 368.

[238] *See* SBF Criminal Case, Dkt. Nos. 262, 265, 283.

They were assisted in these efforts by several outside investigatory and advisory firms, including Nardello & Co. ("Nardello") and Alvarez & Marsal Holdings, LLC ("Alvarez & Marsal").

Investigative efforts included the following steps, among others. The Debtors' counsel reviewed millions of pages of documents collected from the FTX Group.[239] They comprehensively reviewed these documents to assess whether other FTX Group employees were involved in the core fraudulent conduct at the FTX Group. The Debtors' counsel also conducted numerous interviews with FTX Group employees, including in-house legal and compliance employees and members of the FTX Group's senior management.[240] With limited exceptions for limited purposes, the Debtors' counsel did not speak with Wang, Singh, or Ellison, all of whom were actively cooperating with the USAO-SDNY at the time of the investigation. The Debtors' counsel likewise did not speak with Bankman-Fried, who was under indictment during their investigations. In addition, the Debtors' counsel served Bankruptcy Rule 2004 requests on certain individuals.[241]

The Debtors, with assistance from S&C, responded to more than 400 requests for documents and information from the USAO-SDNY, and, on behalf of the Debtors, S&C produced almost 4.5 million pages of documents and the Amazon Web Services FTX Group database to the USAO-SDNY.[242] The Debtors' counsel also responded to over 300 requests

[239] *See, e.g.*, S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 10.

[240] *See* S&C, *FTX Trading Ltd. / Chapter 11 Interview Memos & Notes*; Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 46. The Debtors' counsel sought to interview other employees throughout their investigations, but some declined to cooperate and others were unavailable for interviews due to resource or other constraints.

[241] *See, e.g.*, S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 112, 192.

[242] *Id.* at 10.

from other federal government and law enforcement agencies, as well as over 100 requests from state and local government and law enforcement agencies.[243]

As noted, the Examiner believes that the investigations by the Debtors, the Debtors' counsel, and the government were comprehensive, thorough, and competently conducted. The Debtors' and the Debtors' counsel's investigative work led to the prompt resolution of criminal charges against the FTX Group executives and the filing of numerous avoidance actions.

II. Identification of Former and Current Employees of the FTX Group

The Debtors' investigation into current and former FTX Group employees required, as a threshold matter, an effort to compile a comprehensive list of FTX Group employees before and after the Petition Date. That is because, as described in the First Ray Report, the FTX Group lacked a current and complete list of employees at the time of the bankruptcy filing.[244] Further complicating matters, FTX Group employees resigned informally, including orally and over Signal.[245]

To understand who had departed and who remained at the companies, the Debtors' legal and human resources employees attempted to create a list of employees and their roles and contact information.[246] Additionally, the Debtors' human resources personnel emailed employees in the period immediately following the Petition Date to gather names, work statuses, locations, job titles, supervisor names, and other related information.[247] The Debtors now maintain a list of current Debtor employees.[248] S&C provided that list of employees to the

[243] *Id.* at 35.

[244] *See* First Ray Report, at 13.

[245] *See* S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 5.

[246] *See id.*

[247] *See* Email from the Debtors verifying employment status, Dec. 1, 2022, F10705-E005808688.

[248] *See* Spreadsheet of the Debtors' employees, Mar. 1, 2024.

Examiner, as well as a list of FTX Group employees' statuses as of November 2022 generated by an attorney employed by FTX.US, a spreadsheet showing FTX.US employees as of November 13, 2022, and employee compensation information for 2021 and the first half of 2022.[249]

III. Investigations into Former Employees

a. Samuel Bankman-Fried, Caroline Ellison, Nishad Singh, and Gary Wang

1. USAO-SDNY

Soon after the collapse of the FTX Group and its related bankruptcy filing, the USAO-SDNY brought charges against the FTX Group's executives. Bankman-Fried was first indicted by the USAO-SDNY on December 9, 2022.[250] On December 19, 2022, Wang and Ellison pleaded guilty pursuant to cooperation agreements, and on February 28, 2023, Singh pleaded guilty pursuant to a cooperation agreement.[251] Each testified at the trial of Bankman-Fried in October and November 2023, at which Bankman-Fried was convicted of all counts.[252]

The trial against Bankman-Fried principally focused on his fraud on FTX.com's customers and investors and Alameda's lenders.[253] With regard to FTX.com customers, the evidence established that contrary to Bankman-Fried's and the FTX Group's public representations that customer funds would not and could not be used by FTX Group entities, Bankman-Fried and certain co-conspirators acting at his direction misappropriated massive amounts of FTX.com customer funds.[254] They accomplished this primarily by directing

[249] *See id*.; Spreadsheet of FTX Group employee status, Nov. 2022, F10705-E015112017; Spreadsheet of FTX.US employees, Nov. 13, 2022; Spreadsheet of FTX Group employee compensation information, 2021-2022, F10705-E000595511.

[250] *See* SBF Criminal Case, Dkt. No. 1.

[251] *See* SBF Criminal Case, Dkt. Nos. 19, 21, 102.

[252] *See* Transcript at 3252:3-24, SBF Criminal Case, Dkt. No. 384.

[253] *See* SBF Criminal Case, Dkt. No. 410, at 8-21.

[254] *See id.* at 8-9.

customers to deposit money into bank accounts controlled by Alameda, which Alameda then withdrew for its use, and by creating special privileges for Alameda in FTX.com's software, which allowed Alameda to maintain a negative balance, gave Alameda a $65 billion line of credit, and exempted Alameda from the automatic liquidation feature.[255] Customer funds were used for, among other things, venture investments, stock repurchases, real estate, political and charitable donations, and loan repayments.[256] With respect to the FTX Group's investors, the evidence proved that Bankman-Fried and certain co-conspirators acting at his direction defrauded them by, among other means, misrepresenting Alameda's privileges on FTX.com and misleading investors about an "insurance fund" for the FTX Group and about the FTX Group's revenue.[257] Moreover, the evidence established that Bankman-Fried, along with certain co-conspirators acting at his behest, defrauded Alameda's lenders, including by sending them a false balance sheet for Alameda.[258] The USAO-SDNY also presented evidence during trial regarding several schemes that were charged in superseding indictments against Bankman-Fried but which were ultimately severed from trial, including payments to Chinese government officials, unlawful political donations, and operation of an unlicensed money transmitting business.[259]

As noted above, Bankman-Fried was sentenced to 25 years' imprisonment. The sentencing court found a loss to investors of $1.7 billion, a loss to Alameda's lenders of $1.3 billion, and a loss to FTX.com's customers of approximately $8 billion.[260]

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[255] *See id.* at 10.

[256] *See id.* at 11-12, 98.

[257] *See id.* at 18-20.

[258] *See id.* at 20-21.

[259] *See* SBF Criminal Case, Dkt. No. 410, at 21-30. The USAO-SDNY subsequently declined to proceed to a second trial on the severed counts, including the charged violation of the Foreign Corrupt Practices Act and the charge of conspiracy to operate an unlicensed money transmitting business. *See* SBF Criminal Case, Dkt. No. 388.

[260] *See* Transcript at 6:3-8, SBF Criminal Case, Dkt. No. 426 ("Bankman-Fried Sentencing Transcript").

2. SEC

Other federal government agencies brought parallel civil cases against the four FTX Group executives as well. The SEC filed civil actions against Bankman-Fried, Ellison, Wang, and Singh for violations of Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.[261] In its complaint against Bankman-Fried, the SEC alleges that he raised at least $1.8 billion from investors, including approximately $1.1 billion from United States-based investors, while misleading investors about the FTX Group's misuse of customer funds, Alameda's privileges on FTX.com, and FTX.com's exposure to Alameda and its illiquid collateral.[262] In its complaints against Ellison, Wang, and Singh, the SEC brings allegations regarding their roles in the investor fraud scheme set forth in Bankman-Fried's complaint.[263] The SEC entered into consent judgments with Ellison, Wang, and Singh.[264] The SEC's case against Bankman-Fried was stayed pending resolution of the parallel criminal proceedings.[265]

3. CFTC

The CFTC also brought civil actions against Bankman-Fried, Ellison, Wang, and Singh for violations of Section 6(c)(1) of the Commodity Exchange Act, 7 U.S.C. § 9(1), and

[261] *See Sec. & Exch. Comm'n v. Bankman-Fried*, No. 22-cv-10501 (S.D.N.Y.) (PKC), Dkt. No. 1; *Sec. & Exch. Comm'n v. Ellison*, No. 22-cv-10794 (S.D.N.Y.) (PKC), Dkt. No. 1; *Sec. & Exch. Comm'n v. Singh*, No. 23-cv-1691 (S.D.N.Y.) (PKC), Dkt. No. 1.

[262] *See Sec. & Exch. Comm'n v. Bankman-Fried*, No. 22-cv-10501 (S.D.N.Y.) (PKC), Dkt. No. 1 at ¶¶ 27-29.

[263] *See Sec. & Exch. Comm'n v. Ellison*, No. 22-cv-10794 (S.D.N.Y.) (PKC), Dkt. No. 1; *Sec. & Exch. Comm'n v. Singh*, No. 23-cv-1691 (S.D.N.Y.) (PKC), Dkt. No. 1.

[264] *Sec. & Exch. Comm'n v. Ellison*, No. 22-cv-10794 (S.D.N.Y.) (PKC), Dkt. Nos. 15-16; *Sec. & Exch. Comm'n v. Singh*, No. 23-cv-1691 (S.D.N.Y.) (PKC), Dkt. No. 7.

[265] *See Sec. & Exch. Comm'n v. Bankman-Fried*, No. 22-cv-10501 (S.D.N.Y.), Dkt. No. 16.

Regulation 180.1(a) thereunder, 17 C.F.R. § 180.1(a).[266] As alleged in the CFTC's complaints, Bankman-Fried, Ellison, Wang, and Singh engaged in fraud in connection with the sale of commodities.[267] The CFTC entered into consent judgments with Ellison, Wang, and Singh.[268] The CFTC's case against Bankman-Fried was stayed pending resolution of the parallel criminal proceedings.[269]

4. Debtors' Investigation

As noted above, the Debtors cooperated extensively with the USAO-SDNY in the government's investigation into FTX Group executives Bankman-Fried, Ellison, Singh, and Wang. The Debtors, with assistance from their counsel and other professionals, also conducted their own investigations to further understand the fraudulent conduct of the executives at the FTX Group and to determine whether avoidance actions could be pursued.

The Debtors' investigation into the FTX Group executives spanned a wide array of misconduct at the FTX Group, including investigations into the core scheme of misappropriation of customer funds as well as other criminal activities. Among other things, S&C investigated several schemes that were presented at Bankman-Fried's criminal trial, such as the use of the North Dimension entities; the backdated payment agent agreement between Alameda and FTX Trading generated to "expla[in] why Alameda held FTX cash for the benefit of [] FTX

[266] *See Commodity Futures Exch. Comm'n v. Bankman-Fried*, No. 22-cv-10503 (S.D.N.Y.), Dkt. Nos. 1, 13; *Commodity Futures Exch. Comm'n v. Singh*, No. 23-cv-1684 (S.D.N.Y.), Dkt. No. 1.

[267] *See Commodity Futures Exch. Comm'n v. Bankman-Fried*, No. 22-cv-10503 (S.D.N.Y.), Dkt. Nos. 1, 13; *Commodity Futures Exch. Comm'n v. Singh*, No. 23-cv-1684 (S.D.N.Y.), Dkt. No. 1.

[268] *See Commodity Futures Exch. Comm'n v. Bankman-Fried*, No. 22-cv-10503 (S.D.N.Y.), Dkt. Nos. 25-26; *Commodity Futures Exch. Comm'n v. Singh*, No. 23-cv-1684 (S.D.N.Y.), Dkt. No. 17.

[269] *See Commodity Futures Exch. Comm'n v. Bankman-Fried*, No. 22-cv-10503 (S.D.N.Y.), Dkt. No. 38.

customers";[270] bribes to Chinese government officials;[271] the FTX Group's operation of an unlicensed money transmitting business; and Alameda's fraudulent balance sheets.[272]

The Debtors have filed an avoidance action against Bankman-Fried, Ellison, Wang, and Singh, bringing 48 claims against the four former FTX Group executives, including for breach of fiduciary duty, fraudulent transfer, waste of corporate assets, and conversion.[273] That case remains pending.[274]

b. Ryan Salame

1. USAO-SDNY

Ryan Salame was the CEO and Chairman of FDM and a close associate of the other FTX Group executives. At trial, Ellison testified that Bankman-Fried "said that he really valued [Salame] for his loyalty."[275]

On September 7, 2023, Salame pleaded guilty to conspiracy to make unlawful political contributions and to defraud the FEC, and conspiracy to operate an unlicensed money transmitting business.[276] Pursuant to his plea agreement, Salame is required to pay restitution to the Debtors of more than $5.59 million, which captures a $5 million withdrawal that Salame made from FTX.com in November 2022.[277] The Debtors and Salame recently agreed that

[270] *See* Second Ray Report, at 24 (alterations and internal quotation marks omitted).

[271] As discussed further below, S&C investigated possible payments to current and former Bahamian government officials as well.

[272] *See* S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 12-19.

[273] *See FTX Trading Ltd. v. Bankman-Fried*, No. 23-ap-50448 (Bankr. D. Del.) (JTD), Dkt. No. 1.

[274] *See FTX Trading Ltd. v. Bankman-Fried*, No. 23-ap-50448 (Bankr. D. Del.) (JTD).

[275] Transcript at 689:22-24, SBF Criminal Case, Dkt. No. 358.

[276] *See* SBF Criminal Case, Dkt. Nos. 262, 265, 283.

[277] *See* Salame Plea Transcript at 16:9-21, SBF Criminal Case, Dkt. No. 283; *see also* S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 109.

Salame will satisfy that restitution by transferring his Bahamian apartment, which was appraised at $5.9 million, "to [FDM], acting by the JOLs, as nominee for the Debtors."[278]

2. Debtors' Investigation

As with the other FTX Group executives, the Debtors investigated Salame's role at the FTX Group and his involvement in misconduct there. Among other things, S&C reviewed Salame's relevant communications, as well as his transfer activity and trading on the FTX exchanges and assets he owned.[279] Through its investigation, S&C found that, among other things, Salame assisted with the creation of the backdated payment agent agreement; made or directed other FTX Group employees to make misrepresentations to banks about the purpose of FTX Group bank accounts; misappropriated FTX Group assets to buy real estate, restaurants, and food service companies, and to make other purchases and investments, including a private jet; and withdrew millions of dollars from his FTX.com account shortly before FTX.com halted customer withdrawals. The Debtors also identified millions of dollars of FTX Group-funded political contributions made by Salame.[280]

In addition, S&C investigated the circumstances surrounding two $50 million loans involving Salame, Alameda, and two other companies, Deltec International Group ("Deltec") and Norton Hall Ltd. ("Norton Hall").[281] The investigation concluded that the loans were intended to ameliorate Deltec's capital issues while ensuring that Deltec would "owe" the FTX Group as a result, and the related promissory notes were structured to conceal Alameda's role in

[278] *See* Dkt. No. 13631 at ¶ 3.

[279] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 109.

[280] A more detailed account of the investigations into the FTX Group's political and charitable contributions is provided below. *See infra*, at Part 6, Sections III and VII.

[281] *See* S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 101.

the loans.[282] The investigation further determined that Salame executed one note as a "director" of Norton Hall, despite not being a director of Norton Hall and despite Norton Hall's director being unaware of the note.[283] Following the investigation, the Debtors reached a settlement regarding the loans, with Deltec agreeing to pay the value of the loan with interest and the remaining obligations extinguished.[284]

The Debtors continue to assess next steps with regard to Salame.

c. Other FTX Group Employees

S&C also investigated whether other employees were involved in the core fraudulent conduct at the FTX Group and the misappropriation of customer assets. In furtherance of that effort, S&C conducted an exhaustive review of communications and documents that included those collected from senior FTX Group executives to identify any lower-level employees who communicated with them and may have been involved in criminal conduct. In addition, S&C conducted a preference review of exchange accounts, including accounts of current and former employees. Moreover, and as described in further detail below, S&C reviewed whether employees who would be retained after the Petition Date may have been implicated in wrongdoing at the FTX Group. Finally, in its work responding to government investigations and its own review of FTX Group materials, S&C identified certain employees for further investigation for a range of potential malfeasance.

As S&C represented to the Examiner and based on the record developed at Bankman-Fried's trial, the Examiner understands that the investigative work performed by the Debtors, their professionals, and various government agencies determined that the core fraudulent conduct

[282] *See Alameda Research LLC v. Friedberg*, No. 23-ap-50419 (Bankr. D. Del.) (JTD), Dkt. No. 32 at ¶ 149.

[283] *See* Dkt. No. 1195 at ¶¶ 5, 10.

[284] *See* Dkt. No. 1267 at ¶¶ 3-4.

at the FTX Group (namely, the commingling and misuse of customer funds) was limited to a small group of FTX Group executives. However, S&C separately identified other employees involved in conduct that formed the basis for contemplated or filed adversary proceedings.

For example, S&C's investigation identified John Samuel Trabucco, the former co-CEO of Alameda, as a possible subject of interest.[285] S&C reviewed Trabucco's communications and other documents and served Bankruptcy Rule 2004 requests on Trabucco.[286] With the assistance of Nardello, Alvarez & Marsal, and AlixPartners, S&C also investigated Trabucco's assets, his activity on the FTX exchanges, and his transactions with the FTX Group.[287] Based on those investigations, S&C and their professionals determined that the FTX Group spent over $15 million for real estate, a yacht, and a marina slip for Trabucco during the preference period and found that Trabucco made substantial withdrawals from the FTX.com exchange in September 2022.[288] The Debtors are continuing to assess next steps with regard to Trabucco.

As another example, S&C identified one former FTX Group director as a possible subject of investigation due to high trading volume on his FTX.com account.[289] S&C also investigated a former FTX Group employee who managed token investments for Alameda and, working with Alvarez & Marsal, uncovered certain sales related to those investments that were not properly documented.[290] S&C also found that this employee made substantial withdrawals from his exchange account close to the Petition Date.[291] And S&C also investigated a former FTX Group

[285] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 112.

[286] *Id.*

[287] *Id.*

[288] *Id.*; *see also* Nardello, *Report Prepared for Sullivan & Cromwell LLP re: John Samuel Trabucco*, Jan. 29, 2023, at 7-8.

[289] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 144.

[290] *Id.* at 141.

[291] *Id.* at 142.

employee who was the subject of media reports regarding his transfer of $600,000 of FTT to a charity that he co-founded.[292] Due to the need to prioritize other litigation and potential challenges with any claims against these individuals, the Debtors have not yet elected to proceed with actions against them.

In addition, S&C investigated withdrawals during the preference period by four former FTX Group employees and their affiliates, which resulted in approximately $157 million of transfers from FTX.com and FTX.US during the preference period.[293] S&C, with the assistance of Alvarez & Marsal and Nardello, reviewed relevant accounts and trading activity, as well as communications related to these withdrawals.[294] Based on that investigation, certain Debtor entities filed an avoidance action against Matthew and Michael Burgess, Huy Xuan Nguyen, Jing Yu Wong, and their affiliates.[295] As alleged, the Debtors' investigation identified approximately $73 million in withdrawals in November 2022, by an account registered to Michael Burgess, a former Business Development Manager and Head of Partnerships at FTX.com and the brother of Matthew Burgess, a former customer service employee for FTX.com and FTX.US.[296] Matthew Burgess was still employed by the FTX Group at the time of the withdrawals.[297] As further alleged, Matthew Burgess misled FTX Group employees about the ownership of Michael

[292] *Id.* at 137.

[293] *Id.* at 82-84; *see also FTX Trading Ltd. v. Burgess*, 22-ap-50585 (Bankr. D. Del.) (JTD), Dkt. No. 1 at ¶ 13. The Debtors "selected August 31, 2023," for "indicative spot pricing of a present day judgment in th[e c]omplaint." *FTX Trading Ltd. v. Burgess*, 22-ap-50585 (Bankr. D. Del.) (JTD), Dkt. No. 1 at ¶ 13 n.3.

[294] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 82.

[295] *FTX Trading Ltd. v. Burgess*, 22-ap-50585 (Bankr. D. Del.) (JTD), Dkt. No. 1.

[296] *See id* at ¶¶ 14, 26, 29. Both Michael and Matthew Burgess were formally employed by Salameda Ltd., a non-Debtor affiliate of the FTX Group. *See id.* at ¶¶ 4, 26, 29.

[297] *See id.* at ¶ 11.

Burgess's account in an attempt to prioritize those withdrawals over other customers.[298] In addition, the Debtors allege that the other named former employees, Nguyen and Wong, also withdrew funds from their FTX.com and FTX.US accounts during the preference period.[299] That adversary proceeding was recently stayed pending its resolution.[300]

d. FTX Group In-house Legal and Compliance Employees

In addition to the above-mentioned investigative work into FTX Group employees, Quinn Emanuel specifically examined whether FTX Group in-house legal and compliance employees had knowledge of fraud or other misconduct at the FTX Group.[301] In connection with that effort, Quinn Emanuel interviewed nine employees from the legal and compliance departments, the majority of whom were attorneys.[302] Quinn Emanuel also reviewed FTX Group communications, including Signal messages where available, transaction records, legal documents, and accounting records, as well as other reports and materials produced by Alvarez & Marsal and Nardello.[303] Lastly, Quinn Emanuel served Bankruptcy Rule 2004 requests on Daniel Friedberg and Can Sun, and received an attorney proffer from Sun.

Quinn Emanuel attempted to interview other in-house legal and compliance employees living outside of the United States, but those employees were unresponsive to those requests.[304]

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[298] *See, e.g.*, *id.* at ¶¶ 11, 52; *see also* S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 83.

[299] *See FTX Trading Ltd. v. Burgess*, 22-ap-50585 (Bankr. D. Del.) (JTD), Dkt. No. 1 at ¶¶ 11-14. Like Matthew and Michael Burgess, Nguyen and Wong, although formally employed by Salameda Ltd., worked for other entities. *See id.* at ¶¶ 27-28.

[300] *See FTX Trading Ltd. v. Burgess*, 23-ap-50585 (Bankr. D. Del.) (JTD), Dkt. No. 45.

[301] Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 45.

[302] *See id.* at 46.

[303] *Id.* at 45-46.

[304] *Id.* at 45.

Because of the difficulties in ensuring those individuals' compliance with the requests, Quinn Emanuel did not further attempt to interview them.[305]

Based on its investigation, Quinn Emanuel concluded that the nine in-house legal and compliance employees it interviewed were generally isolated from the scope of misconduct at the FTX Group.[306] Quinn Emanuel further investigated three senior in-house counsel at the FTX Group: Daniel Friedberg, former General Counsel of Alameda and former Chief Compliance Officer of FTX.US;[307] Can Sun, former General Counsel of FTX Trading; and Ryne Miller, former General Counsel of FTX.US. Those three attorneys were interviewed by S&C in the months immediately following the Petition Date.

1. Daniel Friedberg

Friedberg previously served as a partner at Law Firm-1,[308] a law firm frequently used by the FTX Group, where he worked with the FTX Group on "general corporate and tax matters."[309] He joined the FTX Group in January 2020 as General Counsel of Alameda and Chief Compliance Officer of FTX.US, and subsequently served in several other positions during his time at the FTX Group.[310]

Following Quinn Emanuel's investigation into Friedberg, in June 2023, the Debtors filed a complaint against him asserting claims of breach of fiduciary duties and legal malpractice,

[305] *Id.*

[306] *Id.* at 47.

[307] As described in the Debtors' amended complaint against him, Friedberg held numerous titles during his time at the FTX Group. *See Alameda Research LLC v. Friedberg*, No. 23-ap-50419 (Bankr. D. Del.) (JTD), Dkt. No. 32 at ¶ 31.

[308] *See infra*, at Part 5, Section I(e)(1).

[309] *See id.* at ¶ 29.

[310] *See id.* at ¶¶ 30-32.

among others, and seeking to recover transfers and damages.[311] After discovering that Friedberg had deleted files from his work laptop, including the Signal application, S&C, with the assistance of FTI, recovered deleted Signal messages as well as other materials from the laptop.[312] Based on information from those Signal messages, among other sources, the Debtors filed an amended complaint against Friedberg in January 2024.

The amended complaint alleges, among other things, that Friedberg assisted in diverting funds to FTX Group executives, including by assisting in the creation of North Dimension and its bank account, drafting the backdated payment agent agreement, and creating purported loans from the FTX Group to its executives; avoided regulatory requirements and misled regulatory bodies; misrepresented the nature of the Serum Foundation and SRM token; facilitated multi-million dollar payments to acquaintances, including millions of dollars spent on inadequate and often nonexistent marketing services; failed to implement required oversight and controls as Chief Compliance Officer and General Counsel, including by failing to maintain proper know-your-customer protocols; and received token, equity, and other compensation from the FTX Group in exchange for his loyalty.[313] As further alleged in the amended complaint, Friedberg also facilitated the resolution of multiple whistleblower complaints asserting improprieties at the FTX Group, making payments of vast sums of money to the complainants without properly investigating the underlying conduct.[314] *See infra*, at Part 3, Section III(e). The Debtors' action against Friedberg remains pending.[315]

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[311] *See Alameda Research LLC v. Friedberg*, No. 23-ap-50419 (Bankr. D. Del.) (JTD), Dkt. No. 1.

[312] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 29.

[313] *See Alameda Research LLC v. Friedberg*, No. 23-ap-50419 (Bankr. D. Del.) (JTD), Dkt. No. 32 at ¶¶ 41-158, 185-209.

[314] *See id.* at ¶¶ 159-84.

[315] *See Alameda Research LLC v. Friedberg*, No. 23-ap-50419 (Bankr. D. Del) (JTD).

2. Can Sun

Can Sun joined the FTX Group in August 2021 from Law Firm-1. He served as General Counsel of FTX Trading.[316] Sun was called as a witness by the government at Bankman-Fried's trial pursuant to a non-prosecution agreement. At Bankman-Fried's trial, Sun testified that his responsibilities included "licensing[,] regulatory strategy, [and] internal corporate work."[317]

Quinn Emanuel investigated Sun's work for the FTX Group while at Law Firm-1 and while at the FTX Group. Quinn Emanuel learned that, as part of Sun's work at Law Firm-1, he drafted and circulated intercompany agreements for the FTX Group, and continued that work after joining the FTX Group.[318] Quinn Emanuel's investigation also found that, consistent with his testimony at trial, Sun was aware of company loans to FTX Group executives during his time at the FTX Group; Quinn Emanuel further determined that Sun intentionally structured some of these loans to avoid scrutiny regarding the relationship between WRS and Alameda.[319] Quinn Emanuel also concluded that Sun, in coordination with Friedberg, worked to avoid CFTC scrutiny by concealing information about entities with an interest in FTX Trading.[320] Quinn Emanuel's investigation also found that, again consistent with Sun's testimony at trial, Sun purchased a residence in the Bahamas with FTX Group-funded loans.[321] And Quinn Emanuel

[316] *See* Transcript at 1896:14-1897:7, SBF Criminal Case, Dkt. No. 372. Although Sun had formal employment contracts with Salameda Ltd. and FDM, he described his role at the FTX Group at Bankman-Fried's trial as "general counsel" to FTX and the "head[]" of "legal at FTX International." *See id.* at 1897:6-10; *see also* Quinn Emanuel, *Memorandum re: FTX Investigations—Can Sun*, May 14, 2024 ("Quinn Sun Memo"), at 2-5.

[317] *See* Transcript at 1897:6-14, SBF Criminal Case, Dkt. No. 372.

[318] Quinn Sun Memo, at 6.

[319] *Id.* at 7-11; *see also* Transcript at 1946:14-1948:18, SBF Criminal Case, Dkt. No. 372.

[320] Quinn Sun Memo, at 16-19.

[321] *Id.* at 13-15; *see also* Transcript at 1953:24-1954:9, SBF Criminal Case, Dkt. No. 372.

investigated Sun's involvement in resolving whistleblower complaints at the FTX Group, but ultimately concluded that Friedberg took a more active role in negotiating those settlements.[322]

Also consistent with Sun's testimony at trial, Quinn Emanuel determined that while Sun was aware of the existence of the North Dimension entities, there was no evidence that he was aware of their use in unlawfully diverting customer funds.[323] And as Sun further testified at trial, he learned about Alameda's exemption from automatic liquidation in August or September of 2022, but he was unaware that the exemption enabled Alameda to withdraw customer funds from the exchange until Singh told him that on November 7, 2022.[324]

The Debtors continue to assess next steps with respect to Sun.

3. Ryne Miller

Ryne Miller had been a partner at S&C prior to joining the FTX Group. His role as counsel to the FTX Group while at S&C is discussed above, *see supra*, at Part 2. Miller joined the FTX Group in August 2021 as the General Counsel of FTX.US, and he remained employed at FTX.US until March 2023.[325] Miller, unlike Friedberg or Sun, focused primarily on United States-based matters rather than both domestic and international issues.[326] His work included regulatory compliance, corporate acquisitions, lobbying, and employee-related actions.[327]

Quinn Emanuel identified several items of interest with respect to Miller's work at the FTX Group. First, Miller was involved in the resolution of several whistleblower claims

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[322] *See* Quinn Emanuel, *Summary of Investigation of FTX Group Pre-Petition Professionals*, Mar. 29, 2024 ("Professionals Report"), at 53.

[323] *See* Quinn Sun Memo, at 11; *see also* Transcript at 1905:13-1906:3, SBF Criminal Case, Dkt. No. 372.

[324] *See* Transcript at 1923:6-11, 1964:8-21, SBF Criminal Case, Dkt. No. 372.

[325] Quinn Emanuel, *Memorandum re: FTX Investigations—Ryne Miller*, May 10, 2024 ("Quinn Miller Memo"), at 1-3.

[326] *Id.* at 3.

[327] *Id.* at 3-4.

explained in further detail below, including claims raised by Whistleblower-1, Whistleblower-3, and Whistleblower-5.[328] Quinn Emanuel determined that Miller's involvement in resolving whistleblower claims was more limited than Friedberg's.[329] Quinn Emanuel's investigation also found that Miller identified corporate governance concerns shortly after he joined the FTX Group.[330] And while Miller learned about Alameda's exemption from automatic liquidation during the summer of 2022, Quinn Emanuel found no evidence that he was aware that Alameda was used as a vehicle to spend customer funds or that he believed that this could lead to the downfall of the FTX Group.[331] Ultimately, Quinn Emanuel did not find any evidence that Miller knew of or participated in the fraud at the FTX Group and did not find any evidence that Miller knew about the commingling of customer and FTX Group assets.[332]

e. FTX Group Whistleblowers

As part of its review of the FTX Group's in-house compliance and legal employees, Quinn Emanuel investigated the FTX Group's resolution of several whistleblower complaints that alleged systemic misconduct at the FTX Group, primarily those brought by then-active or recently terminated employees.[333] Because the FTX Group did not track whistleblower or employee complaints, in order to identify the universe of complaints to assess, Quinn Emanuel reviewed all severance agreements with FTX Group employees and the circumstances

[328] *Id.* at 4.

[329] *See* Professionals Report, at 53; *see also* Quinn Miller Memo, at 12.

[330] *See* Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 55; Quinn Miller Memo, at 9-10.

[331] *See* Quinn Miller Memo, at 8, 12.

[332] *See* Quinn Miller Memo, at 12. Further discussion of Miller's identification of a shortfall at FTX.US may be found *infra*, in Part 6, Section V.

[333] Professionals Report, at 45-46.

surrounding those agreements.[334] Quinn Emanuel ultimately identified settlement agreements totaling more than $25 million with seven whistleblowers who alleged various improprieties at the FTX Group, with most of that money going to five of those whistleblowers who raised allegations of systemic improprieties.[335]

To investigate these payments, Quinn Emanuel reviewed memoranda of interviews conducted by S&C and FTX Group documents related to the whistleblower complaints, issued Bankruptcy Rule 2004 requests to law firms that advised the FTX Group on these complaints, and interviewed several former in-house legal and compliance employees and two whistleblowers.[336] Quinn Emanuel concluded that FTX Group counsel did not properly investigate the substance of these whistleblower complaints but rather settled them for considerable amounts, and that these resolutions were principally handled by Friedberg, with the assistance of Sun, Miller, and Joseph Bankman, Bankman-Fried's father and senior advisor to the FTX Group.[337] A summary of significant whistleblower settlements investigated by Quinn Emanuel is provided below.

First, Whistleblower-1, a former FTX.US employee, alleged, among other things, market manipulation and insider trading.[338] Quinn Emanuel determined that the FTX Group settled Whistleblower-1's claims—without investigating the merits—for $1.8 million, despite Whistleblower-1 having worked at FTX.US for less than two months at a salary of $200,000 per

[334] *Id.* at 46.

[335] *Id.* at 46.

[336] *Id.* at 47-48.

[337] *See id.* at 48-51; *see also* Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 57.

[338] *See Alameda Research LLC v. Friedberg*, No. 23-ap-50419 (Bankr. D. Del.) (JTD), Dkt. No. 32 at ¶ 172.

year.[339] After resolving Whistleblower-1's claims, the FTX Group retained Whistleblower-1's counsel to provide "general client counseling" at a rate of more than $200,000 per month for five years.[340] Until the Petition Date, that law firm produced only one three-page memorandum pursuant to that retention agreement.[341] The memorandum was drafted and signed by a non-lawyer—again, consistent with the pattern Quinn Emanuel uncovered regarding the FTX Group's retention and use of counsel.[342] Friedberg's alleged involvement in Whistleblower-1's claims is detailed in the pending action against him.[343]

Second, as reported in the Second Ray Report, Whistleblower-2, an attorney at Alameda, raised concerns about regulatory and governance issues at Alameda and Alameda's handling of customer funds without a money transmitting license.[344] Quinn Emanuel's investigation into this complaint determined that Whistleblower-2 was terminated by Friedberg after raising these concerns, and received a $2 million settlement despite having worked at Alameda for less than three months.[345] Friedberg did not investigate or address the issues raised by Whistleblower-2.[346] Friedberg's alleged involvement in resolving Whistleblower-2's claims is detailed in the pending action against him.[347]

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[339] *See id.* at ¶¶ 174-76; *see also* Professionals Report, at 49-50.

[340] *See Alameda Research LLC v. Friedberg*, No. 23-ap-50419 (Bankr. D. Del.) (JTD), Dkt. No. 32 at at ¶ 179.

[341] *See id.* at ¶ 180.

[342] *See id.*

[343] *See id.* at ¶¶ 172-80.

[344] *See* Second Ray Report, at 22-23.

[345] *See Alameda Research LLC v. Friedberg*, No. 23-ap-50419 (Bankr. D. Del.) (JTD), Dkt. No. 32 at ¶¶ 183; *see also* Professionals Report, at 49.

[346] *See Alameda Research LLC v. Friedberg*, No. 23-ap-50419 (Bankr. D. Del.) (JTD), Dkt. No. 32 at ¶ 184.

[347] *See id.* at ¶¶ 181-84.

Third, Whistleblower-3, a compliance employee at FTX.US, claimed that FTX.US lacked sufficient anti-money laundering controls and compliance measures.[348] Whistleblower-3, who was hired to work on anti-money laundering compliance, was subsequently terminated three months after being hired.[349] The FTX Group settled Whistleblower-3's claims without investigation, and Friedberg, Miller, and two other in-house attorneys negotiated a settlement payment that was approximately three times Whistleblower-3's annual salary.[350]

Fourth, Whistleblower-4, an executive at FTX.US, claimed that the FTX Group misled regulators and investors and lacked adequate corporate structure.[351] Whistleblower-4 wrote a letter to Bankman-Fried, Singh, and Friedberg outlining those concerns.[352] Shortly after, Friedberg told Whistleblower-4 that he should not have written the letter and, in particular, should not have suggested that the FTX Group may not satisfy investor expectations. Friedberg further suggested that Whistleblower-4 apologize to Bankman-Fried.[353] Whistleblower-4 resigned from FTX.US in September 2022, and agreed to a settlement worth more than $16 million.[354] The FTX Group resolved Whistleblower-4's claims without investigation.[355]

Fifth, Whistleblower-5 alleged commingling of customer funds, inadequate corporate separation among FTX Group entities, market manipulation, and violation of CFTC

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[348] Professionals Report, at 49; Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 63.

[349] Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 63.

[350] *Id.*

[351] *Id.* at 65.

[352] *See id.*

[353] S&C, *Memorandum re: Interview of* Whistleblower-4, Dec. 22, 2022, at 10-11.

[354] Professionals Report, at 49.

[355] Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 65.

regulations.[356] Friedberg and Miller attempted to settle these claims prior to litigation; Quinn Emanuel did not find any evidence that they otherwise attempted to investigate or remediate the misconduct alleged by Whistleblower-5.[357] After the bankruptcy filing, Whistleblower-5's claims were resolved by settlement.[358]

Sixth, Whistleblower-6 alleged market manipulation and concealment of a relationship with Alameda.[359] He received a settlement offer of $200,000, although the claims were not settled prior to the Petition Date. As with the other whistleblower complaints, Quinn Emanuel found no evidence that the FTX Group investigated Whistleblower-6's claims.[360]

Finally, in 2019, an outside attorney, Pavel Pogodin (now deceased),[361] filed a complaint on behalf of Bitcoin Manipulation Abatement LLC against certain FTX Group entities and several high-ranking employees, alleging money laundering, the operation of an unlicensed money transmitting business, market manipulation, violations of the Commodity Exchange Act, and other unlawful conduct.[362] Friedberg, who was then serving as the FTX Group's outside counsel at Law Firm-1, advised the FTX Group on the complaint. Friedberg ultimately arranged for the FTX Group to pay more than $3 million for two purposes: (1) to resolve those claims, and (2) to retain Pogodin as an attorney for the FTX Group.[363] However, in its investigation, Quinn

[356] Professionals Report, at 50. S&C and Paul Hastings subsequently determined that Whistleblower-5 was terminated for cause for inappropriate conduct. *See* S&C, Whistleblower-5 and Ledger X—FTX Debtors Mediation Statement, Feb. 15, 2023, at 5; Paul Hastings, *FTX—LedgerX Investigation Memorandum*, Nov. 13, 2023, at 2.

[357] Professionals Report, at 50-51.

[358] *Id*.

[359] Professionals Report, at 50.

[360] *See id.*

[361] Pogodin was identified in the Debtors' action against Friedberg. *See Alameda Research LLC v. Friedberg*, No. 23-ap-50419 (Bankr. D. Del.) (JTD), Dkt. No. 32 at ¶¶ 161-71.

[362] *See Bitcoin Manipulation Abatement LLC v. FTX Trading LTD*, No. 4:19-cv-7245 (N.D. Cal.), Dkt. No. 1.

[363] *See Alameda Research LLC v. Friedberg*, No. 23-ap-50419 (Bankr. D. Del.) (JTD), Dkt. No. 32 at ¶¶ 161-71.

Emanuel found no evidence that Pogodin provided any legal services to the FTX Group—a consistent pattern with the FTX Group's retention of counsel, as described in detail below.[364] *See infra*, at Part 5, Section I(e). The Debtors' pending action against Friedberg alleges his relevant conduct in resolving Pogodin's claims.[365]

f. Other Payments to FTX Group Employees

Quinn Emanuel also reviewed payments to other employees who were terminated by the FTX Group but did not raise known whistleblower complaints.[366] Quinn Emanuel found that about half of those terminations occurred during June and July of 2022, and about 73 percent of the termination agreements were for payments of less than $100,000.[367] Quinn Emanuel focused in particular on six large employee payments ranging in size from $885,000 to nearly $12 million.[368] Although Quinn Emanuel's investigation did not fully resolve the circumstances behind each of these large payments, it appears that those settlements did not involve similar allegations of impropriety as the whistleblower complaints described above. The Examiner does not believe that additional investigation is warranted beyond Quinn Emanuel's work.

IV. Current Employees

After the Petition Date, the Debtors considered which of their remaining employees may be necessary to provide assistance to the Debtors moving forward. As part of that review, the Debtors consulted with S&C to determine whether the identified employees engaged in misconduct at the FTX Group. Based on that inquiry, and with the assistance of S&C, the

[364] *See id.* at ¶ 170.

[365] *See id.* at ¶¶ 161-71.

[366] Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 68-69.

[367] *Id.* at 68.

[368] *Id.* at 69.

Debtors retained certain employees who were employed by the FTX Group prior to the Petition Date and who were deemed to have not engaged in any criminal activities. Those employees then provided assistance in recovery efforts.

V. Conclusion

In sum, the Debtors and the Debtors' counsel, along with several government agencies, conducted a broad investigation into possible fraudulent conduct that took place at the FTX Group prior to the bankruptcy filing. That investigation facilitated the resolution of criminal charges against top executives at the FTX Group, including Bankman-Fried, led to many avoidance actions, and prompted the voluntary resolution of other claims. Based on his review of the investigations conducted to date, and given his understanding that the fraudulent activity at the FTX Group was largely perpetrated by a limited and tight-knit group of executives, the Examiner does not believe that any further investigation by him into former employees of FTX Group is warranted.

In addition, the Debtors and the Debtors' counsel have examined whether any employees who remained employed engaged in fraudulent conduct at the FTX Group. Based on discussions with Debtors' counsel, the Examiner understands that the Debtors retained only those employees who they viewed as having no complicity. The Examiner therefore believes that the ongoing and concluded investigations into fraud committed by the Debtors' employees, both current and former, have been adequate to address those issues.

PART 4: MANIPULATION OF FTT AND OTHER TOKENS

The Scope Order directs the Examiner to conduct "[a]n examination of whether the Investigations adequately addressed the Debtors' use of its cryptocurrency, FTT, to inflate the value of FTX and Alameda Research."[369] This Part addresses the investigations into that issue. In addition, individuals associated with the FTX Group were involved in the development of at least three other cryptocurrency tokens also held by Alameda as of the Petition Date. Given certain similarities to FTT and the potential that those other cryptocurrency tokens could have also been used to inflate the value of the FTX Group, this part of the Report also addresses investigations into those other tokens. For the reasons explained below, the Examiner concludes that prior investigations adequately addressed whether the FTX Group used these cryptocurrency tokens to inflate its value, such that no further investigation is necessary.

Section I below provides background on each of the four tokens addressed in this Part, as context for the discussion that follows. Sections II and III then summarize investigations conducted to date into allegations that individuals at or associated with the FTX Group manipulated one or more of these tokens, based on public reports as well as information made available to the Examiner through these bankruptcy cases. Finally, Section IV explains the bases for the Examiner's conclusion that, at this time, further investigation into these issues by the Examiner is not warranted.

I. Cryptocurrency Tokens Associated with the Debtors

This section provides a brief overview of the four cryptocurrency tokens addressed in this Part: FTT, SRM, OXY, and MAPS. As detailed further below, while FTT has been the subject

[369] Scope Order at ¶ 3.

of extensive public discourse and investigation, the other three tokens discussed below have received relatively less attention but could present similar issues.

a. FTT Token

Many cryptocurrency exchanges have native "exchange tokens" that offer benefits when used on the exchange.[370] The FTT token was the exchange token of the FTX.com exchange. According to the FTX Token white paper,[371] FTT could "be used as collateral" on the trading platform, and customers who held a certain amount of FTT received discounts on trading fees as well as "rebates from all OTC trading on FTX."[372] FTT was designed as a deflationary token, with FTX Trading committing to use a portion of its fee revenue to buy and burn FTT tokens "until at least half of all FTT is burned."[373] Generally speaking, a "buy and burn" occurs when an entity associated with a token buys some of the tokens currently circulating in the market and permanently takes them out of circulation.[374] Overall, this design of FTT incentivized users of the FTX.com exchange to buy and hold FTT, and purported to tie the value of the FTT token to

[370] *See* Robert Stevens, *What Is an Exchange Token?*, CoinDesk (Nov. 9, 2022), https://www.coindesk.com/learn/what-is-an-exchange-token/, *archived at* https://perma.cc/57D3-P4PC.

[371] "A cryptocurrency whitepaper is a comprehensive document outlining the technical and economic aspects of a specific cryptocurrency. It is typically written by the cryptocurrency's development team or core members and serves as a guide for potential investors, miners and users." CoinMarketCap, *Whitepaper*, https://coinmarketcap.com/academy/glossary/whitepaper, *archived at* https://perma.cc/2FJ3-YBBA.

[372] FTX Trading, *FTX Token Whitepaper*, 7, https://whitepaper.io/document/502/ftx-token-whitepaper, *archived at* https://perma.cc/3XJ9-K3JH.

