

**United States Bankruptcy Court
District of Massachusetts (Worcester)
Adversary Proceeding #: 15-04055**

Assigned to: Judge Melvin S. Hoffman

Lead BK Case: 14-40987

Lead BK Title: Telexfree, LLC

Lead BK Chapter: 11

Demand:

Nature[s] of Suit: 91 Declaratory judgment
72 Injunctive relief –
other

Date Filed: 10/07/15

Plaintiff

Stephen Darr
Huron Consulting Services, LLC

represented by **Charles R. Bennett, Jr.**
Murphy & King, Professional Corporation
One Beacon Street
Boston, MA 02108
617-423-0400
Fax : 617-556-8985
Email: cbennett@murphyking.com

Andrew G. Lizotte
Murphy & King
Professional Corporation
One Beacon Street
21st floor
Boston, MA 02108
(617) 423-0400
Fax : (617) 556-8985
Email: agl@murphyking.com

Harold B. Murphy
Murphy & King, P. C.
One Beacon Street
21st Floor
Boston, MA 02108
(617) 423-0400
Fax : (617) 556-8985
Email: bankruptcy@murphyking.com
LEAD ATTORNEY

V.

Defendant

**Rita Dos Santos, Individually and as
Putative Class Representative**

represented by **William R. Baldiga**
Brown Rudnick LLP
One Financial Center
Boston, MA 02111
(617) 856-8200
Email: wbaldiga@brownrudnick.com
LEAD ATTORNEY



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Filing Date	#	Docket Text
10/07/2015	<u>1</u>	Adversary case 15-04055. Complaint by Stephen Darr against Rita Dos Santos, Individually and as Putative Class Representative. Fee Amount \$350. Nature of Suit(91 (Declaratory judgment)),(72 (Injunctive relief - other))(Bennett, Charles) (Entered: 10/07/2015)
10/07/2015	<u>2</u>	Brief/Memorandum In Support of <i>Preliminary Injunction</i> (Re: <u>1</u> Complaint) filed by Plaintiff Stephen Darr (Murphy, Harold) (Entered: 10/07/2015)
10/07/2015	<u>3</u>	Affidavit of Stephen B. Darr (Re: <u>1</u> Complaint) filed by Plaintiff Stephen Darr (Murphy, Harold) (Entered: 10/07/2015)
10/07/2015		Receipt of filing fee for Complaint(15-04055) [cmp,cmp] (350.00). Receipt Number 15028530, amount \$ 350.00 (re: Doc# <u>1</u>) (U.S. Treasury) (Entered: 10/07/2015)
10/08/2015	<u>4</u>	Summons Issued on Rita Dos Santos, Individually and as Putative Class Representative Answer Due 11/9/2015. Summons must be served within seven (7) days of issuance. (mhussey, Usbc) (Entered: 10/08/2015)
10/09/2015	<u>5</u>	Motion filed by Plaintiff Stephen Darr For Order (Re: <u>1</u> Complaint) <i>for Scheduling Order Regarding Trustee's Request for Preliminary Injunction</i> with certificate of service. (Bennett, Charles) (Entered: 10/09/2015)
10/19/2015	<u>6</u>	Summons Service Executed on Rita Dos Santos, Individually and as Putative Class Representative 10/14/2015 (Condon, Christopher) (Entered: 10/19/2015)
11/06/2015	<u>7</u>	Stipulation By Defendant Rita Dos Santos, Individually and as Putative Class Representative and between Plaintiffs' Interim Executive Committee, on Behalf of Rita dos Santos, Individually and as Putative Class Representative and Stephen B. Darr as Trustee of the Estates of TelexFree, LLC, TelexFree, Inc. and TelexFree Financial, Inc. <i>Extending Deadline to Answer Adversary Complaint</i> with certificate of service (Re: <u>1</u> Complaint) filed by Defendant Rita Dos Santos, Individually and as Putative Class Representative (Baldiga, William) (Entered: 11/06/2015)
11/12/2015	<u>8</u>	Endorsed Order Dated 11/12/15 Re: <u>7</u> Stipulation filed by Defendant Rita Dos Santos, Individually and as Putative Class Representative. ALLOWED . (mhussey, Usbc) (Entered: 11/12/2015)
11/14/2015	<u>9</u>	BNC Certificate of Mailing - PDF Document. (Re: <u>8</u> Order) Notice Date 11/14/2015. (Admin.) (Entered: 11/15/2015)
12/11/2015	<u>10</u>	Answer to Complaint with certificate of service filed by Rita Dos Santos, Individually and as Putative Class Representative. (Baldiga, William) (Entered: 12/11/2015)
01/19/2016	<u>11</u>	Order of District Court Judge Timothy C. Hillman Dated 1/15/16 Withdrawing the Reference of the Adversary Proceeding to the Bankruptcy Court. See Order For Full Text. (jr) (Entered: 01/19/2016)
01/20/2016	<u>12</u>	Status Conference Scheduled for 1/26/2016 at 10:00 AM at Boston Courtroom 2, 12th Floor, 5 Post Office Square, Boston, MA 02109. (rmb, USBC) (Entered: 01/20/2016)

