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UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF NEVADA

In re: TELEXFREE, LLC, ☐Affects this Debtor ☑Affects all Debtors ☐Affects TELEXFREE, INC. ☐Affects TELEXFREE FINANCIAL, INC	Case No.: BK-S-14-12524-abl Chapter 11 **[PROPOSED]** **Jointly Administered with:** 14-12525-abl TelexFree, Inc. 14-12526-abl TelexFree Financial, Inc **U.S. SECURITIES AND EXCHANGE COMMISSION'S MOTION FOR CHANGE OF VENUE; MEMORANDUM OF POINTS AND AUTHORITIES; DECLARATIONS OF MARK ALBERS AND SCOTT STANLEY** **DATE:** [OST Pending] **TIME:** [OST Pending]

The United States Securities and Exchange Commission ("Commission") hereby appears and moves the court for an order immediately transferring venue of these cases from the District of Nevada to the District of Massachusetts, Central Division, for any further proceedings in these cases. This motion is made and based upon facts showing that transfer is in the interest of justice and for the convenience of the parties. Transfer is requested pursuant to 28 U.S.C. §§ 1408 and 1412 and Rule 1014 of the Federal Rules of Bankruptcy Procedure.

RESPECTFULLY SUBMITTED, this 23rd day of April, 2014.

/s/ Sandra W. Lavigna
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MEMORANDUM OF POINTS AND AUTHORITIES

TelexFree, Inc., a Massachusetts corporation jointly owned by James Merrill and Carlos Wanzeler of Marlborough, Massachusetts, TelexFree, LLC, a Nevada limited liability company jointly owned by Messrs. Merrill and Wanzeler, and TelexFree Financial, Inc., a Florida corporation owned by TelexFree, LLC, hastily filed their Chapter 11 petitions the evening of Sunday, April 13, 2014. All three entities (the "Debtors") claimed proper venue in their petitions by checking the box that states, "There is a bankruptcy case concerning debtor's affiliate, general partner, or partnership pending in this District." However, because all three filed their actions at about the same time, this claim was inaccurate and rather appears to be a coordinated effort to avoid the Massachusetts courts. Admittedly, TelexFree, LLC, designated the "lead" case by the Debtors, was organized under the laws of the State of Nevada and maintains what appears to be a rent-a-space office in Las Vegas. However, TelexFree LLC transacts virtually no business in the state other than the recruitment of participants in its scheme. TelexFree, Inc. is located in Marlborough, Massachusetts (where both it and TelexFree, LLC maintain their principal places of business), and TelexFree Financial, Inc. maintains a Coconut Creek, Florida address. The direct and indirect owners of all these entities, James Merrill ("Merrill") and Carlos Wanzeler ("Wanzeler"), reside in Massachusetts.

On Tuesday, April 15, 2014, the U. S. Securities and Exchange Commission filed an emergency civil enforcement action against these three TelexFree companies and others, in the United States District Court for the District of Massachusetts (No. 1:14-cv-11858-DJC), the Honorable Denise Casper, District Judge, presiding. In its Complaint, attached hereto as Exhibit 1, the Commission alleges that debtors TelexFree, Inc., TelexFree, LLC, and eight individual defendants operated a fraudulent pyramid scheme through the TelexFree entities. The Complaint names debtor TelexFree Financial, Inc., as one of three relief defendants that received proceeds of the fraudulent pyramid scheme. Concurrently with the Complaint, the Commission filed a motion for a Temporary Restraining Order ("TRO"), which included an order freezing all assets of the defendants, including the assets of the debtors here. On Wednesday, April 16, 2014, Judge Casper signed and entered the TRO. A copy of that Order is attached hereto as Exhibit 2. A copy of the transcript of the hearing before Judge Casper is attached hereto as Exhibit 3.

I. The Debtor Companies' Operations, Management and Creditors Are Centered in Massachusetts.

TelexFree, Inc. is a corporation organized under Massachusetts law and doing business in Marlborough, Massachusetts. The "lead" debtor, TelexFree, LLC, although organized under Nevada law, does business at the same address in Marlborough, Massachusetts. Its only address in Nevada appears to be a rent-a-space office in Las Vegas. TelexFree Financial, Inc. is a Florida corporation, with its principal place of business in Coconut Creek, Florida. Except for activities relating to the recruitment of participants in the pyramid scheme, it appears that none of the Debtors do any business in Nevada. To the extent that the Debtors have physical assets, they are all located in Massachusetts at their principal place of business (or have been seized by federal agents in Massachusetts pursuant to a search warrant executed at that location) or potentially at TelexFree Financial, Inc.'s principal place of business in Florida. Most of the Debtors' bank accounts are located in Massachusetts. Merrill and Wanzeler, the fifty percent owners (and the only directors) of the Debtors are located in Massachusetts, as the filings evidence. Moreover, none of the thirty largest creditors identified by the debtors in their petitions are located in Nevada. Approximately a third of these creditors are located in Massachusetts, while the rest appear to be located in Florida or abroad.

In addition, TelexFree, Inc. and TelexFree, LLC, are the subjects of both an administrative complaint filed by the Massachusetts Securities Division and a civil enforcement action filed by the Commission in the U.S. District Court for the District of Massachusetts, both alleging that TelexFree, Inc., TelexFree, LLC and others are operating an illegal pyramid scheme. The District Court entered an order in the Commission's action not only freezing the assets of the debtors but also the assets of the Debtors' co-owners, as well as the assets of the other six defendants, including a sales director resident in Massachusetts. Clearly, under the facts and circumstances here, this matter belongs in the District of Massachusetts, not the District of Nevada.

II. The Principles Governing Appropriate Venue Seek Fairness, Convenience and Economy of Proceedings.

The proper venue for a bankruptcy case is governed by 28 U.S.C. § 1408, which states in relevant part:

> Except as provided in section 1410 of this title [not relevant here], a case under title 11 may be commenced in the district court for the district—

> (1) in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the person or entity that is the subject of such case have been located for the one hundred and eighty days immediately preceding such commencement . . ; or
>
> (2) in which there is pending a case under title 11 concerning such person's affiliate, general partner, or partnership.

When venue may be proper as a technical matter as to the "lead" debtor, but nevertheless unsatisfactory, 28 U.S.C. § 1412 provides as follows: "A district court may transfer a case or proceeding under title 11 to a district court for another district, in the interest of justice or for the convenience of the parties."

Venue determinations are highly factual, and courts have set out a variety of sometimes-overlapping factors or standards to be examined in the analysis of "the interest of justice" and "the convenience of the parties." *See, e.g., In re Northfield Laboratories, Inc.,* 467 B.R. 582, 589-591 (Bankr. D. Del. 2010). Then-Chief Judge Zive set forth standards to determine whether to transfer a case in *In re B.L. of Miami, Inc.*, 294 B.R. 325 (Bankr. D. Nev. 2003). There, he noted that "the case may be transferred 'in the interest of justice or for the convenience of the parties.'" *Id.* at 328 (citing cases). In assessing whether a case should be transferred for the convenience of the parties, the Court set forth "the six factors most commonly analyzed":

> 1. proximity of creditors of every kind to the court;
>
> 2. proximity of the debtor;
>
> 3. proximity of witnesses necessary to the administration of the estate;
>
> 4. location of the assets;
>
> 5. economic administration of the estate; and
>
> 6. necessity for ancillary administration if liquidation should result.

Id. at 329 (citing cases). All of these factors weigh heavily toward a transfer of these cases to the District of Massachusetts.

1. Proximity of the Creditors. First, as the debtors acknowledge in their own filings, *none* of the thirty largest creditors are in Nevada. And while the victims of the pyramid scheme are likely creditors, information gathered by the Commission thus far indicates that a very small fraction of such victims live in Nevada. (For example, an analysis of data obtained from credit card payment

processors shows that, between August 2012 and March 2014, there may be 205 victims in Nevada who paid in about $431,000 to the scheme whereas 2,551 victims in Massachusetts paid in over $7 million. *See* Declaration of Mark Albers, attached hereto as Exhibit 4.) *See also, In re Palmer Lake Plaza, LLC,* 470 B.R. 511, 515 (W.D. Wisc. 2012) (because all the assets, creditors, potential witnesses and the Debtor's sole member were all located in another district, case was transferred).

2. Locus of the Business Operations. Second, the debtors themselves transact no business in Nevada, except as part of their effort to solicit investors. Rather, TelexFree, Inc., and TelexFree, LLC, have stated Marlborough, Massachusetts as their principal place of business. And it is that location that was the subject of a search warrant executed by agents of the Department of Homeland Security. *See* Supplemental Declaration of Scott R. Stanley, attached hereto as Exhibit 5. And, as debtor TelexFree Financial, Inc., states in its petition, its principal place of business is in Florida – not Nevada. Importantly, the Debtors acknowledge that their two owners – Merrill and Wanzeler – live in Massachusetts. Thus, the "nerve center' of the enterprise is located in Massachusetts. *Id.*

3. Proximity of Witnesses. Third, all employees of TelexFree, Inc. and TelexFree, LLC are located at the debtors' headquarters in Massachusetts. And, as noted above, the debtors acknowledge that their two owners – Carlos Wanzeler and James Merrill – live in Massachusetts. These employees and owners, Massachusetts residents, are key witnesses necessary to the administration of the estate.

4. Location of Physical Assets. Virtually all the Debtors' physical assets are located in Massachusetts – either at the headquarters of TelexFree, Inc. and TelexFree, LLC or in the possession of the Department of Homeland Security agents who seized certain assets in connection with the search warrant executed on the TelexFree headquarters on April 15, 2014. As far as the Commission has been able to determine, the debtors' only physical connection to Nevada is the possible rent-a-space office in Las Vegas.

5. Judicial Economy and Economy of Administration. There are several facts that establish Massachusetts as the location that best promotes judicial economy. First, the entry by the District Court in Massachusetts of an order freezing the assets of the Debtors and the ten other defendants alone warrants transfer of this case to the District of Massachusetts. The automatic stay entered in the Debtors' bankruptcy cases reaches only the assets, if any, of these three Debtors. The District

Court can address all elements of the scheme and can coordinate with a Massachusetts bankruptcy court with much greater ease than with the Nevada bankruptcy court.