[373] *Id.*

[374] *See* CoinMarketCap, *Burn/Burned*, https://coinmarketcap.com/academy/glossary/burned, *archived at* https://perma.cc/R3AP-R3R6.

the success of the FTX.com exchange.[375] As described by FTX Trading at the time, "FTT is the token powering the FTX ecosystem."[376]

FTX Trading created the FTT token in or around May 2019.[377] A few months later, following a period in which investors and FTX.com users were able to purchase FTT in advance of the listing, FTX Trading officially listed FTT on the FTX.com exchange. According to FTX Trading, it issued a total of 350 million FTT tokens, of which 175 million were designated as "company tokens." All FTT tokens, including the company tokens, were purportedly "locked" (i.e., unable to be sold)[378] as of the initial listing, but were meant to "unlock" over periods of time depending in part on how and when the FTT token at issue was acquired.[379] According to the FTT white paper, FTX Trading used the sale of these tokens in part to generate capital for the development of the exchange.[380] FTX Trading reported that, as of July 21, 2019, it had sold roughly 73 million FTT tokens prior to the listing, at prices between $0.10 and $0.80 per token.[381] Once FTT was listed, the tokens sold prior to the listing would start to "unlock" and

[375] This design was not entirely novel, in that other "exchange tokens" available at the time also offered discounts to holders and touted a "buy and burn" program. *See*, *e.g.*, Binance, *BNB (BNB)* (Sept. 3, 2020), https://www.binance.com/en/research/projects/bnb (discussing similar features of BNB), *archived at* https://perma.cc/L3CP-J73B.

[376] FTX Trading, *FTT Transparency Page*, (via the Wayback Machine), *archived at* https://web.archive.org/web/20200806161131/https://help.ftx.com/hc/en-us/articles/360029638552-FTT-Transparency-Page.

[377] *See, e.g.,* FTX *Token*, CoinDesk, https://www.coindesk.com/price/ftx-token/, *archived at* https://perma.cc/CJ28-ADBR.

[378] *See*, *e.g.*, CoinMarketCap, *Token Lockup*, https://coinmarketcap.com/academy/glossary/token-lockup, *archived at* https://perma.cc/CG62-U3UG.

[379] FTX Trading, *FTT Transparency Page*, *supra* note 376.

[380] FTX Trading, *FTX Token Whitepaper*, *supra* note 372, at 1 ("We want to scale up as quickly as possible and build a community of strong supporters, and so we are conducting a token raise for people who want to help grow FTX.").

[381] FTX Trading, *FTT Transparency Page*, *supra* note 372.

could be resold.[382] FTX Trading planned to list FTT at an initial price of $1 per token.[383] FTT experienced various price fluctuations after its initial listing; according to some public sources, FTT at one point traded as high as approximately $85 per token.[384]

FTX Trading also used FTT as payment and collateral in various business transactions. For example, Binance's initial investment into FTX Trading in late 2019 included both an equity stake in FTX Trading as well as "a long-term position in the FTX Token (FTT)."[385] In 2021, when FTX Trading decided to buy out Binance's equity stake for a reported $2.3 billion, FTX Trading satisfied the buyout price in part with a transfer to Binance of additional FTT valued at nearly $555 million.[386]

As set forth below, subsequent investigations into the FTX Group have revealed instances in which individuals at the FTX Group engaged in efforts to artificially prop up the market price of FTT. Moreover, Alameda held a significant portion of all outstanding FTT, which it included on its balance sheet and used as collateral for other obligations. The revelation of this information in early November 2022 precipitated a series of events that contributed to the collapse of the FTX Group and the institution of these bankruptcy cases.

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[382] *Id.*

[383] *Id.*

[384] *See*, *e.g.*, FTX Token overview page, CoinMarketCap, https://coinmarketcap.com/currencies/ftx-token/, *archived at* https://perma.cc/3L2D-FQZB (reflecting FTT price of $85.02 on September 9, 2021); *see also* FTX overview page, CoinGecko, https://www.coingecko.com/en/coins/ftx-token, *archived at* https://perma.cc/YJ49-985T (reflecting FTT price of $84.18 on September 9, 2021). For the avoidance of doubt, this Report takes no position as to the actual value or trading price of FTT, or any other cryptocurrency, at any point in time.

[385] Binance, *Binance Announces Strategic Investment in Cryptocurrency Derivatives Exchange FTX*, Binance Blog (Dec. 20, 2019), https://www.binance.com/en/blog/all/binance-announces-strategic-investment-in-cryptocurrency-derivatives-exchange-ftx-414610870200725504, *archived at* https://perma.cc/5ES6-BP2Z.

[386] *See* GX-213 (July 15, 2021, Share Transfer Agreement), at 1, SBF Criminal Case.

b. Other Tokens Associated with the Debtors

While FTT garnered significant public attention in the wake of the FTX Group's collapse and bankruptcy, certain other cryptocurrency tokens also had a close connection to Bankman-Fried and the FTX Group. This Report addresses three such tokens: SRM, MAPS, and OXY. These tokens, along with FTT, at times have been referred to as "Sam Coins" given their close association with Bankman-Fried.[387]

SRM is the exchange token for the Serum exchange. According to the Serum Foundation's July 2020 white paper, the Serum exchange was built on the Solana blockchain and created with the goal of facilitating decentralized trading of cryptocurrencies at high speeds and low costs.[388] Contemporaneous reports disclosed that the Serum Foundation was initially created by FTX Trading and Alameda,[389] and that the Serum exchange was championed by Bankman-Fried.[390] However, the Serum Foundation's white paper represented that "[Project Serum] is permissionless—***we do not hold special power anymore***. It is up to you, the crypto community, to use it as you will."[391] The Serum white paper touted various benefits of SRM, including that holders of SRM would incur lower trading fees when trading on SRM's native exchange

[387] *See* Emily Flitter & David Yaffe-Bellany, *FTX Founder Gamed Markets, Crypto Rivals Say*, N.Y. Times (Jan. 18, 2023), https://www.nytimes.com/2023/01/18/business/ftx-sbf-crypto-markets.html, *archived at* https://perma.cc/C648-VDDU.

[388] Serum Foundation, *Serum—White Paper*, 3-4 (July 2020), https://whitepaper.io/document/626/serum-whitepaper, *archived at* https://perma.cc/GWZ4-EQTC.

[389] Solana Foundation, *FTX Chooses Solana for Serum: A High-Speed, Non-Custodial Decentralized Derivatives Exchange* (July 26, 2020), https://solana.com/news/ftx-chooses-solana-for-serum--a-high-speed--non-custodial-decentralized-derivatives-exchange, *archived at* https://perma.cc/DRR4-262A.

[390] *See*, *e.g.*, Samuel Bankman-Fried (@SBF_FTX), X (formerly Twitter) (July 27, 2020, 4:08 AM), https://twitter.com/SBF_FTX/status/1287661223043928064, *archived at* https://perma.cc/NR6P-4XXU (Bankman-Fried tweet about Project Serum).

[391] Serum Foundation, *Serum—White Paper*, 11 (July 2020) (emphasis added), https://whitepaper.io/document/626/serum-whitepaper, *archived at* https://perma.cc/GWZ4-EQTC.

(Serum).[392] The Serum white paper likewise claimed that net fees generated by the Serum exchange would be used to buy and burn SRM tokens, thereby reducing overall supply.[393] The white paper stated that a total of 10 billion tokens would be minted (i.e., created) with a limited percentage circulated at launch and periodic unlocking of tokens over time.[394]

MAPS is the token for Maps.me. Maps.me began as an offline mapping application, but relaunched in late-2020/early-2021 with new decentralized finance features built on Serum and Solana.[395] A January 2021 white paper for MAPS stated that MAPS "[t]oken holders will benefit from 100% of net-revenues that Maps.me generates" and have the ability to vote on governance issues.[396] Similar to SRM, the MAPS white paper states that a total of 10 billion tokens would be minted, with a limited supply circulated at launch and additional tokens unlocked over a series of years.[397] MAPS also claimed to use 100% of net revenue towards a buy and burn program that would reduce supply and benefit holders.[398] As with SRM, public disclosures at the time revealed a certain degree of connection between Maps.me and individuals associated with the FTX Group. The Maps.me white paper listed Bankman-Fried and Ramnik

[392] *Id.* at 6.

[393] *Id.* at 6.

[394] *Id.* at 7.

[395] *See* Maps Token, *MAPS and Maps.me—FAQ*, Medium (Feb. 2, 2021), https://mapstoken.medium.com/maps-and-maps-me-faq-a204bfd976aa, *archived at* https://perma.cc/LCV2-Y6Q9 (Maps 2.0 launched in December 2020); *see also* Maps.me, *Maps – White Paper*, 3-5 (Jan. 2021), https://maps.me/token/MAPS.pdf, *archived at* https://perma.cc/GRM4-HKWH (January 2021 white paper states that the financial suite would be launched in the coming month).

[396] Maps.me, *Maps—White Paper*, 7-8 (Jan. 2021), https://maps.me/token/MAPS.pdf, *archived at* https://perma.cc/GRM4-HKWH.

[397] *Id*. at 11.

[398] Maps Token, *MAPS and Maps.me—FAQ*, Medium (Feb. 2, 2021), https://mapstoken.medium.com/maps-and-maps-me-faq-a204bfd976aa, *archived at* https://perma.cc/LCV2-Y6Q9.

Arora (at the time, Head of Product within the FTX Group) as advisors to the project,[399] and public reporting disclosed that Bankman-Fried led a $50 million round of funding for "Maps.me 2.0."[400]

Finally, OXY is the token for the Oxygen Protocol. According to Oxygen's December 2020 white paper, Oxygen launched as a decentralized borrowing and lending protocol built on Serum and Solana, and was co-founded by the same individuals who co-founded MAPS.[401] Oxygen sought to leverage the user base of Maps.me by integrating into the platform.[402] Oxygen claimed to offer OXY holders discounts on fees when using the Oxygen Protocol, participation in the governance model, and other benefits through a buy and burn program.[403] The Oxygen white paper stated that a total of 10 billion OXY tokens would be minted, with a small percentage unlocked at launch and additional tokens unlocked over the course of several years.[404]

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[399] Maps.me, *Maps—White Paper*, 9 (Jan. 2021), https://maps.me/token/MAPS.pdf, *archived at* https://perma.cc/GRM4-HKWH.

[400] Samuel Haig, *SBF leads $50M funding round to bring DeFi to Maps.me's 140M users*, Cointelegraph (Jan. 18, 2021), https://cointelegraph.com/news/sbf-leads-50m-funding-round-to-bring-defi-to-maps-me-s-140m-users, *archived at* https://perma.cc/5J8R-P4JC.

[401] Oxygen, *Oxygen: The Prime Brokerage Protocol White Paper*, 4-5, 8-10 (Dec. 2020), https://www.oxygen.org/Oxygen.pdf, *archived at* https://perma.cc/H894-8EJE (listing Alex Grebnev and Viktor Mangazeev as co-founders); *see also*, Maps.me, *Maps—White Paper*, 9 (Jan. 2021), https://maps.me/token/MAPS.pdf, *archived at* https://perma.cc/GRM4-HKWH (listing Alex Grebnev and Viktor Mangazeev as co-founders).

[402] Oxygen, *Oxygen: The Prime Brokerage Protocol White Paper*, 8-9 (Dec. 2020), https://www.oxygen.org/Oxygen.pdf, *archived at* https://perma.cc/H894-8EJE.

[403] Oxygen, *Oxygen: The Prime Brokerage Protocol White Paper*, 9 (Dec. 2020), https://www.oxygen.org/Oxygen.pdf, *archived at* https://perma.cc/H894-8EJE; *see also* Oxygen, *Token*, https://www.oxygen.org/token.html, *archived at* https://perma.cc/HU53-NG37.

[404] Oxygen, *Oxygen: The Prime Brokerage Protocol White Paper*, 11 (Dec. 2020), https://www.oxygen.org/Oxygen.pdf, *archived at* https://perma.cc/H894-8EJE.

Bankman-Fried was listed as an advisor to the Oxygen Protocol,[405] and Alameda led a $40 million round of funding into Oxygen.[406]

c. Role of FTT in the FTX Group's Collapse

On November 2, 2022, CoinDesk published an article on a leaked Alameda balance sheet.[407] CoinDesk reported that Alameda's balance sheet listed $14.6 billion in assets, with "unlocked FTT" as the biggest asset at $3.66 billion, and "FTT collateral" as the third largest asset at $2.16 billion.[408] The CoinDesk article observed that, according to FTX.com's website at the time, "[t]here [were] about 197 million FTT tokens worth $5.1 billion in circulation."[409] According to the CoinDesk article, Alameda's balance sheet also included a generic line item for "$3.37 billion of 'crypto held.'" Separately, it listed "large amounts of the Solana blockchain's native token [SOL]" and holdings of other tokens including SRM, MAPS, and OXY.[410]

Prior to this leak, the crypto industry was already experiencing a downturn, with cryptocurrency values declining and multiple firms shuttering in the summer of 2022.[411] Although the price of FTT reportedly had reached a high of approximately $85 in early

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[405] *Id*. at 10.

[406] Andrew Thurman, *Alameda Research doubles down on Maps.me, invests $40 million in Oxygen*, Cointelegraph (Feb. 24, 2021), https://cointelegraph.com/news/alameda-research-doubles-down-on-maps-me-invests-40-million-in-oxygen, *archived at* https://perma.cc/Q6YT-5NW9.

[407] 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/, *archived at* https://perma.cc/8AQ4-RMXJ. This CoinDesk article, and its role in the collapse of the FTX Group, is also discussed *supra*, at Part 2, Section V(f).

[408] *Id.* The numbers reported by CoinDesk generally correspond with those in a balance sheet that the USAO-SDNY introduced during Bankman-Fried's trial, which purported to reflect Alameda's holdings as of June 30, 2022. GX-419 (Consolidated Balance Sheet 2022 Q2), SBF Criminal Case.

[409] 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/, *archived at* https://perma.cc/8AQ4-RMXJ.

[410] *Id*.

[411] *See*, *e.g.*, David Gura, *Crypto Billionaire says Fed is driving current downturn*, NPR (June 19, 2022), https://www.npr.org/2022/06/19/1105853170/crypto-billionaire-says-fed-is-driving-current-downturn, *archived at* https://perma.cc/GM2L-MWQ7.

September 2021, it had fallen to approximately $25 in the days before the CoinDesk report, according to public sources.[412]

On November 6, Changpeng Zhao ("CZ"), then-CEO of Binance, tweeted that "[d]ue to recent revelations that have came [*sic*] to light, we have decided to liquidate any remaining FTT on our books,"[413] and that "[d]ue to market conditions and limited liquidity, we expect this will take a few months to complete."[414] Caroline Ellison responded with a tweet in which Alameda offered to "happily buy it all from you today at $22!"[415] While public reporting indicates that the price of FTT briefly held around $22 following that tweet, it continued to fall—losing 44% of its value between November 1 and 7.[416] In the face of this downward spiral, investors tried to withdraw significant assets from FTX.com, with reports quoting claims from Bankman-Fried that $6 billion was withdrawn from the exchange in 72 hours prior to the morning of November

[412] *See*, *e.g.*, *FTX Token overview page*, CoinMarketCap, https://coinmarketcap.com/currencies/ftx-token/, *archived at* https://perma.cc/3L2D-FQZB; *see also FTX overview page*, CoinGecko, https://www.coingecko.com/en/coins/ftx-token, *archived at* https://perma.cc/YJ49-985T. Once again, in conveying this information, this Report takes no position as to the actual value or trading price of FTT or any other cryptocurrency at any point in time.

[413] Changpeng Zhao (@cz_binance), X (formerly Twitter) (Nov. 6, 2022, 10:47 AM), https://twitter.com/cz_binance/status/1589283421704290306?lang=en, *archived at* https://perma.cc/68PH-SE3P.

[414] Changpeng Zhao (@cz_binance), X (formerly Twitter) (Nov. 6, 2022, 10:47 AM), https://twitter.com/cz_binance/status/1589283426028642305, *archived at* https://perma.cc/8SGA-WEP3.

[415] Caroline Ellison (@carolinecapital), X (formerly Twitter) (Nov. 6, 2022, 11:03 AM), https://twitter.com/carolinecapital/status/1589287457975304193, *archived at* https://perma.cc/69UE-69GR ("@cz_binance if you're looking to minimize the market impact on your FTT sales, Alameda will happily buy it all from you today at $22!").

[416] *See* Tracey Wang & Oliver Knight, *Binance to Sell Reset of FTX Holdings as Alameda CEO Defends Firm's Finance Condition*, CoinDesk (Nov. 6, 2022), https://www.coindesk.com/business/2022/11/06/binance-sells-holdings-of-ftx-token-as-alameda-ceo-defends-firms-financial-condition/, *archived at* https://perma.cc/8NR6-WUU9 (original article published at 11:55 AM EST); *see also* Sam Reynolds, *FTX Token Plummets on Withdrawal Concerns as Contagion Hits Broader Crypto Markets*, CoinDesk (Nov. 7, 2022), https://www.coindesk.com/markets/2022/11/08/ftt-plummets-as-market-fears-possible-alameda-contagion/, *archived at* https://perma.cc/8XRE-N27Z (original article published at 10:28 PM EST).

8.[417] FTX.com halted crypto withdrawals that afternoon,[418] at which point FTT had fallen to approximately $4.[419] Three days later, on November 11, the Debtors commenced their bankruptcy cases.

II. Summary of Investigations into the Use and Manipulation of FTT

As detailed below, there have been multiple investigations into facts surrounding the FTX Group's use and manipulation of FTT to inflate the value of the FTX Group, including Alameda. This Examination included a review of both public and nonpublic information concerning these investigations. The public information included complaints and indictments by government authorities, as well as transcripts and exhibits from the Bankman-Fried trial in October 2023 and sentencing in March 2024. The nonpublic information included materials created by and for counsel for the Debtors, including memoranda and other documents concerning investigations into aspects of the FTX Group's alleged use and manipulation of FTT. The Examiner's team also spoke to representatives from certain government agencies.

a. Investigative Work

1. Government Investigations and Actions

(i) USAO-SDNY

The USAO-SDNY investigated allegations that the FTX Group used and manipulated FTT to inflate its value. Prosecutors presented evidence of that manipulation during the

[417] Tom Willison & Angus Berwick, *Crypto exchange FTX saw $6 bln in withdrawals in 72 hours*, Reuters (Nov. 8, 2022), https://www.reuters.com/business/finance/crypto-exchange-ftx-saw-6-bln-withdrawals-72-hours-ceo-message-staff-2022-11-08/, *archived at* https://perma.cc/3KH9-S5YN.

[418] Tracy Wang, *FTX Exchange Halts All Crypto Withdrawals*, CoinDesk (Nov. 8, 2022), https://www.coindesk.com/business/2022/11/08/ftx-exchange-halts-all-crypto-withdrawals/, *archived at* https://perma.cc/2GLC-Z9R4 (original article published at 4:51 PM EST).

[419] Krisztian Sandor, *FTX Token Falls 80% Despite Binance Bailout as Alameda Contagion Spreads to Bitcoin*, CoinDesk (Nov. 8, 2022), https://www.coindesk.com/markets/2022/11/08/ftx-token-falls-80-despite-binance-bailout-as-alameda-contagion-spreads-to-bitcoin/, *archived at* https://perma.cc/25WW-L693 (original article published at 4:14 PM EST).

Bankman-Fried trial.[420] This evidence addressed the creation of FTT and its use to inflate the value of Alameda, as well as at least three specific instances where senior executives at the FTX Group manipulated the value of FTT. Each of these instances of manipulation is discussed in further detail in Section II(b)(2) below.

(ii) SEC

As noted above, in December of 2022, the SEC filed two cases—one against Bankman-Fried, and the other against Ellison and Wang—that in part allege misuse and manipulation of FTT. Both complaints conclude that this conduct "violat[es] the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934."[421] Ellison and Wang entered into consent judgments with the SEC shortly after the complaints were filed.[422] The case against Bankman-Fried was stayed pending his criminal prosecution.[423]

The SEC complaint against Ellison and Wang alleges widespread manipulation to artificially inflate the price of FTT. According to the SEC, this was done to increase the value of Alameda's FTT holdings, with those holdings then used as collateral to support loans of customer assets made to Alameda by FTX Trading, as well as loans made to Alameda by third parties.[424] The SEC complaint further alleges that Alameda inflated the price of FTT by "programm[ing] [] automated trading tools (or 'bots') to conduct trades and execute transactions

[420] *See supra*, at Part 3, Section III(a)(1) for additional information concerning the Bankman-Fried trial.

[421] *SEC Charges Caroline Ellison and Gary Wang with Defrauding Investors in Crypto Asset Trading Platform FTX*, Sec. & Exch. Comm'n (Dec. 21, 2022), https://www.sec.gov/news/press-release/2022-234, *archived at* https://perma.cc/8VRS-Y3DF; *see also SEC Charges Samuel Bankman-Fried with Defrauding Investors in Crypto Asset Trading Platform FTX*, Sec. & Exch. Comm'n (Dec. 13, 2022), https://www.sec.gov/news/press-release/2022-219, *archived at* https://perma.cc/BNH8-DZ45 ("The SEC's complaint charges Bankman-Fried with violating the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934").

[422] *Sec. & Exch. Comm'n v. Ellison*, No. 22-cv-10794 (S.D.N.Y.) (PKC), Dkt. Nos. 15-16 (Ellison and Wang consent judgments).

[423] *Sec. & Exch. Comm'n v. Bankman-Fried*, No. 22-cv-10501 (S.D.N.Y.) (PKC), Dkt. No. 16.

[424] *Sec. & Exch. Comm'n v. Ellison*, No. 22-cv-10794 (S.D.N.Y.) (PKC), Dkt. No. 1 at ¶¶ 92-94.

to purchase FTT at specific prices" and "adjust[ing] trading parameters of its trading bots in order to support the price of FTT."[425] The SEC complaint also discusses instances in which Bankman-Fried and Ellison sought to artificially prop up the price of FTT in response to external events, which generally correspond to the three examples of manipulation addressed during the criminal trial of Bankman-Fried.[426]

(iii) CFTC

The CFTC filed a complaint on December 13, 2022, alleging certain violations of law related to the use of FTT by the FTX Group and associated individuals. This complaint named Bankman-Fried, FTX Trading, and Alameda, and an amended complaint filed on December 21, 2022, added claims against Ellison and Wang.[427] The amended complaint charges all defendants except for Wang with "fraud and material misrepresentations in connection with the sale of digital asset commodities," and charges Wang with "fraud in connection with the sale of digital asset commodities."[428]

The amended complaint alleges that the creation and use of FTT contributed to the defendants' artificial inflation of Alameda's balance sheet and other frauds. According to the CFTC, Alameda's holdings comprised "a significant portion of all FTT in circulation."[429] The CFTC further asserts that, although FTT was relatively illiquid and traded at volumes far below

[425] *Id.* at ¶ 92.

[426] *Id.* at ¶¶ 93, 106.

[427] *Commodity Futures Trading Comm'n v. Bankman-Fried*, No. 22-cv-10503 (S.D.N.Y.) (PKC), Dkt. Nos. 1, 13 (original and amended complaints).

[428] *CFTC Charges Alameda CEO and Alameda and FTX Co-Founder with Fraud in Action Against Sam Bankman-Fried and his Companies* , Commodity Futures Trading Comm'n (Dec. 21, 2022), https://www.cftc.gov/PressRoom/PressReleases/8644-22, *archived at* https://perma.cc/D377-5KF6; *see also Commodity Futures Trading Comm'n v. Bankman-Fried*, No. 22-cv-10503 (S.D.N.Y.) (PKC), Dkt. No. 13 at ¶¶ 121-137.

[429] *Commodity Futures Trading Comm'n v. Bankman-Fried*, No. 22-cv-10503 (S.D.N.Y.) (PKC), Dkt. No. 13 at ¶ 70.

Alameda's FTT holdings, Alameda allegedly valued its FTT holdings on its balance sheet at the illiquid market prices, and then used those assets to support a number of large loans.[430] The CFTC also alleges that the buy and burn program of FTT contributed to this inflation in that it was "intended to raise the value of the FTT tokens that remained in circulation, and thereby [raise] the value of the FTT that Alameda held."[431]

As was the case for the SEC action, Ellison and Wang both entered into consent judgments with the CFTC shortly after it filed its amended complaint, and the case was otherwise stayed pending the resolution of the criminal case against Bankman-Fried.[432]

2. The Debtors' Investigations

Information and materials shared with the Examiner revealed that the Debtors and their counsel conducted investigatory work that touched on the use and manipulation of FTT by the FTX Group. Although the Debtors did not undertake a dedicated investigation with the specific purpose of identifying every possible instance of potential FTT manipulation, or all individuals who may have been involved therein, issues related to FTT emerged through investigations into other subjects.

For example, an investigation by Quinn Emanuel into Law Firm-1,[433] a law firm used by the FTX Group prior to the Petition Date, adduced facts related to the original creation of FTT and its use by FTX Group.

S&C also investigated matters related to the buy and burn program of FTT. For example, S&C analyzed an agreement between FTX Trading and the Debtor entity Cottonwood Grove

[430] *Id.* at ¶¶ 70-72.

[431] *Id.* at ¶ 69.

[432] *Commodity Futures Trading Comm'n v. Bankman-Fried*, No. 22-cv-10503 (S.D.N.Y.) (PKC), Dkt. Nos. 25-26 (Wang and Ellison consent judgments).

[433] *See infra*, at Part 5, Section I(e)(1).

Limited ("Cottonwood Grove"), which purportedly was used by FTX Trading to carry out the FTT buy and burn program.[434] S&C also investigated FTX Trading's actual implementation of the buy and burn program for FTT, including to determine whether that activity involved any impropriety.

In addition, S&C interviewed and directed investigations into several former employees. Some of those interviews and investigations touched on conduct related to FTT, although FTT itself was not the focus of such inquiries. Through its broader investigation, S&C also reviewed preserved email and Slack communications[435] involving senior executives of the FTX Group that occurred in the two calendar years prior to the Petition Date.

Finally, although separate from the issue of prepetition manipulation, the Debtors also investigated an allegation of unauthorized "minting" of FTT tokens that took place after the Petition Date.[436] S&C determined that what occurred was not actually a "minting" of new FTT tokens, but rather the release of 195 million non-trading FTT tokens from an account that had held those tokens since the original minting of FTT in 2019. Those 195 million FTT tokens have since been returned to the Debtors.

b. Investigative Findings

As set forth above, both the Debtors and multiple government authorities have, to various degrees, conducted investigations into the use and manipulation of FTT by the FTX Group prior to the Petition Date. This section summarizes the collective findings of these investigations with regards to the original creation of FTT; instances of FTT manipulation; those individuals

[434] S&C, *Cottonwood Agreement Summary*, June 20, 2023 ("Cottonwood Agreement Summary").

[435] As discussed *supra*, at Part 3, employees of the FTX Group frequently communicated through self-deleting Signal messages such that many communications were no longer available.

[436] In his November 17, 2022, declaration, Ray reported the unauthorized "dilutive 'minting' of approximately $300 million in FTT tokens" after the Petition Date. *See* Ray First Day Declaration at ¶ 66.

involved in the manipulation; the use of FTT to inflate Alameda's value; and potential issues related to the FTT buy and burn program.

1. Creation of FTT and its Relation to Alameda's Value

Prior investigations have addressed how Alameda obtained a significant amount of FTT, potentially at little or no cost,[437] and then used those FTT holdings as collateral in order to obtain loans other FTX Group entities as well as from third parties. At the trial of Bankman-Fried, Ellison testified that "for a lot of 2018, [Alameda] had a lot of trouble getting loans"; however, "[i]t started to improve in the beginning of 2019, but the situation definitely got better towards the end of 2019 when we—after we created FTT."[438] Ellison also testified that "shortly after [the FTT tokens] were listed, [Bankman-Fried] said that we should start putting them on our balance sheet and that they would be able to get us more loans from third-party lenders."[439]

Investigative materials provided by the Debtors reveal contemporaneous communications in which Bankman-Fried and others discussed the association between the market value of FTT and the claimed value of Alameda. One Nardello memorandum shared with the Examiner recounts a document circulated by Bankman-Fried on July 22, 2019, a week before the initial listing of FTT, in which Bankman-Fried wrote that "the difference between a $1.5 resting price and a $2.5 resting price is a *$200m swing* in Alameda's [Net Asset Value]."[440]

Bankman-Fried and others also acknowledged the centrality of FTT to Alameda's value and ability to remain in business. In a document dated September 5, 2019, Bankman-Fried

[437] *Sec. & Exch. Comm'n v. Ellison*, No. 22-cv-10794 (S.D.N.Y.), Dkt. No. 1 at ¶ 91; Transcript at 672:13-20, SBF Criminal Case, Dkt. No. 358 (Ellison testifying that Alameda received 60-70% of the initial distribution of FTT for free).

[438] Transcript at 670:22-671:4, SBF Criminal Case, Dkt. No. 358.

[439] *Id.* at 674:8-11.

[440] Nardello, *Memorandum re: FTX/Alameda Research Links to Binance and affiliated entities*, Apr. 19, 2023 ("Binance Memo"), at 7 (quoting F10705-E000282184) (emphasis in original).

acknowledged that Alameda's "NAV is currently extremely dependent on exactly how you count FTT; if FTT counts for anything it's totally fine, but if it doesn't then we aren't able to support our current borrows/etc."[441] Around that same time, another senior executive of Alameda, Trabucco, warned of an "exodus" if employees were to understand Alameda's net asset value without FTT, and yet another senior executive, Singh, expressed concern that Alameda had a "negative-without-FTT NAV."[442]

2. Instances of FTT Manipulation

Prior investigations have also revealed how senior FTX Group executives engaged in various acts intended to artificially inflate the value of FTT—and thus the value of Alameda. This included purchasing FTT at specific prices—even losing money on individual trades—in order to inflate or defend the value of FTT. The SEC has alleged that Alameda executed these trades at least in part through programmed bots.[443]

While the Examiner understands that certain investigations remain ongoing, these investigations have revealed at least three specific instances in which senior executives of the FTX Group sought to manipulate the price of FTT.

One such instance of manipulation involved an effort to keep the price of FTT above one dollar after it was first listed in 2019—at which point some of the pre-listing sales of FTT started to "unlock" and could be resold. Ellison testified that Bankman-Fried "thought 1 dollar was a psychologically important price, and if it went below a dollar, then people might lose confidence in it, so that [Alameda] should try to buy it if it started going below a dollar."[444] Investigations

[441] *Id.* at 9 (quoting F10705-E000273170).

[442] *Id.* at 10 (quoting F10705-E000273198); *id.* at 11 (quoting F10705-E001025865).

[443] *Sec. & Exch. Comm'n v. Ellison*, No. 22-cv-10794 (S.D.N.Y.) (PKC), Dkt. No. 1 at ¶ 92.

[444] Transcript at 672:25-673:5, SBF Criminal Case, Dkt. No. 358.

conducted by S&C likewise identified contemporaneous communications in which Trabucco expressed concerns regarding the price of FTT in 2019, and the potential consequences of a decline in price.[445]

A second example of manipulation occurred in or around July 2021, when Binance began to sell some of its significant FTT holdings. Ellison testified that she was instructed by Bankman-Fried to defend the price of FTT by "buying once the price had gone down a bit," due to the downward pressure created by Binance "selling some of their stake in FTT."[446] Ellison understood that Bankman-Fried wanted her to defend the price of FTT to avoid unnerving the market or "put[ting] any of our loans in danger by having the price go down too much"—even if this resulted in Alameda losing money on the individual trades.[447]

Finally, Ellison testified concerning an effort to prop up the value of FTT on November 6, 2022, after Binance's then-CEO announced an intention to sell all remaining FTT holdings. In response, and in an effort to counteract a reduction in FTT's price and dispel concerns over Alameda's liquidity, Ellison tweeted an offer to buy Binance's holdings for $22 per token.[448] Ellison testified that, while this tweet did stabilize FTT's price around $22 for some time, it continued to decline and she and Bankman-Fried stopped defending FTT at $22 in the face of "a lot of selling."[449]

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[445] Binance Memo, at 10 (quoting F10705-E000273198).

[446] Transcript at 674:18-23, SBF Criminal Case, Dkt. No. 358; *see also Sec. & Exch. Comm'n v. Ellison*, No. 22-cv-10794 (S.D.N.Y.) (PKC), Dkt. No. 1 at ¶ 93 ("In another instance in 2021, the price of FTT was again facing downward pressure from external events, this time related to substantial sales of FTT by a third party. Bankman-Fried again instructed Ellison to have Alameda purchase FTT on trading platforms to support the price.").

[447] Transcript at 676:23-677:2, SBF Criminal Case, Dkt. No. 358.

[448] Transcript at 905:18-22, 906:12-17, SBF Criminal Case, Dkt. No. 360.

[449] *Id*. at 907:10-25.

Additionally, Ellison testified that, in general, Bankman-Fried "gave us a lot of instructions about FTT" and that "at various points he instructed us to buy if there was a large amount of selling or if the price was going down too much."[450]

3. Individuals Involved in Manipulation

The investigations into FTT manipulation have principally centered on conduct by Ellison, under the direction of Bankman-Fried, to manipulate the price of FTT for the benefit of Alameda. At the Bankman-Fried trial, Ellison testified that such information was closely held among select individuals and not widely shared.[451]

On the other hand, testimony and exhibits introduced at the trial suggest that others at the FTX Group may have had occasion to detect efforts to manipulate FTT. For example, Ellison testified concerning an instance in which trades undertaken with the purpose of supporting the price of FTT, as opposed to maximizing value, were questioned by another Alameda trader.[452] Ellison also testified that the plan to publicly tweet the $22 offer for FTT in November 2022 was discussed in a group chat that included not only herself and Bankman-Fried but also other individuals associated with Alameda.[453] Moreover, the SEC complaint alleges that the manipulation was carried out in part through bots that were programmed to trade at certain prices. But the SEC complaint does not identify those involved in the programming. However, while the above individuals and others may have questioned certain trading activity of Alameda and even had reason to suspect ulterior motives, this alone does not indicate actual knowledge as to the manipulative intent of such transactions, nor knowing participation in such conduct.

[450] Transcript at 674:12-17, SBF Criminal Case, Dkt. No. 358.

[451] *Id.* at 674:24-675:7.

[452] *Id.* at 676:4-22.

[453] Transcript at 904:22-906:17, SBF Criminal Case, Dkt. No. 360.

Based on materials reviewed in this Examination and discussions with counsel for the Debtors, it does not appear that the Debtors conducted an investigation with the specific objective of identifying all employees or agents of the FTX Group who had actual knowledge of or contributed to the manipulation of FTT. However, as set forth above, S&C reviewed numerous communications of the FTX Group's senior executives, including Bankman-Fried and Ellison, and investigated other subjects that likely would have identified any others centrally involved in FTT manipulation. Based on information provided by S&C, that work did not reveal any such other individuals.

4. Use of FTT to Inflate Alameda's Value

Apart from the attempts to manipulate the market price of FTT discussed above, prior investigations have concluded that Alameda's valuation of its FTT holdings using open market prices was itself unreasonable given the relatively illiquid market for FTT and the fact that FTT made up a significant portion of Alameda's balance sheet.

Based on these investigations, Alameda executives understood that if Alameda had sought to liquidate its outsized holdings, it could not have obtained the same prices reflected in the market for much smaller transactions. Ellison testified at Bankman-Fried's trial that she initially did not put Alameda's FTT holdings on Alameda's balance sheet, since it would have been "somewhat misleading because we wouldn't have been able to sell all the FTT for that much and it was much larger than the rest of the items on our balance sheet at the time."[454] She similarly testified that, given that Alameda owned most of the FTT in circulation, "if Alameda

[454] Transcript at 678:20-679:3, SBF Criminal Case, Dkt. No. 358.

had actually tried to sell the FTT that we owned, it would have ended up kind of making up way less than" the mark-to-market value reflected on the balance sheet.[455]

Wang similarly testified that if Alameda had sold all of its FTT in 2019 or 2020, "it would cause the price of FTT to drop by large amounts."[456] That was "[b]ecause there is not enough people who would want to buy all of the FTT that is being sold all at once at the price it was currently trading at."[457]

In addition, prior investigations suggest that certain agents of the FTX Group may also have been aware of these risks. For example, in its investigation of Law Firm-1, Quinn Emanuel identified a December 2019 communication from Bankman-Fried to members of that firm in which Bankman-Fried acknowledged that "Alameda holds lots of FTT, which has a high market value but that market value could not be realized without crashing the market."[458] Quinn Emanuel concluded that the firm would have understood at the time that the FTX Group's holdings in FTT were illiquid and thus posed a significant risk to the FTX Group's solvency.[459]

5. The Buy and Burn Program

Bankman-Fried testified at trial that the buy and burn program was a key feature of FTT and functioned "similar to a share buyback. So if, for instance, FTX had $3 million of revenue in a week, it would take 1 million of those dollars and use that to buy FTT tokens in the market, effectively giving value to FTT token holders."[460] While this program was touted as providing

[455] *Id*. at 679:4-12.

[456] Transcript at 378:9-14, SBF Criminal Case, Dkt. No. 352.

[457] *Id.* at 378:15-19.

[458] Document produced by Law Firm-1 to Quinn Emanuel.

[459] Quinn Emanuel's investigation has not, however, identified any evidence that this firm was aware of the efforts by the FTX Group to manipulate the market price of FTT.

[460] Transcript at 2374:5-15, SBF Criminal Case, Dkt. No. 376.

value to ordinary holders of FTT, the CFTC has alleged that this program existed to inflate the value of the FTT that remained in circulation—the vast majority of which was held by Alameda.[461] Through post-Petition Date investigations, S&C similarly concluded that the program created upward pricing pressure on FTT.[462] S&C determined that the FTX Group spent approximately $462 million of its approximately $1.5 billion in gross revenue on this FTT buy and burn program in order to purchase FTT from existing token holders, including Alameda.[463]

S&C has also investigated certain aspects of FTT's buy and burn program. FTX Trading had represented that the FTT buy and burn program was conducted by Cottonwood Grove, a wholly owned subsidiary of Alameda, through the terms of a licensing agreement with FTX Trading.[464] Pursuant to this agreement, dated April 15, 2019, Cottonwood Grove was to receive certain licensing fees from FTX Trading that it could use to repurchase tokens for burning. Bankman-Fried served as the signatory for both Cottonwood Grove and FTX Trading on this agreement.[465] However, through its investigation, S&C concluded that the Cottonwood-FTX agreement was "likely illegitimate" and "likely an attempt to shield revenues from tax authorities."[466] Among other things, forensic experts retained by S&C did not identify any payments between FTX Trading and Cottonwood, which one would have expected to see if there was a legitimate licensing agreement between the companies.[467]

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[461] *Commodity Futures Trading Comm'n v. Bankman-Fried*, No. 1:22-cv-10503 (S.D.N.Y.) (PKC), Dkt. No. 13 at ¶¶ 69-70.

[462] S&C, *Review of Post-Petition Investigations for Examiner,* Mar. 15, 2024, at 175.

[463] *Id.*

[464] Cottonwood Agreement Summary, at 1,3.

[465] Software License, Tokenization, and Co-Marketing Agreement, at 11, F10705-E000004616.

[466] Cottonwood Agreement Summary, at 5, 10.

[467] *Id*. at 6-8.

S&C also conducted an investigation into the actual mechanics of the FTT buy and burn program. S&C, with assistance from Alvarez & Marsal, determined that the buy and burn program was conducted through an FTX Trading account that bought FTT on the open market. A detailed review of data for the buy and burn transactions conducted by Alvarez & Marsal did not reveal any improper preferential trading, non-market price trading, or other potential manipulation conducted through this program.

III. Summary of Investigations into Other FTX-Affiliated Tokens

Compared to FTT, there has been more limited investigation into three other cryptocurrency tokens associated with the FTX Group: SRM, OXY, and MAPS (the "Other FTX-Affiliated Tokens"). As discussed in Section I(b) above, each of these tokens was in part created by, or otherwise associated with, Bankman-Fried. In addition, based on public reporting and exhibits introduced during the trial of Bankman-Fried, Alameda listed holdings of each of these tokens on its balance sheet.

Given this context, this Examination also considered prior investigatory work concerning these tokens, and whether the FTX Group may have also manipulated one or more of these tokens or otherwise used holdings of such tokens to inflate its value.

As set forth below, although the Other FTX-Affiliated Tokens do not appear to have been the principal focus of any investigation to date, certain information regarding these tokens has emerged from investigations into other subjects.

a. Investigative Work

1. Government Investigations and Actions

The complaints filed by the SEC and testimony elicited during the Bankman-Fried criminal trial focused principally on FTT as the subject of token manipulation. However, the complaints also allude to potential misconduct related to Other FTX-Affiliated Tokens.

The SEC complaints allege that "Bankman-Fried . . . misrepresented the risk profile of investing in FTX . . . by failing to disclose FTX's exposure to Alameda and, relatedly, that the collateral Alameda deposited on FTX consisted largely of illiquid, FTX-affiliated tokens, including FTT."[468]

During the Bankman-Fried trial, Ellison testified that Alameda had large holdings of SRM, MAPS, and OXY, and that these illiquid coins, along with FTT, were placed on Alameda's balance sheet.[469] Ellison also testified that Alameda had programmed models to support not only the price of FTT, but also SRM.[470] This testimony is detailed further in the following section.

2. The Debtors' Investigations

The Debtors do not appear to have conducted a dedicated investigation with the specific purpose of identifying manipulation of the Other FTX-Affiliated Tokens. However, these tokens are briefly addressed in certain materials shared with the Examiner.

Specifically, Quinn Emanuel's investigation into Law Firm-1 also addressed certain issues concerning the creation and control of SRM by the FTX Group. The findings of this investigation are detailed below. In addition, in the Motion of Debtors to Estimate Claims Based on Digital Assets, the Debtors asserted that "Alameda's balance sheet holdings of MAPS, OXY and SRM played a large role in Mr. Bankman-Fried's fraud."[471] Additionally, an expert proffered by the Debtors in support of that motion opined that the SRM, MAPS, and OXY tokens appeared "consistent with [a] strategy" to "artificially inflate the trading price of the

[468] *Sec. & Exch. Comm'n v. Bankman-Fried*, No. 22-cv-10501 (S.D.N.Y.), Dkt. No. 1 at ¶ 29; *see also Sec. & Exch. Comm'n v. Ellison*, No. 22-cv-10794 (S.D.N.Y.), Dkt. No. 1 at ¶ 33 (substantially similar language).

[469] Transcript at 681:17-683:7, SBF Criminal Case, Dkt. No. 358.

[470] *Id*. at 719:22-720:16.

[471] Dkt. No. 9566 at ¶ 4.

token" through a restriction of free-float.[472] The Examiner understands that S&C has also investigated certain matters related to MAPS and OXY.

b. Investigative Findings

As set forth above, there has been relatively limited investigation concerning SRM, MAPS, and OXY. This section summarizes the current findings of these investigations based on information reviewed in this Examination.

1. Alameda's Holdings of Illiquid Other FTX-Affiliated Tokens on Its Balance Sheet

At the trial of Bankman-Fried, Ellison testified that, as with FTT, the overall liquidity of these coins "was not very high."[473] Nevertheless, Alameda ultimately included each of these coins on its balance sheet.

At trial, the government introduced a consolidated balance sheet for Alameda for Q2 of 2022 that attributed roughly $1 billion of Alameda's $14.6 billion in total reported assets to holdings of SRM, MAPS, and OXY.[474] This included line items for $182 million in unlocked SRM, $160 million in unlocked MAPS, and $37 million in unlocked OXY, as well as entries for roughly $300 million in locked SRM, $347 million in locked MAPS, and $38 million in locked OXY.[475] By comparison, the same balance sheet reported over $5.8 billion in FTT assets (between "Unlocked FTT" and "FTT collateral").[476]

As with FTT, Ellison testified that if Alameda attempted to sell all of its holdings in the Other FTX-Affiliated Tokens, "we would end up getting a lot less" than the value on the balance

[472] Dkt. No. 9566-2 at ¶ 10.

[473] Transcript at 682:6-17, SBF Criminal Case, Dkt. No. 358.

[474] GX-419 (Consolidated Balance Sheet 2022 Q2), SBF Criminal Case; *see also* Transcript at 811:2-14, SBF Criminal Case, Dkt. No. 360 (USAO-SDNY introducing balance sheets that Ellison prepared, including GX-419).

[475] GX-419 (Consolidated Balance Sheet 2022 Q2), SBF Criminal Case.

[476] *Id*.

sheet.[477] Wang similarly testified that SRM and FTT were cryptocurrencies "that were illiquid" and so Alameda "wouldn't be able to get the full value."[478] This is notable since, based on information provided by S&C, Alameda may have used its SRM holdings to collateralize certain loan obligations—although to a much lesser degree than with FTT.

2. Potential Manipulation of Other FTX-Affiliated Tokens

At the Bankman-Fried trial, Ellison testified that the low liquidity of a given token made it easier to move the price of that token through trades. She gave the following example:

> So liquidity is a measure of how much market trading activity there is in something and how easy it is to buy and sell it without moving the price too much. So for some of these coins, like MAPS, if you tried to buy a little bit of MAPS, the price would go up a lot, and, conversely, if you tried to sell it, the price would go down a lot.[479]

Similarly, in postpetition litigation over the value of SRM, MAPS, and OXY, an expert retained by the Debtors opined that market prices for the tokens were based on amounts of tokens available for trading (free float), which were "*less than three percent* of the tokens' maximum supply."[480] The Debtors' expert observed that others, including Bankman-Fried, had acknowledged that restricting the free float of tokens could allow for the creators of those tokens to inflate the market values; they could then use those inflated market values to inflate the values of the tokens on their balance sheets.[481] The Debtors' expert opined that "[t]he at-issue tokens appear to be consistent with this strategy."[482] However, the Debtors' expert did not investigate these tokens to determine if manipulation had actually occurred.