01/22/2016		<u>13</u>	Order dated 1/22/2016 Re: <u>1</u> Complaint filed by Plaintiff Stephen Darr. See Order for Full Text. (meh, Usbc) (Entered: 01/22/2016)
01/22/2016		<u>14</u>	BNC Certificate of Mailing – Hearing. (Re: <u>12</u> Hearing Scheduled) Notice Date 01/22/2016. (Admin.) (Entered: 01/23/2016)
01/24/2016		<u>15</u>	BNC Certificate of Mailing – PDF Document. (Re: <u>13</u> Order) Notice Date 01/24/2016. (Admin.) (Entered: 01/25/2016)
01/26/2016		<u>16</u>	Order dated 1/26/2016 Re: <u>1</u> Complaint filed by Plaintiff Stephen Darr. STATUS CONFERENCE HELD. WITHIN THIRTY DAYS, THE CHAPTER 11 TRUSTEE MAY AMEND HIS COMPLAINT AND THE PARTIES SHALL FILE THEIR RULE 26(F) CERTIFICATION. (meh, Usbc) (Entered: 01/26/2016)
01/28/2016		<u>17</u>	BNC Certificate of Mailing – PDF Document. (Re: <u>16</u> Order) Notice Date 01/28/2016. (Admin.) (Entered: 01/29/2016)
02/09/2016			Transcript Ordered and Acknowledged. Requested by Kiersten Taylor, Esq. and payment received. The expected completion date is 09/29/2016. (Janice Russell Transcripts) (Entered: 02/09/2016)
02/09/2016		<u>18</u>	An official transcript (RE: <u>12</u> Status Conference Scheduled) heard on 01/26/16 has been filed. Pursuant to Judicial Conference Policy, electronic access to transcripts is restricted for 90 days from the date of filing. The transcript is available for inspection at the Clerk's Office or a copy may be purchased from the transcriber. Contact the ECR Operator for transcriber information. Parties have until 03/1/2016 to file a Request for Redaction with the Court. If no request is filed, the transcript may be made available electronically on 05/10/2016. (Janice Russell Transcripts) (Entered: 02/09/2016)
02/10/2016		<u>19</u>	Notice of Filing of Official Transcript. Notice is hereby given that an official transcript has been filed. Pursuant to the Judicial Conference policy governing public access to transcripts of federal court proceedings, transcripts are not electronically available(online) until 90 days after filing but may be inspected by clerk's office or purchased from the court transcriber during the 90–day period. (ADI) (Entered: 02/10/2016)
02/12/2016		<u>20</u>	BNC Certificate of Mailing. (Re: <u>19</u> Notice of Filing of Official Transcript) Notice Date 02/12/2016. (Admin.) (Entered: 02/13/2016)
02/26/2016		<u>21</u>	Amended Complaint by Charles R. Bennett Jr. on behalf of Stephen Darr against Rita Dos Santos, Individually and as Putative Class Representative. (RE: related document(s) <u>1</u> Adversary case 15–04055. Complaint by Stephen Darr against Rita Dos Santos, Individually and as Putative Class Representative. Fee Amount \$350. Nature of Suit(91 (Declaratory judgment)),(72 (Injunctive relief – other)) filed by Plaintiff Stephen Darr). (Bennett, Charles) (Entered: 02/26/2016)
03/03/2016		<u>22</u>	Order dated 3/3/2016 Re: <u>5</u> Motion filed by Plaintiff Stephen Darr For Order Re: (<u>1</u> Complaint) for Scheduling Order Regarding Trustee's Request for Preliminary Injunction. See Order for Full Text. (meh, Usbc) (Entered: 03/03/2016)
03/05/2016		<u>23</u>	BNC Certificate of Mailing – PDF Document. (Re: <u>22</u> Order on Motion for Order/Authority) Notice Date 03/05/2016. (Admin.) (Entered: 03/06/2016)

