

Restructuring & Insolvency Newsletter

January 2023 (Vol.3)

FTX Chapter 11 from Japanese Law Perspective (2)

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| I. Overview of Regulations on Crypto-asset Exchange Service Providers | Mori Hamada & Matsumoto
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FTX Trading Ltd. ("**FTX**") and its affiliates (collectively, "**FTX Group**"), which operated one of the largest crypto-asset exchanges in the world through the FTX.com platform, filed for Chapter 11 in the United States on November 11 last year. It was pointed out that Chapter 11 filings by FTX Group could affect a large number of stakeholders such as creditors and customers of the crypto-asset exchanges, and, in fact, BlockFi Inc., which had business with FTX and provided crypto-asset lending and borrowing services, also filed for Chapter 11 in the United States less than three weeks later on November 28. The Chapter 11 filing of FTX Group has been triggering a chain of bankruptcies and restructurings of crypto-asset-related companies, with the attention paid toward the FTX case increasing day by day.

Under Japanese law, crypto-assets by their nature are subject to different regulations than other tangible assets. Also, due to the amendment of the Payment Services Act (the "**PSA**") and the Financial Instruments and Exchange Act (the "**FIEA**") in the aftermath of the crypto-asset leaks at Mt.Gox and Coincheck, the protection of crypto-asset users has been emphasized as one of the characteristics of these laws and regulations.

In light of the high-profile nature of the FTX case and the number of stakeholders involved, as well as potential legal issues in Japan brought by future developments, we have been releasing a series of articles focusing on this case from the Japanese law perspective.¹ In this second article, we provide an

¹ Please also see our [Restructuring & Insolvency Newsletter Vol. 2](#), the first article in a series on the FTX case, for our analysis from the Japanese law perspective about (i) the rights that the major creditors of

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overview of regulations on crypto-asset exchange service providers ("**CAESPs**") focusing on the protection of their customers, applicable administrative dispositions, and key points in CAESP insolvency and restructuring.

I. Overview of Regulations on Crypto-asset Exchange Service Providers

In Article 2, Paragraph 7 of the PSA, "crypto-asset² exchange services" means the carrying out of any of the following acts in the course of trade:

- (a) purchase and sale of a crypto-asset or exchange with another crypto-asset;
- (b) intermediary, brokerage or agency services for the act set forth in the preceding item;
- (c) management of users' money, carried out by persons in connection with their acts set forth in the preceding two items; and
- (d) management of crypto-assets on behalf of another person (excluding cases where the relevant management in the course of trade is governed by special provisions of other laws).

Those planning to provide crypto-asset exchange services must be registered with the Prime Minister³ as CAESPs. In addition to meeting the statutory requirements for registration, such as having at least 10 million yen in capital and a non-negative net asset value, it is also necessary to meet soft-law requirements such as the Crypto Asset Guidelines published by the FSA.

Even after successful registration, CAESPs must comply with various obligations under the PSA to protect their customers; for example:

- (a) CAESPs must manage cash and crypto-assets deposited by their customers separately from their own deposits. Specifically, customers' cash must be segregated from CAESPs' own cash by using a money trust created with a trust company. Customers' crypto-assets are not obligated to be held in trust like their cash, but CAESPs must clearly separate them from their own crypto-assets by using the method specified by Cabinet Office

FTX Japan K.K. ("**FTXJ**") have against FTXJ and the impact of the administrative orders of the Financial Services Agency (the "**FSA**") of Japan and (ii) the effects of the commencement of FTXJ's Chapter 11 in Japan including the recently announced planned sale of FTXJ's business.

² In Article 2, Paragraph 5 of the PSA, "crypto-assets" are defined as electronically recorded proprietary value other than legal currency and assets denominated in any legal currency that: (a) can be used to pay unspecified persons for goods and services, can be mutually exchanged into fiat currencies with unspecified persons, and is transferable through an electronic network ("Type I crypto-assets"); or (b) is mutually exchangeable with a Type I crypto-asset between unspecified persons and is transferable through an electronic network ("Type II crypto-assets").

³ The registration and the work related to the supervisory dispositions are actually carried out by the FSA and local finance bureaus delegated by the Prime Minister.

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Order.

- (b) Only up to 5% of the total value of entrusted crypto-assets may be managed in so-called hot wallets. However, in such cases, the crypto-assets of the same type and quantity as those managed in the hot wallet must be held as the CAESPs' own crypto-assets and managed separately in so-called cold wallets.