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[477] Transcript at 683:3-7, SBF Criminal Case, Dkt. No. 358.

[478] *Id*. at 526:12-19.

[479] *Id*. at 682:10-17.

[480] Dkt. No. 9566-2 at ¶ 10 (emphasis in original).

[481] *Id*. at ¶ 10.

[482] Dkt. No. 9566-2 at ¶ 10.

At trial, Ellison testified that Alameda had trading models that "were generally set up to buy FTT and Serum as they went down," in order to "support them, provide liquidity"—and that this was done in part to keep the price up.[483] Based on information provided in this Examination, it does not appear that the Debtors specifically investigated these models.

3. Debtors' Control of Serum

At the time SRM was launched, FTX Trading and Alameda disclosed that they had created the Serum Foundation, which built the Serum protocol.[484] The Serum white paper represented, however, that "[w]hile we have built the Serum protocol, it is permissionless—***we do not hold special power anymore***. It is up to you, the crypto community, to use it as you will."[485] Contrary to such representations, Quinn Emanuel determined that the FTX Group in fact maintained the ability to exercise at least a certain degree of control over Serum.

Quinn Emanuel's investigations further found that, at the instruction of the FTX Group's employees, Law Firm-1 created the Serum Foundation with systems that would allow certain employees of the FTX Group to continue to exercise control over the Serum Foundation and the SRM token. Quinn Emanuel also found that individuals associated with the FTX Group used Law Firm-1 to create an entity called the Incentive Ecosystem Foundation in order to provide incentives for the SRM ecosystem and bolster SRM's market price, while concealing that entity's connection to the FTX Group.[486] In addition, Quinn Emanuel found that, unbeknownst

[483] Transcript at 719:20-720:16, SBF Criminal Case, Dkt. No. 358.

[484] Anatoly Yakovenko, *FTX Chooses Solana for Serum: A High-Speed, Non-Custodial Decentralized Derivatives Exchange*, Medium (July 27, 2020), https://medium.com/solana-labs/ftx-chooses-solana-for-serum-a-high-speed-non-custodial-decentralized-derivatives-exchange-c346a27c1f2b, *archived at* https://perma.cc/672K-GZJU.

[485] Serum Foundation, *Serum—White Paper*, 11 (July 2020) (emphasis added), https://whitepaper.io/document/626/serum-whitepaper, *archived at* https://perma.cc/GWZ4-EQTC.

[486] *See* Andrew Thurman, *Solana DeFi Major Serum's 'Incentive Ecosystem Foundation' Is Raising $100M*, CoinDesk (Jan. 7, 2022), https://www.coindesk.com/business/2022/01/07/solana-defi-major-serums-incentive-ecosystem-foundation-is-raising-100m/, *archived at* https://perma.cc/7XS8-AS8A (article quotes an "pseudonymous Serum core contributor JHL" who framed the foundation as a part of Serum separating itself from the FTX Group).

to the public, the FTX Group and certain affiliated individuals could control the burn of SRM tokens during a transition period. However, Quinn Emanuel has not identified any evidence that Law Firm-1 was aware of any actual manipulation of the buy and burn program.

S&C directed an investigation into Solana, the blockchain platform used for Serum. Although this investigation identified a "significant level of collaboration between the FTX and Solana teams,"[487] the investigation did not find that Solana was aware of any improper control or manipulation by the FTX Group in connection with the Serum Foundation or the SRM token.

4. The Debtors' Involvement with MAPS and OXY

As discussed above, contemporaneous public reports disclosed that Bankman-Fried and/or Alameda had invested in MAPS and OXY, and that Bankman-Fried served as an advisor to both MAPS and OXY. Investigatory work by the Debtors during the bankruptcy cases has revealed additional connections.

First, in a filing in the bankruptcy cases, the Debtors reported that Friedberg—the former General Counsel of Alameda—"commissioned the White Paper for Maps and drafted significant portions of it in October 2020."[488]

Second, S&C requested that Nardello investigate certain matters concerning MAPS Vault, an entity owned by Alexander Grebnev and Victor Mangazeev.[489] Grebnev and Mangazeev are listed as the co-founders of MAPS and OXY in the respective white papers.[490] The January 31, 2024 Nardello investigation memorandum does not address any potential

[487] Nardello, *Memorandum re: Solana*, Sept. 19, 2023, at 18.

[488] Dkt. No. 9566 at ¶ 25.

[489] Nardello, *Memorandum re: Potential Claimant—MAPS Vault Limited*, Jan. 31, 2024 ("MAPS Vault Memo"), at 2.

[490] *See* Maps.me, *Maps—White Paper*, 9 (Jan. 2021), https://maps.me/token/MAPS.pdf, *archived at* https://perma.cc/GRM4-HKWH; Oxygen, *Oxygen: The Prime Brokerage Protocol White Paper*, 9-10 (Dec. 2020), https://www.oxygen.org/Oxygen.pdf, *archived at* https://perma.cc/H894-8EJE.

manipulation of MAPS or OXY. However, the investigation found that companies associated with both MAPS and OXY had signed agreements with Cottonwood Grove—a subsidiary of Alameda.[491]

IV. Conclusion

As set forth above, the Bankruptcy Court charged the Examiner with determining "whether the Investigations adequately addressed the Debtors' use of its cryptocurrency, FTT, to inflate the value of FTX and Alameda Research."[492] This Examination also considered the same question with respect to the Other FTX-Affiliated Tokens, three other cryptocurrency tokens closely associated with the FTX Group.

Based on the information and materials reviewed in the course of this Examination, and given the objectives of the bankruptcy process and this Examination, the Examiner concludes that prior investigations have adequately addressed whether the FTX Group used these cryptocurrency tokens to inflate its value.

To be sure, the investigations to date may not have identified every instance in which FTT or other cryptocurrency tokens may have been manipulated by the FTX Group or otherwise used to inflate the value of the FTX Group, including Alameda, prior to the Petition Date. In particular, the investigations into the Other FTX-Affiliated Tokens have been relatively limited to date, despite indications that those tokens had the potential to be manipulated in a similar manner as FTT. On the other hand, the Other FTX-Affiliated Tokens were less prominent and comprised a significantly smaller portion of Alameda's balance sheet. Moreover, the Examiner

[491] MAPS Vault Memo, at 5 (finding that Cottonwood Grove signed a $15 million revolving loan agreement with MAPS Vault, and that Cottonwood Grove signed an agreement with Oxygen to coordinate any private sales of tokens over $1 million).

[492] Scope Order at ¶ 3.

understands that certain investigations related to the Other FTX-Affiliated Tokens remain ongoing.

Overall, the Examiner concludes that further investigation into these subjects is unlikely to confer significant additional benefit on the estates or the public at this juncture. As set forth above, questions concerning token manipulation and inflation of assets by the FTX Group have been investigated by multiple government agencies, as well as multiple professionals retained by the Debtors. The findings across these investigations are largely consistent and have already identified several methods of manipulation as well as the individuals primarily involved in such conduct. Although further investigation by the Examiner into token manipulation might reveal additional instances of manipulation or other individuals who facilitated such conduct, such an investigation would require significant time and resources that is likely to outweigh any marginal benefit conferred on the estates or the public.

PART 5: MISCONDUCT BY PROFESSIONALS ENGAGED BY THE FTX GROUP

In addition to reporting on the three enumerated issues in the Scope Order, the Examiner was charged with "summariz[ing] the investigations of the Debtors" and "mak[ing] recommendations for additional investigations."[493] Pursuant to that obligation, this Part examines and summarizes investigations into professional service firms used by the FTX Group. A summary of investigations into other issues involving the FTX Group—beyond the three issues enumerated in the Scope Order and the FTX Group's professional service firms—follows in Part Six.

After the FTX Group filed its Chapter 11 petitions, Quinn Emanuel was retained as conflicts counsel and directed to undertake a comprehensive investigation of any professionals the FTX Group engaged prior to the Petition Date. In total, Quinn Emanuel identified 195 different law firms, auditors, accountants, financial consultants, and other professionals engaged by the FTX Group between 2017 and 2022 (collectively, "Professionals").[494] The vast majority of Professionals investigated were law firms.[495] Quinn Emanuel, with Alvarez & Marsal and S&C, used the FTX Group's books and records to identify these firms by locating engagement letters, payments for "Legal Services" or "Professional Services" as reflected in the general ledgers, bank statements, and FTX Exchanges.[496] Additionally, as Quinn Emanuel's parallel investigations into the FTX Group's venture investments and the FTX leadership progressed, it identified several other entities the FTX Group had engaged.[497]

[493] Scope Order at ¶ 2.

[494] Professionals Report, at 1.

[495] *Id.* at 5.

[496] *Id.* at 6-7.

[497] *Id.* at 3, 7.

For the purposes of determining the type of investigation to be undertaken, Quinn Emanuel assigned each Professional to a group depending on the nature and extent of the professional services provided, as well as Quinn Emanuel's determination of the total fees paid to the Professional based on its analysis of the FTX Group's books and records.[498] Each engagement was first reviewed to determine whether it potentially related to, or touched on, the subject of FTX leadership misconduct, including: (1) the treatment of FTX.com customer deposits and funds; (2) the use of the FTX exchanges' customer funds; (3) the sources of assets available to Alameda and other FTX Group entities; (4) the use of FTX Group assets to make venture investments; (5) statements and representations to the FTX exchanges' customers, Alameda's lenders and creditors, regulators, and the investing public generally; (6) interactions with foreign government officials in connection with regulations, licensure, and the disposition of FTX Group cryptocurrency; and (7) legal and internal controls within the FTX Group (collectively, the "Investigative Topics").[499]

Section I discusses the law firms that provided prepetition legal services to the FTX Group; Section II discusses the FTX Group's auditors; Section III discusses the FTX Group's accountants; Section IV discusses the FTX Group's valuation firms; Section V discusses the consultants that provided the FTX Group regulatory, compliance, and licensing services; Section VI discusses the FTX Group's government and community relations consultants; Section VII discusses the FTX Group's lobbyists; Section VIII discusses other professional vendors hired by

[498] *Id.* at 6-7; *see also id*. at Appendix A.

[499] Quinn Emanuel developed these investigative topics after reviewing several publicly filed documents—including the Fifth Superseding Indictment returned on March 27, 2023 against Bankman-Fried; the proceedings leading up to and including the criminal trial of Bankman-Fried; and the findings presented in the First and Second Interim Reports regarding FTX Group's control failures—as well as the Debtors' investigations into FTX leadership, investment and venture acquisitions, and the facts developed through the Debtors' prosecution of civil actions. *Id.* at 4-5.

the FTX Group; and Section IX discusses the FTX Group's banks and financial institutions. Finally, Section X explains the bases for the Examiner's conclusion that, at this time, none of these prepetition professionals warrant further investigation by him.

I. Law Firms

Quinn Emanuel identified 145 law firms that provided prepetition legal services to the FTX Group.[500] Quinn Emanuel categorized each firm into one of three tiers based on criteria reflected below:

Table 1

	Tier One	Tier Two	Tier Three
Primary Criteria	Services significantly intersected with the Investigative Topics **OR** fees over $1 million	> $100k Fees **AND** intersection between services and Investigative Topics	< $100k Fees **AND** no apparent intersection between services and Investigative Topics
Depth of Investigation	• Scope of engagement • Invoices • Review internal documents • Rule 2004 Requests • Investigatory memoranda	• Scope of engagement • Invoices • Review relevant internal documents	• Scope of engagement • Invoices

Initially, Tier One comprised 29 law firms, Tier Two comprised 17 firms, and Tier Three included 99 firms.[501] Twenty-three of the Tier Two and Tier Three law firms were later reclassified to Tier One after Quinn Emanuel determined that the scope of these engagements potentially intersected with certain Investigative Topics.[502]

[500] *Id.* at 7; *see also id.* at Appendix B.

[501] *Id.* at 9.

[502] *See id.* at Appendix B; *see also id*. at 13.

a. Tier One Law Firms

The law firms subject to Tier One investigation received more than $1 million in fees or provided services that touched on the Investigative Topics. Tier One was subject to the most rigorous investigation. The process included Bankruptcy Rule 2004 requests, a review of the FTX Group's internal documents, and preparation of investigatory memoranda.[503] In response to its Bankruptcy Rule 2004 requests, Quinn Emanuel received and reviewed approximately 222,500 documents. Simultaneously, Quinn Emanuel reviewed approximately 226,000 documents in the FTX Group's possession that were specifically tied to known Professionals' names and email addresses.[504] The investigation concluded that the Tier One law firms were paid approximately $54.7 million in fees.

b. Tier Two Law Firms

Seventeen law firms were initially categorized as Tier Two (i.e., the firm was paid more than $100,000 and had some engagements related to the Investigative Topics).[505] Quinn Emanuel analyzed their: (1) scope of engagement; (2) invoices; and (3) other relevant documents and communications maintained by the FTX Group.[506] In the course of the Tier Two investigation, Quinn Emanuel escalated 10 firms to Tier One investigatory scrutiny.[507] For the remaining seven law firms, Quinn Emanuel found that they provided general corporate, general

[503] Professionals Report, at 3, 9.

[504] *Id.* at 11.

[505] *Id.* at 12-13.

[506] *Id.* at 13.

[507] *Id.*; *see also id*. at Appendix B.

employment, or immigration services not relevant to the Investigative Topics.[508] Accordingly, Quinn Emanuel determined that these seven law firms did not warrant further scrutiny.[509]

c. Tier Three Law Firms

The remaining 99 law firms, all of whom invoiced the FTX Group less than $100,000, were investigated as Tier Three firms.[510] Quinn Emanuel reviewed these firms' invoices and engagement letters to assess whether any warranted further investigation.[511] Ultimately, Quinn Emanuel concluded that 13 of these firms should be escalated to Tier One scrutiny, as the firms provided legal services significantly related to the Investigative Topics.[512] The remaining 86 Tier Three firms were not subject to further investigation.[513]

d. Witnesses Interviewed in Connection with Law Firm Investigations

In addition to reviewing documents, Quinn Emanuel and S&C interviewed former FTX Group in-house attorneys and compliance officers.[514] These individuals were interviewed to provide additional background on the prepetition law firms and their work for the FTX Group, as well as to provide more detail on issues such as whistleblower complaints and how they were addressed.

e. Summary of Notable Findings Concerning Law Firms[515]

This Section discusses Quinn Emanuel's investigation into certain Tier One law firms, the law firms subject to the most rigorous investigation. In general, Quinn Emanuel determined

[508] *Id*. at 13.

[509] *Id*.

[510] *Id.*

[511] *Id.*

[512] *Id*. at Appendix B.

[513] *Id.* at 13.

[514] *Id.* at 14.

[515] An analysis of notable findings concerning S&C is included in Part 2, *supra*.

that the FTX Group selected law firms in a disorganized and haphazard manner. Only Law Firm-1 was entrusted with a bird's-eye view. Otherwise, law firms were generally given discrete tasks on an ad hoc basis and work was often duplicated among law firms. As a result, at times, law firms received fees without providing meaningful services. However, Quinn Emanuel's investigation also determined that most law firms' work did not intersect with misconduct at the FTX Group.

1. Law Firm-1

Quinn Emanuel's investigation established that Law Firm-1 was perhaps the law firm most intertwined with the FTX leadership and, unlike other Professionals, had unique access to a vast range of matters and information on behalf of the FTX Group. As of February 2024, Quinn Emanuel reviewed approximately 68,000 documents through strategic searches of the FTX Group's internal database and documents produced by non-law firm third parties (together, the "Database").[516] Quinn Emanuel also obtained more than 183,136 documents from Law Firm-1 through its Bankruptcy Rule 2004 requests.[517] Notably, however, Law Firm-1 frequently used ephemeral messaging platforms such as Signal[518] to communicate with individuals at the FTX Group and, to date, has only produced 144 individual or group chats between Law Firm-1 and FTX Group employees.[519] Only 18 of those chats still contained messages; the remainder only showed that a group message had once existed, but did not contain any content. As of May 2024, Law Firm-1's production and Quinn Emanuel's investigation remain ongoing.[520]

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[516] Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 12.

[517] Professionals Report, at 19.

[518] Ephemeral messaging applications are programs that allow messages to be automatically deleted at some point following receipt of a message. *See supra* note 151.

[519] Professionals Report, at 21.

[520] *Id*. at 19 n.32.

Joseph Bankman selected Law Firm-1 as Alameda's outside counsel in October 2017.[521] Law Firm-1 then served as the FTX Group's primary U.S. outside counsel and advised the company on issues of employment, tax, lending agreements, acquisitions, regulatory matters, government investigations, compliance and risk mitigation, equity incentives, partnership agreements, trademark enforcement, intercompany services agreements, purchase agreements, and financing.[522] Between 2018 and 2022, Law Firm-1 received more than $22 million in legal fees from the FTX Group.[523]

In 2018, while Friedberg was a partner at Law Firm-1, Joseph Bankman encouraged Bankman-Fried to employ Friedberg in a central role at Alameda.[524] Friedberg and Can Sun left Law Firm-1 to join the FTX Group, in January 2020 and August 2021, respectively.[525] Friedberg served as both the Chief Compliance Officer for FTX.US and General Counsel of Alameda, and Sun was the General Counsel for FTX Trading.[526] However, the relationship between Law Firm-1 and the FTX Group went beyond Friedberg and Sun. Joseph Bankman maintained unusually close personal relationships with various other Law Firm-1 lawyers, which sometimes translated into subsidizing perks for certain Law Firm-1 attorneys, such as paying for travel and admittance to sporting events.[527]

Quinn Emanuel found that Law Firm-1 was involved in an expansive range of matters, including those that closely intersected with core aspects of the FTX Group's improper

[521] *Id.* at 18-19.

[522] *Id.* at 19.

[523] *Id.* at 19; *see also id.* at Appendix A.

[524] *Id*. at 19.

[525] *Id*. at 19-20.

[526] *Id*. at 20.

[527] *Id.*

operations and management. For example, Law Firm-1 attorneys were directly involved in the following:

- The FTX Group's issuance of "founder loans," which were used to move at least $2 billion in cash and assets among FTX Group entities, as well as directly into the personal accounts of FTX Group leadership;
- Friedberg's creation of a backdated payment agent agreement between FTX Trading and Alameda;
- FTX Group leadership's efforts to obfuscate from government regulators and investors the close relationship between FTX Trading and Alameda;
- FTX Group leadership's efforts to use unconventional settlements to silence credible whistleblowers; and
- FTX Group's efforts to downplay its involvement with, and control over, the Serum Foundation.[528]

Given Law Firm-1's role and retention concerning several matters related to the misconduct of the FTX Group leadership, Quinn Emanuel continues to assess these facts and evaluate what additional steps it might advise the Debtors to take.[529]

2. Law Firm-2

Quinn Emanuel reviewed all 15,742 documents produced by Law Firm-2 in response to Bankruptcy Rule 2004 requests and approximately 15,950 of the FTX Group's own documents relating to Law Firm-2 identified using various search terms.[530]

Quinn Emanuel's review revealed that Ryne Miller selected Law Firm-2 as counsel for the FTX Group in December 2021.[531] Law Firm-2 was then formally engaged by the FTX

[528] *Id.* at 21.

[529] *Id.* at 21-22.

[530] *Id.* at 29.

[531] *Id.*

Group and worked continuously on FTX Group matters, primarily on issues related to the FTX Group's venture investments, until November 2022.[532]

Many of the venture investments on which Law Firm-2 advised the FTX Group or a counterparty failed, came under regulatory scrutiny, or both.[533] The FTX Group's in-house counsel typically instructed Law Firm-2 to perform little to no diligence on pending venture investments, and Law Firm-2 complied with this client directive.[534] Law Firm-2 itself internally flagged the FTX Group's "light" approach to due diligence on several occasions.[535]

Additionally, Quinn Emanuel's investigation raised questions about the extent to which Law Firm-2 consistently conveyed the full extent of legal risks to the FTX Group, in particular regarding the risks of performing minimal or no diligence prior to executing transactions. The investigation also identified transactions where Law Firm-2 represented a counterparty to the FTX Group during the same period of time that Law Firm-2 represented FTX Group entities in separate transactions.[536] Many of these transactions did not include conflicts waivers.[537]

3. Law Firm-3

Quinn Emanuel reviewed approximately 2,755 documents produced by Law Firm-3 in response to FTX Group's Bankruptcy Rule 2004 requests, and 5,845 documents maintained by the FTX Group.[538] Quinn Emanuel concluded that FTX Trading engaged Law Firm-3 from November 2021 until November 2022 for services related to its venture investments. However,

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[532] *Id.*

[533] *Id.* at 30.

[534] *Id.* at 33.

[535] Quinn Emanuel, *Memorandum re: FTX Investigations Review of Law Firm-2*, Apr. 29, 2024, ("Law Firm-2 Report"), at 11.

[536] Law Firm-2 Report, at 35.

[537] *See id.* at 36-37.

[538] Professionals Report, at 33-34.

Law Firm-3 also provided services to other FTX Group entities, including Alameda Ventures, FTX Ventures, Alameda Research Ltd., and Alameda Research Ventures LLC.[539] As he did with Law Firm-2, FTX Group's in-house counsel routinely instructed Law Firm-3 to perform little to no due diligence on multiple investments and Law Firm-3 complied with these directives.[540]

4. Law Firm-4

Quinn Emanuel sent Rule 2004 requests to Law Firm-4, a Swiss law firm.[541] However, Law Firm-4 refused to produce documents without the approval of FTX Europe AG's sole remaining board member, Dr. Marcel Lötscher, who did not grant his approval.[542] Accordingly, Quinn Emanuel's investigation of Law Firm-4 was limited to an analysis of approximately 1,770 documents from the Database.[543] The review revealed that from October 2021 through November 2022, Law Firm-4 provided services to various FTX Group entities, including FTX Trading, FTX Europe AG, and Alameda Ventures. This work was done in support of the FTX Group's strategy to enter the European cryptocurrency market by acquiring or investing in European entities, including Digital Assets DA AG ("DAAG").[544] Additionally, Law Firm-4 provided tax, regulatory, and general corporate advice in connection with the FTX Group's European expansion.[545] Consistent with their instructions to Law Firm-2 and Law Firm-3, the

[539] *Id.* at 34.

[540] *Id.*

[541] *Id.* at 35.

[542] *Id.* Dr. Lötscher moved to dismiss FTX Europe AG's Chapter 11 filing on November 17, 2023, arguing that the filing was not authorized under Swiss law. *See* Dkt. No. 4037. That motion was withdrawn on April 3, 2024. Dkt. No. 11028.

[543] Professionals Report, at 35.

[544] *Id.* The DAAG acquisition is discussed in greater detail in Part 6 *infra*.

[545] *Id.*

FTX Group's in-house counsel repeatedly instructed Law Firm-4 to provide minimal or no due diligence on potential acquisitions and Law Firm-4 complied with these instructions.[546]

5. Law Firm-5

Quinn Emanuel served Bankruptcy Rule 2004 requests on Law Firm-5, an Australian law firm, but the firm refused to produce documents.[547] Accordingly, Quinn Emanuel's investigation drew on a review of over 10,000 documents from the Database.[548] Quinn Emanuel concluded that Law Firm-5 provided services to the FTX Group in Australia from March 2020 to November 2022.[549] The majority of this work related to the FTX Group's acquisition of fintech businesses Hive Empire Trading Pty Ltd. ("HiveEx"), IFS Markets Pty Ltd., and TigerWit Holdings Ltd. (together with TigerWit Limited (UK), "TigerWit").[550] The FTX Group used HiveEx and IFS Markets Pty Ltd. to form the basis of FTX Australia.[551]

Eventually, Law Firm-5's role grew to include negotiating settlements to avoid negative publicity for the FTX Group.[552] For example, in July 2021, Law Firm-5 arranged for the incorporation of a Cayman Islands company, 707,016 Ltd., to pay off the creditors of Alex Saunders, an Australian crypto-influencer.[553] Saunders was alleged to have used borrowed funds to trade on FTX.com, but lost the funds that he traded.[554] To mitigate any reputational harm and

[546] Professionals Report, at 35.

[547] *Id.* at 36.

[548] *Id.*

[549] *Id.* at 36-37.

[550] *Id.* at 37.

[551] *Id.*

[552] *Id.*

[553] *Id.*

[554] *Id.*

avoid potential litigation, FTX Trading loaned Saunders $13.2 million through 707,016 Ltd. to enable Saunders to pay off his debts.[555] Saunders has not repaid this loan.[556]

A partner at Law Firm-5, who was the FTX Group's primary contact at the firm, personally received at least $727,402 in "finder's fees" for certain acquisitions that he suggested.[557] Law Firm-5 notified Quinn Emanuel in December 2023 that it holds AUD $578,836.82 in trust for FTX Trading, and that it has claims in the amount of AUD $252,787.54 (excluding interest) for unpaid fees.[558]

6. Paul Hastings

FTX.US engaged Paul Hastings in May 2022 to provide regulatory advice on certain compliance matters.[559] Paul Hastings invoiced FTX.US $49,628, but received just $17,678 for its services.[560] Despite the receipt of comparatively modest fees from the FTX Group, Quinn Emanuel subjected Paul Hastings to a more fulsome review due to its role in the bankruptcy cases as counsel to the Unsecured Creditors' Committee. Quinn Emanuel did not serve Bankruptcy Rule 2004 requests on Paul Hastings.[561] Quinn Emanuel's investigation did not uncover any evidence that Paul Hastings engaged in any misconduct or knew of any improprieties by the FTX leadership.[562]

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[555] *Id.*

[556] *Id.*

[557] Quinn Emanuel, *FTX Investigative Review: Law Firm-5*, May 12, 2024, at 1.

[558] *Id.*

[559] Professionals Report, at 40.

[560] *Id.*

[561] *Id*. at Appendix B.

[562] *Id*. at 40-41.

7. Anderson Mōri & Tomotsune

Anderson Mōri & Tomotsune ("AMT") advised Alameda Research K.K. in connection with the FTX Group's expansion into Japan and Japanese operations. This included providing sporadic regulatory and corporate advice.[563] Quinn Emanuel did not serve Bankruptcy Rule 2004 requests on AMT.[564] AMT was paid approximately $1 million in legal fees over the course of its representation.[565] Quinn Emanuel did not identify evidence that AMT engaged in any wrongdoing or had knowledge of the FTX insiders' misconduct.[566]

8. Law Firm-6

Quinn Emanuel served Bankruptcy Rule 2004 requests on Law Firm-6, and Law Firm-6 produced 3,599 documents in response.[567] Alameda and Alameda Research Ltd. retained Law Firm-6 in connection with responses to SEC and CFTC document requests related to the entities' relationship with Tether/Bitfinex.[568] Through its investigation, Quinn Emanuel found that Friedberg engaged Law Firm-6 because Law Firm-1—which would have been his first choice—was conflicted. Law Firm-1 represented FTX.US before the SEC regarding the Tether/Bitfinex matter.[569] Quinn Emanuel discovered that, in responding to the SEC, Law Firm-6 did not produce a document that, according to a Law Firm-6 attorney's notes, raises "[w]orry about market manipulation issues."[570] Quinn Emanuel did not locate this document in either the

[563] *Id.* at 42.

[564] *Id*. at Appendix B.

[565] *Id*. at 42.

[566] Quinn Emanuel, *Memorandum re: FTX Investigations Review of Anderson, Mori & Tomotsune*, Mar. 14, 2024, at 13.

[567] Professionals Report, at Appendix B.

[568] *Id.* at 42-43.

[569] *Id*. at 42.

[570] *Id.* at 43.

documents produced by Law Firm-6 or in the FTX Group's own records.[571] Relatedly, some Law Firm-6 attorneys used Signal to communicate with the FTX Group's in-house counsel, which, due to the ability for the messages to auto-delete, also raised questions as to whether all communications were retained.[572]

9. Law Firm-7

Quinn Emanuel did not issue Bankruptcy Rule 2004 requests to Law Firm-7.[573] Law Firm-7 was engaged by FTX.US to assist with its application to the New York State Department of Financial Services for a Limited Purpose Trust Company Charter ("LPTCC"), a necessary license to engage in a virtual currency business in New York.[574] Quinn Emanuel located documents in which Law Firm-7 voiced its concerns that, in preparing the LPTCC application, FTX.US marked its policies concerning risk assessments and other internal controls as "final" without sufficient review.[575] Nonetheless, at the FTX Group's direction, Law Firm-7 filed the LPTCC application on March 18, 2022.[576] No license was granted as of the Petition Date.[577] Law Firm-7 also provided employment advice to Alameda regarding candidate employees' noncompete agreements with their prior employers. Quinn Emanuel did not identify any issues with this engagement.[578] Quinn Emanuel determined that Law Firm-7 did not appear to have engaged in any actionable misconduct. While Law Firm-7 may have had some knowledge of

[571] *Id.*

[572] *Id.*

[573] *Id.* at Appendix B.

[574] *Id*. at 43-44.

[575] *Id*. at 44.

[576] *Id*.

[577] *Id*.

[578] Quinn Emanuel, *Memorandum of FTX Investigations Review of Law Firm-6*, Nov. 21, 2023, at 1.

FTX.US's deficiencies in policy formation and implementation, the firm attempted to improve those policies.[579]

10. Skadden Arps Slate Meagher & Flom LLP

Quinn Emanuel served a Bankruptcy Rule 2004 request, and Skadden Arps Slate Meagher & Flom LLP ("Skadden") produced 874 documents in response.[580] Skadden advised FTX.US concerning its political donations and lobbying activities.[581] Quinn Emanuel found that, shortly before the Petition Date, Skadden raised numerous concerns regarding undisclosed political contributions by FTX.US.[582] Skadden was paid $370,931 for its legal services.[583]

11. Simmons & Simmons

FTX Trading retained Simmons & Simmons JWS Pte. Ltd ("Simmons & Simmons"), which produced over 100 memoranda on whether certain tokens available on the FTX exchange qualified as regulated assets under Singaporean law.[584] Quinn Emanuel has not located a formal engagement letter with Simmons & Simmons, and it has not served Simmons & Simmons with a Bankruptcy Rule 2004 request.[585] Simmons & Simmons received $544,364 in legal fees.[586]

12. Willkie Farr & Gallagher LLP

Quinn Emanuel served Bankruptcy Rule 2004 requests on Willkie Farr & Gallagher LLP ("Willkie"), which produced 1,277 documents in response.[587] FTX.US retained Willkie to

[579] *Id*. at 8.

[580] Professionals Report, at Appendix B.

[581] *Id.* at 44.

[582] *Id.*

[583] *Id*.

[584] *Id.* at Appendix B.

[585] *Id*. at 45, Appendix B.

[586] *Id*. at 44, Appendix A.

[587] *Id*. at Appendix B.

advise on legal and regulatory options available to allow LedgerX to operate a derivatives exchange without collateral requirements on retail customers' derivatives, and on registration requirements for certain licenses.[588] Eventually, Willkie assisted FTX.US with its lobbying efforts to change the relevant regulations, as the only available options to obtain such licenses risked opening up Alameda's trading activity to regulators.[589] Willkie received $293,632 for its legal services.[590] Quinn Emanuel did not uncover any evidence suggesting that Willkie knew of any misconduct by the FTX leadership.

13. Orrick, Herrington & Sutcliffe LLP

Quinn Emanuel served Bankruptcy Rule 2004 requests on Orrick Herrington & Sutcliffe LLP ("Orrick"), which produced 219 documents in response.[591] FTX Trading retained Orrick in connection with Whistleblower-5's allegations, described *supra*, at Part 3, Section III(e).[592] Specifically, Orrick's role was limited to drafting Whistleblower-5's separation agreement, preparing talking points, and conducting legal research. Quinn Emanuel concluded that Orrick's role in this matter was limited, and did not find any evidence suggesting that Orrick knew of any misconduct by the FTX leadership outside the context of Whistleblower-5's allegations. Orrick was not asked to investigate those allegations.[593] Orrick received $20,762 in legal fees.[594]

[588] *Id.* at 45.

[589] *Id.*

[590] *Id.*

[591] *Id*. at Appendix B.

[592] *Id.* at 52, 55 & n.158.

[593] *Id.* at 52.

[594] *Id.*

14. Holland & Knight LLP

Quinn Emanuel served Bankruptcy Rule 2004 requests on Holland & Knight LLP ("Holland & Knight"), which provided 10,136 documents in response.[595] Holland & Knight advised FTX Trading on a whistleblower's allegations, and various immigration matters.[596] Quinn Emanuel concluded that Holland & Knight's role in advising on the whistleblower's allegations was primarily limited to drafting a settlement agreement. Quinn Emanuel did not find any evidence suggesting that Holland & Knight knew of any misconduct by the FTX leadership outside the context of the whistleblower's allegations. Holland & Knight was not asked to investigate those allegations.[597] Holland & Knight received $64,998 in legal fees.[598]

15. Silver Miller Law

Quinn Emanuel served Bankruptcy Rule 2004 requests on Silver Miller Law ("Silver Miller"), which provided 272 documents in response.[599] The FTX Group retained Silver Miller to provide legal advice concerning a wide array of regulatory matters, and a whistleblower's allegations.[600] Quinn Emanuel concluded that Silver Miller's role in advising on the whistleblower's allegations was limited, and Quinn Emanuel did not find any evidence suggesting that Silver Miller knew of any misconduct by the FTX leadership outside the context of the whistleblower's allegations. Silver Miller was not asked to investigate those allegations.[601] Silver Miller received $760,000 in legal fees.[602]

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[595] *Id.* at Appendix B.

[596] *Id.* at 52.

[597] *Id.*

[598] *Id.*

[599] *Id*. at Appendix B.

[600] *Id.* at 52.

[601] *Id.*

[602] *Id.*; *see also id*. at Appendix A.

16. Pavel Pogodin/Consensus Law

Quinn Emanuel did not receive a response to their Bankruptcy Rule 2004 requests to Pavel Pogodin or his law firms.[603] As noted above, *supra*, at Part 3, Section III(e), Pogodin held himself out as an attorney specializing in legal issues related to cryptocurrency.[604] His law firm, Consensus Law, was retained by the FTX Group after Pogodin represented an entity that had filed a whistleblower lawsuit against the FTX Group and the FTX leadership.[605] Pogodin received "loans" totaling $1 million as part of a settlement with the FTX Group for dropping these whistleblower claims. He also entered into two engagements with the FTX Group. The first totaled $1.4 million and Pogodin received $1.9 million for the second.[606] However, Quinn Emanuel found no evidence that Pogodin ever provided any legal services to the FTX Group.[607]

17. Law Firm-8

Quinn Emanuel issued Bankruptcy Rule 2004 requests to Law Firm-8, which produced 66 documents in response.[608] The FTX Group retained Law Firm-8 after that firm represented Whistleblower-1.[609] As noted above, *see supra*, at Part 3, Section III(e), Quinn Emanuel found that after the FTX Group settled Whistleblower-1's claims, within months, Friedberg retained Law Firm-8 to provide "general client counselling," and paid the firm $200,000 per month for

[603] Pogodin operated five law firms. Professionals Report, at Appendix B.

[604] Quinn Emanuel, *Memorandum re: FTX Investigations Review of Pogodin Report*, May 13, 2024 ("Pogodin Report"), at 1, 2.

[605] Professionals Report, at 53.

[606] Pogodin Report, at 1-2.

[607] Professionals Report at 48-49, 53.

[608] *Id.* at Appendix B.

[609] *Id.* at 48, 53.

five years.[610] During the following six months until the Petition Date, the only work-product Law Firm-8 produced was a single, three-page memorandum prepared by a non-lawyer.[611]

18. Bracewell

Quinn Emanuel served Bankruptcy Rule 2004 requests on Bracewell LLP ("Bracewell") and received 1,342 documents from the firm.[612] LHI engaged Bracewell in June 2021 to provide regulatory advice and subpoena-response support.[613] In addition, Bracewell advised LHI in two employment-related disputes: for former LedgerX board member Andrew Baine, and for former LHI employee Jennifer Liu.[614] Bracewell was paid $172,158 for its services.[615] Quinn Emanuel's investigation did not turn up any evidence that Bracewell engaged in any misconduct or knew of any misconduct by the FTX Group leadership.[616]

19. Morrison & Foerster

Quinn Emanuel served Bankruptcy Rule 2004 requests on Morrison & Foerster LLP ("MoFo") and received 2,029 documents from the firm.[617] Quinn Emanuel's investigation of MoFo also comprised a review of approximately 4,500 documents from the Database.[618] Starting in January 2018, Alameda, FTX.US, and FTX Trading engaged MoFo through its offices in Japan, the United States, and the UK.[619] MoFo Japan advised Alameda on banking

[610] *Id.* at 50.

[611] *Id.* at 53.

[612] *Id.* at Appendix B.

[613] Quinn Emanuel, *Memorandum re: FTX Investigations Review of Bracewell LLP*, Feb. 28, 2024, at 1, 2.

[614] *Id.* at 1.

[615] *Id.* at 2.

[616] *Id.* at 4.

[617] Professionals Report, at Appendix B.

[618] Quinn Emanuel, *Memorandum re: FTX Investigations Review of Morrison & Foerster LLP*, Mar. 14, 2024, at 2.

[619] *Id*. at 1.

and regulatory issues relating to its trading activities in Japan; MoFo US assisted FTX.US in setting up its consumer lending arm and in exercising FTX.US's share purchase option to acquire Digital Custody Inc.; MoFo UK provided advice in connection with FTX Trading's proposed acquisition of TigerWit Limited (UK).[620] MoFo was paid approximately $1.281 million for its services, but in total invoiced approximately $1.673 million.[621] Quinn Emanuel's investigation did not reveal any evidence that MoFo engaged in any misconduct or knew of any misconduct by the FTX leadership.

20. Hogan Lovells International LLP

Quinn Emanuel reviewed approximately 2,482 documents produced by Hogan Lovells International LLP ("Hogan") in response to the FTX Group's Bankruptcy Rule 2004 requests, and 1,741 documents maintained by the FTX Group.[622] Through the review, Quinn Emanuel concluded that FTX Trading engaged Hogan from February 2022 until November 2022 for services related to its subsidiary FTX Europe, specifically: acquiring certain UK companies, preparing change-in-control filings with the U.K. Financial Conduct Authority ("FCA"), and addressing an FCA warning notice.[623] Hogan also provided services to FTX Ventures from March to June 2022 in connection with an investment in JustWontDie Ltd.[624] For its services, Hogan received approximately $1,005,475 from FTX Europe and $121,876 from FTX

[620] *Id.*

[621] *Id.* at 2-3.

[622] Hogan Lovells Memo, at 2.

[623] *Id.* at 1.

[624] *Id*.

Ventures.[625] Quinn Emanuel's investigation found no evidence that Hogan was engaged in any wrongdoing or knew about any misconduct by FTX Group executives.[626]

21. Bahamian Counsel

As reflected in Table 2, the FTX Group retained several Bahamian law firms, including Clement T. Maynard & Co, Brian Simms, and Lennox Patton.[627] Generally, these law firms were engaged in 2021 when the FTX Group formed FDM and began moving several employees and executives to the Bahamas.[628] Quinn Emanuel's investigation of these Bahamian law firms was complicated by the litigation among the Debtors, FDM, and the JOLs appointed by the Bahamas.[629] This litigation was ultimately resolved through a settlement agreement.[630] As part of that agreement, the JOLs are primarily responsible for investigating and pursuing any claims as to Bahamian professionals, as well as maximizing the value of the Debtors' real estate and other assets in the Bahamas.[631] The JOLs' investigation remains ongoing at this time.[632]

II. Auditors

Quinn Emanuel identified the FTX Group's auditors through an examination of the general ledgers of the FTX Group entities, other sources of payment information, and engagement letters.[633] While no FTX Group entity was audited before 2019, three audit firms were engaged after 2019 to provide opinions on WRS and FTX.US, FTX Trading, and

[625] *Id.*

[626] *Id.*

[627] Professionals Report, at 15.

[628] *Id.*

[629] *Id.* at 17-18.

[630] *Id.* at 18.

[631] *Id*.

[632] *Id.*

[633] *Id*. at 61.

Cottonwood Grove.[634] These firms were Auditor-1, Auditor-2, and Moore Stephens CPA Limited ("Moore Stephens").[635] In February 2023, Quinn Emanuel and the Unsecured Creditors' Committee sent Bankruptcy Rule 2004 requests to each audit firm. Quinn Emanuel reviewed 25,000 documents and 10,000 documents Auditor-1 and Auditor-2 produced in response to the Bankruptcy Rule 2004 requests, respectively.[636] Moore Stephens did not respond to the discovery requests.[637]

Quinn Emanuel utilized Alvarez & Marsal to analyze Auditor-1's and Auditor-2's audit papers and the extent of their adherence to Generally Accepted Auditing Standards ("GAAS").[638] Quinn Emanuel's own investigation focused on the relationship between the audits and the Investigative Topics.

a. Auditor-1

FTX.US retained Auditor-1 to audit its balance sheet for fiscal years ending December 31, 2020 and December 31, 2021, in support of FTX.US's application for a Money Transmitter License. Auditor-1 provided FTX.US and WRS clean audit opinions for these fiscal years.[639] Quinn Emanuel's and Alvarez & Marsal's investigation, however, revealed numerous instances where Auditor-1 failed to follow GAAS with respect to these FTX entities.[640] For example, in its audit for 2021, Auditor-1 identified custodial funds due to customers as a class of transactions

[634] *Id.* at 60-61.

[635] *Id.* at 61.

[636] *Id.*

[637] *Id.*

[638] *Id.* at 61-62.

[639] *Id.* at 63-65.

[640] *Id.*

with a high risk of material misstatement.[641] While Auditor-1 planned four substantive audits to substantiate management's assertions concerning the over $200 million due to customers as reported on FTX.US's balance sheet, Auditor-1 completed only one such audit. Quinn Emanuel and Alvarez & Marsal also found deficiencies in Auditor-1's audit of the movement of custodial funds, as well as its treatment of related-party receivables.[642] For example, Auditor-1 investigated certain related-party transactions by simply asking Bankman-Fried to confirm the receivable, without seeking any records proving FTX.US's relationship with the related party or that the related party had sufficient funds to repay the receivable.[643] Quinn Emanuel determined that these issues stemmed, at least in part, from a lack of auditor independence, as many Auditor-1 employees had a close relationship with FTX Group employees, including Friedberg.[644]

FTX.US ultimately terminated Auditor-1 in September 2022 after Auditor-1 submitted drafts of its 2021 WRS and FTX.US Communication of Material Weakness, Significant Deficiencies, and Other Findings and Observations letters. Those drafts identified the entities' lack of internal controls as "Material Weaknesses" and "Significant Deficiencies."[645] In total, Auditor-1 received approximately $470,000 for its services.[646] Quinn Emanuel has concluded WRS and FTX.US may have claims against Auditor-1 for professional negligence and breach of fiduciary duty.[647] Quinn Emanuel continues to assess these facts and consider any additional steps it might advise the FTX Group to take.

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[641] *Id.* at 63.

[642] *Id.* at 63-65.

[643] *Id.* at 64-65.

[644] *Id.* at 65.

[645] *Id.* at 65-66.

[646] *Id.* at 63.

[647] *Id.*

b. Auditor-2

FTX Trading retained Auditor-2 in early 2021 when FTX Trading considered undertaking an Initial Public Offering, which required the preparation of audited financial statements.[648] Auditor-2 audited FTX Trading's financial statements for the fiscal years ending December 31, 2019, 2020, and 2021.[649] Quinn Emanuel and Alvarez & Marsal's investigation indicates that Auditor-2's audit procedures did not conform to GAAS.[650] Similar to Auditor-1, Auditor-2 did not perform any investigation around related-party receivables beyond merely seeking Bankman-Fried's confirmation of a related-party receivable of $1.2 billion owed by Alameda.[651] And while Auditor-2 identified segregation of customer assets as a significant fraud risk, the investigations found that Auditor-2 failed to investigate many unusual transactions that would have revealed FTX Trading's failure to segregate customer funds.[652]

Quinn Emanuel concluded FTX Trading may have claims against Auditor-2 for professional negligence and breach of fiduciary duty.[653] Quinn Emanuel continues to assess these facts and consider any additional steps it might advise the FTX Group to take.

c. Moore Stephens CPA Limited

Moore Stephens was engaged to audit the financial statements of Cottonwood Grove, a Hong Kong entity.[654] Because Moore Stephens did not respond to Quinn Emanuel and the Unsecured Creditors' Committee's joint Bankruptcy Rule 2004 request, Quinn Emanuel

[648] *Id.*

[649] *Id.*

[650] *Id.* at 68-70.

[651] *Id.* at 68.

[652] *Id.* 69-70.

[653] *Id.* at 70.

[654] *Id*. at 71.

conducted a targeted investigation of the FTX Group's internal records related to Moore Stephens.[655] Quinn Emanuel determined that Moore Stephens' work was limited, and that its work did not raise any investigative concerns.[656] Because of the limited nature of Moore Stephens' work, Quinn Emanuel did not investigate it further.[657]

III. Accountants

Quinn Emanuel identified accountants who provided their services to the FTX Group by (1) searching for engagement letters within the FTX Group's internal files, (2) reviewing the FTX Group's books and records, (3) investigating other Professionals, and (4) reviewing information provided by Alvarez & Marsal.[658] Quinn Emanuel divided accounting professionals into two investigative tiers: (1) accountants that provided extensive services to the FTX Group and received more than $100,000 in fees, or provided services that addressed Investigative Topics; and (2) accountants that provided only limited services to the FTX Group or received fees of less than $100,000.[659] Five accounting firms were placed in the first tier: Robert Lee & Associates ("RLA"), Silicon Valley Accountants ("SVA"), Rivers & Moorehead ("R&M"), Pricewaterhouse Coopers LLP ("PwC LLP"), and PricewaterhouseCoopers AG ("PwC AG").[660] Two accounting firms were placed in the second tier: MicroLedgers Co. Ltd. ("MicroLedgers") and Mazars LLP ("Mazars").