03/17/2016		<u>24</u>	Response <i>Plaintiffs' Interim Executive Committee's Response to Order on Trustee's Motion for Order for Scheduling Order Regarding Trustee's Request for Preliminary Injunction</i> with certificate of service filed by Interested Party Plaintiffs' Interim Executive Committee Re: <u>5</u> Motion filed by Plaintiff Stephen Darr For Order (Re: <u>1</u> Complaint) <i>for Scheduling Order Regarding Trustee's Request for Preliminary Injunction</i> with certificate of service., <u>22</u> Order dated 3/3/2016 Re: <u>5</u> Motion filed by Plaintiff Stephen Darr For Order Re: (<u>1</u> Complaint) for Scheduling Order Regarding Trustee's Request for Preliminary Injunction. See Order for Full Text. (Baldiga, William) (Entered: 03/17/2016)
03/22/2016		<u>25</u>	Status Conference Scheduled for 4/13/2016 at 10:00 AM at Boston Courtroom 2, 12th Floor, 5 Post Office Square, Boston, MA 02109. (rmb, USBC) (Entered: 03/22/2016)
03/24/2016		<u>26</u>	BNC Certificate of Mailing – Hearing. (Re: <u>25</u> Hearing Scheduled) Notice Date 03/24/2016. (Admin.) (Entered: 03/25/2016)
04/04/2016		<u>27</u>	DISREGARD– Answer to Complaint with certificate of service filed by Rita Dos Santos, Individually and as Putative Class Representative. (Baldiga, William) CORRECTIVE ENTRY– Document #29 is the corrected version. (Entered: 04/04/2016)
04/05/2016		<u>28</u>	Order Requiring Corrective Action. You are hereby ORDERED to file the required document(s) identified in the attached order within (2) business days of the date of this order Re: <u>27</u> Answer to Complaint filed by Defendant Rita Dos Santos, Individually and as Putative Class Representative. (meh, Usbc) (Entered: 04/05/2016)
04/05/2016		<u>29</u>	Answer to Complaint with certificate of service filed by Rita Dos Santos, Individually and as Putative Class Representative. (Baldiga, William) (Entered: 04/05/2016)
04/13/2016		<u>30</u>	Order dated 4/13/2016 Re: <u>1</u> Complaint filed by Plaintiff Stephen Darr. STATUS CONFERENCE HELD. THE PARTIES SHALL FILE A JOINT PROPOSED FORM OF PRE–TRIAL ORDER IN ECF AS A SUPPLEMENTAL DOCUMENT AND SUBMIT A COPY IN WORD FORMAT TO MSH@MAB.USCOURTS.GOV BY THE CLOSE OF BUSINESS BY MAY 13, 2016. (meh, Usbc) (Entered: 04/13/2016)
04/15/2016		<u>31</u>	BNC Certificate of Mailing – PDF Document. Notice Date 04/15/2016. (Admin.) (Entered: 04/16/2016)
05/10/2016		<u>32</u>	Order dated 5/10/2016 to Show Cause. ANY PARTY IN INTEREST MAY SHOW CAUSE IN WRITING ON OR BEFORE MAY 31, 2016 WHY THE ATTACHED ORDER SHOULD NOT BE ENTERED. THE TRUSTEE SHALL CAUSE A COPY OF THIS ORDER, AND THE ATTACHMENT, TO BE POSTED IN ENGLISH, SPANISH, PORTUGUESE AND CHINESE ON THE WEB SITE MAINTAINED BY KURTZMAN CARSON CONSULTANTS LLC FOR THIS CASE. (meh, Usbc) (Entered: 05/10/2016)
05/12/2016		<u>33</u>	BNC Certificate of Mailing – PDF Document. (Re: <u>32</u> Order to Show Cause) Notice Date 05/12/2016. (Admin.) (Entered: 05/13/2016)
05/13/2016		<u>34</u>	Certificate of Rule 26(f) Conference and Rule 26(f) Discovery Plan (Re: <u>1</u> Complaint) filed by Plaintiff Stephen Darr (Bennett, Charles) (Entered: 05/13/2016)

06/01/2016		<u>35</u>	Order dated 6/1/2016 Re: <u>32</u> Order to Show Cause. See Order for Full Text. (meh, Usbc) (Entered: 06/02/2016)
06/04/2016		<u>36</u>	BNC Certificate of Mailing – PDF Document. (Re: <u>35</u> Order) Notice Date 06/04/2016. (Admin.) (Entered: 06/05/2016)
06/27/2016		<u>37</u>	Notice of Filing of Amended Complaint in Civil Action No. 16–40018 (D. Mass.) with certificate of service filed by Interested Party Plaintiffs' Interim Executive Committee (Baldiga, William) (Entered: 06/27/2016)
07/11/2016		<u>38</u>	Response filed by Plaintiff Stephen Darr Re: <u>37</u> Notice of Filing of Amended Complaint in Civil Action No. 16–40018 (D. Mass.) with certificate of service filed by Interested Party Plaintiffs' Interim Executive Committee (Bennett, Charles) (Entered: 07/11/2016)
08/05/2016		<u>39</u>	Motion filed by Interested Party Plaintiffs' Interim Executive Committee For Summary Judgment with certificate of service. (Baldiga, William) (Entered: 08/05/2016)
08/05/2016		<u>40</u>	Statement <i>Local Bankruptcy Rule 7056–1 Statement of Undisputed Material Facts in Support of PIEC's Motion for Summary Judgment</i> with certificate of service (Re: <u>39</u> Motion for Summary Judgment) filed by Interested Party Plaintiffs' Interim Executive Committee (Attachments: # <u>1</u> Exhibit A # <u>2</u> Exhibit B # <u>3</u> Exhibit C # <u>4</u> Exhibit D # <u>5</u> Exhibit E # <u>6</u> Exhibit F # <u>7</u> Exhibit G # <u>8</u> Exhibit H # <u>9</u> Exhibit I # <u>10</u> Exhibit J # <u>11</u> Exhibit K # <u>12</u> Exhibit L # <u>13</u> Exhibit M # <u>14</u> Exhibit N # <u>15</u> Exhibit O) (Baldiga, William) (Entered: 08/05/2016)
08/05/2016		<u>41</u>	Brief/Memorandum In Support of <i>PIEC's Motion for Summary Judgment</i> (Re: <u>39</u> Motion for Summary Judgment, <u>40</u> Statement) filed by Interested Party Plaintiffs' Interim Executive Committee (Baldiga, William) (Entered: 08/05/2016)
08/16/2016		<u>42</u>	Assented to Motion filed by Plaintiff Stephen Darr to Establish Response Date for Piec's Motion for Summary Judgment with certificate of service. (Attachments: # <u>1</u> Certificate of Service) (Lizotte, Andrew) (Entered: 08/16/2016)
08/17/2016		<u>43</u>	Endorsed Order dated 8/17/2016 Re: <u>42</u> Assented to Motion filed by Plaintiff Stephen Darr to Establish Response Date for Piec's Motion for Summary Judgment. ALLOWED . RESPONSES TO THE PIEC'S MOTION FOR SUMMARY JUDGMENT, INCLUDING AFFIDAVITS, AND ANY CROSS–MOTION FOR SUMMARY JUDGMENT ARE DUE BY SEPTEMBER 2, 2016. RESPONSES TO ANY CROSS–MOTION FOR SUMMARY JUDGMENT ARE DUE BY SEPTEMBER 23, 2016. THE COURT WILL HOLD A HEARING ON THE MOTION AND ANY CROSS–MOTION FOR SUMMARY JUDGMENT ON SEPTEMBER 28, 2016, AT 10:00 A.M. (meh, Usbc) (Entered: 08/17/2016)
08/17/2016			DISREGARD: Hearing Scheduled to 9/28/2016 at 10:00 AM at Boston Courtroom 2, 12th Floor, 5 Post Office Square, Boston, MA 02109 Re: <u>42</u> Assented to Motion filed by Plaintiff Stephen Darr to Establish Response Date for Piec's Motion for Summary Judgment. (meh, Usbc) Corrective entry: disregard. Docketed in error. Modified on 8/17/2016 (ymw). (Entered: 08/17/2016)
08/17/2016			Hearing Scheduled for 9/28/2016 at 10:00 AM at Boston Courtroom 2, 12th Floor, 5 Post Office Square, Boston, MA 02109 Re: <u>39</u> Motion filed

