

Restructuring & Insolvency Newsletter

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FTX Chapter 11 from Japanese Law Perspective (1)

- I. Major stakeholders' rights against FTXJ and the JFSA's orders
- II. Effects of the commencement of FTXJ's Chapter 11 in Japan

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FTX Trading Ltd. (“**FTX**”) and its affiliates, which operated one of the largest cryptocurrency exchanges in the world through the FTX.com platform, filed for Chapter 11 in the United States on November 11 of this year. With its more than 100 group companies being in the proceedings, FTX’s Chapter 11 could affect numerous creditors and customers of the cryptocurrency exchanges.¹

FTX Japan K.K. (“**FTXJ**”), one of several Japanese companies in the FTX group, operated a registered cryptocurrency exchange providing residents of Japan the ability to trade cryptocurrencies and their derivatives. As a Crypto-Asset Exchange Service Provider (a “**CAESP**”), FTXJ is subject to regulatory supervision by the Financial Services Agency of Japan (the “**JFSA**”). As described in section I. below, the several orders issued by the JFSA to FTXJ upon its filing for Chapter 11 have significantly impacted on FTXJ’s authority to conduct its business as a CAESP and to manage the cryptocurrencies and cash it holds for the benefit of its customers.

In light of high-profile nature of the case and the number of stakeholders involved as well as potential legal issues in Japan brought by the future development of FTXJ’s Chapter 11 process, we plan to release a series of articles focusing on FTX case from Japanese law perspective. As the first issue of the series, this article addresses, from the perspective of Japanese laws, (i) rights that FTXJ’s major creditors have against FTXJ and the impact of the JFSA’s orders thereon, and (ii) the effects of the commencement of FTXJ’s Chapter 11 in Japan

¹ Court documents can be found on the online docket service provided by Kroll (<https://restructuring.ra.kroll.com/FTX/Home-DocketInfo>) (the “**Docket**”).

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including the recently announced planned sale of FTXJ's business.²

I. Major stakeholders' rights against FTXJ and the JFSA's orders

1. Customers who deposit cryptocurrencies or cash

The Payment Services Act (the "PSA") provides a high level of protection for CAESPs' customers. CAESPs operating in Japan are generally required to manage cryptocurrencies that they hold for the benefit of customers in so-called cold wallets (Article 63-11, Paragraph 2 of the PSA). Although the right that customers depositing cryptocurrencies with CAESPs have against those providers is usually interpreted as a right in personam, not in rem, to demand the return of their deposited cryptocurrencies (see Tokyo District Court, August 5, 2015, *Hei 26 (wa) No. 33320*, Westlaw Japan 2015WLJPCA08058001),³ the PSA provides that customers shall be prioritized over other creditors with regard to such right (Article 63-19-2, Paragraph 1 of the PSA). This provision is generally interpreted to provide a lien to customers for the right to have their deposited cryptocurrencies returned.

As for cash deposited with CAESPs, customers usually have the right to withdraw it in accordance with the contracts they enter into with those providers. In order to protect customers' rights even in the event of CAESP's insolvency, CAESPs are obliged to segregate customers' cash from its own cash by entrusting the former with third parties such as trust companies (Article 63-11, Paragraph 1 of the PSA), with customers being beneficiaries of the trusts created (Article 26, Paragraph 1 of the Cabinet Office Order on Crypto-Asset Exchange Service Providers).

On November 10, 2022, the JFSA issued several administrative orders upon the commencement of FTXJ's Chapter 11, among which are an order to suspend FTXJ's business as a CAESP and another ordering it to maintain assets in Japan that are equivalent to the amount of liabilities to be recorded on the company's balance sheet, less the amount of its liabilities to non-residents. The initial December 9, 2022 expiration date of these orders has been extended to March 9, 2023.

² Given the unclarity of the facts about and background of FTX's Chapter 11, as well as of how the proceedings will develop in the future, the descriptions and analysis in this article may be subject to changes depending on such future developments.

³ It is pertinent to note that the customer in this case did not have the private key for the wallet that the cryptocurrency at issue belonged to.