[655] *Id.*

[656] *Id.*

[657] *Id.*

[658] Professionals Report, at 72-73.

[659] *Id.* at 73.

[660] *Id.*

Quinn Emanuel and the Unsecured Creditors' Committee served joint Bankruptcy Rule 2004 requests on each of the firms in the first tier.[661] RLA, R&M, and PwC LLP voluntarily complied with the requests.[662] PwC AG refused to produce any documents.[663] SVA initially did not satisfactorily comply with the requests, but Quinn Emanuel and the Unsecured Creditors' Committee jointly compelled production by issuing a subpoena under Bankruptcy Rule 2004.[664]

RLA produced approximately 47,000 documents, R&M produced approximately 38,000 documents, SVA produced approximately 20,000 documents, and PwC LLP produced a small number of documents.[665] Quinn Emanuel reviewed these documents, as well as the FTX Group's internal documents, and consulted with Alvarez & Marsal.[666] Quinn Emanuel additionally interviewed Robert Lee, RLA's founder, as its investigation revealed that RLA was the FTX Group's primary accountant.[667]

a. Robert Lee & Associates

Alameda retained RLA in February 2018 after Bankman-Fried approached Lee.[668] RLA's services, which included bookkeeping, expanded through the next four years.[669] Though initially retained by Alameda, by 2021, RLA billed several FTX Group entities.[670] Quinn

[661] *Id.*

[662] *Id.*

[663] S&C attempted to obtain documents from PwC AG in connection with the DAAG-related litigation, but the litigation was ultimately settled. *Id.* at 74 n.229.

[664] *Id.* at 73.

[665] *Id.*

[666] *Id.*

[667] *Id.*

[668] *Id.*

[669] *Id.* at 74-76.

[670] Professionals Report, at 74.

Emanuel identified 38 FTX-Group affiliated entities that RLA serviced.[671] While some of these entities were shells, several were key entities, including Alameda, Alameda Research Ventures, FTX Trading, WRS, FTX.US, and Paper Bird.[672] RLA used QuickBooks for these entities' day-to-day bookkeeping.[673] However, QuickBooks software is designed for small businesses and is not robust enough to track the billions of dollars of fiat and cryptocurrency that the FTX Group handled.[674]

Quinn Emanuel's investigation found that RLA worked closely with the FTX Group. For example, RLA was given access to internal Slack channels and participated in frequent meetings with the FTX Group's accounting staff.[675] RLA accountant Caroline Papadopoulos eventually became Controller of FTX.US in November 2021.[676] RLA's work primarily involved routine accounting and tax services based only on information provided by the FTX Group.[677] Additionally, RLA prepared personal tax returns for at least 33 FTX Group employees, including senior FTX Group executives Bankman-Fried, Wang, Ellison, and Singh.[678] In total, RLA was paid $4.58 million for its services.[679]

Quinn Emanuel did not discover any evidence that RLA had involvement in or knew of any misconduct or mishandling of customer funds, or that RLA rendered negligent advice.

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[671] *Id.* at 75.

[672] *Id.*

[673] *Id.*

[674] *Id.*

[675] *Id.*

[676] *Id.*

[677] *Id.* at 76.

[678] *Id.* at 75-76.

[679] *Id.* at 75, Appendix A.

b. Silicon Valley Accountants

SVA was initially retained by RLA to provide bookkeeping and document preparation services and to respond to auditor requests during FTX Trading's 2020 audit.[680] FTX Trading, FTX.US, and Alameda then engaged SVA directly to provide accounting services.[681] Quinn Emanuel discovered that SVA's founder and CEO, Gabriel Zubizarreta, maintained a close relationship with Bankman-Fried, Salame, Wang, Jen Chan (Chief Financial Officer, FTX Group), and Caroline Papadopoulos. Zubizarreta provided extensive advice on various accounting issues and often engaged with both Auditor-2 and R&M to discuss FTX Trading's balance sheets.[682] Zubizarreta maintained a FTX.US account, and invested in both FTX Trading and WRS through stock purchases.[683] In one instance, an FTX.US exchange account deposited $100,000 into Zubizarreta's FTX.US account.[684] Jayesh Peswani, FTX.US's Controller at the time, confirmed the payment was from FTX.US to express its appreciation to Zubizarreta for his services.[685] This payment was the only one identified by Quinn Emanuel, as it does not appear SVA ever submitted invoices to the FTX Group for payment.[686] Though Quinn Emanuel noted that these interactions raised questions as to Zubizarreta's and SVA's independence and objectivity, Quinn Emanuel did not identify any documentary evidence that Zubizaretta or SVA participated in or were aware of any misconduct.[687]

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[680] *Id.* at 76.

[681] *Id.* at 76-77.

[682] *Id.* at 77.

[683] *Id.* at 77-78.

[684] *Id.* at 77.

[685] *Id.* at 77-78.

[686] *Id.* at 77, Appendix A.

[687] Professionals Report, at 78-79.

c. Rivers & Moorehead

FTX Trading engaged R&M in February 2021 to assist with an acquisition of Blockfolio. Rivers & Moorehead generally performed services on an *ad hoc* basis when the FTX Group required reporting in connection with audit and financial statements. In total, R&M was paid $187,000 for its services. Quinn Emanuel did not discover evidence that R&M participated in or was aware of any misconduct.

d. PricewaterhouseCoopers Entities

The FTX Group engaged multiple entities within the PwC network to provide accounting services at different times. For example, PwC AG was engaged to provide accounting and tax advice to FTX Europe AG and PwC LLP supported a contemplated acquisition of BTC Africa SA. In total, PwC entities received approximately $1.3 million for their services, with each individual PwC entity receiving a fraction of the total. Quinn Emanuel did not find any evidence that any PwC entity participated in or was aware of any misconduct, and given the small amount of fees paid to the individual PwC entities, Quinn Emanuel concluded further investigation would not benefit the estates.[688]

e. MicroLedgers and Mazars LLP

The two accounting firms in the second tier of investigative depth, MicroLedgers and Mazars, were not issued Bankruptcy Rule 2004 requests. However, Quinn Emanuel investigated the scope of their engagements and the services they performed through a review of the FTX Group's internal documents. Quinn Emanuel additionally consulted with Alvarez & Marsal, and concluded that neither firm participated in or was aware of any misconduct.[689]

[688] *Id.* at 81-82.

[689] *Id.* at 82.

IV. Valuation Firms

Quinn Emanuel identified the FTX Group's valuation firms through a variety of means: (1) its concurrent investigations of other Professionals retained by the FTX Group,[690] (2) its review of payment records and other internal documents,[691] and (3) its review of the relevant engagement letters. Through this methodology, Quinn Emanuel determined that two of the FTX Group's valuation firms did work that appears to have intersected with Investigative Topics: Teknos Associates LLP ("Teknos") and Redwood Valuation Partners ("Redwood").[692] Accordingly, Quinn Emanuel and the Unsecured Creditors' Committee jointly served Bankruptcy Rule 2004 requests on these firms, and Quinn Emanuel further reviewed the FTX Group's internal documents.[693]

S&C identified a third valuation firm, BDO USA LLP ("BDO"), which it investigated in connection with the FTX Europe adversary action.[694]

a. Redwood Valuation Partners

Redwood was engaged from 2020 to 2022 to, among other things, provide WRS and FTX Trading an estimate of the fair market value of those entities' common stock for the purpose of providing stock options to employees.[695] The FTX Group paid Redwood $66,000 for this work.[696] Redwood's valuations relied on documents provided by the FTX Group, though the

[690] *Id.* at 83.

[691] *Id.*

[692] *Id.*

[693] *Id.* at 83-84.

[694] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 121-23. The FTX Europe adversary action is discussed in greater detail below, in Part 6, Section I(b).

[695] Professionals Report, at 84.

[696] *Id.*

FTX Group often failed to share necessary information for Redwood to provide a valuation.[697] Nonetheless, Quinn Emanuel determined that Redwood followed accepted valuation procedures in conducting both valuations.[698]

b. Teknos Associates LLP

Teknos was engaged in September 2022 to perform 30 valuations, including of FTX Trading common share equity, Paper Bird warrants and common share equity, and WRS class A common share equity.[699] However, prior to the Petition Date, Teknos did not send any valuations to the FTX Group.[700] Through its Bankruptcy Rule 2004 requests, Quinn Emanuel received copies of 18 of Teknos' evaluations. Quinn Emanuel ultimately found no documentary evidence that Teknos' valuations were improper or unduly influenced.[701] Quinn Emanuel demanded that Teknos return $60,000 to the estates for Teknos' uncompleted work, but Teknos has refused.[702]

c. BDO USA LLP

S&C served a third-party subpoena on BDO, which produced its work file for its report on DAAG.[703] S&C additionally reviewed the FTX Group's internal records, including communications and documents shared with BDO.[704] S&C found that BDO was retained in early 2022 to perform purchase price allocations for WRS' acquisition of Ledger Holding Inc.

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[697] *Id.* at 84-85.

[698] *Id.* at 85.

[699] *Id.*

[700] *Id.*

[701] *Id.* at 85-86.

[702] *Id.* at 85 & n.274.

[703] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 122.

[704] *Id.*

(LedgerX's parent company) and FTX Trading's purchase of DAAG.[705] S&C's investigation indicates that BDO valued the intangible assets of Ledger Holdings and DAAG at approximately $206 million and $237 million, respectively, based on the value of the operating licenses held by each entity.[706] However, this valuation was likely based on projections provided by FTX Group employees.[707]

V. Regulatory, Licensing and Compliance Consultants

Quinn Emanuel identified four consultants that provided the FTX Group regulatory, compliance, and licensing services: MR Holdings, Varin Strategies (d/b/a Compliers Consulting), XReg Consulting Ltd. ("XReg"), and ProCo Global (d/b/a Chartwell Compliance), ("ProCo").[708] Through its investigations into other Professionals, in-house professionals, and the FTX leadership, Quinn Emanuel determined that each of these consulting firms was involved in identifying acquisition targets, preparing license applications, and internal compliance matters.[709] Thus, Quinn Emanuel subjected all four to investigation, though Bankruptcy Rule 2004 requests were only issued to XReg.[710] XReg did not respond to the requests, however, and Quinn Emanuel did not take further steps to seek these documents as XReg is a Gibraltar entity.[711] Quinn Emanuel additionally reviewed approximately 13,000 internal FTX Group documents related to these consultants.[712]

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[705] Professionals Report, at 84.

[706] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 122.

[707] Professionals Report, at 84.

[708] *Id*. at 101.

[709] *Id.* at 101-02.

[710] *Id.* at 102.

[711] *Id.* at 102 n.337.

[712] *Id.* at 102.

a. MR Holdings & Varin Strategies

Friedberg contacted David Martin, a member of MR Holdings and Varin Strategies, to identify potential broker-dealer acquisitions.[713] Martin assisted with the acquisition of RJL Capital Group ("RJL") by coordinating the deal between the FTX Group and the seller, drafting the purchase agreement, and submitting RJL's application to FINRA to approve its change in ownership.[714] However, after the deal closed, Martin discovered that Alameda's bank account initiated the payment of the purchase price rather than Bankman-Fried's personal account as originally contemplated.[715] The transaction was unwound and re-executed, and the FINRA application was withdrawn and resubmitted, presumably to avoid regulatory scrutiny.[716] In total, the firms collectively received $97,715 for their services.[717]

b. XReg Consulting Ltd.

After the FTX Group and the FTX leadership sought to leave Hong Kong in late 2020, FTX retained XReg to provide FTX Trading options for relocation, with one of the criteria being whether a jurisdiction offered lax regulation of cryptocurrency.[718] XReg additionally assisted on the acquisition of required business licenses in Gibraltar, Cyprus, the United Kingdom, Singapore, and the Bahamas, among other countries.[719] XReg also drafted FTX Trading's anti-money laundering policies.[720] In total, it received approximately $4 million for its services,

[713] *Id.* at 102.

[714] *Id.*

[715] *Id.* at 102 & n.339.

[716] *Id.*

[717] *Id.* at 102.

[718] *Id.* at 103.

[719] *Id.*

[720] *Id.*

including a $2.75 million bonus upon the completion of FTX Trading's business license applications in Singapore and the Bahamas.[721]

c. ProCo Global (d/b/a Chartwell Compliance)

FTX.US retained ProCo from June 2021 to November 2022 to assist FTX.US with obtaining and maintaining its money transmitter licenses in 53 U.S. states and territories, as well as preparing applications under the Multistate Money Services Businesses Licensing Agreement Program.[722] ProCo provided additional consulting services on FTX.US's anti-money laundering services.[723] It received approximately $603,434 for its services.[724]

VI. Government and Community Relations Consultants

Through its investigation into the FTX leadership and law firms, Quinn Emanuel learned that the FTX Group hired three government and community relations consultants to assist with grassroots advocacy and fostering local goodwill.[725] Barbara Miller (Bankman-Fried's aunt) and Alpen Sheth (a consultant doing business as Canopy Labs LLC) were both retained in the South Florida region, while Consultant-1 was engaged in the Bahamas.[726] Quinn Emanuel reviewed the FTX Group's internal documents to investigate these individuals.[727]

a. Barbara Miller (d/b/a BGM Consultants) & Alpen Sheth (d/b/a Canopy Labs LLC)

Shortly after FTX.US obtained the naming rights to the Miami Heat arena in early 2021, Joseph Bankman retained Barbara Miller and Sheth to establish relationships with community

[721] *Id.* at 103-04.

[722] *Id.* at 104.

[723] *Id.*

[724] *Id.*

[725] *Id.* at 96.

[726] *Id.* at 97, 99.

[727] *Id.* at 96.

figures in South Florida.[728] These relationships ultimately led to a failed initiative by FTX.US and the FTX Foundation to donate $500 per month for a year into 100 participants' crypto wallets.[729] FTX.US falsely represented that the accounts would be FDIC insured.[730] Barbara Miller additionally organized a $2.3 million event at the FTX Arena that was attended by only 1,200 people.[731] Joseph Bankman instructed Barbara Miller to spend "whatever it [took]" on the event.[732]

Quinn Emanuel's investigation found that Barbara Miller received payments of $140,000 from the FTX Group over a nine-month period. However, Quinn Emanuel has not identified any colorable claims against Barbara Miller that would meaningfully benefit the estates.[733]

b. Consultant-1

Quinn Emanuel served Bankruptcy Rule 2004 requests on Consultant-1's firm, but it did not respond to these requests.[734] After the FTX Group moved its operations to the Bahamas, it retained Consultant-1 in May 2021 to facilitate its move.[735] Consultant-1 was engaged specifically due to his connections with the Bahamian government.[736] In September 2021, he was hired by FDM as its Vice President of Communications and Corporate Social Responsibility.[737] Consultant-1 was successful in facilitating relationships between the FTX

[728] *Id.* at 97.

[729] *Id.* at 97-98.

[730] *Id.* at 98.

[731] *Id.* at 99.

[732] *Id.*

[733] *Id.*

[734] *Id.* at 89-90.

[735] *Id.* at 99-100.

[736] *Id.*

[737] *Id.* at 100.

leadership and the Bahamian government, and assisted with several property acquisitions in the Bahamas.[738] As a consultant, Consultant-1 received twice the fees contemplated in his retention agreement.[739] Though Quinn Emanuel has identified potential claims against Consultant-1, such claims would be brought by the Bahamian JOLs pursuant to the settlement agreement with FDM.[740]

VII. Lobbyists

Quinn Emanuel identified the FTX Group's lobbyists through reviewing engagement letters and general ledgers, which were cross-referenced against invoices, bank records, and other internal documents and communications.[741] It additionally identified lobbyists through its investigation of the FTX Group's in-house counsel, as well its investigation of Bankman-Fried's parents.[742] Quinn Emanuel calculated the fees each lobbyist received through its work with Alvarez & Marsal.[743]

In total, Quinn Emanuel identified 15 lobbyists and lobbying firms the FTX Group engaged: Cojo Strategies, LLC; Conaway Graves Group, LLC; Empire Consulting; Geoffrey Manne and International Center for Law & Economics; Hinman Straub Advisors LLC; John J. Donohue III; Kensington Strategies; Kevin S. Haeberle; Kimball Stroud and Associates; Law Offices of John J. Faso, P.C.; Message Global, LLC; Michelle Bond (d/b/a ADAM); Patomak Global Partners, LLC; Rich Feuer Anderson; and T Cap Solutions, LLC.[744] Quinn Emanuel did

[738] *Id.*

[739] *Id.* at 101.

[740] *Id.*

[741] *Id.* at 90.

[742] *Id.*

[743] *Id.*

[744] *Id.* at 90-91.

not uncover any evidence that these firms engaged in misconduct or were aware of malfeasance by the FTX Group and its executives, though some were aware of the FTX Group's concealment of its relationship with Alameda.[745] The facts relating to two of the lobbyists warrant some brief comments.

a. ADAM and Michelle Bond

Michelle Bond, the CEO of the Association of Digital Asset Markets ("ADAM"), was Ryan Salame's girlfriend during the relevant time period.[746] In October 2021, Ryne Miller directed a $1 million donation from FTX.US to ADAM to ensure it was at FTX.US's "full disposal" for contacts, scheduling, review of drafts, ideas, and other matters.[747] Quinn Emanuel found that Bond worked closely with Miller, Friedberg, Joseph Bankman, and Law Firm-1 to obscure the FTX Group's lobbying efforts, leverage Bond's connections to lobby for favorable crypto regulations, and connect FTX leadership to government officials.[748] In total, WRS, FDM, and FTX Trading paid $1.4 million in dues and donations to ADAM.[749] Bond additionally received a $400,000 bonus from FDM pursuant to a consulting agreement.[750] Finally, Quinn Emanuel's investigation revealed that Salame on multiple occasions directed wire transfers from FTX-related entities to Bond's personal bank account, totaling approximately $1 million.[751]

[745] *Id.* at 91.

[746] *Id.*

[747] *Id.* at 91-92.

[748] *Id.* at 94.

[749] *Id.*

[750] *Id.* at 94 n.295.

[751] *Id.*

b. Rich Feuer Anderson

Rich Feuer Anderson ("RFA") was FTX.US's primary lobbyist in connection with FTX.US Derivatives' application to the CFTC to amend its order of registration as a derivatives clearing organization.[752] Quinn Emanuel served a Bankruptcy Rule 2004 request on RFA, which produced over 7,000 documents in response.[753] In its review, Quinn Emanuel located several handwritten notes by some RFA employees indicating concerns about FTX.US's business practices. But Quinn Emanuel ultimately concluded that RFA did not participate in any wrongdoing, and was not aware of the commingling and misuse of customer funds.[754]

VIII. Other Professional Vendors

a. Taxbit, M Group, and Inca Digital

Quinn Emanuel investigated TaxBit Inc. ("TaxBit"), a tax and accounting firm, M Group Strategic Communications ("M Group"), a public relations firm, and Inca Digital, Inc. ("Inca"). TaxBit received $1.2 million from FTX.US for its services, and also received a $2 million investment by Alameda Research Ventures in its Series B offering.[755] M Group received $3,066,867 in fees,[756] and Inca Digital received $2,400,000 in fees.[757] Quinn Emanuel's review of the available documents relating to each of these vendor's work did not support conducting any further investigation into the vendors, as there was no evidence of wrongdoing or vendor knowledge of misconduct by the FTX leadership.[758]

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[752] *Id.* at 95.

[753] *Id.* at 90.

[754] *Id.* at 95-96.

[755] Quinn Emanuel, *Memorandum of FTX Investigative Review of TaxBit Inc.*, Nov. 21, 2023 ("TaxBit Memo"), at 1.

[756] Quinn Emanuel, *Memorandum re: FTX Investigative Review of M Group Strategic Communications*, Nov. 11, 2023 ("M Group Memo"), at 1.

[757] Quinn Emanuel, *Memorandum re: FTX Investigations Review of Inca Digital, Inc.*, May 13, 2024, at 2.

[758] TaxBit Memo, at 1; M Group Memo, at 1.

b. Vendors-1, -2, and -3

Quinn Emanuel investigated Vendors-1, -2, and -3 (together "the Consultants"), which were three sports, media, and corporate partnership consultants engaged by the FTX Group. The Consultants helped negotiate many of the FTX Group's most visible marketing partnerships.[759] Nine of these partnerships are currently the subject of consolidated class action lawsuits involving claims of civil conspiracy and violations of the Florida Securities and Investor Protection Act and the Florida Deceptive and Unfair Practices Act.[760]

Quinn Emanuel did not find any completed work as specified in the three production agreements with Vendor-1.[761] In April 2022, WRSS terminated its contracts with the Consultants and agreed to pay them $12 million each over three years to accelerate commissions owed to them.[762] Alameda agreed to make these payments on FTX.US's behalf. By the Petition Date, the Consultants were paid a total of $21.3 million.[763] Quinn Emanuel has recommended that the Debtors conduct further investigation and expert analysis regarding these three vendors.[764]

c. Vendor-4

Quinn Emanuel reviewed over 12,000 internal documents related to Vendor-4 and his related entities, in addition to examining numerous service deliverables and their statements of

[759] Quinn Emanuel, *Memorandum re: FTX Investigations of Vendors-2, and -3*, May 5, 2024 ("The Consultants Report"), at 1.

[760] *In re FTX Cryptocurrency Exchange Collapse Litigation*, No. 23-md-03076 (S.D. Fla., June 5, 2023); *Edwin Garrison v. Samuel Bankman-Fried,* No. 22-cv-23753 (S.D. Fla., Dec 16, 2022); *Podalsky v. Bankman-Fried*, No. 22-cv-23983 (S.D. Fla., Dec. 7, 2022); *Norris v. Brady*, No. 23-cv-20439 (S.D. Fla., Feb. 3, 2023); *Garrison v. Major League Baseball*, No. 23-cv-24479 (S.D. Fla., Nov. 27, 2023).

[761] Quinn Emanuel, *Memorandum re: FTX Investigations Review of Vendor-1*, Mar. 7, 2024, at 1.

[762] The Consultants Report, at 1.

[763] *Id.*

[764] TaxBit Memo, at 1; M Group Memo, at 1.

work.[765] Alvarez & Marsal additionally performed a transaction analysis for FTX Group transfers to Vendor-4 and his related entities.[766] Quinn Emanuel concluded that Vendor-4 coordinated extensively with Friedberg to execute multiple media and marketing agreements that involved duplicative services with significantly inflated fees.[767] Vendor-4's entities received over $34 million from the FTX Group, yet provided minimal-to-no services for these fees.[768] Quinn Emanuel is continuing to assess these facts and any additional steps it might advise the FTX Group to take with respect to Vendor-4.

IX. Financial Institutions

Quinn Emanuel identified the FTX Group's banks and financial institutions through a review of its financial records.[769] Quinn Emanuel selected Silvergate Bank ("Silvergate"), Prime Trust LLC ("Prime Trust"), and Signature Bank ("Signature") for investigation based on an analysis of the FTX Group's accounts conducted by Alvarez & Marsal.[770] Additionally, Farmington State Bank d/b/a Moonstone Bank ("Moonstone Bank") was investigated by S&C after S&C was informed by the General Counsel of Moonstone Bank that it held $50 million in an account in the name of FDM.[771] S&C further investigated Evolve Bank & Trust ("Evolve Bank") after identifying two bank accounts in the name of FTX Philanthropy, each of which held $10 million. [772] Summaries of these investigations are below.

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[765] Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 35.

[766] *Id.*

[767] *Id.* at 36.

[768] *Id*.

[769] *Id.* at 39.

[770] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 169.

[771] An analysis of notable findings concerning Moonstone Bank is included *infra*, at Part 6, Section IX(c)(2)(iv).

[772] *Id.* at 169.

a. Silvergate Bank

Quinn Emanuel investigated Silvergate, as it was the bank where the FTX Group maintained accounts that received customer deposits.[773] Quinn Emanuel and the Unsecured Creditors' Committee served joint Bankruptcy Rule 2004 requests on Silvergate, which produced approximately 35,000 documents.[774] Quinn Emanuel found that the FTX Group had 30 open accounts at Silvergate, 16 of which held commingled customer and FTX Group funds.[775] Funds were often moved from "for the benefit of" or "FBO" accounts into operating accounts.[776] While the movement of funds from FBO accounts to an operational account could signal the misuse of customer funds, Quinn Emanuel did not find any Silvergate policy or procedure in place to detect such transfers.[777] Moreover, the FTX Group failed to properly designate all FBO accounts, which would impair Silvergate's ability to detect any wrongdoing.[778]

b. Prime Trust LLC

Quinn Emanuel selected Prime Trust for investigation, as it was primarily associated with accounts that funded FTX Trading operations and property purchases, and it received funds from commingled accounts.[779] Quinn Emanuel and the Unsecured Creditors' Committee served joint Bankruptcy Rule 2004 Requests on Prime Trust, which produced approximately 342,000 documents.[780] Quinn Emanuel identified 23 total accounts, three of which held commingled

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[773] Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 39.

[774] *Id.*

[775] *Id.* at 40.

[776] *Id.*

[777] *Id.* at 41.

[778] *Id.*

[779] *Id.* at 39.

[780] *Id.*

funds.[781] Prime Trust filed for bankruptcy in August 2023, and a plan of reorganization was confirmed in December 2023.[782]

c. Signature Bank

Quinn Emanuel selected Signature for investigation, as it was a bank where the FTX Group maintained accounts that funded FTX Trading operations and property purchases and received funds from commingled accounts.[783] Quinn Emanuel and the Unsecured Creditors' Committee served joint Bankruptcy Rule 2004 requests on Signature. Signature has produced approximately 125,000 documents, and its production remains ongoing.[784] Thus far, Quinn Emanuel has identified 30 total accounts, six of which held commingled funds.[785] However, no account was identified as an FBO account, though Quinn Emanuel's review remains ongoing.[786] Signature is currently in FDIC receivership, making any recovery unlikely should Quinn Emanuel discover identified FBO accounts.[787]

d. Evolve Bank & Trust and Wise

Evolve Bank held an FBO account for Wise, a payment processor used by non-Debtor FTX Philanthropy.[788] S&C, in its investigation with AlixPartners, located an aggregate $10 million in accounts held by FTX Philanthropy at Evolve Bank (as well as Signature) that were entirely funded through transfers from FTX Group entities WRSS, North Dimension, and FTX

[781] *Id.* at 42.

[782] *Id.*

[783] *Id.* at 39.

[784] *Id.*

[785] *Id.* at 43.

[786] *Id.*

[787] *Id.*

[788] S&C, *Review of Post-Petition Investigations for Examiner,* Mar. 15, 2024, at 171.

Trading.[789] S&C, with the assistance of Jen Chan, recovered the $10 million held in these accounts on April 14, 2023.[790]

e. Deltec Bank & Trust Co. Ltd. and Deltec International Group

Deltec Bank & Trust Co. Ltd. ("Deltec Bank") and Deltec International Group ("Deltec") were both directed by Jean Chalopin, who also served as a director of Moonstone Bank.[791] Deltec Bank (as well as Chalopin and Moonstone Bank) is a defendant in a class-action MDL currently pending in the Southern District of Florida.[792] The relevant complaint alleges that the FTX Group held at least 17 accounts at Deltec Bank, and that had Deltec followed Bahamian law, then Deltec Bank would have detected the unusual transactions between Alameda and other FTX Group entities and thus been obligated to investigate such transactions.[793] However, according to Quinn Emanuel's investigation, Deltec Bank did not conduct any such inquiries.[794]

In addition, Deltec received a $50 million loan from Norton Hall, of which Ryan Salame was purportedly a director.[795] The transaction is discussed *supra*, at Part 3, Section III(b).

X. Further Investigations

At this time, the Examiner does not recommend that he undertake any independent investigation of the Professionals. It appears that Quinn Emanuel (and S&C)[796] applied an effective methodology to rigorously investigate the Professionals that received substantial fees or other payments from the FTX Group, and those Professionals that performed work that had a

[789] *Id.* at 169.

[790] *Id.* at 170-71.

[791] *In re FTX Cryptocurrency Exchange Collapse Litigation*, No. 23-md-03076 (S.D. Fla.); Dkt. No. 155 at ¶ 298.

[792] *See generally id.*

[793] *Id.* at ¶¶ 300-04.

[794] *Id.* at ¶ 302.

[795] Dkt. No. 1195 at ¶¶ 3-5.

[796] S&C conducted investigations in connection with potential avoidance or adversary actions.

significant nexus to the Investigative Topics. Where Quinn Emanuel found evidence that a Professional engaged in, or was aware of, any of the FTX leadership's misconduct, rendered negligent advice, or received excessive or otherwise questionable fees, Quinn Emanuel continues to assess these facts and is advising the FTX Group on what, if any, additional steps to take.

Limited investigations were conducted of certain Professionals that received smaller fees and did not appear to perform work that intersected with the Investigative Topics. Though further investigation of these entities would be possible, the Examiner does not believe such investigation would be an efficient use of the estates' resources given the challenges of likely recoveries, and in many cases, the comparatively low dollar amounts at issue.

The Examiner also considered the following additional circumstances in determining that a further investigation into certain Professionals was not warranted: (i) if the Professional had filed for bankruptcy or liquidation; (ii) applicable standards that may limit liability for Professionals (in particular banks); and, (iii) if the Professional was located internationally, meaning that the cost of retaining foreign counsel and litigating potential claims (and, if successful, the costs of collection) could likely outweigh any potential recoveries for the estates.

PART 6: OTHER INVESTIGATIONS

Pursuant to the Bankruptcy Court's instruction that the Examiner "summariz[e] the investigations of the Debtors" and "mak[e] recommendations for additional investigations,"[797] this Part summarizes other ongoing and completed investigations into the FTX Group's activities which have not been addressed in earlier Parts of the Report, and assesses whether any additional investigations are necessary.

The Examiner largely found that the Debtors' counsel and the relevant government agencies have undertaken thoughtful, comprehensive investigations to establish the full scope of the FTX Group's activities. These investigations have led to extensive and cost-effective recovery of assets for the estates. However, the Examiner recommends one additional investigation into FTX.US: a matter of significant public interest that has not yet been thoroughly explored by the investigations to date.

I. Acquisitions

S&C undertook several investigations into potential claims arising out of corporate acquisitions by the FTX Group. Some of these investigations resulted in litigation. These investigations are described below.

Quinn Emanuel's investigation into the circumstances surrounding the FTX Group's acquisition of LedgerX and the estates' sale of LedgerX is discussed above in Part 2, Section V(b) and will not be repeated here.

[797] Scope Order, at ¶ 2.

a. Embed

Embed was a small securities clearing and custody business.[798] S&C's investigation revealed that the FTX Group entered into an agreement for clearing services in January 2022 and began using Embed's services in April 2022.[799] Shortly after the FTX Group began using Embed's clearing services, Debtor entity WRS acquired Embed for nearly $300 million, using funds from Alameda.[800] WRS conducted minimal due diligence before the acquisition and paid an inflated price to acquire Embed.[801]

After the Petition Date, the Debtors unsuccessfully sought to sell Embed. The highest bid was from Embed's founder, who offered a bid of $1 million, and even the highest non-binding expression of interest was only $78 million, well below the price that WRS had paid.[802]

On behalf of the Debtors, S&C filed an avoidance action against a lengthy list of individuals and entities that received transfers as a result of the Embed acquisition.[803] S&C filed a separate avoidance action on behalf of the Debtors against FTX executives Bankman-Fried, Nishad Singh, and Gary Wang, who had received equity interests in Embed as part of the transaction.[804] The lawsuits allege fraudulent transfer and preference claims.[805] The Embed

[798] *Alameda Research Ltd. v. Giles*, No. 23-ap-50380 (Bankr. D. Del) (JTD), Dkt. No. 1 at ¶ 3.

[799] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 51.

[800] *Alameda Research Ltd. v. Giles,* No. 23-ap-50380 (Bankr. D. Del) (JTD), Dkt. No. 1 at ¶¶ 38, 45.

[801] *Id*. at ¶¶ 39-48.

[802] *Id*. at ¶¶ 58-62.

[803] *Id*. at Ex. A.

[804] *Alameda Research Ltd. v. Bankman-Fried*, No. 23-ap-50381 (Bankr. D. Del) (JTD), Dkt. No. 1.

[805] *Alameda Research Ltd. v. Giles,* No. 23-ap-50380 (Bankr. D. Del) (JTD), Dkt. No. 1 at ¶¶ 69-106; *Alameda Research Ltd. v. Bankman-Fried*, No. 23-ap-50381 (Bankr. D. Del) (JTD), Dkt. No. 1, at ¶¶ 68-126.

litigation is ongoing, but S&C has settled with some of the defendants and has resolved the separate case against the FTX Group executive defendants.[806]

b. FTX Europe/Digital Assets AG

S&C's investigation revealed that the FTX Group purchased DAAG, a small Swiss financial technology company, for $376 million in three tranches of stock purchases between October 2020 and November 2021.[807] At the time of the acquisition, DAAG did not "have any active business."[808] The FTX Group did not conduct a proper due diligence process and significantly overpaid for this company.[809] The investigation further determined that, despite the high purchase price, the acquisition did not include the rights to key pieces of intellectual property, which were retained by another entity owned by one of DAAG's founders.[810] After the acquisition, the FTX Group renamed DAAG as "FTX Europe."[811]

The Debtors attempted to sell FTX Europe after the Petition Date, but concluded that a sale would not be possible because the company had no meaningful saleable assets and did not control key intellectual property.[812] Because the Debtors were unable to monetize FTX Europe, S&C, on behalf of the Debtors, brought an avoidance action against the founders of the company. The avoidance action alleged fraudulent transfer and preferences claims, as well as

[806] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 57.

[807] *Alameda Research Ltd. v. Lorem Ipsum UG*, No. 23-ap-50437 (Bankr. D. Del) (JTD), Dkt. No. 1 at ¶¶ 49-77.

[808] *Id*. at ¶¶ 76-77 (citation omitted).

[809] *Id*.

[810] *Id*. at ¶¶ 78-84.

[811] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 63.

[812] *Alameda Research Ltd. v. Lorem Ipsum UG*, No. 23-ap-50437 (Bankr. D. Del) (JTD), Dkt. No. 1 at ¶ 104.

breach of fiduciary duty claims under the law of Antigua.[813] The Debtors have successfully settled this adversary proceeding.[814]

c. FTX Japan/Liquid

S&C's investigation also found that the FTX Group acquired Liquid, a Japanese cryptocurrency exchange, in April 2022 for approximately $185 million.[815] The acquisition came after the FTX Group had extended Liquid an emergency loan of $120 million prompted by the fact that Liquid had been victimized by a hack.[816] Liquid subsequently operated as FTX Japan.

S&C investigated potential claims arising out of the FTX Japan acquisition and decided against pursuing litigation. S&C concluded that the Debtors had received substantial value from the FTX Japan acquisition, as the company was a successful cryptocurrency exchange that had a difficult-to-obtain Japanese license.[817]

d. Genesis Block

S&C investigated the FTX Group's relationship to Genesis Block Ltd. ("Genesis Block"), an over-the-counter cryptocurrency trading firm that also operated cryptocurrency ATMs.[818] S&C's investigation found that the FTX Group structured a series of transactions whereby the FTX Group acquired nearly the entire economic stake in Genesis Block, but almost all of the shares of Genesis Block were transferred to an entity controlled by Genesis Block's co-

[813] *Id*. at ¶¶ 107-140.

[814] Dkt. No. 9587.

[815] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 129.

[816] *Id*. at 128.

[817] *Id*. at 131.

[818] *Id*. at 114.

founder and CEO.[819] S&C found that, after the transactions were completed, Genesis Block became a *de facto* subsidiary of the FTX Group and the FTX Group maintained control of Genesis Block.[820] S&C also identified and investigated a relationship between Genesis Block and the so-called "Korean friend" account on FTX.com.[821] At Bankman-Fried's trial, Singh testified that Bankman-Fried directed him to move about $8 billion of Alameda's liabilities to that account in August 2022.[822] And Wang testified that in November 2022, Bankman-Fried identified "the special Korean accounts" as the home of Alameda's liabilities to FTX.com.[823]

The Debtors continue to assess next steps with respect to Genesis Block and its affiliated entities and individuals.

II. Bankman-Fried Family Members

Quinn Emanuel thoroughly investigated four of Bankman-Fried's family members and in particular, whether they had knowledge of or involvement in the misconduct at the FTX Group: Joseph Bankman, Barbara Fried, Gabe Bankman-Fried, and Barbara Miller.[824]

Joseph Bankman, Bankman-Fried's father, is a tenured Stanford Law School professor who served as an officer, director, manager and/or *pro bono* counsel to a number of FTX Group entities.[825] Barbara Fried, Bankman-Fried's mother, is a Professor Emerita of Stanford Law School. She served as a member of the Board of Advisors of Stanford University's Ethics

[819] *Id*. at 114-15; *see also* Nardello, *Report Prepared for Sullivan & Cromwell LLP re: Genesis Block Limited*, Mar. 22, 2023 ("Genesis Block Memo"), at 5.

[820] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 116.

[821] *Id*.; Genesis Block Memo, at 30.

[822] *See* Transcript at 1380:3-1382:21, SBF Criminal Case, Dkt. No. 366.

[823] *See* Transcript at 453:5-457:10, SBF Criminal Case, Dkt. No. 352.

[824] Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 71.

[825] *Alameda Research LLC v. Bankman*, No. 23-ap-50584 (Bankr. D. Del.) (JTD), Dkt. No. 26 at ¶ 3.

Center, and was a primary advisor to Bankman-Fried and other senior FTX Group executives regarding political contributions.[826] Gabe Bankman-Fried, Bankman-Fried's younger brother, was the Executive Director of Guarding Against Pandemics ("GAP"), a political action committee.[827] Barbara Miller, Bankman-Fried's aunt, served as a consultant to FTX.US.[828] Barbara Miller's involvement is discussed in Part 5, Section VI.a.

In the course of this investigation, Quinn Emanuel, assisted by Nardello and Alvarez & Marsal, reviewed documents collected from the Debtors and related entities such as GAP, as well as through Rule 2004 requests, and reviewed publicly available information including media reports and IRS filings.[829] In addition, Alvarez & Marsal performed tracing analyses.[830] Quinn Emanuel also considered relevant witness testimony adduced at the criminal trial of Bankman-Fried and information obtained from witness interviews.[831]

Among other things, Quinn Emanuel's investigation identified payments from or traceable to the FTX Group that were made to certain of these family members. Quinn Emanuel's investigation identified two transfers to Gabe Bankman-Fried that were traceable to FTX Group assets: a "gift" of $2 million;[832] and a payment of $200,000, in connection with a December 2021 consulting agreement pursuant to which Gabe Bankman-Fried was to advise Singh on Singh's personal philanthropic donations.[833] Quinn Emanuel also found that Bankman-

[826] *Id*. at ¶¶ 86-87.

[827] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 147.

[828] *Alameda Research LLC v. Bankman*, No. 23-ap-50584 (Bankr. D. Del.) (JTD), Dkt. 26 at ¶ 80.

[829] Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 71-72.

[830] *Id*. Tracing analysis involves using forensic accounting methods to track transfers of cash and assets.

[831] *Id*. at 72.

[832] *Id*. at 73.

[833] *Id.*

Fried made significant donations to GAP, and that while Gabe Bankman-Fried likely knew these were funded through FTX Group, there was no evidence that Gabe Bankman-Fried knew the donations were made up of customer funds.[834] Quinn Emanuel continues to assess next steps with regard to Gabe Bankman-Fried.

Quinn Emanuel also thoroughly investigated the roles, involvement, and knowledge of Joseph Bankman and Barbara Fried regarding wrongdoing at the FTX Group, and the extent to which they benefitted from the improper conduct. Following its investigation, the Debtors filed an avoidance action against Joseph Bankman and Barbara Fried.[835]

The complaint alleges, among other things, that Joseph Bankman "had broad authority to make decisions for" many FTX Group entities.[836] The complaint further alleges that, rather than "insist on and implement controls and raise alarms about the misconduct" within the FTX Group entities, Joseph Bankman "instead, stayed silent and in at least one instance, helped hush a complainant whose allegations threatened to expose the fraud."[837] Joseph Bankman is alleged to have not only "failed to investigate" whistleblower allegations that the FTX Group "had engaged in cryptocurrency price manipulation[,] money laundering, and operat[ing] an unlicensed money transmitter business,"[838] but also to have "applauded others for squashing [the] whistleblower complaint"[839] through, among other things, recommending an investigation into the whistleblower's attorney's disciplinary history.[840] The Debtors also allege that Barbara Fried

[834] *Id.* at 73.

[835] *Alameda Research LLC v. Bankman*, No. 23-ap-50584 (Bankr. D. Del.) (JTD), Dkt. No. 26.

[836] *Id.* at ¶ 4.

[837] *Id.* at ¶ 7.

[838] *Id.* at ¶ 81.

[839] *Id*.

[840] *Id*. at ¶ 82.

"used her access and influence to benefit her own organization," the political action committee Mind the Gap ("MTG"), with "Bankman-Fried and Singh contribut[ing] tens of millions of dollars to MTG or MTG-supported causes."[841] The complaint further alleges that, "[a]s a result of her concern about public scrutiny [of political donations], [Barbara] Fried on multiple occasions suggested, and even encouraged, Bankman-Fried and Singh to falsify disclosure records and misrepresent the sources of . . . particular contribution[s]," and that Barbara Fried knew Singh's contributions were unlawful.[842]

The Debtors also allege that Joseph Bankman and Barbara Fried "wielded their influence and status as Bankman-Fried's parents to enrich themselves at the expense of" the Debtors,[843] including obtaining a payment of $10 million in funds originating from Alameda, and purchasing a Bahamas property worth $16.4 million obtained with funds originating from FTX Trading,[844] both of which the Debtors seek to recover. This action remains pending.

III. Charitable Contributions

As described in the Second Ray Report, the FTX Group channeled funds to non-profit entities and other "purportedly altruistic endeavors."[845] These donations were made by, among other entities, the FTX Foundation (later known as FTX Philanthropy), which was led by Nicholas Beckstead at the time of the FTX Group's collapse.[846] The Second Ray Report explains that the FTX Group "committed publicly to contribute at least 1% of FTX's revenue

[841] *Id.* at ¶ 89.

[842] *Id*. at ¶ 130.

[843] *Id.* at ¶ 91.

[844] *Id*. at ¶ 73.

[845] *See* Second Ray Report, at 28-29.

[846] *See* Second Ray Report, at 28; *see also* S&C, *Memorandum re: Interview of Nicholas Beckstead*, Feb. 27, 2024, at 2-4, 7.

from fees to the FTX Foundation."[847] But, as that Report also notes, "FTX Foundation grants were" instead "funded via transfers from a variety of bank accounts," including several that "contained commingled customer and corporate funds."[848] At Bankman-Fried's criminal trial, the USAO-SDNY introduced evidence on the flow of funds from customer deposits to these FTX Group donations.[849]

As part of its investigative work into the FTX Group's donations, S&C and Landis Rath & Cobb LLP ("Landis") contacted over 300 non-profit entities that together received over $200 million in purported charitable donations from the FTX Group in an effort to recover the FTX Group's donations.[850] S&C's work included extensive negotiations with these recipients, in part to establish that the funds at issue came from the FTX Group.[851] For entities that were less cooperative, S&C made Bankruptcy Rule 2004 requests and, for one organization, served a motion to compel Bankruptcy Rule 2004 discovery.[852] S&C also worked with Nardello to investigate certain non-profits that received FTX Group-funded donations.[853]

Based on facts developed in their investigations, the Debtors filed adversary proceedings related to certain charitable contributions. For example, certain Debtors filed an avoidance action against Bankman-Fried, Beckstead, the FTX Foundation, former FTX Foundation employee Ross Rheingans-Yoo, and various other entities.[854] Based on the Debtors'

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[847] *See* Second Ray Report, at 25-26 (citation and internal quotation marks omitted).

[848] *See id*. at 26.

[849] *See, e.g.*, Transcript at 1750:13-1751:2, SBF Criminal Case, Dkt. No. 370.

[850] *See id.* at 152.; *see also, e.g.*, Dkt. No. 3329.

[851] *See id.*

[852] *See id.* at 152.; *see also e.g.*, Dkt. No. 3329.

[853] *See, e.g.*, Nardello, *Memorandum re: Center for Applied Rationality*, Aug. 25, 2023; Nardello, *Memorandum re: The Centre for Effective Altruism and Effective Ventures*, Aug. 17, 2023.