			by Interested Party Plaintiffs' Interim Executive Committee For Summary Judgment (ymw) (Entered: 08/17/2016)
08/19/2016		<u>44</u>	BNC Certificate of Mailing – PDF Document. (Re: <u>43</u> Order on Generic Motion) Notice Date 08/19/2016. (Admin.) (Entered: 08/20/2016)
09/02/2016		<u>45</u>	Opposition <i>By Trustee to PIEC Motion for Summary Judgment</i> filed by Plaintiff Stephen Darr Re: <u>39</u> Motion filed by Interested Party Plaintiffs' Interim Executive Committee For Summary Judgment with certificate of service. (Lizotte, Andrew) (Entered: 09/02/2016)
09/02/2016		<u>46</u>	Response to Defendants' Local Bankruptcy Rule 7056–1 Statement of Undisputed Material Facts in Support of PIEC's Motion for Summary Judgment filed by Plaintiff Stephen Darr Re: <u>40</u> Statement Local Bankruptcy Rule 7056–1 Statement of Undisputed Material Facts in Support of PIEC's Motion for Summary Judgment with certificate of service (Re: <u>39</u> Motion for Summary Judgment) filed by Interested Party Plaintiffs' Interim Executive Committee. (Attachments: # <u>1</u> Exhibit A # <u>2</u> Exhibit B # <u>3</u> Exhibit C # <u>4</u> Exhibit D # <u>5</u> Exhibit E # <u>6</u> Exhibit F # <u>7</u> Exhibit G # <u>8</u> Exhibit H # <u>9</u> Exhibit I # <u>10</u> Exhibit J # <u>11</u> Exhibit K # <u>12</u> Exhibit L # <u>13</u> Exhibit M # <u>14</u> Exhibit N # <u>15</u> Exhibit O) (Lizotte, Andrew) (Entered: 09/02/2016)
09/02/2016		<u>47</u>	Cross–Motion filed by Plaintiff Stephen Darr For Summary Judgment. (Lizotte, Andrew) (Entered: 09/02/2016)
09/02/2016		<u>48</u>	Statement of Undisputed Material Facts in Support of his Cross–Motion for Summary Judgment (Re: <u>47</u> Motion for Summary Judgment) filed by Plaintiff Stephen Darr. (Attachments: # <u>1</u> Exhibit A # <u>2</u> Exhibit B # <u>3</u> Exhibit C # <u>4</u> Exhibit D # <u>5</u> Exhibit E # <u>6</u> Exhibit F # <u>7</u> Exhibit G # <u>8</u> Exhibit H) (Lizotte, Andrew) (Entered: 09/02/2016)
09/02/2016		<u>49</u>	Affidavit of Stephen B. Darr in Opposition to the PIEC Motion for Summary Judgment and in Support of the Trustee's Cross–Motion for Summary Judgment (Re: <u>45</u> Opposition, <u>47</u> Motion for Summary Judgment) filed by Plaintiff Stephen Darr. (Attachments: # <u>1</u> Exhibit A # <u>2</u> Exhibit B # <u>3</u> Exhibit C # <u>4</u> Exhibit D # <u>5</u> Exhibit E) (Lizotte, Andrew) (Entered: 09/02/2016)
09/02/2016		<u>50</u>	Exhibit <i>I</i> (Re: <u>48</u> Statement) filed by Plaintiff Stephen Darr (Lizotte, Andrew) (Entered: 09/02/2016)
09/02/2016		<u>51</u>	Memorandum of Law In Support of Trustee's Opposition to PIEC Motion for Summary Judgment and Trustee's Cross–Motion for Summary Judgment (Re: <u>45</u> Opposition, <u>47</u> Motion for Summary Judgment) filed by Plaintiff Stephen Darr. (Lizotte, Andrew) (Entered: 09/02/2016)
09/06/2016		<u>52</u>	Hearing Scheduled for 9/28/2016 at 10:00 AM at Boston Courtroom 2, 12th Floor, 5 Post Office Square, Boston, MA 02109 RE: <u>39</u> Motion filed by Interested Party Plaintiffs' Interim Executive Committee For Summary Judgment. (rmb, USBC) (Entered: 09/06/2016)
09/06/2016		<u>53</u>	Hearing Scheduled for 9/28/2016 at 10:00 AM at Boston Courtroom 2, 12th Floor, 5 Post Office Square, Boston, MA 02109 RE: <u>47</u> Cross–Motion filed by Plaintiff Stephen Darr for Summary Judgment. Objections due by 9/23/2016 at 04:30 PM. (rmb, USBC) (Entered: 09/06/2016)