Also, since crypto-assets fall under the category of "financial instruments" under the FIEA, CAESPs are required to separately register as Type 1 Financial Instruments Businesses under the same law if they plan to offer derivative transactions with crypto-assets as underlying assets.

II. Applicable Administrative Dispositions

The Prime Minister may, if necessary, take the following administrative dispositions against CAESPs under the PSA:

- (a) Order a CAESP to take necessary measures to improve the operation of its businesses or its financial status or take other measures necessary for the supervision when necessary for the provision of crypto-asset exchange services in a proper and steady manner.
- (b) Revoke registration as a CAESP or order the provider to suspend all or part of its crypto-asset exchange services, specifying a period of suspension not exceeding six months if, among other things, the CAESP has not established a system that is necessary for the provision of crypto-asset exchange services in a proper and steady manner.

If CAESPs operate as Type 1 Financial Instruments Business Operators, the following administrative dispositions under the FIEA may also be taken by the Prime Minister:

- (a) Rescind registration as a Financial Instruments Business Operator or order the suspension of all or part of the CAESP's business activities during a fixed period of no longer than six months if, among other things, the Financial Instruments Business Operator is found not to have in place the necessary system for performing financial instruments business in an appropriate manner.
- (b) Order a Financial Instruments Business Operator to keep a portion of its assets as specified by Cabinet Order within Japan if the Prime Minister finds it to be necessary and appropriate in the public interest or for the protection

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of investors.

In the FTX case, the above orders under the PSA⁴ and the FIEA⁵ were issued for FTXJ. It was required under the PSA to suspend its crypto-asset exchange-related business and its acceptance of assets from new customers in connection therewith until March 9, 2023. Also, it was required under the FIEA to (i) suspend its business related to OTC derivatives transactions and its acceptance of deposits of margin from new investors in connection therewith, and (ii) hold assets in Japan equivalent to the amount of liabilities to be recorded in the liabilities section of its balance sheet, less the amount of liabilities to non-residents until March 9, 2023.

III. Key Points in CAESP Insolvency and Restructuring

1. Treatment of Rights to Crypto-Assets Deposited with CAESPs

Whereas customers' cash is subject to bankruptcy remoteness since CAESPs have a trust management obligation for cash, it is understood that customers' crypto-assets are not subject to it since CAESPs only have a segregated management obligation for crypto-assets (as such, the treatment of rights that customers who have deposited crypto-assets with CAESPs have against those providers is an issue that arises in the event of insolvency and restructuring).

Although such rights are usually interpreted as rights in personam, not in rem, to demand the return of their deposited crypto-assets, the PSA provides that customers shall be prioritized over other creditors with regard to such rights. Therefore, customers are entitled to receive preferential payment concerning crypto-assets in the event of the insolvency or restructuring of any CAESPs in Japan.

It is worth noting, however, in cases where a CAESP violates the PSA and fails to maintain segregation or where the deposited crypto-assets are leaked (and there have been several such cases in Japan), there will be no crypto-assets to repay, and the right to receive preferential payment will eventually cease to function.

⁴ For further information on this disposition, please see [this link](#) (Japanese only).

⁵ For further information on this disposition, please see [this link](#) (Japanese only).

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2. Considerations in M&As of CAESPs

An M&A transaction by a sponsor may be considered as a means of business rehabilitation for financially distressed CAESPs.⁶ When considering M&A of a CAESP, the following points should be considered from the perspective of Japanese laws and regulations.

A sponsor considering M&A of a CAESP usually conducts due diligence where it is necessary to carefully investigate not only legal issues, but also whether soft laws such as the Crypto Asset Guidelines are being complied with, whether the company has ever been subject to administrative dispositions, and, if so, whether appropriate corrective measures are being taken in response. For this reason, it is recommended that CAESP due diligence be conducted through advisors who are familiar with the laws (including soft laws) and regulations relating to crypto-assets or crypto-asset exchange services.

Moreover, as previously mentioned, CAESPs must be registered (licensed) with the FSA to operate their own businesses in Japan. Under Japanese law, business transfers, mergers, and company splits are options for M&A transactions, but usually in these methods the necessary licenses for the CAESPs are not automatically transferred to the sponsor. On the other hand, when an M&A transaction is conducted by transferring shares of a CAESP, there is generally no need to re-obtain the necessary registrations (licenses), and therefore the transfer of shares may be a simpler procedure⁷ for the transaction.