[854] *Alameda Research Ltd. v. Platform Life Sciences, Inc.*, No. 23-ap-50444 (Bankr. D. Del.) (JTD), Dkt. No. 1.

investigations, the amended complaint alleges that the FTX Foundation and Latona Biosciences Group ("Latona"), a "sham non-profit company organized in the Bahamas," "took over $71 million of commingled funds from Alameda and FTX accounts to make investments in and donations to life sciences companies for Bankman-Fried's personal aggrandizement."[855] It further alleges that "although Latona purported to be a non-profit corporation, Bankman-Fried, Rheingans-Yoo, and Beckstead wanted to participate in and profit from any upside in these investments," and therefore "intentionally obscured Latona's role in making these investments and avoided any discussion of the equity stakes that Latona had received in connection with these investments."[856] The Debtors recently reached a resolution of this adversary proceeding, settling the entire matter with the exception of the Debtors' claims against Bankman-Fried.[857] Issues related to Latona are also addressed later in this Part, in the discussion of the Venture Book. *See infra*, at Part 5, Section IX(c)(2)(ii).

The Debtors' pending avoidance action against Bankman-Fried's parents, Joseph Bankman and Barbara Fried, also includes allegations regarding charitable donations made by Joseph Bankman.[858] As relevant here, the Debtors allege that Joseph Bankman, a Senior Advisor to the FTX Foundation and a Stanford Law School professor, "had considerable leeway in directing charitable donations" and authorized "various FTX Group and affiliated entities"—not just the FTX Foundation—to make those donations.[859] The Debtors further assert that "[s]ome

[855] *See Alameda Research Ltd. v. Platform Life Sciences, Inc.*, No. 23-ap-50444 (Bankr. D. Del.) (JTD), Dkt. No. 73 at ¶ 5.

[856] *Id.* at ¶ 48.

[857] *See Alameda Research Ltd. v. Platform Life Sciences, Inc.*, No. 23-ap-50444 (Bankr. D. Del.) (JTD), Dkt. No. 102.

[858] *Alameda Research LLC v. Bankman*, No. 23-ap-50584 (Bankr. D. Del.) (JTD), Dkt. No. 1.

[859] *See Alameda Research LLC v. Bankman*, No. 23-ap-50584 (Bankr. D. Del.) (JTD), Dkt. No. 26 at ¶¶ 42, 78-79.

of Bankman's work at the FTX Group resulted in a flagrant waste of FTX Group funds."[860] And the Debtors allege that Joseph Bankman directed "donations of more than $5.5 million" to Stanford University in an attempt to "curry favor with and enrich his employer at the FTX Group's expense."[861] This matter remains pending.[862] Further discussion of the avoidance action against Joseph Bankman and Barbara Fried may be found *supra*, at Part 6, Section II.

S&C provided to the Examiner a list of over 1,200 charitable donations made by the FTX Group.[863] S&C initially prioritized recovery of the largest charitable donations, before turning to the next-largest group of donations and, finally, working with Landis to recover funds from recipients of smaller donations. S&C concluded that, for recipients of the smallest value donations, any potential recoveries would likely be outweighed by the costs of further action.

Without engaging in litigation, the Debtors have collected about $70 million from over 50 non-profits that received FTX Group-funded donations.[864] The Debtors continue to assess possible steps to recover charitable contributions.

IV. FTX Tokens/Investments at Third-Party Exchanges

The FTX Group maintained accounts at cryptocurrency exchanges in multiple jurisdictions.[865] By January 27, 2023, the Debtors, in conjunction with S&C and Alvarez & Marsal, identified cryptocurrency assets belonging to the Debtors, but outside of the Debtors' custody, valued at approximately $3.5 billion as of the Petition Date.[866] Of this total, more than

[860] *Id.* at ¶ 80.

[861] *Id.* at ¶ 115.

[862] *See Alameda Research LLC v. Bankman*, No. 23-ap-50584 (Bankr. D. Del.) (JTD).

[863] *See* Spreadsheet of Charitable Contribution Transfers.

[864] *See* S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 151.

[865] *Id*. at 168.

[866] S&C, *UCC Professionals Meeting*, Jan. 27, 2023, at 14.

$1.76 billion worth of cryptocurrency was held in hot wallets,[867] including in hot wallet accounts at third-party exchanges.[868] The Debtors faced several challenges in recovering cryptocurrency assets from third-party exchanges. These difficulties included insufficient documentation, a dearth of knowledgeable personnel, and difficulties obtaining access to accounts at third-party exchanges because the exchanges authorized only a limited number of users to access the accounts.[869]

In November 2022, during her interview with S&C, Caroline Ellison provided information regarding the Debtors' third-party exchange accounts and estimates of the value of the contents.[870] According to Ellison, several third-party exchanges locked access to the accounts or otherwise precluded the Debtors from accessing the assets in the days following the Petition Date.[871] S&C and Alvarez & Marsal contacted third-party exchanges to request that each exchange freeze the Debtor accounts and enter into discussions for transfer of control of the accounts to the Debtors.[872]

S&C and Alvarez & Marsal identified additional accounts at third-party exchanges that belonged to the Debtors by: (1) investigating more than 2,000 potential accounts or log-in credentials; and (2) pursuing on-chain tracing efforts to locate undisclosed token holdings at

[867] A "hot wallet" is a means of storing cryptocurrency on a device that is connected to the Internet. *See* First Ray Report, at 23.

[868] S&C, *UCC Professionals Meeting*, Jan. 27, 2023, at 14.

[869] *Id*. at 15.

[870] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 168.

[871] *Id.*

[872] S&C, *UCC Professionals Meeting*, Jan. 27, 2023, at 17.

exchanges and at other locations.[873] S&C worked to regain control of these accounts with the goals of: (1) recovering the assets; and (2) transferring all tokens to cold storage.[874]

As of January 27, 2023, S&C and Alvarez & Marsal had identified accounts at 23 exchanges. Four exchanges granted the Debtors access to the accounts or had granted access pending verification.[875] Thirteen other exchanges agreed to freeze accounts and were considered to be cooperating, including having requested legal process to turn over control.[876] The remaining six exchanges had not responded as of January 27, 2023, and/orthe Debtors were in discussions with SDNY-USAO regarding pursuit or forfeiture.[877]

As of March 15, 2024, the Debtors reached agreements or had near-complete agreements with nine exchanges, including one newly identified account, to grant the Debtors access to the accounts.[878] The value of the tokens in these resolved accounts was estimated to be approximately $290 million, as of the Petition Date. Two accounts, created by Debtors at Binance and Binance US, were seized by the USAO-SDNY. Those seized accounts held assets estimated to be worth approximately $230 million as of the Petition Date.[879]

Eleven exchanges have not yet agreed to resolutions allowing the transfer of control of the frozen accounts to the Debtors, but are part of ongoing efforts by the Debtors to secure

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[873] *Id*.

[874] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 168. "Cold storage," or a "cold wallet" is a means of storing cryptocurrency on a secure device that is not connected to the Internet. *See* First Ray Report, at 23.

[875] S&C, *UCC Professionals Meeting*, Jan. 27, 2023, at 17. The four exchanges are: (1) Bitfinex; (2) Deribit; (3) LMAX; and (4) Kraken.

[876] *Id.* The 13 exchanges are: (1) Ascendex; (2) Bitbank; (3) Bitflyer; (4) Bitmex; (5) Bitstamp; (6) Bybit; (7) Coinbase; (8) Crypto.com; (9) Gate.io; (10) Gemini; (11) Paxos; (12) Polonex; and (13) Upbit.

[877] *Id*. The six exchanges are: (1) Binance and Binance US; (2) BTCTurk; (3) Huboi; (4) KuCoin; (5) MEXC; and (6) OKCoin.

[878] *Id*. The nine exchanges are: (1) Liquid (not listed among the January 23, 2023 exchanges); (2) Bitstamp; (3) Bitfinex; (4) Coinbase; (5) Deribit; (6) Gemini; (7) Kraken; (8) LMAX; and (9) OKCoin.

[879] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 168.

recovery of the assets. The aggregate value of the assets in these accounts is estimated to be approximately $245 million as of the Petition Date.[880] S&C believes that four exchanges are currently beyond the reach of the Debtors' recovery efforts.[881] S&C estimates that the aggregate Petition Date value of Debtor assets held in accounts at these four exchanges is approximately $130 million.[882]

a. Exchanges For Which Recovery Is Complete or Near Complete

As of March 15, 2024, S&C considered asset recovery to be essentially complete from the following nine exchanges: (1) Liquid; (2) Bitfinex;[883] (3) Bitstamp; (4) Coinbase; (5) Deribit[884]; (6) Gemini; (7) Kraken; (8) LMAX; and (9) OKCoin.[885] The investigations conducted by S&C and Paul Hastings provided additional detail on two of these accounts:

1. Coinbase

This account was determined to represent the greatest value of non-FTT Debtor assets held at a third-party exchange, consisting primarily of SOL tokens estimated to be worth $105 million as of January 30, 2024. However, at that time, this account was jointly controlled by BlockFi and the Debtors.[886] Although the extent to which this joint control was resolved in favor of the Debtors was not detailed in S&C's March 15, 2024 report, the Debtors' recovery of assets held at Coinbase is considered complete or near complete.

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[880] *Id*.

[881] *Id*.

[882] *Id*.

[883] Bitfinex was identified as a holder of FTT. Paul Hastings, *FTT Claims and Holders Summary*, July 10, 2023, at Tab "On-Chain Holders (FTI)."

[884] The Debtors' Deribit account was identified as the source of a payment to Genesis to pay down a loan of 10.6 BTC ($248,000) on July 19, 2022. However, documentation of the underlying loan has not been identified. Paul Hastings, *FTX Unsecured Creditors' Committee—FTI Analysis*, Mar. 1, 2023 ("Document Review"), at Row 4.

[885] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 168.

[886] Paul Hastings, *Presentation to the Official Committee of Unsecured Creditors of FTX Trading Ltd., et al.*, Jan. 30, 2024, at 10.

2. OKCoin

As determined through an investigation conducted by Nardello on behalf of S&C, OKCoin (sometimes referred to as OKX) is a global cryptocurrency exchange with offices in the United States, Malta, Hong Kong, Singapore, and Japan.[887] Nardello's investigation did not, however, reveal the nature or value of Debtor assets held at OKCoin. Nevertheless, S&C reports asset recovery from OKCoin to be complete or near complete.[888]

b. Exchanges At Which Debtor Accounts Were Seized by USAO-SDNY

As of January 27, 2023, S&C reported that the Debtors were aware that the USAO-SDNY was seeking forfeiture of the Debtors' accounts held at two related entities: (1) Binance;[889] and (2) Binance US.[890] By March 15, 2024, the Debtors' crypto-assets in those accounts had, in fact, been seized by the USAO-SDNY.[891]

As part of its investigation into Binance on behalf of S&C, Nardello reviewed an August 2022 study of stablecoins titled "Stablecoin Cyclones: Mint & Burn Patterns." Among other things, the study discussed unexpected aspects of TrueUSD, a U.S. dollar fiat-backed stablecoin. The study found that "FTX and Binance share a redemption address. . . . [E]ither TrueUSD made a mistake and sent the same address to these two rival exchanges or they are coordinating TrueUSD on some level."[892]

[887] Nardello, *Memorandum re: OKCoin*, Dec. 2, 2022, at 1.

[888] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 168.

[889] Binance was also identified as a holder of FTT. Paul Hastings, *FTT Claims and Holders Summary*, July 10, 2023, at Tab "On-Chain Holders (FTI)."

[890] S&C, *UCC Professionals Meeting*, Jan. 27, 2023, at 17.

[891] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 168.

[892] Nardello, *Report Prepared for Sullivan & Cromwell LLP re:Binance Supplemental Research*, Nov. 18, 2023, at 11.

Miller recounted to S&C that, after the Petition Date, he learned of approximately $1 million in cryptocurrency that the Debtors maintained at Binance. Miller stated that he secured these crypto-assets by putting them on a physical metal ledger.[893]

c. Exchanges For Which Recovery Efforts Remain In Process

The Debtors are continuing recovery efforts with respect to 11 other third-party exchanges:[894] (1) AscendEX; (2) Bitbank; (3) Bitexen; (4) bitFlyer; (5) BitMEX; (6) Bybit;[895] (7) Crypto.com; (8) MEXC; (9) Paxos; (10) Poloniex; and (11) Upbit. These accounts represent assets estimated at $245 million as of the Petition Date.[896] The Debtors' investigation of these exchanges uncovered additional detail related to four of them:

1. Crypto.com

According to an investigation conducted by Nardello, Crypto.com is a cryptocurrency exchange operated by Foris DAX MT, a Malta corporation registered to operate in Hong Kong.[897] Foris DAX MT held accounts at FTX.com beginning at least as early as 2019.[898] The Nardello investigation report into Crypto.com did not discuss accounts held by the Debtors at Crypto.com or its parent. However, the report did include evidence that Crypto.com or its parent had more than $33 million in assets on deposit with the Debtors as of October 2022.[899] S&C investigated Crypto.com and identified accounts held by the Debtors at Crypto.com.[900] It

[893] Miller Interview Memo, at 11.

[894] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 168.

[895] Bybit was identified as a holder of FTT. Paul Hastings, *FTT Claims and Holders Summary*, July 10, 2023, at Tab "On-Chain Holders (FTI)."

[896] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 168.

[897] Nardello, *Memorandum re: Foris Dax*, Sept. 12, 2023, at 2.

[898] *Id.* at 9.

[899] *Id*. at 10.

[900] S&C, *UCC Professionals Meeting*, Jan. 27, 2023, at 17.

reported that Crypto.com had frozen these accounts at the Debtors' request, and that the Debtors were in the process of securing control over these assets as of May 2024.[901]

2. MEXC

Nardello identified documents indicating that Alameda had opened accounts on the MEXC platform and held various cryptocurrency tokens in those accounts.[902] MEXC was also identified as a holder of FTT.[903]

3. Poloniex

Poloniex is a cryptocurrency exchange that, as of October 2019, was acquired by Sun Yuchen, a high-profile individual in the cryptocurrency industry who also goes by Justin Sun.[904]

4. Upbit

The investigation by Paul Hastings into preferential transfers involving Alameda identified email exchanges and KYC documentation that indicate "Alameda had direct access" to an account on Upbit.[905] It further identified a letter from Ray to Upbit's General Counsel stating that the Debtors have an account at Upbit, identified by account ID, and requesting that the funds in the account be transferred to the bankruptcy estate.[906]

d. Exchanges Over Which the Debtors Exert No Control

There are four third-party exchanges where S&C identified accounts held by the Debtors, but the accounts are outside the control of the Debtors. These exchanges are: (1) BTCTurk;

[901] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 168.

[902] Nardello, *Memorandum re: MEXC*, Apr. 20, 2023, at 3.

[903] Paul Hastings, *FTT Claims and Holders Summary*, July 10, 2023, at Tab "On-Chain Holders (FTI)."

[904] Nardello, *Memorandum re: Orange Anthem*, July 6, 2023, at 1,6.

[905] Paul Hastings, *FTX UCC - Summary of Alameda Privileges/Preferential Treatment*, June 7, 2023, at Tab "Detailed Analysis".

[906] *Id*.

(2) GATE.io; (3) Huboi; and (4) KuCoin.[907] The Debtors' accounts at these exchanges are estimated to hold assets valued at $130 million as of the Petition Date.[908] Of these, S&C's investigation and reporting offered additional notable information on two of them:

1. GATE.io[909]

In January 2023, S&C determined that GATE.io was willing to cooperate with the Debtors by freezing the Debtors' accounts to preserve value and transferring control of those assets to the Debtors.[910] S&C indicated that GATE.io had, as of January 27, 2023, frozen the account(s) related to the Debtors' holdings.[911] However, along with 12 other third-party exchanges, GATE.io requested legal process prior to granting the Debtors access or control to the frozen assets.[912] Then, in contrast to the 12 cooperating exchanges, GATE.io stopped cooperating with the Debtors.[913]

2. KuCoin[914]

Nardello identified documents indicating that Alameda listed assets equivalent to $115 million in a KuCoin account, with $80 million of that characterized as "currently available" as of November 7, 2022.[915]

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[907] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 168.

[908] *Id*.

[909] GATE.io was identified as holding positions in the FTT token. Paul Hastings, *FTT Claims and Holders Summary*, July 10, 2023, at Tab "On-Chain Holders (FTI)."

[910] S&C, *UCC Professionals Meeting*, Jan. 27, 2023, at 17.

[911] *Id.*

[912] *Id.*

[913] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 168.

[914] KuCoin was also identified as a holder of FTT. Paul Hastings, *FTT Claims and Holders Summary*, July 10, 2023, at Tab "On-Chain Holders (FTI)."

[915] Nardello, *Memorandum re: KuCoin,* Apr. 20, 2023, at 20.

KuCoin has been the target of many regulatory actions, including one by the New York State Attorney General alleging improper securities trading.[916] Although the Debtors have identified assets in a KuCoin account, those assets are assessed by S&C to be outside the control of the Debtors and not subject to advancing recovery efforts.[917]

V. FTX.US

Beginning in 2020, the FTX Group created and maintained FTX.US, an exchange for spot trading of cryptocurrency and other digital assets in the United States.[918] FTX.US was needed because FTX.com, the FTX Group's primary exchange, was not available to users in the United States.[919] FTX.US was a subsidiary of Debtor entity WRS, which also controlled several other businesses related to cryptocurrency trading that served U.S. customers.[920]

On November 8, 2022, after FTX.com paused customer withdrawals, Bankman-Fried tweeted that "FTX.us . . . [is] not currently impacted by this," and on November 10, he claimed that FTX.US was "100% liquid" and "[e]very user could fully withdraw" funds.[921] However, on November 9, representatives of FTX.US informed U.S. regulators and the U.S. House of Representatives that "FTX US . . . customer assets actually held are not immediately reconcilable with the customer assets reported."[922] FTX.US subsequently filed for Chapter 11

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[916] *Id*. at 9.

[917] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 168.

[918] First Ray Report, at 4.

[919] Ray First Day Declaration, at ¶ 33.

[920] Examples of other WRS businesses in this category included LedgerX LLC, a CFTC-licensed cryptocurrency futures and derivatives market, and FTX Capital Markets LLC, an SEC-registered broker-dealer. *See id*. at ¶¶ 12-21.

[921] Letter from Chairman Raja Krishnamoorthi, Subcommittee on Economic and Consumer Policy, Committee on Oversight and Reform, U.S. House of Representatives, to Sam Bankman Fried and John Ray (Nov. 18, 2022), at 3, https://oversightdemocrats.house.gov/sites/evo-subsites/democrats-oversight.house.gov/files/2022-11-18.RK%20to%20Bankman-Fried%20and%20Ray-FTX%20re%20FTX%20Crypto.pdf, *archived at* https://perma.cc/88G8-GEL8.

[922] *Id*.

along with the other FTX Group entities. On January 17, 2023, Bankman-Fried contended that FTX.US should not have filed for bankruptcy, as FTX.US "was and is solvent, likely with hundreds of millions of dollars in excess of customer balances."[923]

S&C has undertaken a number of investigations into issues presented by the collapse of FTX.US. These investigations included whether FTX.US was insolvent when the bankruptcy was filed, as well as an inquiry into Bankman-Fried's various public statements that espoused the opposite position, i.e., that FTX.US was, and remained, solvent. The investigations by S&C confirmed that FTX.US was in fact insolvent on the Petition Date, with a multimillion dollar "hole" in FTX.US's balance sheet,[924] and that Bankman-Fried's statements to the contrary were false. In this section, the Examiner summarizes the investigative steps taken and the findings of these investigations, and recommends that he conduct a further investigation into issues surrounding the "hole" in FTX.US's balance sheet and its causes, and the potential commingling and misuse of customer funds involving FTX.US.

a. Investigative Steps

Immediately after the Petition Date, S&C began investigating the collapse of the FTX Group, including issues related to FTX.US.[925] Relevant here, the initial investigation into FTX.US involved the review of documents collected from Debtor entities and interviews of

[923] *See* Samuel Bankman-Fried, *FTX US Balance Update 2023-01-17*, Substack (Jan. 18, 2023), https://sambf.substack.com/p/ftx-us-balance-update-2023-01-17, *archived at* https://perma.cc/M585-CCVT; *see also* Samuel Bankman-Fried (@SBF_FTX), X (formerly Twitter) (Jan. 17, 2023, 7:31 pm), https://twitter.com/SBF_FTX/status/1615507065337958401, *archived at* https://perma.cc/R3E9-N3ND ("FTX US is solvent, as it always as [sic] been.").

[924] FTX Group executives used the term "hole" to refer to a shortfall in available assets at FTX.US relative to FTX.US's liabilities to customers and others. The CFTC later adopted this terminology in its complaint against FTX Group executives stemming from the collapse of FTX.US. *See Commodity Futures Exch. Comm'n v. Bankman-Fried*, No. 22-cv-10503 (S.D.N.Y.), Dkt. No. 1 at ¶¶ 95-98.

[925] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 26.

several FTX.US executives.[926] S&C identified evidence that, in the leadup to the Petition Date, FTX executives had discussed a $46 million "hole" in customer assets at FTX.US.[927]

After Bankman-Fried claimed on January 17, 2023 that FTX.US was, and had always been, solvent, S&C further investigated the "hole" and the veracity of Bankman-Fried's statements about FTX.US's solvency.[928] S&C reviewed additional documents and communications located on devices obtained from the Debtors and conducted a forensic accounting of FTX.US's assets and liabilities in conjunction with AlixPartners and Alvarez & Marsal.[929]

b. S&C's Findings Regarding the FTX.US "Hole" and Bankman-Fried's Statements

Based on its investigation into FTX.US, S&C found the following: when concerns about FTX.com liquidity issues developed in early November 2022, certain FTX Group executives—including Bankman-Fried, Ellison, Singh, FTX.US CEO Zach Dexter, and FTX.US General Counsel Ryne Miller—discussed issues related to FTX.US.[930] After pointed questions from Dexter and Miller, Bankman-Fried and Wang provided spreadsheets ostensibly reflecting the bank balances of WRS (FTX.US's parent company) and the aggregated customer balances at FTX.US.

Dexter analyzed these spreadsheets and informed the group that the FTX.US bank balances spreadsheet totaled $138.5 million and that the "Wallet Balances" spreadsheet—the customer balances—totaled $184.7 million, leaving a hole (or shortfall) of approximately $46

[926] *See, e.g.*, Miller Interview Memo; S&C, *Memorandum re: Interview of Marissa MacDonald*, Dec. 7, 2022 ("MacDonald Interview Memo"); During Interview Notes.

[927] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 26.

[928] *Id*.

[929] *Id*.

[930] S&C, *Talking Points for SDNY Re: FTX.US Shortfall*, Apr. 4, 2023 ("USAO-SDNY Talking Points"), at 2 (quoting FTX_000022866).

million at FTX.US.[931] Dexter pressured other FTX Group executives to address the hole by transferring funds from FTX.US operating cash accounts to bank accounts that held FTX.US customer funds. Eventually, Bankman-Fried claimed to have resolved the hole by "transferr[ing] 46m from info@alameda-research.com to expenses@ftx.us."[932]

But as S&C's investigation determined and the CFTC later alleged, the transfer that Bankman-Fried described was not what Dexter had prudently recommended: it was not a transfer from an FTX.US operating cash account to increase the amount of cash available for customer withdrawals in FTX.US's bank accounts.[933] Instead, as the CFTC alleges, in an effort to cover the hole at FTX.US, Bankman-Fried made a transfer from Alameda's FTX.US account to another account at FTX.US that could be used to satisfy customer withdrawal demands.[934] In other words, Bankman-Fried used Alameda funds to shore up FTX.US's balance sheet by reducing FTX.US's nominal liability to Alameda, while not, in reality, adding any additional assets to FTX.US's balance sheet.[935] Dexter reported this transfer to the CFTC soon after it was made, and the CFTC incorporated allegations about the transfer into its case against Bankman-Fried.[936]

As S&C's investigation found, the FTX Group executives soon realized that the calculations of FTX.US's financial position were flawed.[937] Dexter identified these errors to a

[931] *Id*. (citing FTX_001567895).

[932] *Id*. at 3 (quoting FTX_000022974).

[933] *Id.*; *Commodity Futures Exch. Comm'n v. Bankman-Fried*, No. 22-cv-10503 (S.D.N.Y.), Dkt. No. 1, at ¶¶ 97-98.

[934] USAO-SDNY Talking Points, at 3; *Commodity Futures Exch. Comm'n v. Bankman-Fried*, No. 22-cv-10503 (S.D.N.Y.), Dkt. No. 1 at ¶¶ 97-98.

[935] *Commodity Futures Exch. Comm'n v. Bankman-Fried*, No. 22-cv-10503 (S.D.N.Y.), Dkt. No. 1 at ¶ 95 ("Bankman-Fried quickly indicated he would fill the hole at FTX US from liquidation of Alameda assets.").

[936] USAO-SDNY Talking Points, at 3; *Commodity Futures Exch. Comm'n v. Bankman-Fried*, No. 22-cv-10503 (S.D.N.Y.), Dkt. No. 1 at ¶ 98.

[937] USAO-SDNY Talking Points, at 3-4 (citing FTX_000287058).

smaller group of FTX.US executives, excluding Bankman-Fried and other key members of FTX Group leadership. Dexter explained that the calculations had involved several bank balances and customer wallet balances, each from a different point in time, and that in the financial documentation provided, "operational cash [was] clearly being counted towards 'backing' cash, which is clearly not how this is supposed to work."[938] Caroline Papadopoulos, FTX.US's controller, pointed out that the calculation was off for another reason: it "includ[ed] [WRS] cash [which] should be considered independent of FTX US."[939] She characterized the ostensible reconciliation as "nonsense."[940] In the wake of this discovery, FTX.US filed for bankruptcy with the other FTX Group entities.

In light of these findings, S&C concluded that Bankman-Fried was incorrect when he claimed FTX.US was solvent on the Petition Date. Bankman-Fried's argument for FTX.US's solvency relied on similar errors to those made during the attempted reconciliation of the balance sheet: it counted cash held by FTX.US affiliates WRS and LedgerX as cash that could be used to pay out FTX.US customers.[941] Additionally, Bankman-Fried claimed that FTX.US had $485 million in crypto-assets available to satisfy customer withdrawals. But this was also false; these tokens had declined significantly in value by the Petition Date.[942] Finally, S&C concluded that even if FTX.US had been solvent, it was appropriate to file it into bankruptcy. Given the extensive evidence of asset commingling across entities in the FTX Group—including the commingling of FTX.US and Alameda assets undertaken in an effort to cover the hole at

[938] *Id*. (citing FTX_000287196).

[939] *Id*.

[940] *Id*.

[941] *Id*. at 5 (citing FTX_000287196).

[942] *Id*. at 5-6.

FTX.US—FTX.US would have been vulnerable to litigation by creditors of other FTX entities if it had not been included in the bankruptcy filings.[943]

c. Recommendations for Further Investigation

S&C's investigation confirmed the hole at FTX.US. In conjunction with Alvarez & Marsal, S&C has continued to investigate the size of the hole as of the Petition Date and refine its estimate. The most recent calculation—as of May 7, 2024—estimates that the hole was approximately $141 million, far greater than FTX.US's leadership and the senior FTX Group executives had understood.[944] However, S&C acknowledged it has not focused on whether there was a hole before November 2022, or how large such a hole may have been.[945]

There is reason to believe that FTX.US may have experienced balance sheet shortfalls far earlier than the Petition Date. S&C found that senior FTX Group executives frequently ordered the transfer of assets (both cryptocurrency and fiat currency) between FTX.US and other entities in the FTX Group, such as Alameda and FTX.com.[946] During S&C's interviews with FTX.US executives, witnesses discussed the movement of funds between FTX.US and other FTX Group entities. For example, a senior executive in FTX.US compliance described a conversation with an employee with FTX.US's settlements team that occurred around the time of the discovery of the hole. As the compliance executive reported, when the topic of the hole came up, the settlements employee mentioned "normally . . . go[ing] to Alameda and switch[ing] [a stablecoin] into fiat from [Alameda]."[947] S&C noted that FTX.US made at least some transfers

[943] *Id*. at 3-4.

[944] Dkt. No. 14301-1, at 29.

[945] USAO-SDNY Talking Points, at 6.

[946] *Id*.

[947] During Interview Notes, at 8.

to and from other FTX Group entities to resolve imbalances in stablecoin reserves, and that at least certain of those transfers involved a swap of one asset held at FTX.US for another asset of equal value held at another FTX Group entity. But it is not clear whether all the transfers took that form, or whether some were transfers undertaken at the direction of FTX Group executives to address balance sheet holes at FTX.US. Another FTX.US executive who served in a senior role in the compliance department described a conversation in which she was told that FTX executive Jayesh Peswani would do "top-side entries on the books" at FTX.US,[948] suggesting to her that "someone can move something around" among FTX Group entities.

These findings suggest that FTX.US may have experienced "holes," or shortfalls of available assets relative to liabilities on occasions before November 2022 and that these holes, as well as the November 2022 hole, may have been resolved by FTX employees transferring, or ordering the transfer of, assets from other FTX Group entities to FTX.US. It does not appear, however, that the Debtors have fully investigated the cause of the November 2022 hole at FTX.US, or the existence or causes of holes that may have existed at other times. Nor have they determined (1) whether the balance sheet holes were the result of commingling of customer or corporate assets; (2) their frequency and size; or (3) how they were covered, and who was involved in covering them. In discussions with the Examiner, S&C explained it would be difficult to conclusively determine the causes of the holes at FTX.US because of the poor state of the FTX Group's record-keeping and the fact that—as the FTX Group's executives found when they attempted to assess the size of the FTX.US hole in the days before the Petition Date—it is difficult to determine the state of FTX.US's balance sheet at any given time. This is due to the high volatility of many crypto-assets and constant fluctuations in fiat and cryptocurrency account

[948] MacDonald Interview Memo, at 19.

balances. Nevertheless, S&C acknowledged it has not investigated in full certain potential causes of the hole or holes at FTX.US.

The Examiner recommends that he be authorized to conduct an investigation into these issues. Further investigation of the existence, cause, and resolution of "holes," or balance sheet shortfalls, at FTX.US may identify additional misconduct or misuse of customer assets. Additionally, further investigation and reporting on FTX.US's insolvency could promote public confidence in the bankruptcy process by refuting Bankman-Fried's false claims that FTX.US was solvent as of the Petition Date. The Examiner notes that further inquiry into potential misuse of customer assets at FTX.US is unlikely to be accretive to the estates given the prior investigations into the FTX Group's misuse of customer assets. However, the Scope Order recognizes that additional investigations may be warranted if those "additional investigations would be in the public interest."[949] Given the significant public interest in issues related to FTX.US—an FTX Group entity that served customers in the United States, was publicly advertised to US customers as a "US based and regulated" exchange that made "[c]rypto investing . . . simple,"[950] and has been the subject of extensive public debate—it is the Examiner's view that further inquiry by him into FTX.US is warranted.

VI. Miscellaneous Investigations

The Debtors' counsel investigated a handful of other issues not readily assigned to one of the other categories of inquiries discussed in this Report, but where the Debtors' counsel saw a possibility of locating value for the estates. These miscellaneous investigations are discussed here.

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[949] The Examiner may recommend additional investigations if they "would be in the public interest." *See* Scope Order at ¶ 2.

[950] FTX.US, https://ftx.us (Feb. 10, 2022), *archived at* https://web.archive.org/web/20220210160911/https://ftx.us/.

a. FTX Group Properties

S&C investigated properties owned by the FTX Group in the Bahamas.[951] Alvarez & Marsal, along with counsel in the Bahamas, reviewed the Bahamas Land and Property Registry to identify properties owned by the FTX Group and affiliated employees and individuals.[952] S&C reviewed relevant records and communications related to each property and identified who lived in the residential properties.[953]

As a result of its investigation, S&C concluded that, although FDM wired funds to purchase the residences, it funded those purchases through transfers from FTX Group bank accounts.[954] In total, S&C identified 35 commercial and residential properties purchased with more than $231 million of Debtor funds.[955] Those properties are the subject of separate actions seeking to recover the value of the properties.[956]

b. Other Investigated Preference Actions

S&C has investigated certain entities for potential preference actions as part of its review of top FTX.com and FTX.US customers. For example, S&C identified two Alameda lenders and found that one lender received loan repayments from Alameda on the days immediately preceding the bankruptcy filing.[957] S&C also identified and investigated one firm that was

[951] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 182.

[952] *Id.*

[953] *Id.*

[954] *Id.*

[955] *Id.* at 183.

[956] *See FTX Trading Ltd. v. Bankman-Fried*, No. 23-ap-50448 (Bankr. D. Del.) (JTD); *Alameda Research LLC v. Bankman*, No. 23-ap-50584 (Bankr. D. Del.) (JTD).

[957] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 138-40.

founded by a since-departed Alameda executive.[958] The Debtors have not yet elected to pursue claims against those individuals and entities, but continue to assess possible next steps.

c. NFT Withdrawals

S&C has also investigated certain non-fungible token ("NFT") transactions that occurred immediately before and on the Petition Date.[959] By analyzing withdrawal and trading data from that period, S&C found that those NFT transactions were part of a scheme whereby FTX.com users, who could not withdraw funds from the exchange after FTX.com froze withdrawals, paid inflated prices for NFTs sold by Bahamian individuals. Those Bahamian individuals, who could withdraw funds from the exchange after FTX.com lifted the withdrawal freeze for Bahamian users on November 10, 2022, would in turn withdraw the proceeds from the sales of NFTs from FTX.com.[960] This investigation also identified two former employees of the FTX Group who withdrew funds in a similar way, but those employees voluntarily agreed to return those funds to the Debtors.[961] The Debtors continue to assess next steps with respect to the individuals involved in these transactions.

VII. Payments to Foreign Officials

The USAO-SDNY and the Debtors' counsel have conducted extensive investigations into transfers from the FTX Group to various foreign government officials, including the transfer of assets to the Securities Commission of the Bahamas ("SCB") and substantial payments to Chinese government officials. A summary of those investigations is set forth below.

[958] *Id.* at 143.

[959] *Id*. at 134.

[960] *Id.*

[961] *Id.* at 135.

a. Payments to and Contacts with Bahamian Government Officials

1. Transfer of Assets to the Securities Commission of the Bahamas

Immediately after the Petition Date, S&C learned that previously unreleased FTT tokens had been transferred to the custody of the Bahamian government.[962] That same week, S&C began investigating the circumstances of these transfers.

S&C corresponded with counsel for Bankman-Fried, Wang, and the JPLs, as well as with FTX Group employees and the USAO-SDNY. In an emergency motion filed by the Debtors in these bankruptcy cases, the Debtors accused the SCB of violating the automatic stay by directing the transfer of the Debtors' digital assets out of their bankruptcy estates and to the Bahamian government.[963] The JPLs subsequently filed an emergency motion for relief from the automatic stay and to compel the turnover of certain electronic records controlled by the Debtors.[964] In opposing this emergency motion, the Debtors provided this Court with a copy of an affidavit from the Executive Director of the SCB, which attached a postpetition, November 12, 2022 *ex parte* order from the Supreme Court of the Bahamas authorizing "all of the digital assets on the FTX.com platform within the possession, custody and/or under the control of [FDM]" be transferred to the SCB.[965] The JPLs and the Debtors subsequently entered into an agreement regarding mutual cooperation that consensually resolved the issues raised by the JPLs' emergency motion.[966]

[962] *See, e.g.*, Dkt. No. 335 at ¶¶ 33-34.

[963] Dkt. No. 22 at ¶ 7; *see also* 11 U.S.C. § 362.

[964] *See* Dkt. No. 197.

[965] *See* Dkt. No. 336-2, at 20, 388-90.

[966] *See* Dkt. No. 402.

During the criminal trial of Bankman-Fried, the USAO-SDNY presented evidence regarding the post-filing transfer of assets to the SCB.[967] The USAO-SDNY relied on this evidence in support of a fraud enhancement at sentencing, to establish that Bankman-Fried's offense involved "a misrepresentation or other fraudulent action during the course of a bankruptcy proceeding."[968] In support of its argument that the enhancement for fraud during a bankruptcy proceeding applied, the USAO-SDNY relied on Wang's trial testimony that Bankman-Fried told him that "ideally [we] should transfer [customer assets] to the Bahamas liquidators or the Bahamas regulators" because "they seemed friendly and seemed willing to let [Bankman-Fried] stay in control of the company."[969] The USAO-SDNY also cited evidence that, while Bankman-Fried and Wang were working to transfer the assets to the Bahamian authorities, Bankman-Fried instructed Wang to continue the transfers despite warnings from Miller that there was "a significant question of who owns the assets," and that Bankman-Fried "cannot transfer any funds that are the subject of the bankruptcy estate."[970] The defense, on the other hand, contended that the enhancement did not apply because Bankman-Fried transferred those assets to "compl[y] with an order of a foreign government with physical jurisdiction over him."[971] When Bankman-Fried was sentenced, the sentencing court agreed with the USAO-SDNY and applied the two-level sentencing enhancement.[972]

[967] *See* Transcript at 464:22-471:8, SBF Criminal Case, Dkt. No. 352.

[968] SBF Criminal Case, Dkt. No. 410, at 57-59 (citing U.S.S.G. § 2B1.1(b)(9)(B)).

[969] *See id.* at 57-58 (second alteration in original) (quoting Transcript at 465:20-466:1, SBF Criminal Case, Dkt. No. 352).

[970] *See id.* at 58-59; *see also* Transcript at 467:22-470:21, SBF Criminal Case, Dkt. No. 352.

[971] *See* SBF Criminal Case, Dkt. No. 414, at 6.

[972] *See* Bankman-Fried Sentencing Transcript at 7:22-8:3, SBF Criminal Case, Dkt. No. 426.

2. Other Payments to and Connections with Bahamian Government Officials

S&C, with assistance from Nardello, also investigated other connections between the FTX Group and current or former Bahamian government officials, including payments made and other benefits conferred in an apparent effort to secure influence in the Bahamas. As described in the Second Ray Report, those payments included a $1 million "bonus" paid to a former Bahamian government official, who was acting as an attorney for FDM.[973] S&C determined that this "bonus" was offered to the former government official to secure her assistance in obtaining a necessary license for FDM under the Bahamas' Digital Assets and Registered Exchanges Act.[974] In its investigation, S&C developed evidence that, when asked whether these payments could possibly constitute bribes, the FTX Group employee who offered the "bonus" dismissed those concerns based on his view that the recipient of those payments was no longer a government official.[975] The former Bahamian government official secured the license for FDM within six weeks.[976]

S&C and Nardello also found that the FTX Group made several donations to entities affiliated with Bahamian government officials and their families.[977] For example, the FTX Group sent $500,000 as a purported donation to an entity owned by relatives of a high-ranking Bahamian government official.[978] In addition, the FTX Group donated $175,000 to other entities

[973] *See* Second Ray Report, at 16.

[974] *See* S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 49; *see also* Second Ray Report, at 16.

[975] S&C, *Memorandum re: Interview of Can Sun*, Jan. 11, 2023 ("Sun Interview Memo"), at 13.

[976] *See* Second Ray Report, at 16.

[977] *See* S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 49.

[978] *See* Nardello, *Memorandum re: Issues Concerning Bahamian Insolvency Proceedings Involving FTX*, May 13, 2023, at 31.

affiliated with family members of high-ranking Bahamian government officials.[979] Finally, S&C and Nardello's investigation identified other contacts between the FTX Group and Bahamian government officials.

b. Payments to Chinese Government Officials

S&C—in conjunction with Alvarez & Marsal, AlixPartners, Nardello, and TRM Labs—also investigated the circumstances surrounding payments to Chinese government officials in 2021 to unlock Alameda accounts in China.[980] Those accounts, which contained around $1 billion, were frozen by the Chinese government as part of its investigation into money laundering involving an Alameda counterparty.[981] The USAO-SDNY brought a superseding indictment against Bankman-Fried charging him with violating the Foreign Corrupt Practices Act in connection with these payments to Chinese government officials, alleging that they totaled "at least approximately $40 million."[982] At the criminal trial of Bankman-Fried, Ellison testified that these payments were in the "ballpark" of $100 million, and that she understood them to be "a large bribe to Chinese government officials to get some of our exchange accounts unlocked."[983] S&C's investigation further found that these payments to Chinese government officials totaled approximately $161 million.[984]

[979] *See id.*

[980] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 15.

[981] *See* Transcript at 827:14-828:14, SBF Criminal Case, Dkt. No. 360.

[982] *See* SBF Criminal Case, Dkt. No. 115 at ¶¶ 102-05. That charge, along with several others, was severed from the counts that proceeded to trial, and following Bankman-Fried's trial, the USAO-SDNY declined to pursue a second trial on the remaining counts. *See* SBF Criminal Case, Dkt. No. 388.

[983] *See* Transcript at 827:9-12, 832:16-24, SBF Criminal Case, Dkt. No. 360.

[984] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 15.

VIII. Political Contributions

As has been widely reported in the press,[985] the FTX Group; affiliated individuals including Bankman-Fried, Nishad Singh, and Ryan Salame; and affiliated non-profit organizations and political action committees made extensive political contributions.[986] Donations were directed to politicians of both major American political parties, as well as to political action committees, national, state, and local political parties, and party-aligned groups.[987] As explained below, multiple investigations have determined that many of these donations were made in violation of law.

a. Government Investigations

As part of its criminal case, the USAO-SDNY charged Bankman-Fried with violating federal election laws by using "straw donors" and corporate funds to make tens of millions of dollars of political contributions in excess of statutory limits.[988] Among those used as "straw donors" were two executives of the FTX Group, Singh and Salame.[989] However, due to legal

[985] *See, e.g.*, Brian Schwartz, *How former crypto king Sam Bankman-Fried and friends quietly donated to political groups and relatives*, CNBC (Dec. 19, 2022), https://www.cnbc.com/2022/12/19/how-ftx-founder-sbf-and-friends-quietly-donated-to-political-groups-and-relatives.html, *archived at* https://perma.cc/UA4A-XTPF; Kenneth P. Vogel & Ken Bensinger, *U.S. Scrutinizes Political Donations by Sam Bankman-Fried and Allies*, N.Y. Times, Dec. 17, 2022, https://www.nytimes.com/2022/12/17/us/politics/sam-bankman-fried-political-donations-doj.html, *archived at* https://perma.cc/UD66-NNJE.

[986] Second Ray Report, at 27; SBF Criminal Case, Dkt. No. 410, at 22; *see also* Brian Schwartz, *How former crypto king Sam Bankman-Fried and friends quietly donated to political groups and relatives*, CNBC (Dec. 19, 2022), https://www.cnbc.com/2022/12/19/how-ftx-founder-sbf-and-friends-quietly-donated-to-political-groups-and-relatives.html, *archived at* https://perma.cc/UA4A-XTPF.

[987] *See* SBF Criminal Case, Dkt. No. 410, at 21-22; *see also* Kenneth P. Vogel & Ken Bensinger, *U.S. Scrutinizes Political Donations by Sam Bankman-Fried and Allies*, N.Y. Times, Dec. 17, 2022, https://www.nytimes.com/2022/12/17/us/politics/sam-bankman-fried-political-donations-doj.html, *archived at* https://perma.cc/UD66-NNJE.

[988] SBF Criminal Case, Dkt. No. 80 at ¶¶ 41, 91-96.

[989] *Id*. at ¶¶ 32-43 (describing a straw donor scheme undertaken with two unnamed executives of the FTX Group); SBF Criminal Case, Dkt. No. 410 (sentencing submission listing Salame and Singh as the unnamed executives).

challenges relating to Bankman-Fried's extradition from the Bahamas, the USAO-SDNY ultimately chose to not try Bankman-Fried on these campaign finance charges.[990]

b. Debtors' Investigation

S&C undertook an extensive investigation into the Debtors' political contributions. This investigation involved a review of the Debtors' internal documents referencing political contributions and cross-referencing identified donations to federal and state campaign finance filings.[991] S&C also worked with AlixPartners to trace transfers from the Debtors' bank accounts to political candidates.[992] Nardello investigated and summarized public records regarding the Debtors' political donations.[993] And S&C inquired into these issues during certain witness interviews.[994] Separately, on behalf of the Unsecured Creditors' Committee, Paul Hastings and FTI Consulting also undertook an investigation into the political contributions.

These investigations identified over 1,000 political contributions totaling over $200 million.[995] They also determined that many of these donations were made using purported "loans" from Debtor entities that were, in fact, transfers from customer or corporate funds to Debtor insiders.[996] In order to recover these funds for the bankruptcy estates, the Debtors requested that the identified recipients of the political contributions voluntarily return the funds

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[990] *See* SBF Criminal Case, Dkt. No. 410, at 18 ("[T]he government of The Bahamas informed the United States after the extradition that Bankman-Fried had not been extradited on the campaign finance count, . . . For that reason alone, the Government was unable to proceed to trial on [that charge]").

[991] S&C, *Review of Post-Petition Investigations for Examiner,* Mar. 15, 2024, at 147.

[992] *Id*.

[993] *See, e.g.*, Nardello, *Memorandum re: Political Entity Contact Information*, Aug. 25, 2023; Nardello, *Report Prepared for Sullivan & Cromwell LLP re: Gabriel Bankman-Fried*, May 17, 2023; Nardello, *Report Prepared for Sullivan & Cromwell LLP re: Alan Joseph Bankman*, May 15, 2023; Nardello, *Report Prepared for Sullivan & Cromwell LLP re: Nishad Thirumale Singh*, Jan. 29, 2023.