09/06/2016		<u>54</u>	Certificate of Service (Re: <u>45</u> Opposition, <u>46</u> Response, <u>47</u> Motion for Summary Judgment, <u>48</u> Statement, <u>49</u> Affidavit/Declaration, <u>50</u> Exhibit, <u>51</u> Brief/Memorandum) filed by Plaintiff Stephen Darr (Lizotte, Andrew) (Entered: 09/06/2016)
09/06/2016		<u>55</u>	Certificate of Service of Notice of Hearing (Re: <u>47</u> Motion for Summary Judgment) filed by Plaintiff Stephen Darr (Attachments: # <u>1</u> Notice of Hearing) (Lizotte, Andrew) (Entered: 09/06/2016)
09/08/2016		<u>56</u>	BNC Certificate of Mailing – Hearing. (Re: <u>52</u> Hearing Scheduled) Notice Date 09/08/2016. (Admin.) (Entered: 09/09/2016)
09/08/2016		<u>57</u>	BNC Certificate of Mailing – Hearing. (Re: <u>53</u> Hearing Scheduled) Notice Date 09/08/2016. (Admin.) (Entered: 09/09/2016)
09/12/2016		<u>58</u>	Notice of Hearing (Re: <u>39</u> Motion for Summary Judgment) filed by Interested Party Plaintiffs' Interim Executive Committee (Baldiga, William) (Entered: 09/12/2016)
09/15/2016		<u>59</u>	Stipulation By Plaintiff Stephen Darr and <i>Plaintiffs' Interim Executive Committee Regarding Settlement Conference</i> filed by Plaintiff Stephen Darr (Lizotte, Andrew) (Entered: 09/15/2016)
09/15/2016		<u>60</u>	Certificate of Service (Re: <u>59</u> Stipulation) filed by Plaintiff Stephen Darr (Lizotte, Andrew) (Entered: 09/15/2016)
09/26/2016		<u>61</u>	Joint Motion filed by Plaintiff Stephen Darr to Continue Hearing [Re: <u>39</u> Motion for Summary Judgment, <u>47</u> Motion for Summary Judgment] with certificate of service. (Attachments: # <u>1</u> Certificate of Service) (Lizotte, Andrew) (Entered: 09/26/2016)
09/26/2016		<u>62</u>	Endorsed Order dated 9/26/2016 Re: <u>61</u> Joint Motion filed by Plaintiff Stephen Darr to Continue Hearing Re: <u>39</u> Motion for Summary Judgment, <u>47</u> Motion for Summary Judgment. GRANTED ; THE SEPTEMBER 28, 2016 HEARINGS ARE CANCELED. A SEPARATE NOTICE OF RESCHEDULED HEARINGS WILL ISSUE. (meh, Usbc) (Entered: 09/26/2016)
09/28/2016		<u>63</u>	BNC Certificate of Mailing – PDF Document. (Re: <u>62</u> Order on Motion to Continue/Cancel Hearing) Notice Date 09/28/2016. (Admin.) (Entered: 09/29/2016)
10/05/2016		<u>64</u>	Supplemental Document: (Re: <u>59</u> Stipulation) filed by Plaintiff Stephen Darr (Lizotte, Andrew) (Entered: 10/05/2016)
11/10/2016		<u>65</u>	Report and Request for Status Conference filed by Plaintiff Stephen Darr (Attachments: # <u>1</u> Certificate of Service) (Lizotte, Andrew) (Entered: 11/10/2016)
11/15/2016		<u>66</u>	Status Conference Scheduled for 12/14/2016 at 11:00 AM at Boston Courtroom 2, 12th Floor, 5 Post Office Square, Boston, MA 02109. (rmb, USBC) (Entered: 11/15/2016)
11/15/2016		<u>67</u>	Certificate of Service of Notice of Hearing /Status Conference filed by Plaintiff Stephen Darr (Attachments: # <u>1</u> Notice of Status Conference) (Lizotte, Andrew) (Entered: 11/15/2016)