Also, as a related matter, in the Ninth Circuit a bankruptcy court cannot enter a final order in a fraudulent transfer action when the transferee is not a claimant in the case. *Exec. Benefits Ins. Agency v. Arkison (In re Bellingham Ins. Agency, Inc.),* 702 F.3d 553 (9th Circuit 2012), *cert. granted,* 133 S.Ct. 2880, 186 L.Ed.2d 908 (2013) If any of the individual defendants in the Commission's case or other non-claimants become subjects of successful fraudulent transfer actions by the debtors-in-possession, the Nevada bankruptcy court will have to coordinate with the Nevada District Court for entry of any final orders. Because the Commission's civil enforcement action against those defendants is pending in the Massachusetts District Court, that Court will already be familiar with the facts and circumstances of the fraudulent scheme; this provides another strong reason to transfer these cases to Massachusetts.

Moreover, the Commonwealth of Massachusetts, Office of the Secretary of the Commonwealth, Securities Division has filed its own enforcement action against debtors TelexFree, Inc., and TelexFree, LLC. Its Administrative Complaint is attached hereto as Exhibit 6. A bankruptcy case more than 2500 miles away would be very burdensome for the Securities Division.

Finally, as noted above, the assets, many of the creditors and most of the witnesses are located in Massachusetts (or, in any event, not in Nevada). Taking all these factors together, judicial economy and economy of administration heavily weigh in favor of transferring these cases to the District of Massachusetts. *See, In re DHP Holdings II Corp.,* 435 B.R. 264, 275 (Bankr. D. Del. 2010) ("Ultimately, however, 'the most important consideration is whether the requested transfer would promote the economic and efficient administration of the estate,'" *quoting In re Commonwealth Oil Refining Co., Inc.,* 596 F.2d 1239, 1247 (5th Cir. 1979)).

6. Ancillary Administration in the Event of Liquidation. This is the sixth and final factor in *In re B.L. of Miami, Inc.,* 294 B.R. 325, cited above. It appears to the Commission that liquidation of the estate may become necessary. If that occurs, it would be far more efficient for any liquidation to take place in the District of Massachusetts than in the District of Nevada. If the Commission seeks to establish a distribution fund to recompense victims (who likely will make up the large majority of the creditors, both in numbers and dollars), that fund would be under the auspices of the Massachusetts

District Court hearing the Commission's fraud case against the Debtors and others. Thus, any liquidation of the estate should occur in the District of Massachusetts, where the District Court and the Bankruptcy Court could easily coordinate.

Not only does the convenience of the parties overwhelmingly favor transferring this case to the District of Massachusetts, so does the interest of justice. The debtors hastily (given the Notice of Incomplete and/or Deficient Filing entered in this case (Docket No. 15)) filed their petitions in the District of Nevada on a Sunday night in a rather transparent effort to avoid the Massachusetts courts. They were aware of the investigation by the Massachusetts Securities Division (given that their principals testified in that investigation in March 2014), and Commission counsel understands that the debtors became aware of the Commission's interest at the latest the weekend the debtors filed their respective petitions. (The Commission's investigation was conducted by staff in its Boston Regional Office.) The interests of justice require that debtors' blatant forum shopping (so as to avoid Massachusetts) not be rewarded. As noted in *In re Palmer Lake Plaza, LLC,* 470 B.R. at 515, the interest of justice factors include whether:

> (i) the transfer would promote the economic and efficient administration of the bankruptcy estate, (ii) the interests of judicial economy would be served by the transfer, (iii) the parties would be able to receive a fair hearing in each of the possible venues, (iv) either forum has an interest in having the controversy decided within its borders, (v) the enforcement of any judgment would be affected by the transfer, and (vi) the plaintiff's original choice of forum should be disturbed.

(Citing *In re Dunmore Homes,* 380 B.R. 663, 671-72 (Bankr. S.D.N.Y. 2008).)

Here, these factors compel transfer: Massachusetts has a definite interest in having the controversy decided within its borders, whereas Nevada's interest is merely that manufactured by the Debtors. These cases can proceed more economically and more conveniently in Massachusetts, saving enormous travel costs and avoiding the potential for conflicting orders from federal courts in different Districts.

Conclusion

In sum, the interests of justice and the convenience of the parties both require that this case be transferred to the Bankruptcy Court for the District of Massachusetts for all further proceedings. The Debtors' late Sunday filing in the District of Nevada is a transparent attempt to avoid Massachusetts, where their "business" and numerous witnesses are located and where various government agencies have been investigating their fraudulent conduct. This court should not reward such behavior but rather should send this case where it belongs – to Massachusetts.

RESPECTFULLY SUBMITTED, this 23rd day of April, 2014.

/s/ Sandra W. Lavigna
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CERTIFICATE OF SERVICE

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is: 5670 Wilshire Blvd., 11th Floor, Los Angeles, California 90036-3648.

A true and correct copy of the foregoing document described as **U.S. SECURITIES AND EXCHANGE COMMISSION'S MOTION FOR CHANGE OF VENUE; MEMORANDUM OF POINTS AND AUTHORITIES; DECLARATIONS OF MARK ALBERS AND SCOTT STANLEY** will be served or was served **(a)** on the judge in chambers in the form and manner required by LBR 5005-2(d); and **(b)** in the manner indicated below:

I. **TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING ("NEF")** – Pursuant to controlling General Order(s) and Local Bankruptcy Rule(s) ("LBR"), the foregoing document will be served by the court via NEF and hyperlink to the document. On **April 23, 2014**, the Attorney of record checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following person(s) are on the Electronic Mail Notice List to receive NEF transmission at the email address(es) indicated below:

☒ Service information continued on attached page.

II. SERVED BY U.S. MAIL OR OVERNIGHT DELIVERY:

On **April 23, 2014,** I served the following person(s) and/or entity(ies) at the last known address(es) in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States Mail, first class, postage prepaid, and/or with an overnight mail service addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

SERVED VIA OVERNIGHT DELIVERY

HONORABLE AUGUST B. LANDIS
Judge, United States Bankruptcy Court
District of Nevada
Foley Federal Building
300 Las Vegas Boulevard South
Courtroom 1, 3rd Floor
Las Vegas, NV 89101

☒ Service information continued on attached page.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

April 23, 2014	Louie M. Adame	
Date	*Type Name*	*Signature*

Mailing Information for Case 14-12524-abl

Electronic Mail Notice List

The following is the list of **parties** who are currently on the list to receive email notice/service for this case.

- **THOMAS H. FELL** BANKRUPTCYNOTICES@GORDONSILVER.COM;bknotices@gordonsilver.com
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- **U.S. TRUSTEE - LV - 11** USTPRegion17.lv.ecf@usdoj.gov

Manual Notice List

The following is the list of **parties** who are **not** on the list to receive email notice/service for this case (who therefore require manual noticing/service). You may wish to use your mouse to select and copy this list into your word processing program in order to create notices or labels for these recipients.

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Creditor List

Click the link above to produce a complete list of **creditors** only.

List of Creditors

Click on the link above to produce a list of **all** creditors and **all** parties in the case. User may sort in columns or raw data format.

EXHIBIT 1

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

TELEXFREE, INC.,
TELEXFREE, LLC,
JAMES M. MERRILL,
CARLOS N. WANZELER,
STEVEN M. LABRIOLA,
JOSEPH H. CRAFT,
SANDERLEY RODRIGUES DE VASCONCELOS,
SANTIAGO DE LA ROSA,
RANDY N. CROSBY and
FAITH R. SLOAN,

Defendants,

and

TELEXFREE FINANCIAL, INC.,
TELEXELECTRIC, LLLP and
TELEX MOBILE HOLDINGS, INC.,

Relief Defendants.

Case No.

JURY TRIAL DEMANDED

COMPLAINT

Plaintiff Securities and Exchange Commission ("the Commission") alleges the following against defendants TelexFree, Inc., TelexFree, LLC, James M. Merrill, Carlos N. Wanzeler, Steven M. Labriola, Joseph H. Craft, Sanderley Rodrigues de Vasconcelos, Santiago De La Rosa, Randy N. Crosby, and Faith R. Sloan, and relief defendants TelexFree Financial, Inc., TelecElectric LLLC, and Telex Mobile Holdings, Inc., and hereby demands a jury trial:

PRELIMINARY STATEMENT

1. This matter involves an illegal pyramid scheme operated by TelexFree, Inc. and TelexFree, LLC (collectively, "TelexFree") and the eight individual defendants: four principals of TelexFree and four primary promoters of TelexFree. TelexFree is a Massachusetts-based "multi-level marketing" company that purports to be in the business of selling local and international telephone service plans that use "voice over internet" ("VoIP") technology. Since at least November 2012, TelexFree and its principals, Merrill, Wanzeler, Labriola and Craft, acting through promoters such as Rodrigues de Vancelos, De La Rosa, Crosby and Sloan, have raised more than $300 million, largely from the Brazilian and Dominican immigrant communities in Massachusetts and twenty other states, through a fraudulent and unregistered offering of securities. (TelexFree publicly claims to have raised more than $1 billion, but documentation for that claim has not been made public.) The securities take the form of "memberships" that promise substantial returns – 200% per year or more – for becoming promoters of the business. TelexFree promises to pay promoters for: (a) placing duplicative TelexFree ads on internet sites – a process which, by itself, generates no revenue; and (b) recruiting other investors who pay the membership fees that constitute the lion's share of monies taken in by TelexFree. Until changes to its compensation plan in March 2014, TelexFree did not require promoters to sell its VoIP product in order to qualify for payments.

2. Despite the misleading appearance of having a legitimate VoIP business, the defendants are actually operating an elaborate pyramid scheme. Documents available to date indicate that its VoIP sales revenues – approximately $1.3 million – have generated barely 1% of the nearly $1.1 *billion* needed to honor its promises to promoters for placing internet ads. As a

result, in classic pyramid fashion, TelexFree is paying its older investors, not with revenue raised from the sale of its VoIP product, but with money received from newer investors.

3. TelexFree has been a money-making machine for the defendants. The company's financial records indicate that, since mid-November 2013, TelexFree has transferred approximately $30 million to be transferred from TelexFree operating accounts to themselves and to affiliated companies in the past few months to accounts owned and controlled by TelexFree or the individual defendants. Tens of millions of additional investor funds received by TelexFree are presently unaccounted for.