[994] *See, e.g.*, S&C, *Memorandum re: Interview of Mark Wetjen,* Jan. 11, 2023; Sun Interview Memo.

[995] *See* Political Contribution Spreadsheet; Political Donation Review Spreadsheet (identifying approximately $200 million in political donations).

[996] *See, e.g.*, SBF Criminal Case, Dkt. No. 410, at 23; Second Ray Report, at 27-28.

in lieu of being subjected to an avoidance action.[997] In response, many of the recipients "have either returned the funds to the Debtors or turned them to [sic] over to the U.S. Department of Justice."[998]

S&C and the USAO-SDNY continue to investigate issues related to political donations by the Debtors and their affiliates.

IX. Venture Book

The FTX Group created a fund, referred to as the "Venture Book," that would allow rapid deployment of capital to invest in companies and tokens. The idea behind the Venture Book was to permit the FTX Group to "move fast," with no "external 'stakeholders' or 'committees.'"[999] The Venture Book's stated core mission was to "advance global blockchain and web3 adoption, with a broad investment mandate across social, gaming, fintech, software, and healthcare."[1000] Investigations have revealed that the FTX Group, through the Venture Book, invested nearly $6 billion, including customer assets, in over 500 individuals and entities between May 2020 and October 2022.[1001]

[997] *FTX Debtors Send Messages to Recipients of Avoidable Donations*, PR Newswire (Feb. 5, 2023), https://www.prnewswire.com/news-releases/ftx-debtors-send-messages-to-recipients-of-avoidable-donations-301738948.html, *archived at* https://perma.cc/RCY8-82U7.

[998] Second Ray Report, at 28.

[999] FTX Ventures, https://ventures.ftx.com (Aug. 11, 2022), *archived at* https://web.archive.org/web/20220811091647/https://ventures.ftx.com/.

[1000] *FTX launches $2 billion Ventures fund, hires former Lightspeed Partner Amy Wu*, PR Newswire (Jan. 14, 2022), https://www.prnewswire.com/news-releases/ftx-launches-2-billion-ventures-fund-hires-former-lightspeed-partner-amy-wu-301461078.html, *archived at* https://perma.cc/5SVR-DFBY.

[1001] Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 77; S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 185.

a. Investigative Steps

After the Petition Date, S&C and Quinn Emanuel investigated the Venture Book and evaluated potential litigation and monetization options.[1002] In January 2023, S&C and Quinn Emanuel divided up the then-known Venture Book investments. S&C retained those it had already begun to investigate and those with close ties to issues that were being addressed in other bankruptcy-related cases; Quinn Emanuel assumed responsibility for investigating the rest.[1003]

1. Quinn Emanuel Venture Book Investigations

With Alvarez & Marsal, Quinn Emanuel compiled information concerning over 500 Venture Book investments, including the nature of the investments, the investment size, the funding dates and sources, and any future payments due.[1004] Quinn Emanuel appropriately prioritized its inquiries based on the size of the investment. For 30 large investments, which Quinn Emanuel defined as investments of $11 million or more, and which comprised 90% of the Venture Book's value, Quinn Emanuel undertook the most comprehensive investigations.[1005] This included a review of the Debtors' documents and data related to each investment, a review of publicly available information, and work with outside consultants to value the investments.

[1002] Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 79.

[1003] S&C and Quinn Emanuel provided inconsistent lists of Venture Book investments over time. The discrepancy arises primarily from differing ways of categorizing instances in which the Debtors made multiple types of investments (e.g. equity and token) in the same entity, and when the Debtors made investments in multiple legal entities associated with the same venture. Additionally, given the poor state of the Debtors' record-keeping, S&C and Quinn Emanuel discovered previously unknown venture investments during their ongoing investigations. The Examiner is satisfied that Quinn Emanuel and S&C have done a fulsome investigation to identify all of the Debtors' venture investments.

[1004] Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 80.

[1005] *Id.* at 81-85.

Quinn Emanuel prepared memoranda summarizing its investigative findings, including its recommendation for additional steps when appropriate.[1006]

For 39 medium-sized investments, defined as investments of $5 million to $11.5 million, that made up 4.7% of the Venture Book's value, Quinn Emanuel conducted more targeted investigations. These involved a more circumscribed review of the Debtors' documents and public documents as compared to the reviews conducted for the large investments. Quinn Emanuel recommended further investigation and analysis with respect to seven of the investments that fell within the $5 million to $11 million range.[1007]

Finally, Quinn Emanuel worked with Alvarez & Marsal to summarize basic information regarding the remaining, smaller Venture Book investments, i.e., those under $5 million. Quinn Emanuel did not investigate each of these investments, reasoning that the cost of such investigations relative to their limited value would not be accretive to the bankruptcy estates. These investments totaled approximately $286 million, making up approximately 4.8% of the Venture Book's total value.[1008]

2. S&C Venture Book Investigations

In conjunction with Nardello, S&C undertook similar investigations into its assigned Venture Book entities. S&C's investigations involved a review of the Debtors' documents and data related to each investment. The firm also had Nardello prepare investigative memoranda regarding many of the entities assigned to S&C, using publicly available documents and the Debtors' internal documents. S&C then evaluated the merits of pursuing litigation.

[1006] *Id*. at 85.

[1007] *Id*. at 86; Quinn Emanuel, *Memorandum re: Analysis of Venture Book Investments Between $5 Million and $11.5 Million*, Apr. 15, 2024, at 1.

[1008] Quinn Emanuel, *QE Assigned Investments Under $5 Million*.

b. Summary of Findings

The investigations into the Venture Book concluded that the FTX Group's venture investment process was haphazard, with an emphasis on speed over reasoned decision-making. Various FTX Group entities made Venture Book investments, with seemingly little regard for corporate formalities. For instance, some Venture Book investments were made by entities affiliated with Alameda, while others were made by entities affiliated with FTX Trading. [1009] Moreover, the FTX Group did not appear to have or follow any investment guidelines.[1010] Investments were made in amounts varying from under $1,000 to over $1 billion. They were made in a variety of modalities, including personal loans to startup founders; purchases of cryptocurrency tokens; and equity investments in publicly traded companies, among others. Investments were paid for in cash, cryptocurrency, and FTX shares.[1011] Investments were often spontaneous or executed very quickly, with limited due diligence prior to investing, and were often based on unsupported valuations.[1012] Finally, a troubling number of Venture Book investments involved entities with ties to FTX Group senior executives.[1013]

c. Avoidance Actions

1. Background

As of the date of this Report, the Debtors have brought only a few avoidance actions against Venture Book entities. The Debtors largely have held off on pursuing litigation concerning the Venture Book because they have been working to monetize these investments

[1009] Quinn Emanuel, *Presentation Regarding FTX Professionals, Legal Insiders, and Venture Investments to Chapter 11 Examiner Robert J. Cleary, Esq.*, Mar. 22, 2024, at 77.

[1010] *Id*. at 78.

[1011] *Id*.

[1012] *Id*.

[1013] *Id*.

without the expense and burden of litigation, and in many cases these efforts have been successful. For some large and medium-sized Venture Book investments, the Debtors have decided not to institute avoidance actions yet, for tactical and strategic reasons that appear prudent to the Examiner. Quinn Emanuel concluded that avoidance actions against the entities involved in the small and medium-sized Venture Book investments would not be accretive to the estates, as the cost of litigation would likely outweigh the potential returns.

The Debtors have, however, pursued avoidance actions against a handful of Venture Book entities investigated by S&C and have conducted additional investigations into certain Venture Book investments of concern. These avoidance actions and investigations are described below. The Debtors continue to investigate issues related to the Venture Book and to evaluate options to secure recoveries from these investments.

2. Actual and Intended Avoidance Actions

In instances where it concluded that doing so would be accretive to the estates, S&C has pursued, or prepared to pursue, a handful of avoidance actions against Venture Book entities it investigated. S&C settled some of the potential avoidance actions on the eve of litigation or decided not to pursue them due to intervening events; other avoidance actions have also been resolved, while still others remain ongoing. The facts underlying the more significant of these actual and intended avoidance actions, as found by S&C, are described below, along with a brief description of their status.

(i) K5 Global

At the direction of Bankman-Fried, Alameda and Alameda Research Ventures invested $700 million in K5 Global and related entities (collectively, "K5").[1014] K5 was a business

[1014] Dkt. No. 1679 at ¶¶ 7-8.

controlled by a celebrity talent agent that operated several investment funds.[1015] The FTX Group hastily invested in K5 after Bankman-Fried attended a dinner party with celebrities at the home of K5's co-owner; the FTX Group conducted little to no due diligence before making the investment.[1016] And although the K5 investment was made using funds from Alameda and Alameda Research Ventures, the investment was held by two newly formed shell corporations, SGN Albany LLC and Mount Olympus Capital LP, that were controlled by senior FTX executives, including Bankman-Fried.[1017]

On June 22, 2023, S&C brought an avoidance action against K5, SGN Albany, Mount Olympus Capital, and individuals associated with K5, alleging fraudulent transfer, preferential transfer, property recovery claims, and tort and contract claims under the laws of Delaware and the British Virgin Islands.[1018] After SGN Albany failed to appear in the action, the bankruptcy estates successfully moved for a default judgment against it, giving the estates ownership of SGN Albany's interest in K5.[1019] The proceeding remains ongoing as to other defendants.

(ii) Latona

Bankman-Fried created Latona as a vehicle to undertake investments in life sciences companies.[1020] Latona was portrayed as part of the FTX Foundation's philanthropic efforts focused on pandemic preparedness. But in reality, it was an investment vehicle controlled by Bankman-Fried and other senior FTX Group executives.[1021] FTX Group entities FTX Trading

[1015] *Id*. at ¶ 1.

[1016] *Id*. at ¶¶ 1-5.

[1017] *Id*. at ¶¶ 28-35.

[1018] *Id*. at ¶¶ 101-169.

[1019] *Alameda Research Ltd. v. Kives*, No. 23-ap-50411 (Bankr. D. Del.) (JTD), Dkt. No. 48.

[1020] *Alameda Research Ltd. v. Platform Life Sciences Inc.*, No. 23-ap-50444 (Bankr. D. Del.) (JTD), Dkt. No. 1, at ¶ 5.

[1021] *Id*. at ¶¶ 46-48.

and Alameda transferred over $71 million to Latona.[1022] That money was used to invest in life sciences companies at excessive valuations, and with little to no due diligence.[1023]

S&C brought an avoidance action against Latona, the companies in which it invested, and its insiders (including Bankman-Fried).[1024] The complaint alleged fraudulent transfer, property recovery claims, and contract and tort claims under the laws of Antigua and Barbuda and the British Virgin Islands.[1025] The estates have reached settlement agreements with all of the defendants except for Bankman-Fried.[1026]

(iii) Modulo

Modulo Capital ("Modulo") was an investment fund that received an investment of nearly $500 million from Alameda and was also a significant creditor of the FTX Group.[1027] An investigation by Nardello and S&C revealed that the operators of Modulo maintained close ties to senior FTX Group executives, and that, in internal emails, Bankman-Fried described Modulo as a *de facto* arm of Alameda.[1028] In light of this information, S&C prepared to litigate an avoidance action against Modulo. However, the Debtors negotiated a settlement agreement in which Modulo transferred over $400 million in cash to the estates and released over $50 million in claims against certain Debtors.[1029]

[1022] *Id*. at ¶ 12.

[1023] *Id*. at ¶¶ 51-54.

[1024] *Id*. at ¶¶ 1-2.

[1025] *Id*. at ¶¶ 114-175.

[1026] *Alameda Research Ltd. v. Platform Life Sciences Inc.*, No. 23-ap-50444 (Bankr. D. Del.) (JTD), Dkt. Nos. 89, 97, 102.

[1027] S&C Venture Book Spreadsheet.

[1028] Nardello, *Memorandum re: Modulo Capital—Ownership, Control and Principals*, Jan. 19, 2023, at 7-9.

[1029] Dkt. No. 1244.

(iv) Farmington State Bank/Moonstone Bank

In early 2022, the Debtors had discussions with Farmington State Bank (then d/b/a Moonstone Bank) regarding the development of a cryptocurrency staking program.[1030] Although Moonstone Bank was a small regional bank with only a few million dollars in assets, Debtor entity Alameda Research Ventures invested $11.5 million in Moonstone Bank's holding company, FBH Corporation.[1031] The discussions around the staking program did not prove fruitful, but FTX Group entity FTX Trading nonetheless deposited $50 million in a Moonstone Bank account.[1032] The USAO-SDNY seized the $50 million deposit in January 2023.[1033]

S&C considered a potential avoidance action against Moonstone Bank to recover the $11.5 million investment by Alameda Research Ventures.[1034] However, while S&C was evaluating litigation, the Federal Reserve Board and Washington Department of Financial Institutions announced an enforcement action against Moonstone Bank and, as a consequence, the bank wound down its operations.[1035] Accordingly, S&C determined that litigation was unlikely to be accretive to the estates.[1036]

(v) Deck Technologies

Bankman-Fried personally acquired political data analytics company Deck Technologies ("Deck") in August 2022, using an ostensible $5 million loan from FTX Group entity Alameda and $1.5 million in personal funds.[1037] S&C investigated this acquisition and determined that at

[1030] S&C, *Review of Post-Petition Investigations for Examiner*, at 106.

[1031] *Id*.

[1032] *Id*.

[1033] *Id*. at 107.

[1034] *Id*.

[1035] *Id*. at 108.

[1036] *Id*.

[1037] *Id.* at 124-125; Nardello, *Memorandum re: Deck Technologies, Inc. and Max Wood*, May 2, 2023, at 3.

the time of the acquisition, Deck had significant debt, lacked funds to make payroll, and did not expect to reach profitability until 2025.[1038] Bankman-Fried nonetheless agreed to Deck's proposed purchase price without negotiation.[1039]

Given the circumstances surrounding the Deck acquisition, S&C evaluated fraudulent transfer claims against Deck.[1040] While S&C concluded that such claims were plausible, it ultimately decided not to pursue them because the cost of any litigation would outweigh any potential recovery.[1041] Instead, the Debtors attempted to sell Deck.[1042] When those efforts failed, the Debtors placed Deck in a wind-down process.[1043]

3. Other Efforts to Monetize Venture Investments

As discussed above, the Debtors have made significant efforts to monetize the FTX Group's venture investments and secure a recovery for the estates without litigation. These efforts are ongoing. Because this monetization project involves sensitive negotiations with potential buyers, this Report does not address the status of monetization efforts in detail. However, one example of a successful monetization that came before this Bankruptcy Court is discussed here.

In its investigation, S&C found that the Debtors held a large stake in the Pyth Network, a "public blockchain-based software system that aggregates pricing data for various financial assets[] . . . in order to provide a real-time public blockchain[-]based feed of prices for such

[1038] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 125.

[1039] *Id*.

[1040] *Id*. at 126.

[1041] *Id*.

[1042] *Id*.

[1043] *Id*.

assets," which would be used by "[m]arket data providers and consumers."[1044] Debtors Cottonwood Grove, Alameda, and other affiliated entities held approximately 1.12 billion of the original PYTH tokens, the "native cryptographic token of the Pyth Protocol," and nearly all of the 10 billion original PYTH tokens were held in a blockchain wallet address on FTX.com on the Petition Date.[1045] Because almost all of the original PYTH tokens were "inaccessible" due to the filing of the bankruptcy cases, Pyth Data Association contended that "there [was] a substantial risk that without relief from the automatic stay, participants in the Pyth Network and Pyth Protocol[] . . . w[ould] start abandoning the Pyth project."[1046]

S&C consulted with the Pyth Data Association, and the parties ultimately agreed that the latter could seek relief from the automatic stay in order to mint new PYTH tokens, which "would have the same technical characteristics and potential uses" as the original PYTH tokens held by the Debtors.[1047] As part of that agreement, Debtors Cottonwood Grove and Alameda would receive "an amount of New PYTH equal to the amount of Original PYTH that they and their affiliates owned as of the Petition Date."[1048] The Bankruptcy Court approved Pyth Data Association's motion for relief from the automatic stay,[1049] and the Pyth Network subsequently launched along with the newly minted PYTH tokens.[1050] The Debtors then sold an initial tranche of the newly minted PYTH tokens for the benefit of the estates.

[1044] Dkt. No. 1632 at ¶ 2.

[1045] *Id.* at ¶¶ 4-5.

[1046] *Id.* at ¶ 33.

[1047] *Id.* at ¶¶ 8-9.

[1048] *Id.* at ¶ 9.

[1049] Dkt. No. 1693.

[1050] S&C, *Review of Post-Petition Investigations for Examiner*, Mar. 15, 2024, at 167.

4. Venture Book Investments of Concern

Quinn Emanuel has identified several additional Venture Book investments of concern. The Debtors are evaluating their options with respect to these investments. Three examples are described below.

(i) Venture Investment-1

Debtor entity Alameda Ventures made several equity investments in Venture Investment-1, a Bitcoin mining company that is incorporated in Cyprus and operates Bitcoin mining facilities in Kazakhstan, the United States, and elsewhere.[1051] Between August 2021 and April 2022, the Debtors purchased four separate tranches of shares in Venture Investment-1, with a total purchase price of over $1 billion.[1052] Bankman-Fried personally executed three of the four share purchase agreements on behalf of Alameda Ventures.[1053] There is evidence that some of the purchases were made using FTX Group customer funds.[1054]

The investigation into Venture Investment-1 uncovered problematic facts. At the time of the investment, the company's financial statements raised red flags, both among other potential investors and internally at the FTX Group.[1055] Individuals associated with Venture Investment-1, including a board member, were aware of potential inaccuracies in the company's financial statements and valuation materials provided to potential investors.[1056] There was also evidence that co-founders of Venture Investment-1 had been involved in criminal conduct in

[1051] Quinn Emanuel, *Memorandum re: FTX Venture Book Review of Venture Investment-1*, Jul. 12, 2023, at 7.

[1052] *Id*. at 2-3.

[1053] *Id*. at 3-4.

[1054] *Id*. at 11.

[1055] *Id*. at 10, 18-20.

[1056] *Id*. at 12-13.

Kazakhstan.[1057] And while the FTX Group's due diligence process identified many of these issues,[1058] the FTX Group nevertheless chose to invest.[1059]

(ii) Venture Investment-2

Debtors Alameda and Alameda Research Ventures made three loans totaling $43 million in support of Venture Investment-2, three cryptocurrency-related ventures associated with a single individual.[1060] Bankman-Fried personally authorized these loans, which were disbursed between March 2021 and April 2022.[1061]

Quinn Emanuel's investigation revealed that several "badges of fraud" were present at the time of the investments: (1) the individual who controlled all three entities involved in Venture Investment-2 had a close relationship with several senior FTX Group executives, including a possible romantic relationship with a senior executive; (2) the investments were concealed from the public; (3) the loan agreements with Venture Investment-2 may not have been for reasonably equivalent value, as they contemplated several questionable, non-monetary "alternatives to repayment"; and (4) the FTX Group may have been insolvent at the time of the transfers.[1062]

(iii) Venture Investment-3

Quinn Emanuel identified a $10 million "membership interest" that Debtor entity Alameda Research Ventures purchased in Venture Investment-3 in June 2022.[1063] Venture

[1057] *Id*. at 7-8.

[1058] *Id*. at 14-16.

[1059] *Id*. at 16.

[1060] Quinn Emanuel, *Memorandum re: FTX Venture Book Review of Venture Investment-2*, Apr. 3, 2023, at 4.

[1061] *Id*. at 1-4.

[1062] *Id*. at 12-14.

[1063] Quinn Emanuel, *Memorandum of FTX Venture Book Review of Venture Investment-3*, July 12, 2023, at 1-2.

Investment-3 was founded by an individual who was formerly associated with several FTX Group entities.[1064] There is no evidence the FTX Group conducted any due diligence before making this investment, and there is no evidence supporting the valuation at which the FTX Group invested.[1065] More fundamentally, there is no evidence Venture Investment-3 conducted any business when the investment was made.[1066] Therefore, it is likely the Debtors would be able to prove that the FTX Group did not receive reasonably equivalent value in exchange for the $10 million investment.[1067]

d. Further Venture Book-Related Efforts

The Debtors' counsel undertook significant efforts to investigate and recover funds associated with the large venture investments that make up the vast majority of the Venture Book.

To date, however, for the reasons outlined above, similar investigative efforts have not been undertaken with respect to the Venture Book's small and medium-sized investments. As noted above, Quinn Emanuel has not pursued detailed investigations into individual small and medium-sized investments because it has concluded that doing so would not be cost-effective. The Examiner agrees with Quinn Emanuel's assessment. Given the high cost of investigation and the limited potential return, it would not be accretive to the estates for the Debtors' counsel or the Examiner to investigate the circumstances surrounding each of the hundreds of small and medium-sized Venture Book investments. The Debtors continue to evaluate accretive and cost-effective strategies for asset recovery from small and medium-sized Venture Book investments.

[1064] *Id*. at 2.

[1065] *Id*. at 5.

[1066] *Id*. at 1-2.

[1067] *Id*. at 5.

PART 7: RELATED ADVERSARY PROCEEDINGS

This Part sets forth information regarding certain adversary proceedings that have been brought by the Debtors in an effort to recover assets for the estates, and are not discussed elsewhere in this Report.[1068]

Alameda Research Ltd. v. Voyager Digital, LLC, No. 23-ap-50084 (Bankr. D. Del.) (JTD): This avoidance action seeks to recover alleged preferential transfers based on the Debtors' transactions with Voyager Digital after Voyager Digital filed for Chapter 11 protection in the Southern District of New York on July 5, 2022.[1069] Voyager Digital was a "feeder fund," a type of investment fund that pools funds for investment into another fund, which for Voyager Digital was Alameda. The complaint alleges that, between August and October 2022, at the request of Voyager Digital, Alameda and FTX Trading repaid certain loans that Voyager Digital made to Alameda, with accrued interest, with various cryptocurrencies (including repayment of certain loans prior to maturity).[1070] The complaint asserts that the combined value of the transfers made by both Alameda and FTX Trading to Voyager Digital amounted to more than $453.1 million, with more than 98 percent of the total traceable to Alameda.[1071] This action was resolved[1072] by a settlement in which the Debtors agreed to release Voyager Digital and related entities from three claims of Alameda Ventures and one claim of Alameda Research Ventures[1073] in exchange for Voyager Digital releasing the Debtors from 100 claims of Voyager Digital.[1074]

[1068] The information in this Part is current as of the date of this report.

[1069] *Alameda Research Ltd. v. Voyager Digital, LLC*, No. 23-ap-50084 (Bankr. D. Del.) (JTD), Dkt. No. 8 at ¶¶ 3-5.

[1070] *Id*. at ¶¶ 24-28.

[1071] *Alameda Research Ltd. v. Voyager Digital, LLC*, No. 23-ap-50084 (Bankr. D. Del.) (JTD), Dkt. Nos. 8-1, 8-2.

[1072] *Alameda Research Ltd. v. Voyager Digital, LLC*, No. 23-ap-50084 (Bankr. D. Del.) (JTD), Dkt. No. 23.

[1073] Dkt. No. 13123-1.

[1074] Dkt. No. 13123-2.

Alameda Research LLC v. FTX Digital Markets Ltd., No. 23-ap-50145 (Bankr. D. Del.) (JTD): The Debtors allege that the Bahamian JPLs erroneously claim that FDM, a Bahamian entity, "is the constructive owner of FTX.com's property, including fiat and cryptocurrency, intellectual property, and customer relationships, as a matter of non-bankruptcy law."[1075] This action seeks declaratory relief that FDM has no ownership interest in the Debtors' assets—including its cryptocurrency, fiat currency, intellectual property, and customer information or relationships—and that any assets held by FDM are held for the Debtors or represent avoidable fraudulent transfers.[1076]

FTX Trading Ltd. v. Mirana Corp., No. 23-ap-50759 (Bankr. D. Del.) (JTD): This action is brought to avoid and recover transfers made to Mirana Corp., the investment arm of Bybit, the operator of one of the world's largest cryptocurrency exchanges.[1077] The complaint asserts that between September 2021 and the Petition Date, Mirana's account balance on FTX.com grew from $40 million to as much as $500 million, and was valued at "several [hundred] million dollars" in the period preceding FTX Group's collapse.[1078] The complaint alleges that based on its large account value and high levels of trading activity, Mirana was granted "VIP status" by the FTX.com exchange.[1079]

According to the complaint, Mirana became aware of the financial distress at FTX.com in November 2022, and then "sought to leverage its VIP status on FTX.com to ensure that it

[1075] *Alameda Research LLC v. FTX Digital Markets Ltd*., No. 23-ap-50145 (Bankr. D. Del.) (JTD), Dkt. No. 18 at ¶ 3.

[1076] *Id*. at ¶¶ 66-130.

[1077] *FTX Trading Ltd. v. Mirana Corp*., No. 23-ap-50759 (Bankr. D. Del.) (JTD), Dkt. No. 1 at ¶¶ 1-4.

[1078] *Id*. at ¶ 46.

[1079] *Id*. at ¶¶ 47, 50.

received priority treatment over other customers."[1080] The complaint claims that, on November 7-8, 2022, just prior to withdrawals being halted, Mirana was able to withdraw more than $327 million in assets. The complaint further alleges that the aggregate value of all assets withdrawn by Mirana- and Bybit-affiliated entities and individuals was $953.2 million.[1081]

This action also alleges postpetition misconduct by Mirana and its related entities, claiming that Mirana and Bybit violated the automatic stay based on Bybit's: (1) refusal to transfer estate assets held in Bybit accounts; and (2) efforts to devalue token holdings of the estates that were part of a token swap agreement whereby Alameda received 100 million BIT tokens in exchange for approximately 3.4 million FTT tokens.[1082]

FTX Trading Ltd. v. LayerZero Labs Ltd., No. 23-ap-50492 (Bankr. D. Del.) (JTD): This is an action to avoid and recover fraudulent and preferential transfers made to LayerZero Labs Ltd. ("LayerZero") by Alameda Ventures.[1083] The complaint alleges that Alameda Ventures used funds misappropriated from the Debtors to enter into a series of financing arrangements with LayerZero, including: (1) equity investments in LayerZero of $70 million; (2) the purchase of STG tokens for $25 million; and (3) a loan agreement pursuant to which Alameda borrowed $45 million from LayerZero.[1084] The Debtors further allege that as the Debtors faced financial crisis, LayerZero leveraged its position to extract an agreement that: (1) required Alameda Ventures to relinquish its equity stake in LayerZero and warrants it held for LayerZero (ZRO)

[1080] *Id*. at ¶ 50.

[1081] *Id*. at ¶¶ 52, 57 (assets valued as of November 10, 2023).

[1082] *Id*. at ¶¶ 117-121.

[1083] *FTX Trading Ltd. v. LayerZero Labs Ltd*., No. 23-ap-50492 (Bankr. D. Del.) (JTD), Dkt. No. 1 at ¶ 1.

[1084] *Id.* at ¶¶ 3-4.

and Stargate (STG) tokens[1085] in exchange for forgiveness of Alameda Ventures' loan, and (2) allowed LayerZero to purchase Alameda Ventures' 100 million STG tokens for $10 million.[1086]

[1085] The LayerZero token, ZRO, is a token minted by LayerZero, a protocol for applications to operate across blockchains. The Stargate token, STG, is a token minted by Stargate Finance, a protocol for asset transfer that employs LayerZero technology.

[1086] *Id*. at ¶¶ 6-9.

PART 8: ESTIMATED DURATION AND PROPOSED BUDGET FOR RECOMMENDED INVESTIGATIONS

As explained above, pursuant to the Scope Order, at ¶ 2, the Examiner recommends that he be authorized to undertake additional investigations of the following issues:

1. S&C's representation of Bankman-Fried in connection with his purchase of the Robinhood Shares. This inquiry would focus on (1) the scope and contours of that representation and (2) based on that representation, what, if anything, S&C knew or should have known about the FTX Group's fraud. *See supra*, at Part 2, Section VI.
2. Potential claims against the former shareholders of LHI that sold their interests to WRS, to the extent these claims were not released in the postpetition transaction. This inquiry would (1) determine whether an avoidance action is warranted with respect to these unreleased shareholders, and (2) enable the Examiner to report on the underlying details of the prepetition sale of LHI to WRS. *See supra*, at Part 2, Section VI.
3. The "holes" or balance sheet shortfalls at FTX.US. This inquiry would center on (1) the reasons these holes arose at FTX.US, (2) whether the balance sheet holes were the result of commingling of customer or corporate assets, (3) the frequency and magnitude of the holes, and (4) how they were resolved and by whom. *See supra*, at Part 6, Section V(c).

The Examiner estimates that the additional investigative work related to these issues would take approximately ten weeks. It is estimated that the cost of this work, along with a Report to the Court summarizing the same, would not exceed $2,400,000.

The Examiner hereby respectfully requests that the Court authorize him to conduct the three investigations summarized above.

Dated: May 20, 2024

Respectfully submitted,

By: */s/ Robert J. Cleary*

Robert J. Cleary
Chapter 11 Examiner

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CERTIFICATE OF SERVICE

I, Michael D. DeBaecke, hereby certify that on May 23, 2024, I caused one copy of the *Report of Robert J. Cleary, Examiner* to be served upon (i) all parties of record via CM/ECF; and (ii) the parties on the attached service list via electronic mail, unless otherwise indicated.

Dated: May 23, 2024

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IN RE: J & S PROPERTIES, LLC, Debtor

Phoenician Mediterranean Villa, LLC, Appellant

v.

Lisa M. Swope, Esquire, Trustee of the Bankruptcy Estate of J & S Properties, LLC; James Focht; J & S Properties, LLC

No. 16-3366

United States Court of Appeals, Third Circuit.

Argued May 23, 2017

(Filed: September 28, 2017)

Background: Chapter 7 debtor's commercial tenant brought adversary proceeding against trustee under § 1983 for trustee's alleged violation of tenant's constitutional rights, and for her conversion and tortious interference with tenant's prospective business advantage, in having locks changed in order to gain access to premises after water pipes burst due to tenant's failure to set thermostat at recommended temperature during period when restaurant that it operated on premises was closed. Trustee moved to dismiss. The United States Bankruptcy Court for the Western District of Pennsylvania, Jeffery A. Deller, Chief Judge, granted trustee's motion, and tenant appealed. The District Court, No. 3-15-cv-00268, Kim R. Gibson, J., 554 B.R. 747, affirmed. Tenant appealed.

Holdings: The Court of Appeals, Hardiman, Circuit Judge, held that:

(1) bankruptcy trustees are government officials entitled to qualified immunity from § 1983 claims by third parties for actions that they take in their official capacity that are not contrary to clearly established law, and

(2) trustee was qualifiedly immune from liability to debtor's commercial tenant for actions that she took in order to preserve estate's interest in property.

Affirmed.

Fisher, Circuit Judge, filed opinion concurring in judgment.

1. Bankruptcy ⚿3782, 3786

On appeal from district court's affirmance of decision of bankruptcy court, the Court of Appeals, like the district court, reviews bankruptcy court's legal determinations de novo and its factual findings for clear error. Fed. R. Bankr. P. 8013.

2. Federal Courts ⚿3603(7)

Factual finding is "clearly erroneous" only if appellate court is left with definite and firm conviction that mistake has been made.

See publication Words and Phrases for other judicial constructions and definitions.

3. Bankruptcy ⚿3011

Chapter 7 trustee was entitled to absolute immunity from liability for actions that she took in faithfully carrying out bankruptcy court's order.

4. Bankruptcy ⚿3011

Bankruptcy trustees are government officials, who are entitled to qualified immunity from § 1983 claims by third parties for actions that they take in their official capacity in a manner that is not contrary to clearly established law. 42 U.S.C.A. § 1983.

5. Civil Rights ⚿1376(2)

Properly applied, qualified immunity from liability under § 1983 protects all but the plainly incompetent or those who knowingly violate the law. 42 U.S.C.A. § 1983.

6. Civil Rights ⚿1376(1, 2)

To overcome government official's qualified immunity from liability under § 1983, plaintiff must plead facts showing: (1) that the official violated a statutory or constitutional right, and (2) that the right was clearly established at time of the challenged conduct. 42 U.S.C.A. § 1983.

7. Civil Rights ⚿1376(2)

Government official's conduct violates "clearly established law," such that official will not be protected by qualified immunity from suit under § 1983 for violating a plaintiff's constitutional rights, if there is sufficient precedent at time of official's action, factually similar to plaintiff's allegations, to put official on notice that his or her conduct is constitutionally prohibited, and such precedent must come either from the United States Supreme Court or from a robust consensus of cases of persuasive authority in the Court of Appeals. 42 U.S.C.A. § 1983.

See publication Words and Phrases for other judicial constructions and definitions.

8. Bankruptcy ⚿3011

Chapter 7 trustee was qualifiedly immune from liability to debtor's commercial tenant for actions that she took in order to preserve estate's interest in property after water pipes burst during cold spell, after discovering that keys supplied by tenant did not open inner door of property and that she did not have access to premises, in accepting key from debtor-landlord after having locks changed and thereby effectively locking tenant out of premises while remediation work necessitated by flooding was underway; trustee acted in furtherance of her statutory duty to administer and preserve estate property in dearth of case law on whether trustee could take control of building which she was obliged to preserve and which was at imminent risk of destruction, and in face of lack of cooperation from tenant.

9. Bankruptcy ⚿3008.1

Fact that bankruptcy trustee seeks to have his or her action ratified by court, out of abundance of caution, does not mean that trustee acts improperly if he or she acts before the court can respond.

10. Bankruptcy ⚿3770

Arguments not raised in either the bankruptcy court or the district court are forfeited on further appeal to the Court of Appeals.

11. Bankruptcy ⚿3011

Chapter 7 trustee did not waive her right to assert qualified immunity from liability under § 1983 for taking control of debtor-landlord's leased commercial space, and for effectively locking tenant out of premises prior to expiration of its lease, by not raising qualified immunity claim at hearing to adjudicate tenant's motion for equitable relief and trustee's emergency motion for control over the property; hearing was not a trial on the merits of tenant's damages claims. 42 U.S.C.A. § 1983.

On Appeal from the United States District Court for the Western District of Pennsylvania, District Judge: Honorable Kim R. Gibson, (D.C. No. 3-15-cv-00268)

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Before: HARDIMAN, ROTH, and FISHER, Circuit Judges.

OPINION OF THE COURT

HARDIMAN, Circuit Judge.

A bankruptcy trustee sometimes must act quickly to safeguard property of the estate. In this case, Chapter 7 Trustee Lisa Swope took control of a commercial leasehold possessed by Phoenician Mediterranean Villa, LLC in a building owned by the debtor. Phoenician requested equitable relief to regain possession of its leasehold, claiming that Swope violated the law when she accepted the key to locks that had been changed. The United States Bankruptcy Court for the Western District of Pennsylvania denied the relief sought by Phoenician, holding that Swope was qualifiedly immune from suit. The District Court affirmed and Phoenician filed this appeal.

The question presented is whether qualified immunity applies to discretionary actions taken by a trustee to preserve the bankruptcy estate's assets, and whether that immunity protects Trustee Swope's conduct in this case. We will affirm because Swope exercised reasonable care under the circumstances and did not violate clearly established law.

I

J & S Properties, LLC filed a Chapter 7 petition in the Bankruptcy Court on July 10, 2013. Attorney Lisa Swope was appointed as Chapter 7 Trustee of the estate. The estate's largest asset was a building located in Altoona, Pennsylvania, in which Phoenician was a lessee and previously operated a restaurant. *In re J & S Props., LLC*, 545 B.R. 91, 94 (Bankr. W.D. Pa. 2015). Pursuant to a court order dated November 5, 2013, Swope rejected Phoenician's lease to facilitate a sale of the property. Although Phoenician was not operating the restaurant at that time, its tenancy had not expired. After the lease was rejected, Phoenician attempted to remove personal property from the restaurant, but Swope objected because the Bankruptcy Court had not determined ownership of the contents of the restaurant, although Phoenician claimed to own all of it.

After learning from J & S's principal, James Focht, that the restaurant had been shut down, that Phoenician had cancelled its insurance on the premises, and that heating the property could be an issue with an "anticipated arctic blast," Swope met at the property with Phoenician's principal, Husam Obeid, along with his counsel and a contractor on January 3, 2014. *Id.* At that meeting, Obeid gave Swope a key to the premises and the contractor recommended that the thermostat be set to at least "sixty degrees Fahrenheit to prevent the pipes from freezing." *Phoenician Mediterranean Villa, LLC v. Swope*, 554 B.R. 747, 750–51 (W.D. Pa. 2016). Unfortunately, Obeid did not heed this advice, the pipes burst, and the property was flooded on January 13, 2014. Obeid contacted a disaster restoration company, but they apparently refused to work on the property "because there were problems with insurance coverage, the relationship between the parties was acrimonious, and no one agreed to provide the company with a lien." *Id.* at 751. According

to Trustee Swope, Obeid and Focht "did not trust each other" and had previously tried to hurt each other's businesses. *Id.* at 750. It was in this context that Swope set about to protect, or "adequately preserve[ ]," the largest asset of the bankruptcy estate. *Id.*

Swope asked for another meeting on January 15, 2014 to assess the damage to the property and discuss the status of the building's insurance. Obeid and his counsel did not show up, asking that the meeting be rescheduled and held without Focht; Swope declined the request "[g]iven the urgent nature of the situation." *In re J & S Props.*, 545 B.R. at 95. Swope tried to inspect the premises but discovered the key Obeid had given her did not open the locked interior door to the building.[1] Focht then "had the locks changed and provided Trustee Swope with the key" on January 16. *Phoenician Mediterranean Villa*, 554 B.R. at 751. Swope claimed in an email to Phoenician that in accepting control of the building, she was attempting to preserve the assets to the best of her ability. On the same day, Swope filed an emergency motion asking the Bankruptcy Court to grant her immediate possession of the property and its contents. In the meantime, she retained the "sole key" and thus control of the premises, and subsequently provided both parties with only "supervised access" to the property. *Id.*

Phoenician filed a complaint in equity to "regain possession of the premises," and the Bankruptcy Court conducted an emergency hearing on January 24, 2014. Phoenician Br. 12.[2] After the hearing, at which Swope testified, the Court denied Phoenician's requests for an injunction and temporary restraining order on January 27. During the hearing, the Bankruptcy Court noted that "the trustee has possession, custody and control of the property," and opined that Swope is "protected by the automatic stay," which precludes Phoenician from interfering with the property in any way. App. 399. And on February 7, 2014, the Bankruptcy Court ordered that Phoenician and J & S and their associates "are prohibited from entering into or upon the [Estate] Property without the express authorization of the Trustee, or further order from this Court." Order of Court Granting First Commonwealth Bank Relief from Stay (hereinafter "Feb. 7, 2014 Order"), Bankruptcy No. 13-70512-JAD, ECF No. 113, at ¶¶ 7–8 (Bankr. W.D. Pa. Feb. 7, 2014).

In its complaint, Phoenician also sued Swope under 42 U.S.C. § 1983 for wrongful eviction, claiming violations of its Fourth and Fourteenth Amendment rights. Swope moved to dismiss this suit based on quasi-judicial immunity. On September 30, 2015, the Bankruptcy Court granted Swope's motion to dismiss the complaint against her, though because the Court looked to additional briefing and other hearings, the Court evaluated the motion under a summary judgment standard. *See In re J & S Props.*, 545 B.R. at 95. It ultimately found that "no genuine dispute of material fact exists as to wheth-

1. The Bankruptcy Court noted that "the Lease Agreement [between Phoenician and J & S] provides that Phoenician was required to provide the lessor with access to the premises so that it could be inspected and/or repaired." *In re J & S Props.*, 545 B.R. at 108 n.8. As such, Phoenician likely violated its lease. *Id.*

2. The parties dispute whether Phoenician ever asked for and was denied access to the building between January 16 (when the locks were changed) and January 24 (when the emergency hearing was held). The Bankruptcy Court found that resolution of the immunity issue did not require a resolution of this dispute, and so assumed that Phoenician had been denied access. *See In re J & S Props.*, 545 B.R. at 95.

er the Trustee exercised her business judgment as to the steps she deemed necessary to protect Estate Property," and thus Swope was entitled to immunity. *Id.* at 96.

On July 27, 2016, the District Court affirmed the Bankruptcy Court's order granting Swope's motion to dismiss. The District Court found that Swope was "entitled to qualified immunity" and that she did not engage in any wrongful or *ultra vires* conduct since she "took appropriate action to administer and preserve the Estate Property" in accordance "with her duties as the trustee." *Phoenician Mediterranean Villa*, 554 B.R. at 756–57.

Phoenician filed this timely appeal.

II

[1, 2] The Bankruptcy Court had jurisdiction under 28 U.S.C. § 157(a). The District Court exercised jurisdiction under 28 U.S.C. § 158(a). We have appellate jurisdiction under 28 U.S.C. § 158(d). Like the District Court, we review the Bankruptcy Court's legal determinations de novo and its factual findings for clear error. *In re VistaCare Grp., LLC*, 678 F.3d 218, 224 (3d Cir. 2012). A factual finding is clearly erroneous only if we are "left with the definite and firm conviction that a mistake has been committed." *In re W.R. Grace & Co.*, 729 F.3d 311, 319 n.14 (3d Cir. 2013) (citation omitted).

III

[3] The principal issue on appeal is whether Swope is immune from Phoenician's suit complaining of actions she took between January 16, 2014 and February 7, 2014.[3] The Bankruptcy Court held that Swope is entitled to qualified immunity because she acted within her statutory duties and the District Court agreed, finding Swope did not violate clearly established law. We reach the same conclusion based on a straightforward application of *Harlow v. Fitzgerald*, 457 U.S. 800, 818, 102 S.Ct. 2727, 73 L.Ed.2d 396 (1982).

A

The Supreme Court held in *Harlow* that "government officials performing discretionary functions generally are shielded from liability for civil damages insofar as their conduct does not violate clearly es-

3. It appears undisputed that the Bankruptcy Court's Order on February 7 provided Swope with absolute quasi-judicial immunity for actions taken thereafter. That order explicitly allowed ''changing all locks so that only the Bank and the Trustee have access to the Property,'' Feb. 7, 2014 Order, at ¶ 3, and prohibited Phoenician from entering ''without the express authorization of the Trustee,'' *id.* at ¶ 8. Because a trustee enjoys absolute immunity from liability when she carries out a bankruptcy court's order, *see In re Harris*, 590 F.3d 730, 742 (9th Cir. 2009) (finding ''derived quasi-judicial immunity'' applies to trustees acting ''pursuant to court order'' (citation omitted)); *Boullion v. McClanahan*, 639 F.2d 213, 214 (5th Cir. Unit A Mar. 1981) (per curiam) (listing cases so holding from the First, Second, Fourth, Eighth, and Tenth Circuits), and because the lower courts didn't clearly err when they found Swope faithfully carried out the Bankruptcy Court's February 7, 2014 Order, Swope is not amenable to suit for her later actions.

While Phoenician doesn't explicitly challenge Swope's immunity after February 7, it does make passing complaints about the restrictive nature of Swope's consent to enter the property on several dates after the Order. These criticisms are ineffectual, however, because the terms of the Court's Order gave Swope discretion over Phoenician's ability to enter the property and the record indicates that Swope did allow Phoenician to enter the premises to remove its personal property several times. Although it was not entirely satisfied with the length of each visit or the items it was allowed to remove, Phoenician doesn't point to evidence showing the lower courts clearly erred in finding these decisions consistent with the Court's Order.

tablished statutory or constitutional rights of which a reasonable person would have known." *Id.* But if such officials take actions in their official capacity which they "knew or reasonably should have known ... would violate the [plaintiff's] constitutional rights," they are not entitled to qualified immunity. *Id.* at 815, 102 S.Ct. 2727 (emphasis and citation omitted).

It appears clear that Chapter 7 Bankruptcy Trustees like Swope are government officials for purposes of *Harlow*. Phoenician does not dispute the finding of the lower courts that Swope is a public official generally entitled to qualified immunity. In fact, Phoenician claims that because "the Chapter 7 Trustee is appointed and supervised by the United States Trustee [and] is an officer of the appointing Court, ... it is appropriate to apply Fourth Amendment limits on government power" to Swope. Phoenician Br. 22. Regardless of the Fourth Amendment analysis, Swope *is* a government official for purposes of immunity. The Chapter 7 Trustee is created by Congress, appointed by and "operating under the aegis of the U.S. Trustee," and entrusted with the "statutory duties ... to gather and liquidate the property of the estate, to be accountable for the estate, ensure that the debtor performs his or her obligations," and "perform[ ] [other] adjudicatory and administrative functions." *In re Castillo*, 297 F.3d 940, 950–51 (9th Cir. 2002).

[4] We thus hold that bankruptcy trustees are government officials, entitled under *Harlow* to qualified immunity from § 1983 claims by third parties when they act in their official capacity in a manner that is not contrary to clearly established law. *See* 457 U.S. at 818 & n.30, 102 S.Ct. 2727.