11/17/2016		<u>68</u>	BNC Certificate of Mailing – Hearing. (Re: <u>66</u> Hearing Scheduled) Notice Date 11/17/2016. (Admin.) (Entered: 11/18/2016)
11/18/2016		<u>69</u>	Motion filed by Plaintiff Stephen Darr to Continue Hearing [Re: <u>66</u> Hearing Scheduled] / <i>Reschedule Status Conference</i> with certificate of service. (Attachments: # <u>1</u> Certificate of Service) (Lizotte, Andrew) (Entered: 11/18/2016)
11/22/2016		<u>70</u>	Endorsed Order dated 11/22/2016 Re: <u>69</u> Motion filed by Plaintiff Stephen Darr to Continue Hearing Re: <u>66</u> Hearing Scheduled/Reschedule Status Conference. GRANTED ; THE STATUS CONFERENCE WILL BE RESCHEDULED BY SEPARATE NOTICE. (meh, Usbc) (Entered: 11/22/2016)
11/22/2016		<u>71</u>	Status Conference Rescheduled for 12/21/2016 at 10:15 AM at Boston Courtroom 2, 12th Floor, 5 Post Office Square, Boston, MA 02109. (rmb, USBC) (Entered: 11/22/2016)
11/22/2016		<u>72</u>	Certificate of Service of Notice of Hearing / <i>Status Conference</i> (Re: <u>1</u> Complaint, <u>71</u> Hearing Scheduled) filed by Plaintiff Stephen Darr (Attachments: # <u>1</u> Notice of Rescheduled Hearing) (Lizotte, Andrew) (Entered: 11/22/2016)
11/24/2016		<u>73</u>	BNC Certificate of Mailing – Hearing. (Re: <u>71</u> Hearing Scheduled) Notice Date 11/24/2016. (Admin.) (Entered: 11/25/2016)
11/24/2016		<u>74</u>	BNC Certificate of Mailing – PDF Document. (Re: <u>70</u> Order on Motion to Continue/Cancel Hearing) Notice Date 11/24/2016. (Admin.) (Entered: 11/25/2016)
12/20/2016		<u>75</u>	Opposition by PIEC to Trustee's Cross–Motion For Summary Judgment (Re: <u>47</u> Motion for Summary Judgment) filed by Interested Party Plaintiffs' Interim Executive Committee (Baldiga, William) (Entered: 12/20/2016)
12/20/2016		<u>76</u>	Response to Memorandum of Law in Support of Trustee's Opposition to PIEC Motion for Summary Judgment and Trustee's Cross Motion for Summary Judgment with certificate of service (Re: <u>47</u> Motion for Summary Judgment) filed by Interested Party Plaintiffs' Interim Executive Committee (Attachments: # <u>1</u> Exhibit A) (Baldiga, William) (Entered: 12/20/2016)
12/20/2016		<u>77</u>	Response to Trustee's Statement of Undisputed Material Facts In Support of his Cross Motion for Summary Judgment with certificate of service (Re: <u>47</u> Motion for Summary Judgment) filed by Interested Party Plaintiffs' Interim Executive Committee (Baldiga, William) (Entered: 12/20/2016)
12/21/2016		<u>78</u>	Order dated 12/21/2016 Re: <u>1</u> Complaint by Stephen Darr against Rita Dos Santos, Individually and as Putative Class Representative. STATUS CONFERENCE HELD AND COMPLETED. (clm, Usbc) (Entered: 12/21/2016)
12/22/2016		<u>79</u>	Hearing Scheduled for 2/22/2017 at 10:00 AM at Boston Courtroom 2, 12th Floor, 5 Post Office Square, Boston, MA 02109 RE: <u>39</u> Motion filed by Interested Party Plaintiffs' Interim Executive Committee For Summary Judgment. (rmb, USBC) (Entered: 12/22/2016)

12/22/2016		<u>80</u>	Hearing Scheduled for 2/22/2017 at 10:00 AM at Boston Courtroom 2, 12th Floor, 5 Post Office Square, Boston, MA 02109 RE: <u>47</u> Cross-Motion filed by Plaintiff Stephen Darr for Summary Judgment. (rmb, USBC) (Entered: 12/22/2016)
12/22/2016		<u>81</u>	Certificate of Service of Notice of Hearing (Re: <u>47</u> Motion for Summary Judgment) filed by Plaintiff Stephen Darr (Attachments: # <u>1</u> Notice of Hearing) (Lizotte, Andrew) (Entered: 12/22/2016)
12/22/2016			Please see case #14-40987 entry #835 for the audio file of the hearing held on 12/21/2016. (ymw) (Entered: 12/22/2016)
12/22/2016			Transcript Requested by William Baldiga, Esq.. Transcriptionist awaiting payment upon completion of transcript. (Janice Russell Transcripts) (Entered: 12/22/2016)
12/23/2016			Transcript Ordered and Acknowledged. Requested by William Baldiga, Esq. and payment received. The expected completion date is 12/23/16. (Janice Russell Transcripts) (Entered: 12/23/2016)
12/23/2016		<u>82</u>	An official transcript (RE: <u>71</u> Status Conference Rescheduled) heard on 12/21/16 has been filed. Pursuant to Judicial Conference Policy, electronic access to transcripts is restricted for 90 days from the date of filing. The transcript is available for inspection at the Clerk's Office or a copy may be purchased from the transcriber. Contact the ECR Operator for transcriber information. Parties have until 01/13/2017 to file a Request for Redaction with the Court. If no request is filed, the transcript may be made available electronically on 03/24/2017. (Janice Russell Transcripts) (Entered: 12/23/2016)
12/23/2016		<u>83</u>	BNC Certificate of Mailing – PDF Document. (Re: <u>78</u> Order) Notice Date 12/23/2016. (Admin.) (Entered: 12/24/2016)
12/24/2016		<u>84</u>	BNC Certificate of Mailing – Hearing. (Re: <u>79</u> Hearing Scheduled) Notice Date 12/24/2016. (Admin.) (Entered: 12/25/2016)
12/24/2016		<u>85</u>	BNC Certificate of Mailing – Hearing. (Re: <u>80</u> Hearing Scheduled) Notice Date 12/24/2016. (Admin.) (Entered: 12/25/2016)
12/24/2016		<u>86</u>	Notice of Filing of Official Transcript. Notice is hereby given that an official transcript has been filed. Pursuant to the Judicial Conference policy governing public access to transcripts of federal court proceedings, transcripts are not electronically available(online) until 90 days after filing but may be inspected by clerk's office or purchased from the court transcriber during the 90-day period. (ADI) (Entered: 12/26/2016)
12/27/2016		<u>87</u>	Certificate of Service of Notice of Hearing (Re: <u>39</u> Motion for Summary Judgment) filed by Interested Party Plaintiffs' Interim Executive Committee (Baldiga, William) (Entered: 12/27/2016)
12/29/2016		<u>88</u>	BNC Certificate of Mailing. (Re: <u>86</u> Notice of Filing of Official Transcript) Notice Date 12/29/2016. (Admin.) (Entered: 12/30/2016)
02/21/2017		<u>89</u>	<i>Brief of the Class Defendants as Amici Curiae Relative to Cross-Motions for Summary Judgment</i> filed by Interested Party Frantz Balan (Rona, Ilyas) (Entered: 02/21/2017)
02/22/2017		<u>90</u>	