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An interesting question is how the abovementioned rights and protections given to Japanese customers under the PSA are treated in Chapter 11 under the current circumstances. In this regard, it is important to note that FTXJ announced on December 1 that cryptocurrencies and cash deposited by customers with FTXJ are not included in the property subject to Chapter 11, taking into consideration the method of deposit and custody of these assets as well as the nature of customers' rights under Japanese law, and that FTXJ plans to resume services for the disbursement of cryptocurrencies and withdrawal of cash as part of its normal operations.⁴

2. Commercial creditors

The PSA does not provide any protection over commercial creditors of FTXJ, such as vendors, suppliers, lessors and landlords (if any). Because the commencement of FTXJ's Chapter 11 itself does not automatically affect such commercial creditors' rights against the company (as explained in section II.), those commercial creditors are in theory able to exercise their contractual rights against it.

II. Effects of the commencement of FTXJ's Chapter 11 in Japan

1. Automatic stay

In the U.S., filing for Chapter 11 imposes an automatic stay on debtors' creditors, and essentially hits the pause button on all sorts of cash disbursements, other lawsuits, etc.

In Japan, however, the effects of foreign insolvency proceedings like Chapter 11 that include an automatic stay do not automatically extend to domestic properties. In order for foreign insolvency proceedings to take effect for rights holders in this country, an order of recognition of those proceedings must first be obtained from the Tokyo District Court under the Act on Recognition of and Assistance for Foreign Insolvency Proceedings (the "RAFIP Act"). Upon or

⁴ <https://help-jp.ftx.com/hc/ja/articles/13054195917593-%E3%82%B5%E3%83%BC%E3%83%93%E3%82%B9%E5%BE%A9%E6%97%A7%E3%81%AB%E5%90%91%E3%81%91%E3%81%9F%E5%8F%96%E7%B5%84%E3%81%BF%E3%81%AB%E3%81%A4%E3%81%84%E3%81%A6>

It is also pertinent to note that an interim order granted on November 23 provides that the "Debtors shall not unfreeze any 'FBO' or custodial accounts held for the benefit of others without further order of the Court," while authorizing the debtors to, among other things, operate a post-petition cash management system, maintain existing business forms, and perform intercompany transactions (see Doc. 145 of the Docket).

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after the issuance of an order of recognition, the court may, when it finds it necessary to achieve the purpose of recognizing foreign insolvency proceedings, order relief or assistance upon petition by the interested persons or by its own authority. Specific relief/assistance includes:

- (a) Suspension or revocation of compulsory execution or court proceedings already conducted with respect to the debtor's property in Japan.
- (b) Suspension of execution of security interests or other such proceedings already conducted with respect to the debtor's property in Japan.
- (c) General prohibition of compulsory execution or other such proceedings with respect to the debtor's property in Japan.
- (d) Prohibition of disposition and payment with respect to the debtor's businesses and property in Japan.
- (e) Issuance of administration orders exclusively conferring the right to dispose of businesses and property onto the recognized trustee (please note that court permission is additionally required for the appointed trustee to dispose of property or remove it from the country).

Thus, an automatic stay for FTXJ can only be extended to Japan only through such relief/assistance granted by the Tokyo District Court. In this regard, the court's practice has been that only an order of general prohibition of compulsory execution or other such proceedings with respect to the debtor's property (item (c) above) is issued in cases where the foreign insolvency proceedings do not deprive the debtor's existing management of its authority to manage the company during the process as is the case in Chapter 11 (so-called debtor-in-possession proceedings).

Given that there has never been a public announcement that a recognition order for FTXJ's Chapter 11 is granted, none of the rights or claims of FTXJ's creditors in Japan have been legally affected by the commencement of the Chapter 11 process to date.

2. Reorganization plan and 363 sale

Unlike Chapter 15 in the U.S., the RAFIP Act does not entail any mechanisms to recognize or enforce the effects of reorganization plans that have already been endorsed by courts in foreign insolvency proceedings. Rather, such endorsement is effectuated in Japan through the application of Article 118 of the Code of Civil Procedure (the "**CCP**"), which sets forth that foreign court

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decisions (interpreted to include foreign courts' approval on reorganization plans) are binding in Japanese civil lawsuits under certain requirements. This means that Japan does not have any legal regime which confirms that a foreign plan is generally and collectively binding for any relevant parties – the bindingness of a foreign court decision approving a reorganization plan (i.e. whether the decision meets all the requirements under Article 118 of the CCP) can be confirmed by Japanese courts only with regard to specific parties to specific lawsuits in which the effectiveness of the plan in Japan is at issue.⁵