B

[5–7] Qualified immunity, "properly applied, ... protects all but the plainly incompetent or those who knowingly violate the law." *Ashcroft v. al-Kidd*, 563 U.S. 731, 743, 131 S.Ct. 2074, 179 L.Ed.2d 1149 (2011) (citation omitted). "To overcome qualified immunity, a plaintiff must plead facts 'showing (1) that the official violated a statutory or constitutional right, and (2) that the right was "clearly established" at the time of the challenged conduct.' " *Mammaro v. N.J. Div. of Child Prot. & Permanency*, 814 F.3d 164, 168–69 (3d Cir. 2016), *cert. denied*, —— U.S. ——, 137 S.Ct. 161, 196 L.Ed.2d 121 (2016) (quoting *al–Kidd*, 563 U.S. at 735, 131 S.Ct. 2074). And an official's conduct violates clearly established law if "there [is] sufficient precedent at the time of action, factually similar to the plaintiff's allegations, to put defendant on notice that ... her conduct is constitutionally prohibited." *McLaughlin v. Watson*, 271 F.3d 566, 572 (3d Cir. 2001). Such precedent must come either from the Supreme Court or a " 'robust consensus of cases of persuasive authority' in the Court of Appeals." *Mammaro*, 814 F.3d at 169 (quoting *Taylor v. Barkes*, —— U.S. ——, 135 S.Ct. 2042, 2044, 192 L.Ed.2d 78 (2015) (per curiam)).

[8] In this case, Swope was not plainly incompetent and did not violate clearly established law. We agree with the Bankruptcy Court that there is a "dearth of case law on the topic" of whether a bankruptcy trustee may take control of a building which she is obliged to preserve and which is at imminent risk of destruction or damage, especially in the face of the lack of cooperation by a third-party tenant. *In re J & S Props.*, 545 B.R. at 110.

Rather than point to any case balancing a bankruptcy trustee's duties to preserve the estate under her care in the face of "exigent circumstances" and her duties to a third-party tenant, *id.*, Phoenician cites

black-letter Pennsylvania law indicating that self-help eviction is generally impermissible. Because "[s]tate law defines property interests for purposes of procedural due process claims," and Pennsylvania leaseholders are entitled to a trial before being evicted, Phoenician claims that it is clear that "self-help evictions are unlawful in Pennsylvania." Phoenician Br. 20–21 (citing, *e.g.*, *Berman v. City of Philadelphia*, 425 Pa. 13, 228 A.2d 189 (1967)). Phoenician also argues that since Swope, as trustee of the property, "stands in the shoes of the landlord debtor," Reply Br. 5, 8 (citing *Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1154 (3d Cir. 1989)), and the lease remained operative even after its rejection by the Bankruptcy Court, *id.* at 8 (citing 11 U.S.C. § 365(h)(1)(A)(ii)), she constructively evicted Phoenician without due process when she received the only key to the building after the locks were changed. Phoenician adds that its inability to remove its personal items from the property after the locks were changed effected an impermissible seizure.

Phoenician's thorough review of Pennsylvania law stands in stark contrast to its failure to acknowledge the many duties imposed upon Trustee Swope by federal bankruptcy law. Under 11 U.S.C. § 704, Swope had to safeguard, liquidate, and administer the estate property for the benefit of creditors. Section 704(a) states that the bankruptcy trustee "shall":

> (1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest;
>
> (2) be accountable for all property received[.]

As the Bankruptcy Court noted, "there is no dispute" that Swope's statutory duties "include protecting and preserving the Estate Property." *In re J & S Props.*, 545 B.R. at 108.

And the events of January 2014 required Swope to act to preserve the estate. Phoenician's inaction caused significant flooding to the debtor's estate and Swope did not have a key to access the building and survey the damage. She accepted the key after the locks had been changed in order to fulfill her duty to preserve the property from further damage. Phoenician points to no case that addressed, much less established, whether such conduct by a trustee amounts to an unconstitutional eviction. In fact, the DOJ's own guidance for bankruptcy trustees notes that for "cases where the property appears to have value for the estate, the trustee must obtain control over the property, which may include changing the locks at the premises . . . ." U.S. Dep't of Justice, Executive Office for U.S. Trustees, *Handbook for Chapter 7 Trustees*, at § 4.C.3.f (applying 11 U.S.C. § 704). The DOJ also notes that trustees "must immediately take all other steps which may be reasonably necessary to preserve the assets." *Id.* Here, the Bankruptcy Court found, and the District Court agreed, that the imminent damage to the estate's largest asset would reasonably lead a trustee in Swope's position to believe that taking control of the property was not only permissible, but statutorily required.

The Supreme Court has cautioned that the question of "objective legal reasonableness" with respect to clearly established precedent should not be applied at too high a level of generality. *Anderson v. Creighton*, 483 U.S. 635, 639, 107 S.Ct. 3034, 97 L.Ed.2d 523 (1987). Phoenician makes that mistake by noting that its rights to due process of law and to be free of illegal seizure are "quite clearly established." *Id.* But the existence of those clearly established rights sheds no light on

whether Swope's actions would violate them in the circumstances presented here. *Id.* at 640, 107 S.Ct. 3034. The cases Phoenician cites do not approach the level of specificity required for clearly established law. For example, several of those cases have nothing to do with bankruptcy trustees, *see Soldal v. Cook Cty.*, 506 U.S. 56, 113 S.Ct. 538, 121 L.Ed.2d 450 (1992); *Bd. of Regents of State Colls. v. Roth*, 408 U.S. 564, 92 S.Ct. 2701, 33 L.Ed.2d 548 (1972); *Ruiz v. New Garden Twp.*, 376 F.3d 203 (3d Cir. 2004), and the one case that does involve a trustee has nothing to do with a potential conflict between a landlord's duties under state law and a trustee's duty to preserve estate property under federal law. *See Beard v. Braunstein*, 914 F.2d 434 (3d Cir. 1990).

None of the cases upon which Phoenician relies involved a trustee attempting to preserve assets of an estate under her care in the face of past and future damage to those assets. And considering Phoenician's lack of cooperation by giving Swope a key that only opened the outer door, its refusal "to keep the property adequately heated," and its failure to meet at the property and maintain insurance, App. 397, there is no law that clearly establishes the unlawfulness of Swope's actions. Accordingly, we agree with the lower courts that "Swope, in accordance with her duties as the trustee, took appropriate action to administer and preserve the Estate Property." *Phoenician Mediterranean Villa*, 554 B.R. at 756–57. This conclusion is fatal to Phoenician's appeal.

It strains credulity to suggest, as Phoenician does, that "every reasonable official would have understood that what" Swope did constituted an impermissible eviction that violated due process. *al-Kidd*, 563 U.S. at 741, 131 S.Ct. 2074 (internal quotation marks and citation omitted). "[W]here an official's duties legitimately require action in which clearly established rights are not implicated, the public interest may be better served by action taken 'with independence and without fear of consequences.' " *Harlow*, 457 U.S. at 819, 102 S.Ct. 2727 (citation omitted); *see also Pearson v. Callahan*, 555 U.S. 223, 231, 129 S.Ct. 808, 172 L.Ed.2d 565 (2009). The circumstances of this case required Swope to act quickly to preserve the estate and she did so in a manner not contrary to law. Accordingly, she should not be subject to suit for her actions.[4]

C

[9] Phoenician's two remaining counterarguments are also unavailing. It first argues that the fact that Swope "filed her emergency motion for turnover and possession shortly after ... lock[ing] the Phoenician out of the restaurant" (she got the key to the new locks on January 16 and filed on the same day) should be interpreted as an admission by Swope that a reasonable trustee would know she needed a court order for possession before accepting the new key. Phoenician Br. 26. This logic is faulty and would lead to undesirable outcomes. There are several other reasons Swope may have sought the Bankruptcy Court's permission for these actions. As Swope argued, that a trustee seeks to have "her action ratified by a court, out of an abundance of caution, does not mean that she acts improperly" if she acts before the court could respond. Swope Br. 27. In this case, Swope claims she sought the emergency court order as quickly as possible, and accepted the new keys from the debtor only "because of the

4. Because we hold that Swope is entitled to qualified immunity, we need not address her contention that she is entitled to absolute quasi-judicial immunity for the actions she took before the Bankruptcy Court's February 7, 2014 Order.

emergency need to preserve the estate's largest asset" from water and other damage. *Id.*

The Amici explain that bankruptcy trustees often seek post hoc court approval to ratify quick actions they take to preserve an estate based on exigent circumstances. If we were to interpret this practice as an admission of wrongful behavior, it would upend years of custom and impair the ability of trustees to protect estates or encourage them to refrain from seeking court supervision of their actions. We eschew such undesirable results.

Phoenician also claims that Swope "gave up her qualified immunity when she testified at the hearing on Phoenician's request for a temporary restraining order." Phoenician Br. 28. According to Phoenician, because "Trustee Swope never raised her immunity from suit at [the] hearing" on January 24, 2014, and instead "testified at that hearing with regard to the specific facts of the lockout," she waived her right to claim immunity later. Phoenician Br. 22.

[10, 11] It does not appear that Phoenician raised this argument in either the Bankruptcy Court or the District Court, *see* Swope Br. 26 (citing docket), so it is forfeited. *See United States v. Joseph*, 730 F.3d 336, 341–42 (3d Cir. 2013). In any event, the claim that Swope waived her immunity is not supported by legal authority. She was not put on notice as to any clear illegality at the emergency hearing; quite to the contrary, the Bankruptcy Court rejected Phoenician's motion for an injunction and temporary restraining order after holding that Phoenician did not establish a likelihood of success on the merits. Moreover, Swope was not required to assert her right to qualified immunity at the January 24, 2014 hearing since it was not a trial on the merits of Phoenician's damages claims against Swope. The hearing was to adjudicate Phoenician's motion for equitable relief and Swope's emergency motion for control over the property. As such, there is no colorable argument of waiver here.

IV

For the reasons stated, we will affirm the order of the District Court affirming the order of the Bankruptcy Court.

FISHER, Circuit Judge, concurring in the judgment.

Bankruptcy trustees play a role in our federal judicial system rooted in centuries of Anglo-American bankruptcy law. Like their predecessors, modern-day trustees perform functions that are essential to the judiciary's orderly disposition of a bankrupt's estate. I would hold that the Chapter 7 bankruptcy trustee in this case (hereinafter Trustee) is immune from suit on the basis of quasi-judicial immunity. I therefore agree with the majority that the judgment of the District Court should be affirmed. In this separate opinion, I explain why, in my view, the doctrine of qualified immunity upon which the majority rests its decision is not properly before this Court, and then set forth my conclusion that the Trustee should be accorded quasi-judicial immunity.

I

Qualified immunity protects government officials "from liability for civil damages insofar as their conduct does not violate clearly established statutory or constitutional rights of which a reasonable person would have known." *Harlow v. Fitzgerald*, 457 U.S. 800, 818, 102 S.Ct. 2727, 73 L.Ed.2d 396 (1982). "The presumption is that qualified rather than absolute immunity is sufficient to protect government officials in the exercise of their duties." *Burns v. Reed*, 500 U.S. 478, 486-87, 111

S.Ct. 1934, 114 L.Ed.2d 547 (1991). The Supreme Court has thus admonished that the extension of absolute immunity should be "quite sparing" and not extended "any further than its justification would warrant." *Id.* at 487, 111 S.Ct. 1934.

It is my respectful submission, however, that the Trustee's *Harlow* qualified immunity defense is not adequately preserved for our consideration. Qualified immunity "is an affirmative defense that must be pleaded by a defendant official." *Harlow*, 457 U.S. at 815, 102 S.Ct. 2727. The Supreme Court has therefore long held that "the burden of pleading it rests with the defendant." *Gomez v. Toledo*, 446 U.S. 635, 640, 100 S.Ct. 1920, 64 L.Ed.2d 572 (1980) (citing Fed. R. Civ. P. 8(c)); *see also Crawford-El v. Britton*, 523 U.S. 574, 595, 118 S.Ct. 1584, 140 L.Ed.2d 759 (1998); *Thomas v. Independence Twp.*, 463 F.3d 285, 293 (3d Cir. 2006). As the majority recognizes, the Trustee failed to invoke *Harlow* qualified immunity before the Bankruptcy Court. Quasi-judicial immunity is the only defense she pleaded. While our cases permit a defendant to "raise qualified immunity as a defense at trial," *Sharp v. Johnson*, 669 F.3d 144, 168 (3d Cir. 2012), we have not allowed a defendant to raise *Harlow* qualified immunity for the first time on appeal. And understandably so, since the Supreme Court has rejected efforts by courts to alter established rules of procedure in immunity cases. *See Crawford-El*, 523 U.S. at 594-97, 118 S.Ct. 1584; *Johnson v. Jones*, 515 U.S. 304, 317-18, 115 S.Ct. 2151, 132 L.Ed.2d 238 (1995); *Leatherman v. Tarrant Cty. Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 164-69, 113 S.Ct. 1160, 122 L.Ed.2d 517 (1993); *Gomez*, 446 U.S. at 639-40, 100 S.Ct. 1920.

As I read the opinions of the Bankruptcy Court and the District Court, neither decided this case on the basis of *Harlow* qualified immunity. The Bankruptcy Court's opinion does not cite any *Harlow* qualified immunity cases. And while the District Court did reference *Harlow*'s standard once, that brief mention appears only in the court's description of Phoenician's arguments on appeal. *See* 554 B.R. 747, 755 (W.D. Pa. 2016) ("[Phoenician] argues that Trustee Swope is not entitled to qualified immunity because she violated its clearly established rights and because a reasonable Chapter 7 [t]rustee would have believed that evicting [Phoenician] from the restaurant without a court order violated its Fourth Amendment rights and deprived it of procedural due process."). The District Court instead cited two quasi-judicial immunity decisions—*Antoine v. Byers & Anderson, Inc.*, 508 U.S. 429, 113 S.Ct. 2167, 124 L.Ed.2d 391 (1993), and *In re Castillo*, 297 F.3d 940 (9th Cir. 2002)—for the proposition that such immunity "is historically accorded to trustees." 554 B.R. at 756. Though the Bankruptcy Court and District Court each stated that the Trustee "is entitled to qualified rather than absolute immunity" because she "did not act pursuant to a court order," *id.*; *see* 545 B.R. 91, 113-14 (Bankr. W.D. Pa. 2015), that proposition simply refers to the fact that quasi-judicial immunity can at times be qualified rather than absolute. *See* 6 *Collier on Bankruptcy* ¶ 704.04[1], p. 704-13 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2017) ("Trustees who act within the scope of the authority and discretion that they are given have been held entitled to quasi-judicial immunity, and to the extent that they are executing orders of the court, they have been held entitled to absolute immunity.") (footnote omitted).

That quasi-judicial immunity can be qualified does not mean that *Harlow* qualified immunity is at issue. Unlike quasi-judicial immunity, *Harlow* qualified immunity is a contemporary doctrine. In *Harlow* the Supreme Court "completely reformu-

lated qualified immunity along principles not at all embodied in the common law, replacing the inquiry into subjective malice so frequently required at common law with an objective inquiry into the legal reasonableness of the official action." *Anderson v. Creighton*, 483 U.S. 635, 645, 107 S.Ct. 3034, 97 L.Ed.2d 523 (1987). While quasi-judicial immunity is rooted in the common law, *see infra* Part II, *Harlow* qualified immunity is not. A distinction between the two doctrines exists and it should be observed.

Because neither the Bankruptcy Court nor the District Court decided this case on the basis of *Harlow* qualified immunity, the issue is not properly before us. Like the Supreme Court, we are "a court of review, not first view." *Cutter v. Wilkinson*, 544 U.S. 709, 718 n.7, 125 S.Ct. 2113, 161 L.Ed.2d 1020 (2005); *see Wood v. Milyard*, 566 U.S. 463, 473, 132 S.Ct. 1826, 182 L.Ed.2d 733 (2012) ("[A]ppellate courts ordinarily abstain from entertaining issues that have not been raised and preserved in the court of first instance."). This precept applies as well in bankruptcy cases. Our precedent instructs district courts to follow "the general rule that when a party fails to raise an issue in the bankruptcy court, the issue is waived and may not be considered ... on appeal." *In re Kaiser Grp. Int'l Inc.*, 399 F.3d 558, 565 (3d Cir. 2004). I would therefore not absolve the Trustee of her obligation to raise *Harlow* qualified immunity before the Bankruptcy Court.

II

Whether or not the Trustee sufficiently preserved her *Harlow* qualified immunity defense, I believe this case should be decided based on the historical tradition of according quasi-judicial immunity to bankruptcy trustees sued by third parties for actions taken within the scope of their official duties.

It has long been understood that the various immunities from suit possessed by public officials at common law in 1871, the year Congress passed 42 U.S.C. § 1983, are retained in suits against state officials under that statute. *See, e.g.*, *Tenney v. Brandhove*, 341 U.S. 367, 376, 71 S.Ct. 783, 95 L.Ed. 1019 (1951); *Rehberg v. Paulk*, 566 U.S. 356, 361-62, 132 S.Ct. 1497, 182 L.Ed.2d 593 (2012). The availability and scope of these immunities is the same in actions brought against federal officials under *Bivens v. Six Unknown Fed. Narcotics Agents*, 403 U.S. 388, 91 S.Ct. 1999, 29 L.Ed.2d 619 (1971). *See Butz v. Economou*, 438 U.S. 478, 503-04, 98 S.Ct. 2894, 57 L.Ed.2d 895 (1978). Among the immunities firmly established in the common law is the absolute immunity judges enjoy for actions when carrying out their judicial functions. *See Bradley v. Fisher*, 80 U.S. (13 Wall.) 335, 347, 20 L.Ed. 646 (1872) (Describing judicial immunity as "the settled doctrine of the English courts for many centuries" that "has never been denied ... in the courts of this country."). Pre-1871 common-law courts also extended quasi-judicial immunity to public servants performing "official acts involving policy discretion but not consisting of adjudication." *Burns*, 500 U.S. at 500, 111 S.Ct. 1934 (Scalia, J., concurring in the judgment in part and dissenting in part).

In *Antoine v. Byers & Anderson*, *supra*, the Supreme Court adopted a two-step approach for determining when quasi-judicial immunity attaches to the acts of officials other than judges who are involved in the judicial process. First, "[i]n determining which officials perform functions that might justify full exemption from liability," courts must undertake "a considered inquiry into the immunity historically accorded the relevant official at common law and the interests behind it." *Antoine*, 508 U.S. at 432, 113 S.Ct. 2167 (internal quotation

marks omitted). Next, courts must "consider whether judges, when performing that function, were themselves entitled to absolute immunity." *Id.* at 435, 113 S.Ct. 2167. Stated differently, "judicial immunity is extended to officials other than judges" when "their judgments are functionally comparable to those of judges—that is, because they, too, 'exercise discretionary judgment' as part of their function." *Id.* at 436, 113 S.Ct. 2167 (brackets omitted) (quoting *Imbler v. Pachtman*, 424 U.S. 409, 423 n.20, 96 S.Ct. 984, 47 L.Ed.2d 128 (1976)). This approach accords with the " 'touchstone' " for the applicability of judicial immunity, namely, " 'the performance of the function of resolving disputes between parties, or of authoritatively adjudicating private rights.' " *Id.* at 435-36, 96 S.Ct. 984 (quoting *Burns*, 500 U.S. at 500, 111 S.Ct. 1934 (opinion of Scalia, J.)). And while *Antoine*'s functional approach "is tied to the common law's identification of the functions that merit the protection of absolute immunity," the Supreme Court's precedents "have not mechanically duplicated the precise scope of the absolute immunity that the common law provided to protect those functions." *Rehberg*, 566 U.S. at 364, 132 S.Ct. 1497.

Applying the analytical framework set forth in *Antoine*, Chapter 7 bankruptcy trustees should be accorded quasi-judicial immunity for actions taken within the scope of their duties that are necessary to the bankruptcy court's adjudication of a debtor's estate. The bankruptcy trustees of today perform quasi-judicial functions that trace back to their sixteenth-century English predecessors. England's first bankruptcy laws were passed in 1542 and 1570. *See* 34 & 35 Hen. 8 c. 4 (1542-43); 13 Eliz. c. 7 (1570). The latter statute "filled out the basic parameters of the English bankruptcy system ... and remained in effect until the time of the American Revolution." Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 Am. Bankr. Inst. L. Rev. 5, 8 (1995). In addition to naming acts of bankruptcy, the law vested in the Lord Chancellor "power to appoint, by commission of the great seal, certain persons to exercise the powers of the Chancellor over the person and property of the bankrupt." 8 William S. Holdsworth, *A History of English Law* 470 (3d ed. 1922). These commissioners "had substantial powers, originally akin to a combination of today's trustee and bankruptcy judge." Tabb, *supra*, at 8. They supervised a process that "mirrored a modern straight liquidation case" wherein they would perform "normal trustee-like activities of collecting, liquidating, and distributing the debtor's property to creditors, and more traditional judicial activities, such as seizing property, summoning persons to appear before them, and committing people to prison." *Id.* at 8-9. A statute of 1707, 4 Anne c. 17, delegated these trustee-like duties to assignees—so-called because they were assigned the bankrupt's property. *See also Central Va. Community College v. Katz*, 546 U.S. 356, 370, 126 S.Ct. 990, 163 L.Ed.2d 945 (2006) (observing that English bankruptcy assignees were "the 18th-century counterparts of today's bankruptcy trustees").

Early American bankruptcy law followed the English system in many respects. Though the Framers gave Congress the power to "establish ... uniform Laws on the subject of Bankruptcies throughout the United States," U.S. Const. art I, § 8, cl. 4, no permanent bankruptcy legislation existed until 1898. Temporary legislation was in place, however, from 1800 to 1803, from 1841 to 1843, and from 1867 to 1878, each passed in the wake of a major financial panic. At every step of the way, Congress retained the three-part English model: bankruptcy jurisdiction was placed in the district courts, those courts

appointed commissioners (called "registers" in the 1867 Act and "referees" in the 1898 Act) to assist the judges in executing their duties, and assignees would perform functions critical to the liquidation and distribution of the bankruptcy estate. *See* Act of Apr. 4, 1800, ch. 19, 2 Stat. 19 (repealed 1803); Act of Aug. 19, 1841, ch. 9, 5 Stat. 440 (repealed 1843); Act of Mar. 2, 1867, ch. 176, 14 Stat. 517 (repealed 1878); Act of July 1, 1898, ch. 541, 30 Stat. 544 (repealed 1978).

Another antecedent to the modern-day bankruptcy trustee can be found in the equity receivership commonly used during the late nineteenth and early twentieth centuries to assist with corporate reorganizations, especially with regard to struggling railroads. *See* Tabb, *supra*, at 21-22. As this Court has previously recognized, "[a] bankruptcy trustee is the 'statutory successor to the equity receiver' and 'just like an equity receiver, a trustee in bankruptcy is working in effect' for the court overseeing the bankruptcy proceeding, 'administering property that has come under the court's control by virtue of the Bankruptcy Code.' " *In re VistaCare Grp., LLC*, 678 F.3d 218, 229 (3d Cir. 2012) (brackets omitted) (quoting *In re Linton*, 136 F.3d 544, 545 (7th Cir. 1998)). So to the extent equity receivers and nineteenth century assignees performed duties that required the exercise of discretionary judgment to assist courts in adjudicating bankruptcy-related disputes, they would have enjoyed quasi-judicial immunity from suit under the common law.

The courts of appeals have uniformly held that the procedural and substantive immunities of equity receivers at common law carried over to the bankruptcy trustees of today. Thus, there is considerable acknowledgment that the common law procedural immunity known as the "*Barton* doctrine," *see Barton v. Barbour*, 104 U.S. 126, 128-29, 26 L.Ed. 672 (1881), whereby an equity receiver could not be sued without leave of the court that appointed him, applies to the present-day bankruptcy trustee. *See In re VistaCare Grp.*, 678 F.3d at 232; *Carroll v. Abide*, 788 F.3d 502, 505 n.12 (5th Cir. 2015) (collecting cases from ten circuits). Among the rationales courts have articulated in favor of the *Barton* doctrine is the "strong interest" "the court that appointed the trustee has . . . in protecting him from unjustified personal liability for acts taken within the scope of his official duties." *In re Lehal Realty Assocs.*, 101 F.3d 272, 276 (2d Cir. 1996); *see also Vass v. Conron Bros. Co.*, 59 F.2d 969, 970 (2d Cir. 1932) (L. Hand, J.) ("A trustee is equally an officer of the court; and [like a receiver] his possession is protected because it is the court's . . . ." (citation omitted)).

There is also a broad consensus that bankruptcy trustees are substantively immune from suit under the doctrine of quasi-judicial immunity. Generally speaking, there are "two types of actions against trustees: breach of fiduciary duty claims brought by parties interested in the administration of the estate, and claims in tort or contract brought by third parties." *In re Mailman Steam Carpet Cleaning Corp.*, 196 F.3d 1, 7 n.4 (1st Cir. 1999). It is settled that a bankruptcy trustee may be held personally liable for breach of fiduciary duty. *See Mosser v. Darrow*, 341 U.S. 267, 271, 274, 71 S.Ct. 680, 95 L.Ed. 927 (1951); *In re McKenzie*, 716 F.3d 404, 413 (6th Cir. 2014); *In re Mailman Steam Carpet Cleaning*, 196 F.3d at 6-7. Courts have also held that bankruptcy trustees are covered by quasi-judicial immunity when acting pursuant to an express court order. *See, e.g.*, *In re Harris*, 590 F.3d 730, 742 (9th Cir. 2009); *Boullion v. McClanahan*, 639 F.2d 213, 214 (5th Cir. Unit A Mar. 1981) (per curiam).

Phoenician's suit is of the second type, as it alleges no breach of fiduciary duty. Rather, Phoenician is a third party raising a claim sounding in tort. In such cases, "a bankruptcy trustee is ordinarily entitled to quasi-judicial immunity from suit ... for actions taken in his official capacity." *In re McKenzie*, 716 F.3d at 413; *see In re Mailman Steam Carpet Cleaning*, 196 F.3d at 7 n.4; *Ziegler v. Pitney*, 139 F.2d 595, 596 (2d Cir. 1943); *McRanie v. Palmer*, 2 F.R.D. 479, 481 (D. Mass. 1942). This immunity was recognized long ago in *McNulta v. Lochridge*, 141 U.S. 327, 12 S.Ct. 11, 35 L.Ed. 796 (1891), when the Supreme Court held that equity receivers cannot be held personally liable in suits by third parties—the suit instead can lie only against the receivership itself:

> So long as the property of the corporation remains in the custody of the court and is administered through the agency of a receiver, such receivership is continuous and uninterrupted until the court relinquishes its hold upon the property, though its *personnel* may be subject to repeated changes. Actions against the receiver are in law actions against the receivership, or the funds in the hands of the receiver, and his contracts, misfeasances, negligences and liabilities are official and not personal, and judgments against him as receiver are payable only from the funds in his hands.

Id. at 332, 12 S.Ct. 11 (emphasis in original).

While the quasi-judicial immunity of bankruptcy trustees does not extend to acts by a trustee that are *ultra vires*, *see, e.g.*, *Leonard v. Vrooman*, 383 F.2d 556, 560 (9th Cir. 1967), a bankruptcy trustee "is not required to obtain prior court approval in order to invoke quasi-judicial immunity from suit by a third party for actions taken by the trustee on behalf of the estate and within the scope of his authority." *In re McKenzie*, 716 F.3d at 414. The Bankruptcy Court and the District Court thus drew an unnecessary distinction between "the absolute immunity analyses associated with actions taken pursuant to a court order [and] the qualified immunity analyses of actions undertaken absent an authorizing order of court." 545 B.R. at 104 (emphasis deleted); *see* 554 B.R. at 756. As already noted, while it is true that a "trustee's derivative judicial immunity is qualified" in certain respects, *see* 1 Joan N. Feeney *et al.*, *Bankruptcy Law Manual* § 4:16, p. 799 (5th ed. 2016), the qualified nature of a bankruptcy trustee's quasi-judicial immunity is different from the doctrine of *Harlow* qualified immunity.

Against this background, granting the Trustee quasi-judicial immunity in this case is not a close call. The Trustee's efforts to secure the property of J & S's estate—here, the real property leased to Phoenician—were discretionary actions performed within the scope of her statutory duties. The Bankruptcy Code requires Chapter 7 trustees to "collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest," and, in connection with this responsibility, to "be accountable for all property received." 11 U.S.C. § 704(a)(1), (2). Both the Bankruptcy Court and District Court noted the undisputed fact that the Trustee's duties included safeguarding the estate property. *See* 545 B.R. at 108; 554 B.R. at 756. Those courts therefore sensibly found that "a Chapter 7 [t]rustee has a duty to secure and preserve estate assets, including changing the locks to a building when circumstances warrant." 545 B.R. at 113; *see* 554 B.R. at 757.

This conclusion is consistent with the guidance provided by the Department of

Justice's Office of the United States Trustee, which advises Chapter 7 trustees:

> In those cases where the property appears to have value for the estate, the trustee must obtain control over the property, which may include changing the locks at the premises, hiring guards, etc. The trustee also must immediately take all other steps which may be reasonably necessary to preserve the assets. It is not always sufficient to wait until after the meeting of creditors to take action to preserve assets.

U.S. Dep't of Justice, *Handbook for Chapter 7 Trustees* § 4.C.3.f, p. 4-6 (2012) (citing 11 U.S.C. § 704). Neither the Bankruptcy Code nor the Trustee Handbook specifies how trustees are to exercise their duty to safeguard estate property. A trustee must accordingly "exercise a discretionary judgment as part of th[is] function." *Antoine*, 508 U.S. at 436, 113 S.Ct. 2167 (internal quotation marks omitted). The Trustee is thus entitled to quasi-judicial immunity for the discretionary acts she took in furtherance of her duty to safeguard the property of J & S's estate.

* * *

Because I would hold that the Trustee is shielded from liability under the doctrine of quasi-judicial immunity, I concur in the judgment.



Paul SATTERFIELD, Appellant

v.

DISTRICT ATTORNEY PHILADELPHIA; Attorney General Pennsylvania; Secretary Pennsylvania Department of Corrections

No. 15-2190

United States Court of Appeals,
Third Circuit.

Argued March 27, 2017

(Opinion Filed: September 26, 2017)

Background: Following affirmance of his first degree murder conviction, 369 Pa.Super. 652, 531 A.2d 528, state inmate filed petition for writ of habeas corpus. The United States District Court for the Eastern District of Pennsylvania, Jan E. DuBois, J., 322 F.Supp.2d 613, granted petition, and respondent appealed. The Court of Appeals, 434 F.3d 185, reversed and remanded. Following dismissal of petition on remand, petition moved for relief from judgment. The United States District Court for the Eastern District of Pennsylvania, No. 2–02–cv–00448, Jan E. DuBois, J., denied motion, and petitioner appealed.

Holding: The Court of Appeals, Vanaskie, Circuit Judge, held that district court was required to consider full panoply of equitable circumstances in determining whether change of law in Supreme Court's decision in *McQuiggin v. Perkins* warranted relief from judgment.

Vacated and remanded.

1. Federal Courts ⚿3607

Court of Appeals reviews district court's denial of motion for relief from judgment for abuse of discretion. Fed. R. Civ. P. 60(b)(6).

So Ordered.

Signed this 28 day of July, 2023.

Patrick G. Radel
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

M. BURTON MARSHALL,

Debtor.

Chapter 11
Case No. 23-60263-pgr

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MEMORANDUM-DECISION AND ORDER
DETERMINING NEED FOR EVIDENTIARY HEARING
REGARDING U.S. TRUSTEE'S MOTION TO APPOINT A TRUSTEE

Presently pending before the Court is the United States Trustee's Motion to Appoint a Chapter 11 Trustee pursuant to 11 U.S.C. § 1104 (a) or, in the alternative, to Appoint an Examiner under 11 U.S.C. § 1104 (c). (Docket No. 106). The U.S. Trustee's motion was joined by the Official Committee of Unsecured Creditors (Docket No. 140) and is supported by two groups of unsecured creditors. (Docket No. 130, 132). The motion was opposed, in part, by the Debtor (Docket No. 137) and Megan Marshall, the Debtor's wife and a creditor. (Docket No. 135). The U.S. Trustee filed a declaration in further support of the motion on July 24, 2023. (Docket No. 150).

A hearing was held before this Court on July 25, 2023, in Utica, New York, with counsel for the above-named parties appearing and being heard. Decision was reserved.[1]

For the following reasons, this Court finds an evidentiary hearing necessary.

[1] A telephonic status conference was held on July 28, 2023, at the request of Debtor's counsel, who asked to supplement the record. That request is moot, as the information proffered by counsel played no role in this Court's decision.

JURISDICTION

This Court has core jurisdiction over the parties and the subject matter of this contested matter in accordance with 28 U.S.C. §§ 1334(b) and 157(b)(2). Venue is proper in this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

BACKGROUND

For more than three decades, M. Burton Marshall has operated a series of businesses and owned scores of properties in a rural community located in Madison County, New York. Mr. Marshall's endeavors included tax return preparation, self-storage, printing, insurance brokering, property maintenance, and real estate rental. (Docket No. 7, at ¶ 1-5).

Mr. Marshall filed a Petition for Relief under Chapter 11 of the Bankruptcy Code on April 20, 2023. (Docket No. 1). He disclosed assets of $21,854,009.89 against liabilities of $92,746,873.06. (Docket No. 3-1, at p. 1). The substantial majority of debt consists of unsecured promissory notes issued to individuals. (Docket No. 3-1, at p. 84-414).

There appears to be no dispute that most of the creditors were friends, neighbors, customers, or clients of Mr. Marshall. Numerous creditors believe they are victims of a wide-ranging, long-standing Ponzi scheme, wherein they were promised an 8% return for investing in a fund Mr. Marshall claimed to be maintaining. (Docket No. 100, 104, 125, 128, 130, 132).

Mr. Marshall denies any fraud and claims these were loans he intended to repay. (Docket No. 106-1, at p. 40-41, 45-47, 68-69, 131-32). He explains that his bankruptcy was "largely precipitated" by health problems, which resulted in lost revenue and increased demands from noteholders for payment. (Docket No. 7, at ¶ 6).

DISCUSSION

Section 1104 of the Bankruptcy Code provides, in pertinent part, that, upon motion of the U.S. Trustee or a party in interest, and after notice and hearing, the Court "shall" order the appointment of a trustee "for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management" or if "such appointment is in the interests of creditors, any equity security holders, and other interests of the estate…." 11 U.S.C. § 1104 (a)(1) & (2).

Ordinarily, a Chapter 11 debtor remains in control of the estate and appointment of a trustee is "the exception, rather than the rule." *In re Adelphia Commc'ns. Corp*., 336 B.R. 610, 655 (Bankr. S.D.N.Y. 2006) (quoting *In re Sharon Steel Corp*., 871 F.2d 1217, 1225 (3d Cir. 1989)). "There is a strong presumption that the debtor should be permitted to remain in possession absent a showing of need for the appointment of a trustee." *In re Ionosphere Clubs, Inc*., 113 B.R. 164, 167 (Bankr. S.D.N.Y. 1990); *see also In re Univ. Heights Ass'n, Inc*., No. 06-12672, 2007 WL 316281, at *2 (Bankr. N.D.N.Y. Jan. 22, 2007)("The appointment of a § 1104 trustee is an extraordinary remedy.").

"[T]he standard for § 1104 appointment is very high...." *In re Smart World*, 423 F.3d 166, 176 (2d Cir. 2005). "The U.S. Trustee has the burden of showing by 'clear and convincing evidence' that the appointment … is warranted." *In re Bayou Grp., LLC*, 564 F.3d 541, 546 (2d Cir. 2009).[2]

[2] The U.S. Trustee argues that the Supreme Court's decision in *Octane Fitness, LLC v. ICON Health & Fitness*, 134 S. Ct. 1749 (2014) casts doubt on the continued validity of *Bayou Group*. The U.S. Trustee contends that preponderance of the evidence is the appropriate standard. This Court would reach the same conclusion under either standard and, as such, need not resolve this question.

A. Appointment for "Cause" – Issues of Fact Regarding "Current Management"

The appointment of a trustee is authorized and, indeed, required upon a showing of "cause," which includes "fraud, dishonesty, incompetence or gross mismanagement of the debtor's affairs by current management…." 11 U.S.C. § 1104 (a)(1). "Although the court's finding is limited to a factual determination [as to] whether 'cause' exists, a court is given wide latitude in determining whether the challenged conduct rises to the level of 'cause.'" *In re The 1031 Tax Grp., LLC*, 374 B.R. 78, 86 (Bankr. S.D.N.Y. 2007)(citing *Comm. of Dalkon Shield Claimants v. A.H. Robins Co., Inc*., 828 F.2d 239, 241–42 (4th Cir. 1987)).

The court may consider both pre-petition and post-petition misconduct when deciding whether cause exists. *See* 11 U.S.C. §1104 (a)(1)(defining cause as "including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, *either before or after* the commencement of the case")(emphasis added); *see also 1031 Tax Grp.,* 374 B.R. at 86; *In re Anchorage Boat Sales, Inc*., 4 B.R. 635, 644–45 (Bankr. E.D.N.Y. 1980).

However, the court's inquiry is directed toward "current management." *See* 11 U.S.C. § 1104 (a)(1)(defining cause as including "fraud, dishonesty, incompetence or gross mismanagement of the affairs of the debtor *by current management*")(emphasis added); *In re Bayou Grp*., 564 F.3d 547, at n. 3 ("The U.S. Trustee makes no attempt to impute the pre-petition fraudulent activity of Bayou's former management to Marwil. Such an imputation would be improper, as '[w]hen considering whether to appoint a trustee for cause, a court's focus is on the debtor's current management, not the misdeeds of past management.'")(quoting *1031 Tax Grp.*, 374 B.R. at 86); *see also In re Sletteland*, 260 B.R. 657, 672 (Bankr.S.D.N.Y.2001)("[O]n a motion for the appointment of a trustee, the focus is on the debtor's current activities, not past misconduct.").

1. Marshall as Management

The Debtor's Schedules and submissions disclose that he incurred more than $90 million dollars in unsecured debt (much of it from friends and neighbors) while operating small businesses (all but one of which are sole proprietorships) engaged in relatively modest pursuits (tax preparation, insurance sales, printing, property management) in a rural community in upstate New York. (Docket No. 3-1, at p. 1, 84-414; Docket 7, at ¶ 1-5).

Although the precise pathway is obscure, there is no conceivable way the Debtor reached this destination absent massive fraud, dishonesty, incompetence, or gross mismanagement.

The Debtor's Schedules disclose net income not remotely sufficient to service the debt on the terms promised in the demand notes. (Docket No. 3-1, at p. 460-64; Docket No. 3-3).[3] Moreover, the sheer size of the shortfall establishes, *prima facie*, that whatever the Debtor's cashflow might have been during his peak profitable periods, no competent, honest manager of these businesses could possibly have believed the debt could be serviced on the promised terms, let alone find it prudent or proper to continue borrowing.

The Debtor claims he intended no fraud and believed he would eventually be able to repay his creditors through appreciation in the value of his real estate holdings. (Docket No. 106-1, at 40-41, 45-47, 68-69, 131-32).[4] Even if accepted as true for present purposes, this admission is further evidence of incompetence and/or gross mismanagement, as no competent, honest person

[3] "When offered against a debtor, a debtor's schedules may be treated as judicial admissions." *In re Ridge Mountain, LLC*, No. 12-31090, 2012 WL 6681838, at *11 (Bankr. N.D.N.Y. Dec. 21, 2012); *see also In re Arcade Pub., Inc.,* 455 B.R. 373, 383 n.7 (Bankr. S.D.N.Y. 2011).

[4] The Debtor made these statements at his meeting of creditors. The question of whether and under what circumstances a debtor's statements at their § 341 meeting can be considered evidence is unsettled. *Compare In re Johnson*, No. 6:18-AP-01106-MH, 2022 WL 16731090, at *3 (B.A.P. 9th Cir. Nov. 4, 2022); *In re Jost*, 136 F.3d 1455, 1459 (11th Cir. 1998); *with In re Avery*, 594 B.R. 655, 660 (Bankr. S.D. Miss. 2018). This Court need not resolve this question. If the Debtor is "current management," his Schedules and the other undisputed facts in the record, standing alone, establish cause under §1104 (a)(1).

could believe a debt load of this size could be serviced, let alone satisfied, by anticipated appreciation in real estate of the type owned by the Debtor.

The Debtor also attempts to deflect allegations of a Ponzi scheme by explaining that while proceeds of new loans may have been used to make payments on old loans, this should cause no concern because he deposited all of his personal and business income, and paid all of his personal and business expenses, from a single checking account. (Docket No. 106-1, at p. 44-45). Even if this colossal commingling is credited as a defense to fraud, it constitutes additional evidence of incompetence and/or gross mismanagement.

If it was clear that the Debtor was still managing his businesses, this Court would find cause and appoint a trustee pursuant to §1104 (a)(1) without an evidentiary hearing. *See Ionosphere Clubs, Inc*., 113 B.R. at 167 ("Although in this case a full four day evidentiary hearing was conducted, in considering a motion for the appointment of a trustee, a bankruptcy court is not required to conduct a full evidentiary hearing."); *In re Casco Bay Lines, Inc*., 17 B.R. 946, 950 (B.A.P. 1st Cir. 1982)(affirming appointment of an 1104 trustee without an evidentiary hearing because the "bankruptcy court's order … had as its basis an analysis of existing, undisputed facts in the case which were a matter of record").

However, the situation is more complicated than that.

2. Algon's Arrival

On May 22, 2023, approximately one month after filing for bankruptcy protection, the Debtor engaged Algon Capital, LLC, d/b/a Algon Group, to act as a financial advisor and chief restructuring officer. The Debtor filed an application to approve that employment. (Docket No. 72). As originally contemplated, the relationship was primarily advisory, with the Debtor remaining responsible for operating his businesses. (Docket No. 72, Exhibit A, at p. 1-2).

On July 18, 2023, the Debtor filed a reply in further support of the application to employ Algon. (Docket No. 134). The Debtor, through counsel, explained that Algon's role had "significantly evolved." (Docket No. 134, at ¶ 3). To wit, according to counsel, the Debtor had "ceded all decisional authority over the businesses … to Algon," which now had "full control over the businesses[']s finances and bank accounts." (Docket No. 134, at ¶ 4, 5).

In a further submission filed July 24, 2023, the Debtor, through counsel, detailed Algon's performance of the management duties of the businesses and set forth controls put in place to ensure that Debtor's surrender of control is effective (*e.g.*, changing the office locks and not providing Debtor with a key, opening new financial accounts, revoking Debtor's signatory authority on existing accounts). (Docket No. 151, at ¶ 29).

At oral argument on July 25, 2023, Debtor's counsel represented that Algon had no connection with Debtor prior to the bankruptcy and was introduced to the Debtor by counsel.

Based on the foregoing, the Debtor argues that Algon is "current management" and contends there is no cause for an 1104 Trustee because there is no evidence of fraud, dishonesty, incompetence, or gross mismanagement *by Algon*.

The U.S. Trustee cites no evidence – and makes no allegation – of fraud, dishonesty, incompetence, or gross mismanagement by Algon. (Docket No. 106). When questioned at oral argument, counsel for the U.S. Trustee and the Official Committee of Unsecured Creditors, expressed positive, albeit tentative, approval of Algon's management of Debtor's affairs, including its transparency and responsiveness to requests. Committee counsel stated that the Committee had "no credibility issues with" Algon and believed the firm was "doing a good job."

Several parties, including the U.S. Trustee and Committee, objected to the Debtor's application to retain Algon. (Docket No. 129, 131, 133, 138). However, the objections are

primarily focused on Algon's fee structure and do not substantively question the firm's impartiality, integrity, qualifications, or competency.

On the current record, this Court finds no basis on which to conclude that Algon has engaged in fraud, dishonesty, incompetence, or gross mismanagement and/or that any other aspect of Algon's management of the Debtor's affairs constitutes cause sufficient to justify the extraordinary remedy of appointing an 1104 trustee.

Accordingly, the question of whether to appoint a trustee under § 1104 (a)(1) turns on the identity of "current management."

3. Analysis

Congress included "current management" in §1104 (a)(1).

To give meaning to these words and respect to Congress's intent, courts should not appoint an 1104 trustee if the underlying cause can be attributed only to past management. *See 1031 Tax Grp.*, 374 B.R. at 86-90 (finding pre-petition change in management sufficient to defeat motion for 1104 trustee, given evidence that new management was "free from any taint associated with … prior management"); *In re Real Est. Partners, Inc*., No. SA 07-13239 TA, 2007 WL 7025114, at *3 (Bankr. C.D. Cal. Nov. 20, 2007), aff'd, No. SA CV 07-1440 ODW, 2009 WL 3246619 (C.D. Cal. Oct. 5, 2009)("If the fraud, dishonesty or gross incompetence can be attributed to past management only, then the Court is not compelled to appoint a trustee."); *In re Microwave Prod. of Am., Inc*., 102 B.R. 666, 671 (Bankr. W.D. Tenn. 1989)("[T]he fact that prior management of the debtor is guilty of fraud, dishonesty, incompetence, or gross mismanagement does not necessarily provide grounds for the appointment of a trustee under section 1104(a)(1), as long as the court is satisfied that current management is free from the taint of prior management."); *In re Climate Control Mech. Servs., Inc*., 585 B.R. 192, 200 (Bankr. M.D. Fla. 2018)("Section 1104(a)

applies to misconduct of the 'current management.' However, the unrefuted evidence places all fault for the accounting deficiencies on Pressley, who is no longer a part of the 'current management.'"); *In re Express Grain Terminals*, LLC, No. 21-11832-SDM, 2022 WL 245421, at *12 (Bankr. N.D. Miss. Jan. 25, 2022)(declining to appoint 1104 trustee where "most, if not all, of the allegations of fraud, dishonesty, or gross mismanagement against [debtor] concern the actions of prior management").

