LEGAL UPDATES

PUBLISHED: NOVEMBER 11, 2022

# FTX Files for Bankruptcy: Industry Contagion Possible

## Services

Crypto, Digital Assets, & Blockchain

Insolvency & Commercial Bankruptcy

## Professional

MICHAEL A. BRANDESS

CHICAGO:

312.526.1542

MICHAEL.BRANDESS@HUSCHBLACKWELL.COM

On Friday, November 11, 2022, FTX and approximately 130 of its affiliates filed, or will soon file, Chapter 11 bankruptcy petitions in the District of Delaware. FTX's CEO, Sam Bankman-Fried, also known as SBF, who until recent days had enjoyed celebrity status and deep industry credibility, resigned as part of FTX's bankruptcy filing. It is unclear at this time whether SBF will face potential criminal liability.

FTX's filing is surprising even with the rash of crypto industry bankruptcies this year; however, in recent days, there have been concerningreports about FTX's financial wherewithal and management. Due to FTX's significant size, the potential for its problems to cascade throughout the industry due to the exposure of large market players to FTX will further cloud the industry's difficult year. For example, former "blue-chip" crypto unicorn BlockFi has also announced that it is halting withdrawals due to FTX's troubles just a few months after FTX bailed BlockFi out of its liquidity challenges. Over the past few years, FTX had grown into one of the more meaningful market players and enjoyed widespread attention, in part due to its public endorsements from celebrities such as Tampa Bay Buccaneers quarterback Tom Brady, Golden State Warriors guard Steph Curry, and NBA Hall of Famer Shaquille O'Neal.

The list of crypto bankruptcies attributable to liquidity problems continues to grow. To date, Three Arrows Capital, Babel Finance, CoinFLEX, Voyager, Hodlnaut, and Celsius Network's bankruptcy filings reveal that cryptocurrency-based centralized financial platforms present significant investor risk unless they are able to demonstrate not only "proof of reserves" but also substantiate transaction history in real-time to confirm the availability of those reserves. Investors must also be able to self-custody their crypto-based value until investor protections are in place. The bankruptcy proceedings facing Celsius, FTX, and other industry players has clarified that the platforms' issues can significantly diminish investor recoveries, likely leaving many with fractions of their initial investments.

While many investors believe that the crypto industry will enjoy a resurgence at some point in the coming months or years, it is apparent that the federal government must quickly establish more definitive investor safeguards and a clear regulatory framework. While the Biden administration has directed federal agencies to develop recommendations for crypto regulation, the passage and implementation of legislation is likely to take at least several years. In the interim—and for the foreseeable future—it is advisable to consider maintaining cryptocurrency off of centralized exchanges in a more secure digital hard wallet. Alternatively, investors should store any crypto holdings with centralized exchanges that can verify that their assets are backed one-to-one by the exchanges' assets and undergo frequent third-party audits, such as Wyoming-based Kracken and Avanti, which enable customers to see their holdings in real-time from their website and are also state-licensed institutions. Due to the market turmoil, many in the industry are pushing to make proof of reserves and real-time audits the industry standard.

### What this means to you

The bankruptcy proceedings facing Celsius, FTX, and other industry players has clarified that the platforms' issues can significantly diminish investor recoveries, likely leaving many with fractions of their initial investments.

### Contact us

Husch Blackwell's team of blockchain attorneys will continue to monitor industry developments and keep its crypto clients apprised. Should you have bankruptcy, blockchain, or cryptocurrency related questions, please contact our team of blockchain professionals Michael Brandess, Miguel Suazo, Iana Vladimirova or your Husch Blackwell attorney.