4. The defendants are continuing to enroll new investors every day, but it is clear that the pyramid has collapsed. On March 9, TelexFree changed its compensation plan so that promoters would now be required to sell its VoIP product in order to qualify for the payments that TelexFree had previously promised to pay them. The rule change generated a storm of protests from promoters who cannot recover their money. On April 1, dozens of promoters descended on the company's office in Marlborough, Massachusetts to complain – in part because, as one of them told the press, the VoIP service is "almost impossible to sell". Then on April 14 (yesterday), TelexFree filed for bankruptcy in Nevada under Chapter 11, admitting that it cannot meet its obligations with its VoIP revenues and seeking authority to reject all its current obligations to promoters.

5. Through the activities alleged in this Complaint, the defendants have engaged and are still engaged in: (a) fraudulent or deceptive conduct in connection with the purchase or sale of securities, in violation of Section 10(b) of the Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder; (b) fraud in the offer or sale of securities, in violation of Section 17(a) of

the Securities Act of 1933 ("Securities Act"); and (c) the offer or sale of unregistered securities, in violation of Section 5 of the Securities Act.

6. To halt the defendants' ongoing unlawful conduct, maintain the status quo, and preserve any remaining assets for defrauded investors before entry of a final judgment, the Commission seeks emergency equitable relief, including a temporary restraining order and preliminary injunction, to: (a) prohibit the defendants from continuing to violate the relevant provisions of the federal securities laws; (b) freeze the defendants' and the relief defendants' assets; (c) require the defendants and relief defendants to repatriate all proceeds of the fraud that are now located abroad; (d) require the defendants and relief defendants to submit an accounting of investor funds and other assets in their possession; (e) prevent the defendants and relief defendants from destroying relevant documents; and (f) authorize the Commission to undertake expedited discovery.

7. The Commission also seeks: (a) a permanent injunction prohibiting the defendants from further violations of the relevant provisions of the federal securities laws; (b) disgorgement of the defendants' and relief defendants' ill-gotten gains, plus pre-judgment interest; and (c) civil penalties due to the egregious nature of the defendants' violations.

JURISDICTION

8. The Commission seeks a permanent injunction and disgorgement pursuant to Section 20(b) of the Securities Act [15 U.S.C. §77t(b)] and Section 21(d)(1) of the Exchange Act

[15 U.S.C. §78u(d)(1)]. The Commission seeks the imposition of civil penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. §77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. §78u(d)(3)].

9. This Court has jurisdiction over this action pursuant to Sections 20(d) and 22(a) of the Securities Act [15 U.S.C. §§77t(d), 77v(a)] and Sections 21(d), 21(e) and 27 of the Exchange Act [15 U.S.C. §§78u(d), 78u(e), 78aa]. Venue is proper in this District because TelexFree, Inc. and TelexFree, LLC have their principal place of business in Massachusetts, and defendants Merrill, Wanzeler, Merrill, Labriola, and De La Rosa live in Massachusetts.

10. In connection with the conduct described in this Complaint, the defendants directly or indirectly have made use of the mails or the means or instruments of transportation or communication in interstate commerce.

11. The defendants' conduct has involved fraud, deceit, or deliberate or reckless disregard of regulatory requirements, and has resulted in substantial loss, or significant risk of substantial loss, to other persons.

DEFENDANTS

12. TelexFree, Inc. is a Massachusetts corporation with its principal place of business in Marlborough, Massachusetts. Prior to a name change in February 2012, it was known as Common Cents Communications, Inc. ("Common Cents"), which was incorporated by defendants Wanzeler, Merrill and Labriola in 2002. TelexFree, LLC is a Nevada corporation with its principal place of business at the same address in Marlborough. It was incorporated by Wanzeler, Merrill, and Carlos Costa (a resident of Brazil) in July 2012, and it registered to do

business in Massachusetts in April 2013. TelexFree, Inc. and TelexFree, LLC have never been registered with the Commission, nor have they ever registered or attempted to register any offering of securities under the Securities Act or any class of securities under the Exchange Act. On April 14, 2014, TelexFree, Inc. and TelexFree, LLC filed for bankruptcy protection in Nevada under Chapter 11.

13. James M. Merrill, age 52, lives in Ashland, Massachusetts. He is the co-owner of TelexFree, Inc. and TelexFree, LLC. Prior to the bankruptcy filing on April 14, 2014, he was also the president of TelexFree, Inc. He has appeared in many TelexFree promotional videos that have been posted on the internet. He is the owner of Cleaner Image Associates, Inc., a small commercial cleaning business that he has operated from his home in Ashland since 1986.

14. Carlos N. Wanzeler, age 45, lives in Northborough, Massachusetts. He is the co-owner and treasurer of TelexFree, Inc. and the co-owner of TelexFree, LLC. He has appeared in many TelexFree promotional videos that have been posted on the internet. He is the owner of Brazilian Help, Inc. ("Brazilian Help"), a Massachusetts corporation with its principal place of business at TelexFree's address in Marlborough. He is also the owner of Above & Beyond the Limit, LLC, a New Mexico corporation.

15. Steven M. Labriola, age 53, lives in Northbridge, Massachusetts. He is the international sales director of TelexFree and has appeared in many TelexFree promotional videos that have been posted on the internet. He was a founding director of Common Cents. He also operates Gyver Work, a small computer repair and maintenance business located in Southborough, Massachusetts.

16. Joseph H. Craft, age 50, lives in Boonville, Indiana. He is a Certified Public Accountant with offices in Indiana and Kentucky. He is the chief financial officer of TelexFree, Inc. and TelexFree, LLC and prepares the company's financial statements. He has been the chief financial officer of other multi-level marketing companies.

17. Sanderley Rodrigues de Vasconcelos, age 42, previously lived in Revere, Massachusetts, and now lives in Davenport, Florida. He is one of the most successful promoters of TelexFree, especially among the Brazilian community in Massachusetts and elsewhere. He has appeared in TelexFree promotional videos that have been posted on the internet (he posted at least one himself), and he publicly claims to be the first U.S. promoter to become a millionaire. He is the owner of WWW Global Business Inc., a Massachusetts corporation that he formed in February 2013. In 2007, he settled charges brought by the Commission for operating a fraudulent pyramid scheme known as Universo FoneClub Corporation. He was permanently enjoined from violating Section 10(b) of the Exchange Act and Rule 10b-5, and Sections 5(a), 5(c) and 17(a) of the Securities Acts. He was also ordered to pay approximately $1.8 million of disgorgement.

18. Santiago De La Rosa, age 42, lives in Lynn, Massachusetts. He is one of the most successful promoters of TelexFree, especially among the Dominican community in Massachusetts and elsewhere. He has appeared in TelexFree promotional videos that have been posted on the internet. He is the owner of Magica Media Corp., a Massachusetts corporation that he formed in March 2013.

19. Randy N. Crosby, age 51, lives in Alpharetta, Georgia. He is one of the most successful promoters of TelexFree and has appeared in TelexFree promotional videos that have

been posted on the internet. He has also promoted TelexFree through a website called "everybodygetspaidweekly.biz".

20. Faith R. Sloan, age 51, lives in Chicago, Illinois. She is one of the most successful promoters of TelexFree and has appeared in promotional videos for TelexFree that have been posted on the internet. She has also promoted TelexFree through a website called "telexfreepower.com".

RELIEF DEFENDANTS

21. TelexFree Financial, Inc. ("TelexFree Financial") is a Florida corporation with its principal place of business in Coconut Creek, Florida. It was incorporated by Craft on December 26, 2013. Its officers and directors are Wanzeler and Merrill, and Wanzeler is its registered agent. On December 30 and December 31, 2013, it received wire transfers totaling $4,105,000 from TelexFree, Inc. and TelexFree, LLC. On April 14, 2014, TelexFree Financial filed for bankruptcy protection in Nevada under Chapter 11.

22. TelexElectric, LLLP ("TelexElectric") is a Nevada limited partnership with its principal place of business in Las Vegas, Nevada. It was formed on December 2, 2013. Its general partners are Wanzeler and Merrill. Financial statements prepared by Craft indicate that TelexFree made a $2,022,329 "loan" to TelexElectric.

23. Telex Mobile Holdings, Inc. ("Telex Mobile") is a Nevada corporation with its principal place of business in Las Vegas, Nevada. It was incorporated on November 26, 2013. Its officers are Wanzeler and Merrill. Financial statements prepared by Craft indicate that TelexFree made a $500,870 "loan" to Telex Mobile.

STATEMENT OF FACTS

Background of TelexFree

24. In the late 1990s, Wanzeler and Merrill became sales agents for WorldxChange, one of many companies then offering inexpensive long-distance phone service through "10-10" access numbers. (To make a call, customers dialed the company's seven-digit access number and then dialed the phone number they wanted to reach.) WorldxChange was a multi-level marketing company using sales agents to recruit other sales agents as well as customers. Wanzeler and Merrill recruited Labriola as one of their marketers. In 2002, the three of them incorporated Common Cents as a vehicle for their sales efforts on behalf of WorldxChange. Wanzeler did most of the company's recruiting through his contacts in Brazil and the Brazilian community in Massachusetts. In 2003, however, the three stopped working with WorldxChange after it was acquired by another company and ceased its multi-level marketing.

25. In 2005, Wanzeler began selling analog telephone adapters – devices that link a traditional telephone line with a digital network or VoIP service. Most of his customers were in Brazil, and Wanzeler used the name "Brazilian Help" in the United States and "Disk A Vontade Telefonia" (Portuguese for "Call Unlimited") in Brazil. The business relied primarily on television and radio advertisements in Brazil to attract customers, because an attempt to employ WorldxChange's multi-level marketing model was not successful. The monthly charge was \$49.90. In 2007, Wanzeler incorporated Brazilian Help in Massachusetts. Merrill assisted Wanzeler but never held a title or an ownership interest in Brazilian Help.

26. In early 2012, Carlos Costa, who had been Wanzeler's top sales agent in Brazil, suggested that they start recruiting customers through advertisements on the internet. Taking

that suggestion, Wanzeler and Merrill changed the name of Common Cents to TelexFree, Inc. They adopted the name "99TelexFree" for their VoIP service, which they continued to price at $49.90 per month. Wanzeler, Costa, and associates in Brazil created a website called "telexfree.com". The site content was written in Portuguese and translated into English. In July 2012, Wanzeler, Merrill and Costa formed TelexFree, LLC, ostensibly to handle transactions outside Massachusetts.