As discussed above, there is no evidence before this Court of any fraud, dishonesty, incompetence, or gross mismanagement by Algon. Nor is there evidence of other cause sufficient to justify removing Algon from management of the Debtor's businesses.

The parties advocating for an 1104 trustee argue that the absence of such evidence should not prevent the appointment. They offer four (4) main arguments. This Court will address each argument in turn.

a. Sole Proprietorship Status

The appointment proponents argue that because all but one of Debtor's businesses are sole proprietorships, a change in "management" is an oxymoron. In other words, they claim the Debtor essentially *is* these businesses and it is legally and practically impossible for him to be removed from management.

This appears to be an issue of first impression, as the parties did not cite, and this Court could not find, any published decisions ruling on the question of whether, as a matter of law, a sole proprietorship can "change management" in a pending Chapter 11 case.

However, two cases decided in the corporate context provide persuasive reasons for concluding that a management change can be practically effectuated by sole proprietorships in an

individual Chapter 11, notwithstanding any formal governance issues arising under non-bankruptcy law.

In *Real Estate Partners*, the debtor changed management by appointing an independent "responsible person." 2007 WL 7025114, at *1. The U.S. Trustee challenged this arrangement as contrary to California corporate governance law. *Id.* at *5. The Bankruptcy Court rejected the U.S. Trustee's argument on the grounds that, by operation of 11 U.S.C. § 1107 (a), the debtor in possession has the powers and duties of a trustee "subject to such limitations or conditions as the court prescribes" and, as such, "not only the assets of the estate but its governance as well are in *custodia legis*." *Id.*

The District Court affirmed this finding on appeal, noting that the U.S. Trustee's "highly technical argument ignores the very obvious fact that in federal bankruptcy proceedings, authority of management-*board of directors or otherwise*-is already significantly curtailed and often times subject to conditions and/or limitations set by the bankruptcy court." *In re Real Est. Partners, Inc*., 2009 WL 3246619, at *1 (emphasis added).

In *In re Blue Stone Real Est., Const. & Dev. Corp*., 392 B.R. 897, 902 (Bankr. M.D. Fla. 2008), the U.S. Trustee objected to the appointment of a chief restructuring officer ("CRO") and sought an 1104 trustee on the ground that the court lacked the "ability to enter an order imposing conditions or limitations under section 1107(a) that would, in effect, leave the [debtor] corporations without boards of directors."

The court rejected this argument, finding that "the Bankruptcy Code contemplates that the state law powers of a corporation's board of directors can be altered while the corporation is a debtor in bankruptcy." *Id.* at 903. The court concluded that "the plain meaning of section 1107(a) permits the Court to alter the powers of the Debtors' boards of directors (and managers, in the

cases of the Debtors that are limited liability companies) and impose requirements that will alleviate any concern, however unfounded, of a party in interest that [the] … CRO will be some toady or crony of [prior management] instead of an independent professional with absolute control over the Debtors." *Id.*

In sum, in *Real Estate Partners* and *Blue Stone*, the courts looked beyond the formal/technical governance structure to the practical reality of the debtors' operations in light of the significant authority of the bankruptcy court to regulate the power, duties, and governance of a debtor-in-possession.

In the present case, irrespective of whether the Debtor can technically be removed from "management" under applicable non-bankruptcy law, as a debtor-in-possession he is subject to the jurisdiction of this Court, which has the authority to regulate his actions, including his involvement in the businesses and access to assets of the estate. *See* 11 U.S.C. § 1107 (a); *see also generally In re Garden Manor Associates*, 70 B.R. 477, 478 (Bankr. N.D. Cal. 1987)("Section 1107 provides that these powers include the power to operate the debtor's business *unless the court orders otherwise*.")(emphasis added); *Matter of Gaslight Club, Inc*., 782 F.2d 767, 770 (7th Cir. 1986)("The case law demonstrates that the court has considerable authority to interfere with the management of a debtor corporation in order to protect the creditors' interests."); *In re K.G. IM, LLC*, 620 B.R. 469, 482 (Bankr. S.D.N.Y. 2020)(approving "consensual delegation of authority by the Debtors' former management to an independent [chief restructuring officer]").

Moreover, during the motion hearing, the Debtor, through counsel, indicated a willingness to stipulate to an Order giving judicial force to his divestiture of management responsibilities and consent to additional safeguards that might be proposed by other parties in interest and/or required by the Court. This type of representation is enforceable by judicial estoppel. *See 1031 Tax Grp*,

374 B.R. at 88 ("[I]n response to continuing questions by the U.S. Trustee and the Court whether Okun has irrevocably transferred management authority, Okun's counsel agreed on the record in open court that Okun has irrevocably transferred management authority during the pendency of the chapter 11 cases, a representation which the Debtors contend and the Court concludes is enforceable by judicial estoppel.").

As such, provided the Debtor has, in fact, been divested of management duties and powers, any technical governance irregularity with that arrangement does not, without more, justify the extraordinary remedy of appointing an 1104 trustee.[5]

b. Taint

The second argument advanced by the proponents of an 1104 trustee is that although there is no evidence of fraud, dishonesty, incompetence, or gross mismanagement by Algon, the firm is tainted by its association with the Debtor -- a "bad guy" who should not be permitted to choose his successor.

This Court must determine whether Algon is "free from the taint of prior management."*1031 Tax Grp*., 374 B.R. at 86. "[H]eightened scrutiny" should be applied where, as here, new management was selected by tainted former management. *Id.* at 88.

However, the mere fact that former management selected new management does not irreparably taint new management. Rather, it shifts the burden to the debtor, or other parties opposing appointment, "to demonstrate that the new management is unconflicted by any association with the tainted members of the governing body that made the selection or appointment." *Id.; see also Real Estate Partners, Inc.*, 2007 WL 7025114, at *1.

[5] As discussed further below, if the record developed at the evidentiary hearing reveals that the Debtor has not been (or practically cannot be) divested of management responsibility, this Court's analysis would change.

In the present case, Debtor's counsel proffered that Algon had no prior association with the Debtor, was introduced to the Debtor by counsel, and is a disinterested, well-qualified, independent actor. In response, the advocates of appointment point to no evidence of wrongdoing by Algon, any relationship between Algon and the Debtor inconsistent with the representations of Debtor's counsel, or any reason to find "taint" beyond the fact that the Debtor selected Algon.

The advocates of appointment understandably consider it unseemly for the Debtor to be "allowed" to choose new management.

However, creating a rule that a management change initiated by the debtor invariably and irreparably taints new management would be a disincentive to a debtor voluntarily taking necessary and appropriate corrective action. *See Real Estate Partners*, 2007 WL 7025114, at *3 ("Taken to its logical conclusion, the U.S. Trustee's *per se* rule would mean that neither the board nor management of troubled companies could ever/would ever clean their own house as an alternative to the appointment of a trustee. The bad acts of former management would remain forever as an anchor around the debtor and would serve as a huge disincentive to either taking corrective action in the first place or to filing a reorganization proceeding at all.").

In addition, creating such a categorical rule would be inconsistent with the fact-specific, case-by-case approach consistently applied by courts when asked to appoint an 1104 trustee.

While the appointment advocates insist Algon wears a scarlet "D" because it was selected by the Debtor, the focus of this Court's inquiry concerns (a) whether Algon was involved with the prior misconduct/mismanagement and (b) whether Algon is disinterested and qualified to perform the management duties.

The record before this Court indicates no prior connection between Algon and the Debtor, let alone involvement by Algon with the Debtor's pre-petition endeavors, and no party has raised

any concern (or submitted any evidence giving rise to concern) regarding Algon's rectitude or aptitude. *See Real Est. Partners, Inc*., 2007 WL 7025114, at *4 ("In a case by case approach the Court can evaluate the crucial factors of whether there is a taint, whether prior management still has vestiges of control, whether the designated fiduciary is a known or an unknown and whether the designated fiduciary has the reputation and competence needed for the engagement.").

c. Timing

Third, the advocates of an 1104 trustee contend that the Debtor's purported divestiture of management responsibility was strategically timed to defeat or delay the effort to appoint an 1104 trustee and should therefore be viewed with suspicion.

The timeline does tend to support the conclusion that the management change was materially motivated by a desire to avoid appointment of an 1104 trustee.

The application to employ Algon was filed on May 23, 2023, approximately one month after the case was filed. (Docket No. 72). The original engagement included a broad range of services, with Algon "report[ing]" to the Debtor and with the "day-to-day operation" being performed by the Debtor's "management." (Docket No. 72, Exhibit A, at p. 1-2).

The U.S. Trustee moved for appointment of an 1104 Trustee on June 27, 2023. (Docket No. 106).

On July 18, 2023, the Debtor filed a reply in further support of his application to approve the Algon engagement. (Docket No. 134). The Debtor, through counsel, explained that Algon's role had "significantly evolved." (Docket No. 134, at ¶ 3). To wit, according to counsel, the Debtor had "ceded all decisional authority over the businesses … to Algon," which now had "full control over the businesses['] finances and bank accounts." (Docket No. 134, at ¶ 4, 5). The Debtor provided an amended engagement agreement, dated July 14, 2023, in which the Debtor was

divested of all authority to manage the businesses and in which Algon was given full management control. (Docket No. 134, Exhibit A).

During the motion hearing, Debtor's counsel proffered that the evolution of Algon's role was based more on what it learned about the underlying businesses during the course of its engagement than it was motivated by litigation strategy.

This Court finds that the Debtor's motivation in making the change is less important than the change itself. In other words, whether the Debtor divested himself from management based on an honest acknowledgment that he was incapable of performing the duties or removed himself to avoid an 1104 trustee, the important question is whether he has, in fact, been removed from management. *See Blue Stone*, 392 B.R. at 905 (rejecting "the United States trustee's position that a proposed change of management following the filing of a still pending motion to appoint a Chapter 11 trustee is proscribed by section 1104(a)"); *Real Estate Partners*, 2007 WL 7025114, at *1 ("The fact that the change in management was obviously motivated by the imminent appointment of a receiver in district court, is just one such factor for the Court to consider.").

d. Inadequate Safeguards

The proponents of an 1104 trustee assert that there are inadequate safeguards in place to ensure that the Debtor has, in fact, been divested of all management responsibilities. In other words, given the nature and extent of the Debtor's past conduct, along with the timing of the apparently strategic shift in management, the appointment advocates question whether the purported transfer of authority by the Debtor to Algon is (a) genuine, (b) sustainable, and (c) sufficient to safeguard the interests of the parties and facilitate reorganization.

These are legitimate and serious concerns, but they are not grounded in any evidence before the Court. The record currently contains a written agreement between Algon and the Debtor that

removes him from management, Debtor's counsel has cited objective steps taken to effectuate that removal, and the Debtor, through counsel, has offered to submit to entry of Orders memorializing the new structure.[6]

e. Need for an Evidentiary Hearing

The record presently before this Court indicates that Algon is currently managing the Debtor's businesses, Algon is free of any taint from the Debtor, and there are no grounds for establishing cause sufficient to remove Algon and appoint a trustee under § 1104 (a)(1).

However, given the nature and extent of the Debtor's pre-petition conduct, as well as the highly personal, closely-held nature of the underlying businesses, this Court finds that an evidentiary hearing is warranted. With respect to this aspect of the motion, the Court will be seeking evidence as to (a) whether there has actually been a change in management and (if so) whether there is (b) cause for concern regarding Algon's management and (c) whether sufficient safeguards can be established to ensure the Debtor remains divested of control and deprived of any opportunity to engage in fraud, dishonesty, incompetence, or gross mismanagement,

B. Appointment in the Parties' "Interests"– Questions of Fact Regarding Balancing

Even where there is no cause to appoint a trustee pursuant to § 1104 (a)(1), the court may consider whether the appointment is "in the interests of creditors, any equity security holders, and other interests of the estate …." 11 U.S.C. § 1104 (a)(2).[7]

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[6] If evidence developed at the evidentiary hearing indicates that the Debtor is still materially involved in management and/or that there are no practical or legal safeguards sufficient to effectively guard against the Debtor doing so, this Court's analysis would change.

[7] The U.S. Trustee's motion explicitly discusses appointment of a trustee for cause under §1104 (a)(1). (Docket No. 106). The Committee's joinder to the motion advocates for appointment under both §1104 (a)(1) and (a)(2). (Docket No. 140). Appointment under §1104 (a)(2) was extensively addressed and explored at oral argument, with the U.S. Trustee orally adding a request for appointment under that section. The Debtor, through counsel, objected to this amendment as inconsistent with due process. Because this Court finds an evidentiary hearing necessary, any arguable issue of notice/due process is moot. The Debtor has had, and will have, ample opportunity to present evidence and be heard regarding whether the §1104 (a)(2) factors are present.

"[T]he factors constituting a basis for appointing a trustee under § 1104(a)(2) are amorphous, diverse, and necessarily involve a great deal of judicial discretion." *In re V. Savino Oil & Heating Co., Inc*., 99 B.R. 518, 527, n.11 (Bankr. E.D.N.Y. 1989). "The twin goals of the standard for the appointment of a trustee should be protection of the public interest and the interests of creditors …." *Ionosphere Clubs, Inc*., 113 B.R. at 168 (quoting H.R.Rep. No. 595, 95th Cong., 1st Sess. 232 (1977), U.S.Code Cong. & Admin.News 1978, p. 61920); *see also 1031 Tax Grp.*, 374 B.R. at 91 ("In essence, § 1104(a)(2) reflects 'the practical reality that a trustee is needed.'")(quoting *Savino Oil*, 99 B.R. at 527 n. 11)).

Although judicial discretion is broad in this area, courts generally consider the following factors: (i) the trustworthiness of the debtor; (ii) the debtor in possession's past and present performance and prospects of the debtor's rehabilitation; (iii) the confidence—or lack thereof—of the business community and of the creditors in present management; and (iv) the benefits derived by the appointment of a trustee, balanced against the cost of appointment. *See 1031 Tax Grp.*, 374 B.R. at 91 (collecting cases); *In re Sillerman*, 605 B.R. 631, 652 (Bankr. S.D.N.Y. 2019).

Here, if the Debtor remained in control, the elements of trustworthiness and past performance would toll heavily, if not dispositively, in favor of appointing an 1104 trustee. However, this Court's analysis is again impacted by the apparent change in management to Algon. The record lacks evidence to create questions about the trustworthiness and performance of *Algon*.

The advocates of appointment contend that an 1104 trustee is nevertheless appropriate under §1104 (a)(2) due to a complete lack of creditor confidence and trust.

The loss of creditor confidence and/or extreme acrimony is a factor to be considered by the Court under §1104 (a)(2). *See 1031 Tax Grp*., 374 B.R. at 91(noting that "well-founded distrust and a lack of confidence in the Debtors, even with their new management … standing alone, would

point to the appointment of a chapter 11 trustee"); *see also In re Euro–Am. Lodging, Corp*., 365 B.R. 421, 432 (Bankr.S.D.N.Y.2007).

However, the lack of creditor confidence does not *per se* mandate the appointment of a trustee. *See In re Marvel Ent. Grp., Inc*., 140 F.3d 463, 473 (3d Cir. 1998)("We expressly hold that there is no *per se* rule by which mere conflicts or acrimony between debtor and creditor mandate the appointment of a trustee."); *In re LHC, LLC*, 497 B.R. 281, 311 (Bankr. N.D. Ill. 2013)("This Court finds that the mere acrimony between Wells Fargo and the Debtor is insufficient to warrant the appointment of a trustee."); *In re Sundale, Ltd*., 400 B.R. 890, 910 (Bankr. S.D. Fla. 2009)("Neither loss of confidence, however reasonable, or acrimony, however bitter, necessarily results in appointment of a trustee.").

Moreover, the lack of confidence must be rooted in objective fact, rather than mere personal animus. *See Sundale*, 400 B.R. at 910 ("[A] creditor's lack of confidence must be based on some objective fact before a court should consider lack of confidence as a factor in considering appointment of a trustee."); *In re CPESAZ Liquidating, Inc*., No. 9:20-BK-10554-DS, 2022 WL 2719642, at *7 (B.A.P. 9th Cir. July 12, 2022)("[A]s the bankruptcy court observed, 'feelings and perceptions do not rise to the level of evidence establishing cause for what the [courts have] recognized as an extreme remedy.'")(alteration in original); *In re Morningstar Marketplace, Ltd*, 544 B.R. 297, 305 (Bankr. M.D. Pa. 2016)("Lack of confidence must be more than a personal dislike for management and should relate to the objectives of the case.").

Here, the only reason provided for the lack of confidence in *Algon* is the fact that it was selected by the Debtor. For the reasons outlined above, however utterly understandable the creditors' dislike for, and distrust of, the Debtor may be, and however unseemly the creditors may

find it that the Debtor "picked" Algon, there is insufficient justification in the record for transferring those sentiments, and imputing a lack of confidence, to Algon.

Having said that, if the evidentiary hearing develops facts that would give objective cause for the creditors to lack confidence in Algon, then this Court's analysis will change.

In addition, the record is not well developed with respect to several other factors in the §1104 (a)(2) analysis. To wit, this Court has been provided with little information concerning the prospects of rehabilitation, the benefits anticipated from the appointment of a trustee, and the cost of appointment.

In sum, to adequately consider the interests implicated by §1104 (a)(2), this Court needs to assess the likely logistics of, and prospects for, rehabilitation and consider whether and how those logistics and prospects would be impacted by the appointment of an 1104 trustee, as opposed to allowing Algon to continue its work, subject to the oversight of the U.S. Trustee, the Committee, and the Committee's advisor.

Further development of the record is required for a proper determination of these §1104 (a)(2) factors. *See, e.g., Blue Stone*, 392 B.R. at 902, 904-905 (denying appointment of 1104 trustee because "[n]o party in interest was able to articulate any credible difference between the skill set of a Chapter 11 trustee and the skill set that Mr. Oscher would bring to the table as a CRO" and noting that appointment is appropriate "only if the protection afforded by a trustee is needed and expenses of a trustee would not be disproportionately higher than the value of the protection afforded")(citations omitted); *In re Bergeron*, No. 13-02912-8-SWH, 2013 WL 5874571, at *9 (Bankr. E.D.N.C. Oct. 31, 2013)(declining to appoint trustee because there had been "no showing that the benefits accompanying the appointment of a trustee outweigh the detriment to the bankruptcy estate"); *Morningstar Marketplace*, 544 B.R. at 305 ("A court is more likely to appoint

a trustee under § 1104(a)(2) when reorganization is not possible, and a Debtor's principal may be motivated to protect his own interests rather than the interests of creditors."); *In re Eurospark Indus., Inc*., 424 B.R. 621, 632 (Bankr. E.D.N.Y. 2010)(granting appointment because, *inter alia*, "the UST … established, by clear and convincing evidence, that a chapter 11 trustee is in the best interests of the estate because there is no genuine possibility of reorganization …."); *In re Euro-Am. Lodging Corp*., 365 B.R. 421, 432 (Bankr. S.D.N.Y. 2007)(appointing trustee based on finding that a planned sale was more likely to be completed by a trustee).

CONCLUSION

For the foregoing reasons, this Court finds an evidentiary hearing necessary with respect to the United States Trustee's Motion to Appoint a Chapter 11 Trustee or, in the Alternative, to Appoint an Examiner. (Docket No. 106). A Scheduling Order will follow.

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So Ordered.

Signed this 20 day of September, 2023.

Patrick G. Radel
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

M. BURTON MARSHALL,

Debtor.

Chapter 11
Case No. 23-60263-pgr

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MEMORANDUM-DECISION AND ORDER
GRANTING MOTION TO APPOINT A TRUSTEE

Presently pending before the Court is the United States Trustee's Motion to Appoint a Chapter 11 Trustee pursuant to 11 U.S.C. § 1104 (a) or, in the alternative, to Appoint an Examiner under 11 U.S.C. § 1104 (c). (Docket No. 106). The U.S. Trustee's motion was joined by the Official Committee of Unsecured Creditors (Docket No. 140) and is supported by two groups of unsecured creditors. (Docket Nos. 130, 132). The motion was opposed, in part, by the Debtor (Docket No. 137) and Megan Marshall (the Debtor's wife and a creditor). (Docket No. 135). The U.S. Trustee filed a declaration in further support of the motion. (Docket No. 150).

This Court heard oral argument on July 25, 2023, and reserved decision. On July 28, 2023, this Court issued a Memorandum-Decision and Order determining that an evidentiary hearing was necessary. (Docket No. 160).[1]

On August 30, 2023, the parties filed a Stipulation of Facts (Docket No. 195) and Statements of Contested Legal and Evidentiary Issues. (Docket Nos. 196, 197, 198, 199).

[1] On August 16, 2023, this Court ordered (Docket No. 188) that the evidentiary hearing include evidence and arguments regarding Debtor's Amended Application to Employ Algon Capital, LLC d/b/a Algon Group as Financial Advisors. (Docket No. 72). A separate Order will be entered regarding that application.

An evidentiary hearing was held on September 6 and 12, 2023, in Utica, New York. Documents were admitted into evidence by stipulation. (Docket Nos. 206 and 207). The following witnesses testified: Jon Scherr, the Debtor, Troy Taylor, Stephen Douglass, Ron Braver, and John Schuyler.

At the conclusion of the hearing, this Court heard argument and issued an oral ruling granting the motion and appointing a trustee pursuant to § 1104 (a)(1) of the Bankruptcy Code. This Memorandum-Decision and Order provides the reasons for that ruling.

JURISDICTION

This Court has core jurisdiction over the parties and the subject matter of this contested matter in accordance with 28 U.S.C. §§ 1334(b) and 157(b)(2). Venue is proper in this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

BACKGROUND

Familiarity with this Court's prior Memorandum-Decision and Order (Docket No. 160), which sets forth the factual and procedural history, is presumed.

In sum, the parties stipulated to the following facts: The Debtor operates a series of sole proprietorships, including tax preparation, self-storage, printing, insurance brokering, property maintenance, and real estate rentals of over 100 properties (containing over 240 residential units) located in Central New York, principally in Madison County. (Docket No. 195, at ¶ 11). He is the sole shareholder of an insurance agency organized as a corporation, which has not sought bankruptcy protection. (Docket No. 195, at ¶ 14).

The Debtor filed a Petition for Relief under Chapter 11 of the Bankruptcy Code on April 20, 2023. (Docket No. 195, at ¶1). He disclosed assets of $21,854,009.89 against liabilities of $92,746,873.06. (Docket No. 195, at ¶17). Most of the debt consists of unsecured promissory notes issued to individuals, including friends, neighbors, customers, clients, and family members. (Docket No. 195, at ¶ 17).

Numerous creditors believe they are victims of a wide-ranging, long-standing Ponzi scheme,[2] wherein they were promised an 8% return for investing in a fund the Debtor claimed to be maintaining. (Docket No. 195, at ¶ 18). The Debtor denies any fraud and claims these debts were loans he intended to repay. (Docket No. 195, at ¶ 19).

DISCUSSION

A. Legal Standard

Section 1104 of the Bankruptcy Code provides, in pertinent part, that, upon motion of the U.S. Trustee or a party in interest, and after notice and hearing, the Court "shall" order the appointment of a trustee "for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management" or if "such appointment is in the interests of creditors, any equity security holders, and other interests of the estate…." 11 U.S.C. § 1104 (a)(1) & (2).

A Chapter 11 debtor usually remains in control of its property and operations during a bankruptcy as a debtor-in-possession. The appointment of a trustee is "the exception, rather than the rule." *In re Adelphia Commc'ns. Corp*., 336 B.R. 610, 655 (Bankr. S.D.N.Y. 2006) (quoting *In*

[2] "The term 'Ponzi scheme' is named after Charles Ponzi, who developed a 'remarkable criminal financial career' by convincing people to invest in his fake international postal coupons business." *In re Bernard L. Madoff Inv. Sec. LLC*, 12 F.4th 171, 179 n.1 (2d Cir. 2021)(quoting *Cunningham v. Brown*, 265 U.S. 1, 7, 44 S.Ct. 424, 68 L.Ed. 873 (1924)).

re Sharon Steel Corp., 871 F.2d 1217, 1225 (3d Cir. 1989)). "There is a strong presumption that the debtor should be permitted to remain in possession absent a showing of need for the appointment of a trustee." *In re Ionosphere Clubs, Inc*., 113 B.R. 164, 167 (Bankr. S.D.N.Y. 1990); *see also In re Univ. Heights Ass'n, Inc*., No. 06-12672, 2007 WL 316281, at *2 (Bankr. N.D.N.Y. Jan. 22, 2007)("The appointment of a § 1104 trustee is an extraordinary remedy.").

"[T]he standard for § 1104 appointment is very high...." *In re Smart World*, 423 F.3d 166, 176 (2d Cir. 2005). "The U.S. Trustee has the burden of showing by 'clear and convincing evidence' that the appointment … is warranted." *In re Bayou Grp., LLC*, 564 F.3d 541, 546 (2d Cir. 2009).[3]

The court is required to appoint a trustee upon a showing of "cause." 11 U.S.C. § 1104 (a)(1). "Although the court's finding is limited to a factual determination [as to] whether 'cause' exists, a court is given wide latitude in determining whether the challenged conduct rises to the level of 'cause.'" *In re The 1031 Tax Grp., LLC*, 374 B.R. 78, 86 (Bankr. S.D.N.Y. 2007)(citing *Comm. of Dalkon Shield Claimants v. A.H. Robins Co., Inc*., 828 F.2d 239, 241–42 (4th Cir. 1987)).

The court may consider both pre-petition and post-petition misconduct when deciding whether cause exists. *See* 11 U.S.C. §1104 (a)(1)(defining cause as "including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, *either before or after* the commencement of the case")(emphasis added); *see also 1031 Tax Grp.,* 374 B.R. at 86; *In re Anchorage Boat Sales, Inc*., 4 B.R. 635, 644–45 (Bankr. E.D.N.Y. 1980).

[3] The U.S. Trustee argues that the Supreme Court's decision in *Octane Fitness, LLC v. ICON Health & Fitness*, 134 S. Ct. 1749 (2014) casts doubt on the continued validity of *Bayou Group*. The U.S. Trustee contends that preponderance of the evidence is the appropriate standard. This Court need not resolve this question as the U.S. Trustee satisfied the clear and convincing evidence standard.

B. Analysis

In its prior decision, this Court determined that cause sufficient to mandate the appointment of a trustee under §1104 (a)(1) had been established with respect to the Debtor. (Docket No. 160, at p. 6-7). That finding is incorporated herein.

In sum, it is undisputed that the Debtor incurred more than $90 million dollars in unsecured debt (much of it from friends and neighbors) while operating small businesses engaged in relatively modest pursuits (tax preparation, insurance sales, printing, property management) in a rural community in upstate New York. There is no credible or conceivable explanation for this circumstance that does not entail fraud, dishonesty, incompetence, and/or gross mismanagement by the Debtor.

However, as discussed in this Court's prior decision, the situation is complicated by the fact that the Debtor claims to have ceded control over his businesses to his financial advisor, Algon Capital, LLC, d/b/a Algon Group. The Debtor argues that Algon is "current management" and there is no cause for an 1104 trustee because there had been no showing of fraud, dishonesty, incompetence, and/or gross mismanagement *by Algon*.

This Court determined that an evidentiary hearing was needed to resolve this argument. *See 1031 Tax Grp.*, 374 B.R. at 86 ("When considering whether to appoint a trustee for cause, a court's focus is on the debtor's current management, not the misdeeds of past management.").

For the following reasons, this Court finds that it is not legally possible, or practically feasible, to separate the Debtor's businesses from the Debtor himself, as would be necessary to consider the businesses under new "management." As such, this Court finds clear and convincing evidence of cause sufficient to require the appointment of a trustee under 1104 (a)(1) of the Bankruptcy Code.

1. Legal Impossibility

This is a Chapter 11 filing by an individual debtor. Although one might refer to the Debtor's various businesses as distinct entities or enterprises, "a sole proprietorship has no legal existence apart from its owner." *Lattanzio v. COMTA*, 481 F.3d 137, 140 (2d Cir. 2007).

Furthermore, a sole proprietorship is not a "person" within the meaning of the Bankruptcy Code and cannot be a debtor in bankruptcy. *See In re Know Thy Self, Inc*., No. 06-62628, 2006 WL 6589908, at *3 (Bankr. N.D. Ga. Mar. 17, 2006)("A proprietorship is not a person apart from the individual who owns it and cannot file bankruptcy in its own name."); *In re Drimmel*, 108 B.R. 284, 287 (Bankr. D. Kan. 1989), *aff'd*, 135 B.R. 410 (D. Kan. 1991), *aff'd sub nom. Unruh v. Rushville State Bank of Rushville, Mo*., 987 F.2d 1506 (10th Cir. 1993)("Quite simply, the reason there is no separate legal definition for a sole proprietor's interest in his or her business is that none is necessary where only one person owns a business … '[t]he business and the proprietor are one.'"); *see also In re KRSM Properties, LLC*, 318 B.R. 712, 717 (B.A.P. 9th Cir. 2004); *In re Christenberry*, 336 B.R. 353, 356 (Bankr. E.D. Tenn. 2005*); In re Phillips*, No. 19-30566-KKS, 2020 WL 4001038, at *2 (Bankr. N.D. Fla. June 12, 2020).

In its initial decision, this Court noted authority for the proposition that a bankruptcy court may look beyond formal corporate governance structure to the practical reality of a debtor's operations when deciding whether to recognize a change in management. (Docket No. 160, at p. 10-13); *see, e.g., In re Real Est. Partners, Inc.,* No. SA 07-13239 TA, 2007 WL 7025114, at *5 (Bankr. C.D. Cal. Nov. 20, 2007), *aff'd*, No. SA CV 07-1440 ODW, 2009 WL 3246619 (C.D. Cal. Oct. 5, 2009); *In re Blue Stone Real Est., Const. & Dev. Corp*., 392 B.R. 897, 902 (Bankr. M.D. Fla. 2008).

Upon further reflection and after additional briefing, evidence, and argument, this Court finds that this authority is not applicable to cases involving an individual debtor doing business as a sole proprietor. Recognizing a change in "management" of the Debtor would involve more than merely overlooking (or working around) a formality of corporate governance. It would require recognition of the sole proprietorships as entities in themselves, distinct from the Debtor. This is not possible or permitted under applicable law.

In addition, the Debtor is effectively arguing that he has been replaced as the debtor-in-possession, with Algon being empowered to manage the "businesses" as the true debtor-in-possession. This is an outcome outside the power of this Court to impose on the parties.

"[A] Chapter 11 reorganization contemplates only two possible scenarios for control of the debtor's business operations: a debtor in possession, or a debtor out of possession." *In re Casco Bay Lines, Inc*., 17 B.R. 946, 951 (B.A.P. 1st Cir. 1982). "The latter situation contemplates and mandates the appointment of a trustee." *Id.*

In other words, "either the debtor must be in control, or the court will authorize the appointment of a trustee to take control of the debtor's affairs." *Id.*; *see also In re Adelphia Commc'ns Corp*., 336 B.R. 610, 664 (Bankr. S.D.N.Y. 2006), *aff'd*, 342 B.R. 122 (S.D.N.Y. 2006)("Using section 105(a) to appoint a fiduciary to act as a trustee shorn of the name, but with few other substantive differences, would be the exact kind of wrongful judicial action that the Second Circuit has forbidden. Section 1104 already provides for two kinds of fiduciaries, trustees and examiners.").

In sum, the Debtor's argument that he has allowed Algon to replace him as "management" (a) assumes a distinction between the Debtor and his businesses that is not recognized by the law

and (b) asks this Court to engineer a debtor-in-possession governance structure outside of the options authorized by the Code. The Debtor's argument must therefore fail.

2. Practical Infeasibility

In addition and in the alternative, even if one could accept the concept of Algon as new "management," the evidence establishes that the Debtor retains vestiges of control and that Algon cannot act as an independent fiduciary with respect to this Chapter 11 case.

a. Vestiges of Control

Evidence produced at the evidentiary hearing belies the assertion that the Debtor has been completely removed from control and causes concern that there could be a continuation of the pre-petition fraud, dishonesty, incompetence, or gross mismanagement. *See Real Est. Partners, Inc*., 2007 WL 7025114, at *4 ("In a case by case approach the Court can evaluate the crucial factors of whether there is a taint, *whether prior management still has vestiges of control*, whether the designated fiduciary is a known or an unknown and whether the designated fiduciary has the reputation and competence needed for the engagement.")(emphasis added).

To wit, while the Debtor ceded check-writing and decision-making authority for some of his businesses to Algon, he remained in control of a separate bank account and solely responsible for his personal finances. The Debtor testified that he was responsible for supervising the work of his employees.[4] He also continued to participate in the day-to-day operations of his businesses in worrisome ways, including handling cash, withdrawing funds from business accounts, accessing computer systems, and shredding documents.

[4] Although Algon's representative testified that he believed they were responsible for employee supervision, the lack of clarity on this critical question is of material concern. At a minimum, it shows that the lines of authority between Algon and the Debtor are not firmly established and/or well-understood.

b. Algon as Fiduciary

In addition, even assuming *arguendo* that Algon can be considered new management, it must still be able to fulfill the fiduciary duties of a debtor-in-possession with impartiality and independence. *See In re V. Savino Oil & Heating Co., Inc*., 99 B.R. 518, 526 (Bankr. E.D.N.Y. 1989)("The willingness of Congress to leave a debtor-in-possession is premised on an expectation that current management can be depended upon to carry out the fiduciary responsibilities of a trustee. And if the debtor-in-possession defaults in this respect, Section 1104(a)(1) commands that the stewardship of the reorganization effort must be turned over to an independent trustee.").

The Debtor bears the burden of showing that Algon "is unconflicted by any association with" him. *1031 Tax Grp.*, 374 B.R. at 88; *cf. also Real Estate Partners*, 2007 WL 7025114, at *4 (denying motion for 1104 trustee where new manager "has absolutely no connection to prior management, is in no way beholding to them and can serve as the kind of fiduciary that the case needs").

Although Algon is not complicit in, or tainted by, the Debtor's pre-petition conduct, Algon has not acted, and is not able to act, as an independent fiduciary. Algon's loyalty lies with the Debtor.

Algon's retainer agreement requires the Debtor to indemnify Algon, mandates that Algon keep information confidential, and states that Algon will notify the *Debtor* if it discovers any "potential conflict of interest …." (Debtor's Exhibit 4). Algon allowed the Debtor to handle cash (including making cash withdrawals from the businesses), and permitted him unfettered, unmonitored access to business records and a document shredder. Algon's representatives repeatedly consulted with Debtor's counsel (and followed his directives) regarding the manner, timing, and extent of disclosures to the Creditors' Committee and its financial advisor.

Most significantly, during an interview of the Debtor by HKA Global (the Committee's financial advisor), Algon's representative (on his own initiative) contacted Debtor's counsel and then instructed the Debtor not to answer certain questions, on the advice of counsel, presumably because counsel believed answering the questions would be against Debtor's interest. Algon was also involved in the belated discovery and disclosure of estate assets, including a bank account opened by the Debtor post-petition and a safe containing valuables that was not disclosed on Debtor's Schedules.

Algon's attitude and actions have led to a breakdown in the trust and transparency necessary to sustain a productive working relationship with the other parties in interest. In this regard, it is notable that the Creditors' Committee and two other groups of creditors vigorously support the U.S. Trustee's motion for an 1104 trustee. The only creditor opposing the motion is the Debtor's spouse.

Algon sought to allay these concerns by insisting that it is working for the "estate" and asserting that it is not conflicted because all parties are seeking to maximize the distribution to creditors. However, Algon's retention is proposed by, and its engagement is with, the Debtor, whose interests are not always aligned with his creditors. Although one need not question Algon's intentions, one should not share its optimistic assessment of the invariable unity of its interests with those of the estate.

This divergence of interests is especially to be expected when recognizing that a significant source of recovery will likely be avoidance actions arising from a full investigation of suspected fraud. The Debtor and Algon (as an entity retained by the Debtor and in regular consultation with his counsel) are not appropriately suited to pursue these possible paths to recovery. *See In re Sillerman*, 605 B.R. 631, 647 (Bankr. S.D.N.Y. 2019)("Tasking the individual debtor with the

responsibility of bringing avoidance actions against a family member or an entity in which the debtor has a substantial interest may be daunting. Moreover, the temptation for self-dealing may be heightened in the case of an individual debtor whose natural instinct is to protect his own self-interest.")*; In re Microwave Prod. of Am., Inc*., 102 B.R. 666, 676 (Bankr. W.D. Tenn. 1989)("[B]ecause the debtor is not in a strong posture to pursue possible claims that may have resulted from conflicts of interest and fraudulent transfers, a trustee would likely be able to investigate claims that could result in additional sums of money coming into the estate."); *see also Wabash Valley Power Ass'n, Inc. v. Rural Electrification Admin*., 903 F.2d 445, 451 (7th Cir. 1990)("We are surprised that the bankruptcy judge has allowed Wabash to operate as debtor in possession, when the clash of interests between creditors and its current management is so obvious."); *In re Ashley River Consulting, LLC*, No. 14-13406 (MG), 2015 WL 1540941, at *10 (Bankr. S.D.N.Y. Mar. 31, 2015)(finding cause for an 1104 trustee where "the Debtors' and their current management's post-petition conduct before this Court has fallen short of forthcoming").

In sum, while Algon is well-qualified to perform many of the services necessary for an effective reorganization, its relationship with the Debtor precludes it from performing the duties of an independent fiduciary with the requisite loyalty and accountability to the bankrupt estate. Such a fiduciary plays an important part in any Chapter 11; it is vital in a case such as this – "a large and messy bankruptcy that promises to get worse without a disinterested administrator at the helm." *Matter of Cajun Elec. Power Co-op., Inc*., 69 F.3d 746, 751 (5th Cir. 1995), *opinion withdrawn in part on reh'g*, 74 F.3d 599 (5th Cir. 1996).

A trustee appointed pursuant to § 1104 (a)(1) will serve this critical role and provide the necessary confidence to the Court and parties in interest. *See, e.g., In re Marvel Ent. Grp., Inc*., 140 F.3d 463, 473 (3d Cir. 1998)("Having found that this unhealthy conflict of interest was

manifest in the 'deep-seeded conflict and animosity' between the Icahn-controlled debtor and the Lenders and in the lack of confidence all creditors had in the Icahn interests' ability to act as fiduciaries, the district court did not depart from the proper exercise of discretion when it determined sufficient cause existed under § 1104(a)(1) to appoint a neutral trustee to facilitate reorganization.").

CONCLUSION

For the foregoing reasons, the United States Trustee's Motion to Appoint a Chapter 11 Trustee (Docket No. 106) is GRANTED pursuant to 11 U.S.C. §1104 (a)(1).[5]

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[5] The proponents of this motion also argue that appointment of a trustee is warranted under § 1104 (a)(2). This Court's ruling renders that portion of the motion moot.

Faculty

Hon. Jeffery A. Deller is a U.S. Bankruptcy Judge for the Western District of Pennsylvania in Pittsburgh, appointed in 2005. From 2013-18, he served as Chief Judge. He was the lead judicial officer assigned to over 40,000 cases and oversaw the day-to-day operations of the court. Some of the notable cases over which Judge Deller has presided include the corporate restructuring of the iconic hotel formerly known as the Pittsburgh Hilton, the sale of natural gas and exploration company Rex Energy and its affiliates, the reorganization of the Pittsburgh Riverhounds professional soccer team, the sale of the historic Pittsburgh Athletic Association, the reorganization of Pittsburgh's largest taxi operator Pittsburgh Transportation Group, and the reorganization of the Trustees of Conneaut Lake Park, Inc. He also served as the judicial mediator in hundreds matters, mediating most of the avoidance actions arising out of one the largest financial fraud cases in the Western District of Pennsylvania, Le-Nature's, Inc. Prior to his appointment, Judge Deller was a shareholder in the bankruptcy and insolvency practice group at Klett Rooney Lieber & Schorling, P.C. While in private practice, some of his representations included representing the University of Pittsburgh Medical Center Health System (UPMC) in connection with its $100 million acquisition of the assets of St. Francis Hospital, serving as counsel to the unsecured creditors' committees of various chapter 11 cases (including the cases filed by National Record Mart and Arcadia Energy Corp.), and serving as advisor to most of the Pittsburgh region's banks and financial institutions with respect to bankruptcy and loan workout matters. Judge Deller is a prior recipient of the Allegheny County Bar Association's Young Lawyer of the Year Award. He also is a contributing author to West's *Pennsylvania Forms: Debtor-Creditor*, a forms guide and treatise for practitioners. Judge Deller received his B.A. in economics and political science from the University of Pittsburgh and his J.D. *cum laude* from Duquesne University School of Law, where he served as a member of *The Duquesne Law Review* and was the recipient of the *American Bankruptcy Law Journal* Prize awarded by the National Conference of Bankruptcy Judges and the Gerald K. Gibson Memorial Award granted by the Bankruptcy and Commercial Law Section of the Allegheny County Bar Association.

Michelle A. Dreyer is managing director of CSC's Global Financial Markets business in Wilmington, Del., leading the company's Independent Director and Restructuring services. During her tenure with CSC, she has served in a variety of roles, including administrative manager for special-purpose vehicles and trust administrator. Ms. Dreyer serves as an independent director for both bankruptcy remote entities, other SPVs and distressed companies, and in this capacity she has participated in many complex distress matters, including General Growth Properties, Sears Holding Corp. and Medley LLC. In addition, she has managed post-effective date creditor trusts for Knotel, Inc., Boy Scouts of America and WeWork, Inc. Ms. Dreyer is a member of ABI and the International Women's Insolvency & Restructuring Confederation (IWIRC). She received her B.S. in finance with honors from Kent State University and her J.D. *cum laude* from Taft Law School.

Jeffrey N. Rothleder is partner in Squire Patton Boggs (US) LLP's Restructuring and Insolvency practice group in the firm's Washington, D.C., office, where his practice focuses on financial restructuring, corporate trust matters and workout proceedings on behalf of financially distressed companies or their creditors, including the representation of debtors, indenture trustees, creditors and creditors' committees, investors and purchasers in in-court and out-of-court restructurings. Mr. Rothleder

represents a wide variety of clients in the enforcement of the entire spectrum of creditors' rights involving secured, unsecured, public or private, and taxable and tax-exempt debt through his work with indenture trustees, lenders, individual creditors and official committees in chapter 11 cases. He also has experience representing debtors, including the restructuring of large companies through the chapter 11 process or conducting the orderly liquidating and comprehensive asset sales for a diverse group of companies. Mr. Rothleder received his B.A. from the University of Michigan in 1999 and his J.D. from the University of Maryland School of Law in 2002 with honors, where he was a member of the Order of the Coif.

Sara C. Temes is a member of Bond Schoeneck & King, PLLC in its Syracuse, N.Y., office, where she focuses her practice on a wide range of restructuring matters throughout New York State, including out-of-court workouts, cross-border insolvency cases and representations of debtors, creditors, creditors' committees, landlords, lenders and purchasers in chapter 11 cases. She also advises senior managers and boards of directors of financially troubled companies with respect to turnaround strategies. Ms. Temes has been recognized in *Super Lawyers* as a "Rising Star" in the area of business bankruptcy for 2019-23 and as a "Rising Star" for 2018, and she has been listed in *The Best Lawyers in America* for Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law since 2023. She also serves on the Local Bankruptcy Rules Standing Committee for the U.S. Bankruptcy Court for the Northern District of New York. Prior to joining Bond, Schoeneck & King, she was an associate at Weil, Gotshal & Manges LLP in New York. Ms. Temes received her B.A. from Wellesley College and her J.D. from the University of Pennsylvania Law School.

Andrew R. Vara is the U.S. Trustee for Regions 3 and 9 in Cleveland, which encompass 10 field offices in Delaware, New Jersey, Pennsylvania, Ohio and Michigan. He has worked for the U.S. Department of Justice for 30 years, serving as a trial attorney, Assistant U.S. Trustee in Cleveland and Wilmington, Del., and the acting assistant U.S. Trustee in both the Southern District of New York and Western District of Michigan. Following law school, Mr. Vara clerked for Hon. Laurence Howard, Chief Judge for the U.S. Bankruptcy Court in Grand Rapids, Mich. He also is a regular faculty member and lecturer at training seminars held at the National Advocacy Center in Columbia, S.C. Mr. Vara has been a panelist at numerous ABI conferences, including its Annual Spring Meeting, Winter Leadership Conference, Mid-Atlantic Bankruptcy Workshop and Central States Bankruptcy Workshop. He was a member of the ABI's Ethics Task Force and chaired ABI's Ethics and Professional Compensation Committee. Mr. Vara served as a presenter on U.S. and international insolvency law at forums sponsored by the Commercial Law Development Program in Bahrain and the Kingdom of Saudi Arabia. He received his B.A. *magna cum laude* in political science from Duke University and his J.D. with honors from The Ohio State University in May 1991, where he was awarded membership in the Order of the Coif.