			Order dated 2/22/2017 Re: <u>39</u> Motion filed by Interested Party Plaintiffs' Interim Executive Committee For Summary Judgment. HEARING HELD. THIS MOTION IS HEREBY TAKEN UNDER ADVISEMENT. (clm, Usbc) (Entered: 02/22/2017)
02/22/2017		<u>91</u>	Order dated 2/22/2017 Re: <u>47</u> Cross-Motion filed by Plaintiff Stephen Darr For Summary Judgment. HEARING HELD. THIS MOTION IS HEREBY TAKEN UNDER ADVISEMENT. (clm, Usbc) (Entered: 02/22/2017)
02/22/2017		<u>92</u>	PDF with attached Audio File. Court Date & Time [2/22/2017 10:08:36 AM]. File Size [32297 KB]. Run Time [02:14:34]. (admin). Re: <u>39</u> Motion filed by Interested Party Plaintiffs' Interim Executive Committee For Summary Judgment and <u>47</u> Cross-Motion filed by Plaintiff Stephen Darr For Summary Judgment. Modified on 2/23/2017 (ymw). (Entered: 02/23/2017)
02/24/2017		<u>93</u>	BNC Certificate of Mailing – PDF Document. (Re: <u>90</u> Order on Motion For Summary Judgment) Notice Date 02/24/2017. (Admin.) (Entered: 02/25/2017)
02/24/2017		<u>94</u>	BNC Certificate of Mailing – PDF Document. (Re: <u>91</u> Order on Motion For Summary Judgment) Notice Date 02/24/2017. (Admin.) (Entered: 02/25/2017)
08/11/2017			Transcript Requested by Kasey Emmons, Esq.. Transcriptionist awaiting payment upon completion of transcript. (Janice Russell Transcripts) (Entered: 08/11/2017)
08/28/2017			Transcript Ordered and Acknowledged. Requested by Kasey Emmons, Esq. and payment to be received. The expected completion date is 08/28/17. (Janice Russell Transcripts) (Entered: 08/28/2017)
08/28/2017		<u>95</u>	An official transcript (RE: <u>79</u> Hearing Scheduled RE: <u>39</u> Motion filed by Interested Party Plaintiffs' Interim Executive Committee For Summary Judgment and <u>47</u> Cross-Motion filed by Plaintiff Stephen Darr for Summary Judgment) heard on 02/22/17 has been filed. Pursuant to Judicial Conference Policy, electronic access to transcripts is restricted for 90 days from the date of filing. The transcript is available for inspection at the Clerk's Office or a copy may be purchased from the transcriber. Contact the ECR Operator for transcriber information. Parties have until 09/18/2017 to file a Request for Redaction with the Court. If no request is filed, the transcript may be made available electronically on 11/27/2017. (Janice Russell Transcripts) (Entered: 08/28/2017)
08/29/2017		<u>96</u>	Notice of Filing of Official Transcript. Notice is hereby given that an official transcript has been filed. Pursuant to the Judicial Conference policy governing public access to transcripts of federal court proceedings, transcripts are not electronically available(online) until 90 days after filing but may be inspected by clerk's office or purchased from the court transcriber during the 90-day period. (ADI) (Entered: 08/29/2017)
08/31/2017		<u>97</u>	BNC Certificate of Mailing. (Re: <u>96</u> Notice of Filing of Official Transcript) Notice Date 08/31/2017. (Admin.) (Entered: 09/01/2017)
12/18/2017		<u>98</u>	Proposed Findings of Fact and Conclusions of Law on Cross-Motions for Summary Judgment dated 12/18/2017 Re: <u>39</u> Motion filed by Interested Party Plaintiffs' Interim Executive Committee For Summary Judgment