27. In November 2012, TelexFree began operations in the United States.

The Structure of the Pyramid

Emphasis on Recruiting New Members

28. TelexFree purports to be in the business of providing its "99TelexFree" VoIP service, which costs $49.90 per month. Customers register their phone numbers with TelexFree and receive software that enables their computers to place phone calls through the company's network servers in Marlborough.

29. It is no secret, however, that the primary business of TelexFree is recruiting new members and paying them to promote the company by placing internet advertisements and recruiting more members. As Merrill stated in a press release dated March 1, 2013:

> In addition to providing an excellent service at a very reasonable price, the real "secret sauce" of our success is our compensation plan. We have developed a unique system which allows every one of our independent representative [sic] the ability to make money every week. We actually pay our representatives weekly if they follow our system and advertise our service on the Internet.

30. TelexFree's business model is straightforward: in return for modest membership fees, it promises significant financial returns if promoters place meaningless ads for its VoIP product on the internet and recruit others to do the same.

31. To reach out to new members, TelexFree relies on its company website and on websites maintained by its leading promoters. The internal portion of the company website (usually called the "back office") contains marketing materials that promoters may download and use for their own websites and other recruiting efforts. TelexFree monitors the activities of its promoters, who are not permitted to use any marketing materials that have not been approved by the company. If TelexFree objects to something posted by a promoter, the company may limit the promoter's access to the company's internal website or even revoke the promoter's registration. In addition, the individual defendants appear at public seminars, many of which are captured on videos that are posted on the internet, including sites such as "YouTube". Examples of YouTube promotional videos featuring statements by one or more of the individual defendants include:

> December 14, 2012: "Telexfree en Espanol – Santiago De La Rosa."
>
> March 13, 2013: "TelexFree Steve Labriola – Atlanta Sheraton."
>
> March 13, 2013: "TelexFree USA first Millionaire Sann Rodriguez [sic] Tells His Story." The video was posted by Sloan.
>
> April 20, 2013: "TelexFree Webinar Presentation + Leaders in HD." The presentation was by Crosby.
>
> June 12, 2013: "TelexFree Faith Sloan TelexFree Global Power Team Webinar."
>
> June 20, 2013: "TelexFree Investigation with President James Merrill, Vice President Carlos Wanzeler and Steve Labriola."

June 21, 2013: "Testimonio Santiago de la Rosa Vision telexfree."

July 31, 2013: "TelexFree USA – Los Angeles 1." The video, which was posted by Rodrigues, includes remarks by Merrill, Wanzeler and Labriola.

August 1, 2013: "TelexFree Corporate Speakers at Newport Beach Extravanganza." The video includes comments by Merrill, Wanzeler and Labriola.

August 17, 2013: "Telexfree Intervención y testimonios Sann Rodriguez y Santiago De La Rosa."

October 16, 2013 "TelexFree Business Presentation – En Espanol con Santiago De La Rosa."

January 29, 2014: "TelexFree Steve Labriola Corporate Update Call 1/29/14."

April 6, 2014 "TelexFree Steve Labriola Lots of Questions I Have Answers."

Membership Options

32. TelexFree charged $50 for an investor to become a "member" or "partner". By itself, a membership was meaningless. The only way for an investor to make money was to become a "promoter" who placed internet ads, recruited new members, and/or sold the VoIP service.

33. Prior to the rule change on March 9, 2014, TelexFree had two primary programs whereby promoters could make money by placing internet ads:

a. The "AdCentral" program cost $339 ($50 membership fee plus $289 contract fee) for a 52-week contract. Promoters in the AdCentral program received ten one-month packages of "99TelexFree" VoIP service and were required to place one internet ad per day. For each week that AdCentral promoters placed the required number of ads, they received one additional VoIP package. AdCentral promoters who posted the necessary ads were promised a weekly $20 payment, or $1,040 for the year. An AdCentral promoter who completed one 52-week contract was thus supposed to receive $1,040 – an annual return of 207% on an investment of $339.

b. The "AdCentral Family" program cost $1,425 ($50 membership fee plus $1,375 contract fee) for a 52-week contract. Promoters in the AdCentral Family program received fifty one-month packages of VoIP service and were required to place five internet ads per day. For each week that AdCentral Family promoters placed the required number of ads, they received five additional VoIP packages. AdCentral Family promoters who posted the necessary ads were promised a weekly $100 payment, or $5,100 for the year. An AdCentral Family promoter who completed one 52-week contract was thus supposed to receive $5,200 – an annual return of 265% on an investment of $1,425.

34. New members could pay the membership fee by credit card, or they could pay the promoter who recruited them (whose internal account with TelexFree would be debited in the amount of the fee). New members signed up through their promoter's page on the internal "back office" portion of the TelexFree website, registered their phone number, and received a personal log-in number.

<u>**Incentives for Promoters**</u>

35. Prior to the rule change on March 9, 2014, TelexFree employed a multi-level marketing structure in two respects. First, it had several programs whereby promoters were promised commissions simply for recruiting new AdCentral or AdCentral Family members:

a. Promoters were promised a one-time bonus of $20 for each new AdCentral member and $100 for each new AdCentral Family member they recruited.

b. Promoters who recruited two additional promoters were promised a bonus of $20 for each direct or indirect participant in their "network", up to a maximum of $440.

c. Under the "Team Builder Plan", AdCentral Family promoters who recruited ten AdCentral Family members, each of whom sold five VoIP packages (to themselves or to others), were promised 2% of TelexFree's net billing in the following month, up to a maximum of $39,600.

d. Promoters were promised 2% of all payments to each participant in their network who had at least once active VoIP customer (which could be the participants themselves), down to six levels of the promoters' network.

36. Second, TelexFree offered several commission programs for promoters based on sales of the "99TelexFree" VoIP service:

a. Promoters were promised a commission of 90% (or $44.90) for the initial VoIP package sold to a retail customer they recruited.

b. Promoters were promised a commission of 10% (or $4.99) per month for each direct participant who renewed the VoIP service and 2% (or $0.99) per month for each indirect participant who renewed the VoIP service, down to the sixth level of the promoters' network.

c. Promoters were promised a commission of 2% of all sales of VoIP packages by direct or indirect participants in their network, down to the sixth level of their network.

37. Promoters received their own page in the website's "back office", so that they could keep track of the participants in their network.

<u>The Sole Requirement for Getting Paid: Posting Internet Ads</u>

38. Prior to the rule change on March 9, 2014, there was no requirement that AdCentral promoters actually sell any VoIP packages in order to receive their weekly payments. Indeed, TelexFree and its promoters repeatedly emphasized that AdCentral members did not have to sell anything – they simply had to post the internet ads. The slogan repeated over and over was "everybody gets paid weekly."

a. One of the marketing presentations that appeared on the company's website was entitled "TelexFREE: Advertise & Technology." The presentation proclaimed, "Work over the Internet Posting ads daily." Only one slide mentioned the VoIP service; the rest described the various membership and commission programs in detail.

b. When telling his success story in an internet video on March 13, 2013, Rodrigues stated, "Just place your ads every day and everyone gets paid weekly." He also asked and answered the following question: "What company in the country, in the world, you can make money ... you don't need to sell anything? Now it exists. TelexFree."

c. Crosby stated in an internet video on April 20, 2013, "What if you were with a company that would pay you just to advertise the service? ... They're paying us to advertise the service. It's just that simple." He added that members do not have to "worry about selling to the public."

d. Sloan stated in an internet video on June 12, 2013, "Place your ads, and you go about your day. You do that for seven days a week, you get paid every single week." She added, "You don't have to build. You don't have to sell."

e. Defendants often characterized the payments of $20 per week to AdCentral promoters and $100 per week to AdCentral Family promoters as the company's repurchase of the VoIP packages they received each week (at $20 each).

39. Promoters were required to post ads written by TelexFree and found on the "back office" portion of the company website. Most of the ads offer a 60-minute free trial of the VoIP service. The "back office" also contains links to many external websites where the ads can be posted. Using a computer, the promoter copies the ad, pastes it on the external website, and returns to the "back office" to "validate" that the ad was placed.

40. TelexFree and its promoters emphasized that the process of placing the ads is extremely simple.

a. One version of the marketing presentation on the company website stated, "TelexFree turnkey marketing system makes internet advertising simple & duplicatelable [sic]."

b. Another version of the marketing presentation on the company website stated: "We have it all computerized [sic], with only 3 steps, in your virtual office."

c. Crosby stated in his April 2013 video, "It takes less than thirty seconds to place each ad. Most people do it in 15 to 20 seconds."

d. Sloan stated in her June 2013 video, "You post your ads. Take you a minute and a half. Three minutes. Five minutes max."

41. In fact, promoters who wanted to place many ads per day could take advantage of third-party services that automated the ad posting and validating process for a small fee.

42. The sheer volume of virtually identical advertisements for TelexFree's VoIP service rendered them largely meaningless, especially because anyone who used "telexfree" as an internet search term would be led to the company's own website. In early April 2014, one website, Adpost.com, contained more than 33,000 ads for TelexFree, while another, ClassifiedsGiant.com, contained more than 25,000 ads posted just since February 1, 2014.

43. TelexFree and its promoters repeatedly emphasized that promoters who posted ads and recruited more members could earn substantial amounts of money.

a. One version of the marketing presentation on the company website contained slides indicating that an AdCentral promoter could clear $2,296 per year on a $289 investment, that an Ad Central Family promoter could clear $11,599 per year on a $1,375 investment, and that a Team Builder promoter could receive as much as $39,600 per year.

b. Another version of the marketing presentation on the company website stated, "Earn Income Down to Infinity."

c. Telexfree stated in a March 1, 2013 press release that 23 promoters had already become millionaires in Brazil.

d. Crosby stated in his April 2013 video, "Dozens and dozens of people have become millionaires because of this." He added, "How deep does it go? It pays down to infinity."

e. Labriola stated in his January 2014 video, "There are some people that are making incredible money in this."