NEWS

➤ 19 new partners and 17 new counsels

As of January 1, 2023, 18 lawyers and one tax accountant became partners of the firm.

Partners:

Fumiko Hama, Ryosuke Nishimoto, Hironobu Noma, Noriaki Wakabayashi, Kazuhisa Kita, Takahiro Sato, Noboru Kitayama, Takao Kitano, Ryo Kawabata,

⁶ In fact, a motion was made for entry of orders approving, among other things, FTX Group to sell FTXJ's business through so-called "363 sale"

⁷ It should be noted that the regulatory law also requires procedures to be taken before or after executing an M&A transaction, such as filing a notification after the fact when there is a change in shareholders under the PSA.

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Takafumi Goto, Mitsuhiro Tateishi, Koki Kanemura, Aritsune Miyoda, Masaaki Hirota, Fuyuki Uchitsu, Takeshi Fukuda, Ryosuke Okuda and Panupan Udomsuvannakul

Partner (Tax Accountant):

Koyo Madokoro

Also, 16 lawyers and one tax accountant became counsels as of January 1, 2023.

Counsels:

Mariko Morita, Ryoko Akizuki, Rina Shimada, Hiroshi Shirane, Daisuke Tsuta, Wataru Ishida, Yu Nimura, Hideaki Kuwahara, Satoshi Tatsugawa, Hiroko Kasama, Soni Tiwari, Patthanawach Nuntawowart, Pitiporn Anantaset, Sarunporn Chaianant, Piyawanee Watanasakolpunt and Jirayu Sanguankaew

Counsel (Tax Accountant):

Yuko Maruyama

➤ **Announcement of new Jakarta Office and new partners and counsel**

On January 1, 2023, Mori Hamada & Matsumoto commenced a business alliance with ATD Law, an Indonesian law firm with an office in Jakarta, to launch ATD Law in association with Mori Hamada & Matsumoto.

ATD Law was established in October 2022 and led by Abadi Abi Tisnadisastra, an experienced M&A and corporate lawyer, with expertise in the financial, telecommunications, and technology sectors. ATD Law can provide a wide range of legal services for multinational and local investors with interests in Indonesia. The experienced team includes Alfa Dewi Setiawati, a partner who has deep knowledge of the banking and finance sector, and Robbie Julius, a counsel who has been involved in a wide range of Indonesian projects for many years. At present, ATD Law has more than 10 lawyers with the plan to grow organically to more than 20 lawyers in two years.

In addition, Tetsu Takeuchi, a partner currently based at MHM in Singapore, and Zaki Shahab, an associate qualified in Japanese law, will be based at the office in Jakarta. Tetsu has considerable experience in M&A and corporate law. After being stationed in Jakarta from 2014-2017, he was involved in a wide range of Indonesian matters (including advising on M&A, joint ventures, labor, bribery, fraud

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investigations, debt collection, insolvency and dispute resolution) while based in Singapore.

Our Jakarta office will leverage off its extensive experience advising on Indonesian projects over many years to provide clients with the best service to meet their diverse needs. By working closely with members of our offices in Japan, Singapore, Thailand, Vietnam, Myanmar and China, we aim to offer our clients in Indonesia the expertise and resources of our regional network. Our extensive regional network also means we are well placed to advise on cross-border work originating from ASEAN and Japan.

We are committed to working together as one firm to ensure that we remain our clients' Firm of Choice.

Abadi Abi Tisnadisastra, Managing Partner of ATD Law applauded, *“This alliance is an exciting opportunity for us and we very much look forward to working with MHM’s regional and international network to develop our practice in Indonesia to provide the highest quality legal services for our clients.”*

➤ **Top Rankings Received from The Legal 500 Asia Pacific 2023**

Mori Hamada & Matsumoto has been ranked in the top tier of recommended law firms in Japan, Thailand (Chandler MHM Limited), Myanmar (Myanmar Legal MHM Limited) and Vietnam for several areas of practice in The Legal 500 Asia Pacific 2023. The following lawyers have been acknowledged as “Leading Individuals” or “Next Generation Partners” in Restructuring and insolvency practice area.

Leading Individuals: Soichiro Fujiwara and Takahiro Inou

Next Generation Partners: Dai Katagiri

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