In FTXJ's case, however, a motion for entry of orders approving, among other things, the sale of its business pursuant to Section 363 and other relevant sections of the U.S. Bankruptcy Code has been filed.⁶ If approved by the court, this so-called "363 sale" would enable FTX to sell FTXJ's business without having a reorganization plan approved by a majority of creditors. Depending on how the planned sale goes, the effect of such 363 sale (if it actually occurs) in Japan would be an interesting topic that has scarcely been discussed in this country.

PUBLICATIONS

- Article "Latest Practice in Corporate Rehabilitation Based on the Marelli Case - Considerations from the First Case in Japan that was Transferred to Simplified Rehabilitation Proceedings"
- Publication MARR Online No.339
- Author Wataru Ishida

NEWS

- **Top Rankings Received from Chambers Asia-Pacific 2023**
- Mori Hamada & Matsumoto and our lawyers are recognized in the practice areas listed below in Japan for Chambers Asia-Pacific 2023. Our offices and lawyers in Thailand (Chandler MHM Limited), Myanmar (Myanmar Legal MHM Limited) and Vietnam have also received prestigious rankings as shown below.

Practice areas

⁵ A typical example of how Article 118 of the CCP works in the case of foreign restructuring plans is where a creditor enforces its claim against a debtor in Japan after a restructuring plan that exempts the debtor from its liability to the creditor is endorsed by a court in foreign insolvency proceedings. In such case, the debtor may rely on Article 118 to argue that the creditor's claim has already been waived by the restructuring plan, and therefore the creditor's enforcement is not allowed in Japan.

⁶ Doc. 233 of the Docket.

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JAPAN

- Banking & Finance (Band 1)
- Capital Markets (Band 1)
- Capital Markets: Securitisation & Derivatives (Band 1)
- Competition/Antitrust (Band 1)
- Corporate/M&A (Band 1)
- Dispute Resolution (Band 1)
- Employment (Band 1)
- Insurance (Band 1)
- Intellectual Property (Band 2)
- International Trade (Band 1)
- Investment Funds (Band 1)
- Life Sciences (Band 2)
- Projects & Energy (Band 1)
- Real Estate (Band 1)
- Restructuring/Insolvency (Band 1)
- Tax (Band 1)
- Technology, Media, Telecoms (TMT) (Spotlight Table)

JAPAN - OSAKA

- General Business Law (Band 2)

THAILAND

- Aviation (Band 2)
- Banking & Finance (Band 2)
- Competition/Antitrust (Band 2)
- Corporate/M&A (Band 2)
- Employment (Band 3)
- Projects & Energy (Band 1)
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- Restructuring/Insolvency (Band 2)
- Technology, Media, Telecoms (TMT) (Band 4)

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- General Business Law (Band 2)

VIETNAM

- Real Estate (Band 3)

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➤ **42 new lawyers joined Mori Hamada & Matsumoto**

42 lawyers who qualified in December 2022 joined Mori Hamada & Matsumoto.

Arisa Ishikawa, Ryu Aoki, Satoshi Iga, Souto Ikeda, Ryoya Ishikawa, Misa Izutani, Ryunosuke Ito, Nonoka Iwanami, Karin Omata, Shintaro Kimura, Kaya Kim, Ryuichi Kuraoka, Ryota Kodaka, Yohsuke Gondo, Risa Sasaki, Taiga Shimada, Masayuki Shimada, Kazuki Shoda, Yuri Sukegawa, Toru Son, Koshi Takatsu, Takaya Tachi, Tatsuki Tanaka, Takumi Togawa, Takuya Nemoto, Hanako Nonoguchi, Kana Hashinaga, Akane Hirata, Naoki Hiramatsu, Shinji Fukue, Mio Fukumoto, Ryo Maekawa, Koshi Matsumoto, Hanako Matsumoto, Rina Matsuyama, Maho Minabe, Yasuaki Mori, Akihiro Yano, Ryo Yabumoto, Taishu Yamashita, Hiroki Yamaya and Mayu Yarinome

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