Material Misrepresentations and Omissions about TelexFree

44. In all their statements to the public through the company website and internet videos, the defendants never disclosed that revenues from the VoIP business were very small (see paragraph 50 below) and that they were actually operating a pyramid scheme.

45. In addition, TelexFree and its promoters made numerous false public statements about the company, its founders, and its business:

a. The TelexFree website, in a section entitled "Founder", states that Merrill received a B.A. in Economics from Westfield State University. The statement is false. Merrill dropped out of Westfield State after only two years.

b. The "Founder" section of the TelexFree website includes a photo of Merrill standing in front of a large three-story building, with the caption "Mr. Merrill in front of the headquarters of Telexfree in the USA." At least two versions of the marketing presentation on the company website contained a photo of Merrill and a photo of the same building with the caption "The Company HS: United States." The use of the building photo is misleading. TelexFree, Inc. does not own or occupy the entire building. In fact, it originally shared a single suite (consisting of a receptionist, conference rooms, and cubicles) with 28 other companies. Only in December 2013 did it move into its own suite, which occupies a portion of the first floor. TelexFree, LLC has no physical office at all, just a mailing address in Nevada.

c. On March 21, 2014, TelexFree issued a press release with the following quote from Merrill: "We have been in VOIP telecommunications for more than a decade." The statement is false. As noted above, Common Cents was founded in 2002, and its business was marketing "10-10" long-distance plans for WorldxChange – not VoIP technology.

d. The public portion of the TelexFree website contains a picture of a Best Western hotel and a banner reading "Hotel Best Western Opportunity." The TelexFree "back office" website includes an icon with the logo of Best Western Hotels that is entitled "Best Western, Telexfree Tijuca". At least one version of the marketing presentation on the company's website included descriptions of Best Western's activities in the United State and South America. Crosby stated in his April 2013 video, "This company has a joint venture with Best Western." The representation and other suggestions that TelexFree has a business relationship with Best Western is false. Ympactus Comercial Ltda. ("Ympactus"), a Brazilian corporation controlled by Wanzeler and Costa, has a promotional agreement with a Brazilian company that is partnering with Best Western on a new hotel. TelexFree has no relationship at all with Best Western.

e. The "Founder" section of the TelexFree website states, "Being well versed in one of the new technologies in the era (VoIP), in 2002 he [Merrill] decided to found TelexFree, Inc. to serve this market." On August 1, 2013, Wanzeler told a gathering of TelexFree promoters, "We have a company since 1995. It's a VoIP product company." The statements are false, for several reasons. First, Common Cents – not TelexFree – was founded in 2002. Second, Wanzeler, Merrill and Labriola – not just Merrill – incorporated Common Cents. Third, the business of Common Cents was marketing "10-10" long-distance access plans for WorldxChange – not VoIP technology.

Reassuring Statements about Regulatory Action by Brazil

46. In June 2013, a court in the Brazilian state of Acre suspended the operations of Ympactus and froze its assets in Brazil, based on the suspicion of operating a pyramid scheme. In a video posted on June 20, 2013, Merrill, Wanzeler and Labriola sought to reassure promoters. Merrill stated, "Inquiries like this are very common in network marketing... We have such unbelievable growth that we're going to draw attention." Labriola stated, "These things happen to network marketing companies over and over again... Let's not worry about it." Wanzeler added, "We're still here. We're going to stay here for a long time."

47. In its bankruptcy filings on April 14, 2014, however, TelexFree claims that after the Brazilan enforcement action against Ympactus, it began planning to restructure its compensation program – planning which resulted in the changes announced on March 9, 2014.

48. Defendants did not disclose that several banks and at least one payment processor stopped doing business with TelexFree, apparently due to concerns about the legality of its multi-level marketing program. As a result, TelexFree has repeatedly been forced to open new accounts at different banks and to switch payment processors.

Secrets of the Pyramid

49. After the enforcement action in Brazil, certain persons affiliated with TelexFree made public statements to the effect that TelexFree is different from illegal multi-level marketing programs because it has an actual product to sell – the 99TelexFree VoIP service.

a. In a video posted on August 2, 2013, Gerald Nehra, who claims to be the TelexFree's attorney, stated, "The special ingredient is that you have a real product."

b. In a video posted on August 15, 2013, Costa stated that TelexFree "never was, never will be" an illegal pyramid because of the sales of the VoIP service. He asserted, "We do not depend on everyone coming in in order to pay the people who are already in."

50. The reality is quite different. Based on the information available to date, it is clear that TelexFree's VoIP revenue has been only a small fraction of the money it promised to pay to AdCentral promoters. Credit card transactions from August 2012 to March 2014 indicate that TelexFree received slightly more than $1.3 million from the sale of approximately 26,300 VoIP contracts. During the same period, TelexFree received more than $302 million from approximately 48,000 AdCentral promoters and 202,000 AdCentral Family promoters. Through the sale of those one-year contracts, TelexFree promised to pay more than $1.1 billion to the promoters who placed the required internet ads – a task which, as explained above, was extremely easy to accomplish. In other words, the receipts from selling VoIP packages covered barely 1% of TelexFree's obligations to pay promoters who placed ads. The disparity between TelexFree's VoIP revenues and its AdCentral obligations was actually worse than that, because the $1.1 billion of estimated obligations does not include the commissions and incentives that TelexFree promised to pay to promoters under the additional programs described above.

51. In short, TelexFree was operating a classic pyramid. Because revenues from VoIP sales were so small, TelexFree was forced to use money from newer investors to make its payments to older investors.

Diversion of Funds

52. The Commission has not yet been able to obtain a complete set of statements from the defendants' banks, brokerage firms, and credit card payment processing services. However, the information available to date, from bank records and other financial records as well as from statements made by various defendants, indicates that Merrill and Wanzeler, who had sole authority to transfer TelexFree corporate funds until the bankruptcy filing, have caused more than $30 million to be transferred from TelexFree operating accounts to themselves and to affiliated companies in the past few months:

a. Bank statements show that TelexFree Financial, Inc. received $4,105,000 on December 30 and December 31, 2013.

b. Financial statements prepared by Craft indicate that TelexFree made a $2,022,329 "loan" to TelexElectric.

c. Financial statements prepared by Craft indicate that TelexFree made a $500,870 "loan" to Telex Mobile.

d. Bank statements show that, in December 2013, approximately $14.3 million was transferred to newly-created brokerage accounts in the name of TelexFree, LLC.

e. Bank statements show that Merrill received $3,136,200 on December 26 and December 27, 2013.

f. Bank statements show that Wanzeler received $4,317,800 on December 26 and December 27, 2013.

g. Bank statements show that two companies controlled by Craft received more than $2,010,000 between November 19, 2013 and March 14, 2014.

h. Federal wire transfer records show that Wanzeler wired $3.5 million to the Oversea-Chinese Banking Corporation in Singapore on January 2, 2014.

i. In addition, a bank has informed the Commission that TelexFree, LLC sent $10,389,000 to an entity known as TelexFree Dominicana, SRL on April 3, 2013.

53. Also, on April 11 (just before TelexFree filed for bankruptcy), Merrill and the wife of Wanzeler obtained cashier's checks in the total amount of $25,552,402. The checks are payable to TelexFree, LLC.

Collapse of the Pyramid

54. On March 9, 2014, TelexFree made changes to its compensation plan that made it much harder for promoters to qualify for payments. The most significant change was that promoters may not receive any payments – even if they had qualified for the payments before March 9 – until they have recruited ten VoIP customers, including five who remain active each month, as well as two direct recruits who each have five active VoIP customers per month. In other words, promoters must now actually sell the TelexFree's VoIP product in order to get paid.

55. The rule change generated a storm of protests from AdCentral members. On April 1, dozens of members descended on the company's office in Marlborough to complain – in part because, as one member told the press, the VoIP service is "almost impossible to sell".

56. On April 14, 2014, defendants TelexFree, Inc. and TelexFree, LLC and relief defendant TelexFree Financial Inc. filed for bankruptcy in Nevada under Chapter 11. The three

companies claimed to have liabilities of as much as $600 million but assets of no more than $120 million. The companies stated that, in the five weeks after the March 9 rule change, promoters submitted claims for $174 million, primarily for AdCentral ad placements. The companies also stated that revenues under the new March 9 compensation plan – which requires AdCentral promoters to sell VoIP products in order to get paid – have been so disappointing that the companies cannot meet their obligations. Confirming that VoIP sales have not generated enough revenue to honor their promises to AdCentral promoters, the companies seek authority to reject all existing AdCentral contracts.

57. The whereabouts and/or disposition of much of the more than $300 million of investor funds raised by TelexFree is unknown.

FIRST CLAIM FOR RELIEF
(Violation of Section 10(b) of the Exchange Act and Rule 10b-5)

58. The Commission repeats and incorporates by reference the allegations in paragraphs 1-56 of the Complaint as if set forth fully herein.

59. Defendants, directly or indirectly, acting intentionally, knowingly or recklessly, by the use of means or instrumentalities of interstate commerce or of the mails, in connection with the purchase or sale of securities: (a) have employed or are employing devices, schemes or artifices to defraud; (b) have made or are making untrue statements of material fact or have omitted or are omitting to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) have engaged or are engaging in acts, practices or courses of business which operate as a fraud or deceit upon certain persons.

60. As a result, defendants have violated and, unless enjoined, will continue to violate Section 10(b) of the Exchange Act [15 U.S.C.§78j(b)] and Rule 10b-5 thereunder [17 C.F.R. §240.10b-5].

SECOND CLAIM FOR RELIEF
(Violation of Section 17(a) of the Securities Act)

61. The Commission repeats and incorporates by reference the allegations in paragraphs 1-56 of the Complaint as if set forth fully herein.

62. Defendants, directly and indirectly, acting intentionally, knowingly or recklessly, in the offer or sale of securities by the use of the means or instruments of transportation or communication in interstate commerce or by the use of the mails: (a) have employed or are employing devices, schemes or artifices to defraud; (b) have obtained or are obtaining money or property by means of untrue statements of material fact or omissions to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) have engaged or are engaging in transactions, practices or courses of business which operate as a fraud or deceit upon purchasers of the securities.

63. As a result, defendants have violated and, unless enjoined, will continue to violate Section 17(a) of the Securities Act [15 U.S.C. §77q(a)].

