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INSIGHT · CORPORATE GOVERNANCE

Q4 2022 Legal Review: The FTX Collapse, Insolvency Clawbacks, and the Battle Over Digital Asset Custody

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The November 2022 Chapter 11 filing of FTX and its affiliated debtors created a watershed moment in corporate governance, commingling litigation, and bankruptcy avoidance actions.

In the fourth quarter of 2022, the sudden insolvency and Chapter 11 filing of FTX Trading Ltd. and over one hundred affiliated entities in the District of Delaware sent shockwaves through global finance and corporate litigation. The failure illuminated profound governance vacuums, commingling of customer funds, and initiated massive avoidance litigation under the U.S. Bankruptcy Code.

I. The Anatomy of Corporate Failure and Governance Breakdown

When FTX collapsed in November 2022, the appointment of veteran restructuring CEO John J. Ray III revealed an unprecedented lack of corporate controls, internal auditing, and board oversight. The debtors' initial filings described complete absences of cash management systems, unvetted intercompany lending between FTX and Alameda Research, and undocumented corporate transfers totaling billions of dollars.

The failure prompted immediate criminal indictments in the Southern District of New York for wire fraud, conspiracy to commit securities fraud, and money laundering, alongside parallel regulatory enforcement actions by the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC).

II. Bankruptcy Clawbacks & Custodial Property Ownership

The central legal issue in the FTX insolvency and similar crypto bankruptcies (such as Celsius Network and Voyager Digital) centers on property of the estate under 11 U.S.C. § 541. Courts were tasked with determining whether deposited digital assets were held in trust for account holders or constituted general unsecured estate property governed by exchange terms of service.

Furthermore, Chapter 11 debtors initiated aggressive clawback actions under 11 U.S.C. §§ 547 (preferential transfers) and 548 (fraudulent transfers), seeking to recover billions in withdrawals made by institutional investors, celebrity endorsers, and political entities in the 90-day preference period preceding bankruptcy.

III. Corporate Governance Takeaways for Commercial Counsel

The collapse underscored foundational corporate governance principles for tech and emerging growth companies:

- **Fiduciary Duty of Oversight:** Corporate directors face severe liability under *Caremark* and California corporate law if they fail to implement reporting and internal monitoring systems for enterprise risk and asset custody.
- **Segregation of Client Funds:** Commingling customer deposits with corporate operational capital destroys the corporate veil and gives rise to direct tortious conversion and fraud claims against individual corporate officers.
- **Commercial Due Diligence:** Venture capital funds, corporate partners, and counterparties must conduct forensic transactional diligence rather than relying on unaudited representations when executing significant financing rounds or mergers.

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