THIRD CLAIM FOR RELIEF
(Violation of Sections 5(a) and 5(c) of the Securities Act by Defendants TelexFree, Inc., TelexFree, LLC, Merrill and Wanzeler)

64. The Commission repeats and incorporates by reference the allegations in paragraphs 1-56 of the Complaint as if set forth fully herein.

65. TelexFree, Inc. and TelexFree, LLC have never registered or attempted to register any offering of securities under the Securities Act or any class of securities under the Exchange Act, and no exemption from registration was available.

66. Defendants TelexFree, Inc., TelexFree, LLC, Merrill and Wanzeler, directly or indirectly: (a) have made or are making use of the means or instruments of transportation or communication in interstate commerce or of the mails to sell, through the use or medium of a prospectus or otherwise, securities as to which no registration statement has been in effect and for which no exemption from registration has been available; and/or (b) have made or are making use of the means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell, through the use or medium of a prospectus or otherwise, securities as to which no registration statement has been filed and for which no exemption from registration has been available.

67. Defendants TelexFree, Inc., TelexFree, LLC, Merrill and Wanzeler have violated and, unless enjoined, will continue to violate Sections 5(a) and (c) of the Securities Act [15 U.S.C. §§77e(a), (c)].

PRAYER FOR RELIEF

WHEREFORE, the Commission requests that this Court:

A. Enter a preliminary injunction, order freezing assets, and order for other equitable relief in the form submitted with the Commission's motion for such relief;

B. Enter a permanent injunction restraining defendants and each of his agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of the injunction by personal service or otherwise, including facsimile transmission or overnight delivery service, from directly or indirectly engaging in the conduct described above, or in conduct of similar purport and effect, in violation of:

1. Section 10(b) of the Exchange Act [15 U.S.C. §78j(b)] and Rule 10b-5 thereunder [17 C.F.R. §240.10b-5] as to all defendants;

2. Section 17(a) of the Securities Act [15 U.S.C. §77q(a)] as to all defendants; and

3. Section 5 of the Securities Act [15 U.S.C. §77e] as to defendants TelexFree, Inc., TelexFree, LLC, Merrill and Wanzeler;

C. Require defendants to disgorge their ill-gotten gains and losses avoided, plus pre-judgment interest, with said monies to be distributed in accordance with a plan of distribution to be ordered by the Court;

D. Order defendants to pay an appropriate civil penalty pursuant to Section 20(d) of the Securities Act [15 U.S.C. §77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. §78u(d)(3)];

E. Retain jurisdiction over this action to implement and carry out the terms of all orders and decrees that may be entered; and

F. Award such other and further relief as the Court deems just and proper.

Respectfully submitted,

Frank C Huntington

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Dated: April 15, 2014

EXHIBIT 2

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

TELEXFREE, INC.,
TELEXFREE LLC,
JAMES M. MERRILL,
CARLOS N. WANZELER,
STEVEN M. LABRIOLA,
JOSEPH H. CRAFT,
SANDERLEY RODRIGUES DE VASCONCELOS,
SANTIAGO DE LA ROSA,
RANDY N. CROSBY and
FAITH R. SLOAN,

Defendants,

and

TELEXFREE FINANCIAL, INC.,
TELEXELECTRIC, LLC and
TELEX MOBILE HOLDINGS, INC.,

Relief Defendants.

Case No. 14-11858-DJC

~~[proposed]~~

TEMPORARY RESTRAINING ORDER

Having considered the emergency *ex parte* motion for a temporary restraining order, order freezing assets, and order for other equitable relief filed by plaintiff Securities and Exchange Commission ("the Commission"), as well as the Complaint, the Commission's memorandum of law and accompanying evidentiary materials the Court finds that the Commission has made the showing required by Fed. R. Civ. P. 65(b)(1), and in addition, that the Commission has shown that: (1) it is reasonably likely to establish that defendants Telex Free, Inc. and TelexFree LLC (collectively "TelexFree") and the individual defendants James H. Merrill, Carlos N. Wanzeler, Steven M. Labriola, Joseph H. Craft, Sanderley Rodrigues de Vasconcelos, Santiago De La Rosa, Randy N. Crosby, and Faith R. Sloan (collectively "Individual Defendants") have directly or indirectly engaged in the violations alleged in the Complaint; (2) there is a reasonable likelihood that these violations will be repeated; (3) there is a strong indication that unless restrained and enjoined by Order of this Court, TelexFree, and the Individual Defendants may dissipate and conceal assets which could be subject to an order of disgorgement or an order to pay a civil monetary penalty in this action; and (4) entry of a temporary restraining order freezing assets is in the public interest. In consideration of the foregoing:

I.

IT IS HEREBY ORDERED that Telexfree and the Individual Defendants and each of their agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including via facsimile or email transmission, or overnight delivery service, are restrained from violating Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77q(a)] by, directly or indirectly, through the use of any means or instrumentalities of interstate commerce or the mails or of any facility of any national securities exchange,

(a) employing any device, scheme or artifice to defraud;

(b) obtaining any money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(c) engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser,

in the offer or sale of any securities.

II.

IT IS HEREBY FURTHER ORDERED that TelexFree and each of the Individual Defendants and each of their agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including via facsimile or email transmission, or overnight delivery service, are restrained from violating Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5] by, directly or indirectly, through the use of the means or instrumentalities of interstate commerce or of the mails or of any facility of any national securities exchange,

(a) employing any device, scheme or artifice to defraud;

(b) making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(c) engaging in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

III.

IT IS HEREBY FURTHER ORDERED that TelexFree, Merrill, and Wanzeler and each of their agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including via facsimile or email transmission, or overnight delivery service, are restrained from violating Section 5 of the Securities Act [15 U.S.C. § 77e] by, directly or indirectly, in the absence of any applicable exemption:

(a) Unless a registration statement is in effect as to a security, making use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise;

(b) Unless a registration statement is in effect as to a security, carrying or causing to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale; or

(c) Making use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed with the Commission as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under Section 8 of the Securities Act [15 U.S.C. § 77h].

IV.

IT IS HEREBY FURTHER ORDERED that:

A. TelexFree and the Individual Defendants and each of their officers, agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including via facsimile or email transmission, or overnight delivery service, shall hold and retain funds and other assets of defendants presently held by them, for their direct or indirect benefit, under their direct or indirect control or over which they exercise actual or apparent investment or other authority, in whatever form such assets may presently exist and wherever located, and are restrained from taking any actions to withdraw, sell, pay, transfer, dissipate, assign, pledge, alienate, encumber, dispose of, or diminish the value of in any way (including, but not limited to, making any charges on any credit card or draws on any other credit arrangement), any funds and other assets of TelexFree and the Individual Defendants presently held by them, for their direct or indirect benefit, under their direct or indirect control, or over which they exercise actual or apparent investment or other authority, in whatever form such assets may presently exist and wherever located. According to Fed. R. Civ. P. 65(b)(2), this Order will expire on April 24 2014, at 2 p.m. unless before that date, it is extended by the Court for good cause.

B. All banks, brokerage and other financial institutions (including but not limited to Bank of America, Citizens Bank, Fidelity Cooperative Bank, Banco do Brazil-Miami, Digital Credit Union, American Express Bank, Bonneville Bank (Green Dot Bank), Citibank, Commerce Bank and Trust Company, Discover Bank, Waddell & Reed, Middlesex Savings Bank, Royal Bank of Scotland, TD Bank, Wells Fargo, Banterra Bank, Infinex Investments, Bank of New England, Eastern Bank, First Citizens' Federal Credit Union, and PNC Bank) and other persons or entities (including but not limited to payment processors, investors and/or promoters) that receive actual notice of this Order by personal service or otherwise, including via facsimile or email transmission, or overnight delivery service, holding any funds or other assets in the name, for the direct or indirect benefit, or under the direct or indirect control of defendants or over which defendants exercise actual or apparent investment or other authority, in whatever form such assets may presently exist and wherever located, shall hold and retain within their control and prohibit the withdrawal, removal, sale, payment (including, but not limited to, any charges on any credit card or draws on any other credit arrangement), transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds or other assets; and that such funds and assets are hereby frozen.

C. The above Paragraphs IV.A and IV.B shall immediately cease to apply to any assets located within the United States, including any bank, brokerage or other financial institution account, which becomes subject to any later order entered by any federal court as a result of proceedings which may be filed by the United States or any department or agency thereof under any federal civil or criminal forfeiture statute, to the extent such later order requires the transfer of any asset to the United States government.

V.

IT IS HEREBY FURTHER ORDERED that:

A. Relief Defendants TelexFree Financial, Inc., TelexElectric LLLC, and Telex Mobile Holdings, Inc. and each of their agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including via facsimile or email transmission, or overnight delivery service, shall hold and retain funds and other assets of the Relief Defendants presently held by them, for their direct or indirect benefit, under their direct or indirect control or over which they exercise actual or apparent investment or other authority, in whatever form such assets may presently exist and wherever located, and shall prevent any withdrawal, sale, payment (including, but not limited to, any charges on any credit card or draws on any other credit arrangement), transfer, dissipation, assignment, pledge, alienation, encumbrance, disposal, or diminution in value of any such funds or other assets, which are hereby frozen; and

B. All banks, brokerage and other financial institutions and other persons or entities which receive actual notice of this Order by personal service or otherwise, including via facsimile or email transmission, or overnight delivery service, holding any funds or other assets in the name, for the direct or indirect benefit, or under the direct or indirect control of the Relief Defendants or over which the Relief Defendants exercise actual or apparent investment or other authority, in whatever form such assets may presently exist and wherever located, shall hold and retain within their control and prohibit the withdrawal, removal, sale, payment (including, but not limited to, any charges on any credit card or draws on any other credit arrangement), transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds or other assets; and that such funds and assets are hereby frozen.

C. The above Paragraphs V.A and V.B shall immediately cease to apply to any assets located within the United States, including any bank, brokerage or other financial institution account, which becomes subject to any later order entered by any federal court as a result of proceedings which may be filed by the United States or any department or agency thereof under any federal civil or criminal forfeiture statute, to the extent such later order requires the transfer of any asset to the United States government.

VI.

IT IS HEREBY FURTHER ORDERED that TelexFree and the Individual Defendants shall submit in writing and serve upon the Commission, within five (5) business days following service of this Order upon them, an accounting identifying:

1. all transfers or payments of funds to them or any other entity controlled by them from investors or "promoters" in connection with the misconduct described in the Complaint (the identification shall include the amount of each such transfer or payment, the date of the transfer or payment, and the name, address, account number and financial institution of the party making and the party receiving the transfer or payment);

2. in detail, the precise disposition of each transfer or payment identified in response to paragraph 1 above and all assets derived therefrom, including but not limited to:

   a. the nature and results of any investment in which the funds were used;

   b. any subsequent transfer or payment of the funds (the identification shall include the amount of each such transfer or payment, the date of the transfer or payment, the name, address, account number and financial institution of the party making and receiving the transfer or payment, and the reason for the transfer or payment); and

   c. any fees or expenses charged and a detailed statement of the nature and purpose of such fees and expenses.

3. by name and address, all persons, entities and accounts currently holding funds or assets derived from the transfers or payments described in paragraph 1 above and the reason each

received the funds or assets (the identification shall include the amount each received, the date received, the reason received, the institution and account number or location in which the funds or other assets are held and the name, address, account number and financial institution of the person or entity who provided each with the funds or other assets);

4. assets of every type and description with a value of at least five hundred dollars ($500) presently owned by or held for the direct or indirect benefit, or subject to the direct or indirect control, of TelexFree and the Individual Defendants, whether in the United States or elsewhere;

5. all accounts held at any bank, brokerage or other financial institution in the United States or elsewhere in the name, for the direct or indirect benefit, or under the direct or indirect control, of TelexFree and/or the Individual Defendants, or in which TelexFree and/or the Individual Defendants has or had any direct or indirect beneficial interest, at any time from January 1, 2012 to the present; and

VII.

IT IS HEREBY FURTHER ORDERED that TelexFree and the Individual Defendants and each of their officers, agents, servants, employees and attorneys, and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including via facsimile or email transmission, or overnight delivery service, and each of them, shall, within five (5) days of receiving actual notice of this Order, take such steps as are necessary to repatriate and deposit into the registry of the Court in an interest bearing account, any and all funds or assets that presently may be located outside of the United States that were obtained directly or indirectly from investors and/or "promoters."

VIII.

IT IS HEREBY FURTHER ORDERED that TelexFree and the Individual Defendants and each of their agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including via facsimile or email transmission, or overnight delivery service, are hereby prohibited from soliciting, accepting, or depositing any monies obtained from actual or prospective investors or "promoters" pending the resolution of this action nor may they open new bank accounts.

IX.

IT IS HEREBY FURTHER ORDERED that TelexFree and the Individual Defendants and each of its agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including via facsimile or email transmission, or overnight delivery service, are hereby restrained from destroying, mutilating, concealing, altering, disposing, or transferring custody of any items, including but not limited to any books, records, documents, correspondence, contracts, agreements, assignments, obligations, tape recordings, computer media or other property relating to defendants or the misconduct described in the Complaint.

X.

IT IS HEREBY FURTHER ORDERED that the Commission, notwithstanding the provisions of Fed. R. Civ, P. 26(d) and the Local Rules of this Court, may commence discovery immediately. In the event the Commission chooses to depose any witnesses prior to any hearing on the Commission's requests for temporary or preliminary relief, such witnesses shall be required to appear for a deposition on three business days notice. Such depositions shall not count towards any of the limits on depositions set forth in the Federal Rules of Civil Procedure or the Local Rules, including but not limited to Fed. R. Civ. P. 30 (a)(2)(A) and 30(d)(2). Moreover, notwithstanding the provisions of Fed. R. Civ. P. 30(a)(2)(B), the Commission shall be entitled to depose these witnesses again during the discovery period.

Denise J. Casper
UNITED STATES DISTRICT JUDGE

Dated: April 16th, 2014 at 3:35 ~~a.m.~~/p.m.

EXHIBIT 3

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

Civil Action No. 14-11858-DJC

v.

April 16, 2014
3:03 p.m.

TELEXFREE, INC., et al.,

Defendant.

TRANSCRIPT OF MOTION HEARING

BEFORE THE HONORABLE DENISE J. CASPER

UNITED STATES DISTRICT COURT

JOHN J. MOAKLEY U.S. COURTHOUSE

1 COURTHOUSE WAY

BOSTON, MA 02210

DEBRA M. JOYCE, RMR, CRR
Official Court Reporter
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Boston, MA 02210
joycedebra@gmail.com

APPEARANCES:

FOR THE PLAINTIFF:

FRANKLIN C. HUNTINGTON, IV, ESQ.
DEENA R. BERNSTEIN, ESQ.
Securities and Exchange Commission
33 Arch Street
23rd Floor
Boston, MA 02110
617-573-8960

P R O C E E D I N G S

(The following proceedings were held in open court before the Honorable Denise J. Casper, United States District Judge, United States District Court, District of Massachusetts, at the John J. Moakley United States Courthouse, 1 Courthouse Way, Boston, Massachusetts, on April 16, 2014.)

THE CLERK: Civil action 14-11858, SEC v. TelexFree, Inc.

Would counsel please state your name for the record.

03:03 MR. HUNTINGTON: Certainly. Good afternoon, your Honor. Frank Huntington and Deena Bernstein from the Securities and Exchange Commission.

THE COURT: Good afternoon, counsel.

Counsel, I'm in receipt of the complaint, the application for temporary restraining order and the supporting materials, including a number of affidavits, including what I've been handed as the supplemental affidavit of Scott Stanley, which, having looked through it quickly, seems to relate to certain events of yesterday and a conversation this morning. Okay. 03:04

MR. HUNTINGTON: That's correct, your Honor. I should just add that Mr. Stanley and Mr. Albers, who also submitted an affidavit, are both here in Court if you have any questions you would like to pose to them directly.

THE COURT: Okay.

Counsel, I had a chance to read over the papers. I know there were quite a number of exhibits as well.

Counsel, I have a sense of the claims that you make against the various defendants, these are two corporate entities and then a number of individual defendants, but I guess I'd like to hear you on -- focused on why I should do this *ex parte* with a focus on irreparable harm and why there shouldn't be any notice in providing the relief that you seek.

MR. HUNTINGTON: Your Honor, I think it's pretty simple. These are people who are already in the act of trying to secrete away investors' assets as recently as today, I believe there was -- another request to withdraw money was delivered to one of the banks that we've identified. It's part of Mr. Stanley's supplemental declaration.

On Friday, even though they knew they were about to file for bankruptcy, Mr. Merrill and the wife of defendant Wanzeler went into a bank and came out with $25 million in cashier's checks. Now, on the one hand, they kind of know the regulators are coming --

THE COURT: And, counsel, this is in regards to defendant Merrill, I think.

MR. HUNTINGTON: The events on Friday were defendant Merrill and wife of defendant Wanzeler, who went in together to the branch down in Providence, I believe.

THE COURT: And the events of yesterday, I'm just looking again at the supplemental declaration of Mr. Stanley, that on April 15th, which would be yesterday, counsel --

MR. HUNTINGTON: Yes.

THE COURT: Mr. Merrill also submitted an unsolicited order for what I take to be $1.1 million; is that correct?

MR. HUNTINGTON: Yes, your Honor.

THE COURT: Okay.

MR. HUNTINGTON: And, your Honor, on the one hand, they do know the regulators are coming. The Secretary of

03:07 State's securities division has had an investigation and they filed a case yesterday as well, and the FBI executed a search warrant yesterday.

Of course, yet, another indication of what the defendants are like, the people we're dealing with here, defendant Craft was there, he is, again, represented in the supplemental Stanley declaration. He tells them that he's only a consultant when, in fact, he's been the CFO for two years. He starts to walk out with what he says is just a personal briefcase with personal items in it; they say they have to

03:07 search it, and he's got millions of dollars of cashier's checks in there.

These are not people you can trust, and even though they know the government is coming, we're the only party in the mix that can get an immediate asset freeze. I think it's essential to do that today. We're standing by to be able to fax the freeze order to what I think are over 30 banks, at least 30 banks. There are a lot of institutions here. They are moving a lot of money. They have already diverted $30 million in the last four months or five months that we've identified in our papers. There's plenty more money unaccounted for, and they've got -- we've got to do our best to stop them right now.

Notice will only give them more incentive to try to move more money before we have whatever hearing will be scheduled.

03:08

THE COURT: Counsel, obviously, likelihood of success is one of the findings I need to make at this point. I've read through your papers. Certainly I understand the argument as to the corporate entities overall, but can you walk me through the basis of your argument of likelihood of success as to the individual defendants?

MR. HUNTINGTON: Your Honor, every single one of the individual defendants, apart from Mr. Craft, who is the accountant for the enterprise, every single one of the others has made public statements at seminars, many of which have been videoed so that you're able to see them on YouTube, they're all on record publicly promoting the TelexFree service but really promoting how you can get paid for essentially doing nothing. You can get paid for placing ads, and they explain how easy it is to do that, how much money you can get for doing that.

03:08

They're all actively involved. Thanks to several hours of watching YouTube videos myself and transcribing what I could, there are plenty of examples of each of those people helping to promote the scheme and helping to explain how great it is, how much money you can make for virtually no effort, and without -- they're all active enough, these people -- well, Merrill, Wanzeler, and Labriola are officers, they certainly know this.

THE COURT: And then De La Rosa, Crosby, and Sloan are promoters, counsel?

03:09 MR. HUNTINGTON: Yes, and also Rodrigues De Vasconcelos, not sure how to pronounce that -- the last four are promoters.

Mr. Rodrigues is subject to an injunction entered by Judge O'Toole in an earlier pyramid scheme case we had about five years ago.

They're all on record promoting the scheme, explaining how great it is and how you get money for doing little. They all know the justification for this. The reason why it is supposedly not an illegal pyramid scheme is that they have a 03:10 supposedly real product that they're selling, this VOIP service. And they do have a real product. The trouble is, as documented in Mr. Albers' declaration, the sales of that product generate a tiny amount of money, a million dollars based on the last two years' worth of credit card payment processing data that we were able to get. That's whereas they've taken in at least 300 million. They've incurred obligations to pay, if they honor the promises, a billion dollars that we know of, and there is no way in the world that the amount of money they're taking in from selling the actual product, which is way overpriced for what it is, and hence, hard to sell, they all know that they can't possibly be satisfying the promises based on the sales of the product.

The only way that they've been keeping this going for as long as they have is because they keep on recruiting new
03:11 members, a classic Ponzi scheme and pyramid scheme.

THE COURT: Meaning, the recruiting of new members for the purposes of promotion.

MR. HUNTINGTON: Yes, and getting more money into the system of which they get a share.

The reason why it's fair to sue the four promoters is because you participate in this scheme through the person who promoted you, you know the promoter who brought you in, and then they have, as you've probably seen from the marketing presentations, you can do this down about six layers within
03:11 your network. The promoters at the top of the scheme know perfectly well how many new members of ad central they're bringing in and how many actual VOIP customers they're bringing in because they get commissions for all of that stuff.

Of course, we haven't been able to do an investigation directly against the defendants yet because the -- until

03:12 03:13

yesterday, the U.S. Attorney's Office was operating in secret. We couldn't reveal ourselves without tipping things, so we had to wait until the search warrant was executed. So we're relying on what we've been able to get from banks and brokerage firms, the payment processors, independent third-party sources. So we don't know everything, obviously, what the defendants have in their possession, and so it's harder to prove their state of mind to you right now than it will be after we get discovery from them. But it is a real plausible inference, it's more than plausible, it's got to be true that they know the money coming in is coming from people participating in this ad central program where they place the ads. The money is not coming in from selling that product. So they have got to know.

In the case of Mr. Rodrigues, who has experience with pyramid schemes -- obviously, they know how this works, and they know the money they're paying out to people is coming from new people they're bringing in. So it's fair to assert they have *scienter*, certainly the corporate officers have *scienter*.

Mr. Craft, he's not making public statements, but he's preparing financial statements, so he really knows where the money is coming from, and financial statements that they have represented as being accurate in terms of what revenues they're bringing in. And revenue figures that we can't document at all based on the financial information we've seen.

So it's fair to include them all, your Honor, it's fair to name them all, and it's fair to have the asset freeze apply to every one of them.

THE COURT: And, counsel, what's the basis for your proposal at the end of the proposed order about having discovery start immediately? Are you just asking me to do that as an exercise of my discretion, counsel?

MR. HUNTINGTON: Just discretion to permit expedited discovery?

THE COURT: Yes.

03:14 MR. HUNTINGTON: Oh, yes, your Honor. It's something we typically ask for in this kind of case, and I believe it's part of your general equitable powers to order it. It enables us to try to get more information so that when it would come time for hearing to convert this into a preliminary injunction, we have a bit more of a record to give you. We certainly hope we can.

THE COURT: Counsel, about what about the security requirement under Rule 65(c) that applies to TROs and preliminary injunctions, which -- well, let me ask you about

03:14 that.

MR. HUNTINGTON: Your Honor, without having anything to cite, I am a hundred percent sure that does not apply to the Commission.

THE COURT: Let me just see.

MR. HUNTINGTON: Let's just say I've been at the

Commission for 14 years, I've been involved in a number of TROs.

THE COURT: Counsel, I think you're right. I have it open here. I think you're right as to a federal agency.

MR. HUNTINGTON: Thank you. I would think the Commission might be good for it, but presumably we don't need to be.

THE COURT: Well, counsel, I understand your position. I see the language, the specific language, at the end of Rule 65(c).

03:15 And, counsel, here where the rule requires that it not exceed 14 days, you've left this open, counsel, in terms of proposal for the date.

MR. HUNTINGTON: Yes, your Honor. We really left it blank because we leave it to up your Honor to do what you thought was appropriate.

THE COURT: And are all the defendants in the District of Mass.?

MR. HUNTINGTON: No. Let's see. As far as we know at

03:15 the moment, unless they've fled the jurisdiction, Merrill and Wanzeler and Labriola live here. De La Rosa lives here. Craft was here yesterday when the offices were searched, although we understand his residence is out in Michigan or Kentucky, it's somewhere in the midwest.

De Vasconcelos, Rodrigues used to live here, but we believe he has moved in Florida, although where he is today, I'm not sure. Crosby definitely lives in Georgia, and Sloan lives in Illinois.

(Pause.)

MR. HUNTINGTON: Your Honor, if I might, this actually relates to the location of the defendants. In the papers we submitted we suggest, propose that the asset freeze -- excuse me, the seal would be lifted once we had served all the defendants.

03:17 THE COURT: Yes.

MR. HUNTINGTON: When we thought about it, we realized that's impracticable under the circumstances. What really matters is once we have served all the banks that we're aware of, if we serve them with the freeze order, then it would be appropriate to come back with a motion to lift the seal.

THE COURT: Is that a change? I got a new proposed order, I'm not clear on what the changes are.

MR. HUNTINGTON: Actually, that is not a change we managed to put in the proposed order, it's something we thought

03:17 of on the way over.

MS. BERNSTEIN: There are two different orders, there's the motion to seal, which has -- that doesn't lift until we serve all of the defendants. In this particular circumstance, because the defendants are out of state, the minute we can serve the banks, it would be appropriate for us to come back in and move to lift the seal.

The change in the revised order was to make it clear, now that we understand that they're actually holding cash, they're holding cashier's -- may be holding cashier's checks, we just changed 4 A of the -- paragraph 4 A of the order to make it clear that both through the banks and both through the defendants that they have an obligation to hold whatever assets they have that would be subject to the freeze, as well as not to allow the withdrawal, dissipation or selling, et cetera, all 03:18 that language that's there, or opening credit cards.

THE COURT: Okay.

Counsel, anything else you want to add?

MR. HUNTINGTON: I don't think so, your Honor. I think -- I apologize for the pile of paper, but we felt it was essential -- given that we're asking for extraordinary relief, we thought it was essential to give you as much background about the case as we can, given what we currently know. Once we undertake discovery from the defendants, we hope to learn a great deal more. But we certainly believe we have enough on 03:18 the record now to get the relief that we've requested.

THE COURT: Counsel, give me a moment. I'm going to take a recess, I'll come back to the bench.

THE CLERK: All rise.

(Recess taken.)

THE COURT: Counsel, I'm prepared to rule on the motion from the bench.

Counsel, do you want to be heard on whether or not it should be in open Court?

MR. HUNTINGTON: It depends on what you're going to say, I suppose. If you simply say, "motion allowed," I think we're okay.

THE COURT: I think I was going to say more than that.

Should I hear you at sidebar? Should you hear me at sidebar?

03:33 MR. HUNTINGTON: I think that would be better.

(At sidebar on the record.)

THE COURT: Counsel, I just wanted to state my reasons for ruling on the motion on the record.

I am going to allow the motion. I will allow it in the form in which it's been proposed in the temporary restraining order. In terms of expiration, counsel, I'm only going to allow it through next Thursday, April 24th, at 2:00 p.m.

Counsel, just a few additional things so that my

03:40 reasons are clear on the record. I think in terms of the considerations that I have to make for a temporary restraining order regarding substantial likelihood of success, the risk of irreparable harm, the balance of hardships between the parties if I grant or deny the injunction, and consideration of the public interest, I think those weigh in favor of the moving party here, the SEC.

I just further want to note that I do find that the additional considerations I should make for granting this *ex parte* as a temporary restraining order are met here. I think there has been a substantial record created in regards to the dissipation of certain assets which was occurring as recently or implicated as recently as yesterday by certain of the individual defendants that cause me to grant this motion for at least a limited period of time on an *ex parte* basis.

I'd also note that the moving party has shown on this record why notice shouldn't be given to the defendants for the same reason in terms of dissipation of assets. The standard for both the asset freeze order and the other injunctive relief sought, including the accounting, I think it's the same test, and I think that's met here.

I do want to note on the record that I considered whether or not there was a reasonable likelihood of success shown as to each of the defendants, not just the corporate defendants, but also to the individual defendants who fell into a few sets of categories. There are the defendants who are the officers of the company; Mr. Craft, who's the accountant; and then the separate defendants who I heard about in argument who were the promoters. I considered whether or not I thought that there was a reasonable likelihood of success as to the individual claims made against those defendants. I focused on the SEC 10b claims in regards to whether or not the defendants in connection with the purchase or sale of the security employed in any device, scheme or artifice to defraud made an untrue statement of material fact or a material omission or engaged in any act, practice or cause of business which operates or would operate as a fraud or deceit upon any person, the standard under 10b-5, and I do find that that showing has been made.

I've already addressed the concern about irreparable

03:40 harm. And in terms of the balance of the hardship between to the parties, given that I'm allowing this only for a limited period of time, I think the balance of hardship weighs in favor of granting this relief.

And finally, given the nature of the claims that the SEC makes here on a significant record, I think the public interest is served by the relief that I grant here.

For all those reasons, I'm going to allow the TRO, as I said, through April 24th at 2:00 p.m.

Counsel, anything else I should address ?

03:40 MR. HUNTINGTON: Well, I guess, your Honor, we were going to put on the record that your granting the motion to seal and granting of our permission to file a really long brief.

THE COURT: Yes. I will grant the motion to file an extra long brief *nunc pro tunc*, having considered it, counsel, 03:40

already, and I do -- what time -- 3:35. Today is the 16th.

MR. HUNTINGTON: Yes.

THE COURT: Okay. I've signed the TRO.

This was to sealing. As we said before, the order that's going to -- the various orders that are going to be served on the banks, as I understand it, to seal everything --

MS. BERNSTEIN: To seal everything --

THE COURT: -- until such time as you serve the banks.

MR. HUNTINGTON: It won't hit ECF until we come back.

THE COURT: Okay. I'll allow this motion. I'm just going to do it on the margin.

Counsel, anything else I should address at this time?

MR. HUNTINGTON: I don't think so, your Honor. We appreciate all the time you've given us.

THE COURT: Okay. Thank you.

(End of discussion at sidebar.)

(Court adjourned at 3:40 p.m.)

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CERTIFICATION

I certify that the foregoing is a correct transcript of the record of proceedings in the above-entitled matter to the best of my skill and ability.

/s/Debra M. Joyce
Debra M. Joyce, RMR, CRR
Official Court Reporter

April 21, 2014
Date