			and <u>47</u> Cross-Motion filed by Plaintiff Stephen Darr For Summary Judgment. FOR THE REASONS SET FORTH ABOVE, I RECOMMEND GRANTING MR. DARR'S MOTION FOR SUMMARY JUDGMENT AND DENYING THE PIEC'S. See Order for Full Text. (Telam, Usbc) (Entered: 12/19/2017)
12/21/2017		<u>99</u>	Assented to Motion filed by Interested Party Plaintiffs' Interim Executive Committee to Extend the Deadline to Object to the Court's [Re: <u>98</u> Opinion Issued] with certificate of service. (Baldiga, William) (Entered: 12/21/2017)
12/21/2017		<u>100</u>	BNC Certificate of Mailing – PDF Document. (Re: <u>98</u> Opinion Issued) Notice Date 12/21/2017. (Admin.) (Entered: 12/22/2017)
12/22/2017		<u>101</u>	Endorsed Order dated 12/22/2017 Re: <u>99</u> Assented to Motion filed by Interested Party Plaintiffs' Interim Executive Committee to Extend the Deadline to Object to the Court's Re: <u>98</u> Opinion Issued. ALLOWED . (Telam, Usbc) (Entered: 12/22/2017)
12/27/2017			Transcript Requested by William Baldiga, Esq.. Transcriptionist awaiting payment upon completion of transcript. (Janice Russell Transcripts) (Entered: 12/27/2017)
01/12/2018		<u>102</u>	Objections to the Bankruptcy Court's December 19, 2017 Proposed Findings of Fact and Conclusions of Law on Cross-Motions for Summary Judgment filed by Interested Party Plaintiffs' Interim Executive Committee Re: <u>98</u> Proposed Findings of Fact and Conclusions of Law on Cross-Motions for Summary Judgment dated 12/18/2017 Re: <u>39</u> Motion filed by Interested Party Plaintiffs' Interim Executive Committee For Summary Judgment and <u>47</u> Cross-Motion filed by Plaintiff Stephen Darr For Summary Judgment with certificate of service. (Attachments: # <u>1</u> Exhibit 1 # <u>2</u> Exhibit 2 (Part 1 of 2) # <u>3</u> Exhibit 2 (Part 2 of 2) # <u>4</u> Exhibit 3 # <u>5</u> Exhibit 4 # <u>6</u> Exhibit 5 # <u>7</u> Exhibit 6 # <u>8</u> Exhibit 7 # <u>9</u> Exhibit 8 # <u>10</u> Exhibit 9 # <u>11</u> Exhibit 10) (Baldiga, William) (Entered: 01/12/2018)

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS**

In re:)	
)	
TELEXFREE, LLC <i>et al.</i>	)	Chapter 11
	)	Case No. 14-40987-MSH
Debtors	)	Jointly Administered
)	
)	
STEPHEN B. DARR, AS TRUSTEE OF)	
THE ESTATES OF TELEXFREE, LLC,)	
TELEXFREE, INC. AND TELEXFREE	)	Adversary Proceeding
FINANCIAL, INC.	)	No. 15-4055
)	
Plaintiff)	
)	
v.)	
)	
RITA DOS SANTOS, INDIVIDUALLY)	
AND AS PUTATIVE CLASS)	
REPRESENTATIVE AND MARIA)	
MURDOCH, ANGELA BATISTA)	
JIMENEZ, ELISANGELA OLIVEIRA)	
AND DIOGO DE ARAUGO, AS)	
PUTATIVE CLASS)	
REPRESENTATIVES)	
)	
Defendants)	
)	

**PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW ON CROSS-
MOTIONS FOR SUMMARY JUDGMENT**

Before me are cross-motions for summary judgment filed by the plaintiff, Stephen B. Darr, the trustee in the jointly administered chapter 11 cases filed by Telexfree, LLC, Telexfree, Inc. and Telexfree Financial, Inc. (individually and collectively, “Telexfree”), and an interested party, the Plaintiffs’ Interim Executive Committee (“PIEC”), appointed by the United States

District Court to represent the victims of the Telexfree fraud.¹ In this adversary proceeding, Mr. Darr seeks to enjoin the defendants, individually and as putative class representatives of Telexfree's victims, from proceeding with claims for unjust enrichment in lawsuits filed in the district court against certain participants in the Telexfree Ponzi and pyramid schemes.²

The dispute before me is over who, as between Mr. Darr and the Ponzi scheme victims, is the proper party to pursue recovery from the class of Telexfree participants who profited from the scheme, the so-called "Net Winners." Mr. Darr requests summary judgment on counts I and III of his amended complaint. In count I he seeks a declaratory judgment that the defendants' unjust enrichment claims are property of the Telexfree bankruptcy estates, and in count III he asks for an injunction enjoining the defendants from prosecuting those claims directly. The PIEC seeks summary judgment dismissing Mr. Darr's complaint on the basis that he lacks standing to

¹ The PIEC was appointed to represent victims of the debtors' Ponzi/pyramid scheme by Judge Timothy Hillman of the United States District Court for the District of Massachusetts on December 23, 2014, in the multidistrict litigation pending in that court, *In re: Telexfree Securities Litigation*, MDL No. 14-02566 (the "MDL Proceeding"). See MDL Case Management Order No. 3 attached as Exhibit A to the PIEC's Statement of Undisputed Facts.

² The first action was commenced by Ms. Dos Santos and others in the district court and consolidated in the MDL Proceeding. A motion to amend the complaint to add a count for unjust enrichment precipitated the filing of this adversary proceeding. After the district court denied the motion to amend, a second action was filed in the district court by Elisangela Oliveira and others (CA No. 16-40018-TSH) (the "Oliveira Lawsuit"). Judge Hillman, finding that the second action was an attempt by the class action plaintiffs to circumvent his ruling denying their motion to amend, stayed the Oliveira Lawsuit. Both Ms. Dos Santos and Ms. Oliveira are defendants in this adversary proceeding. On May 26, 2017, Judge Hillman modified the stay to permit Ms. Dos Santos and Ms. Oliveira to amend their complaints to add additional parties and to assert additional counts in order to pre-empt the running of relevant statutes of limitation. See 14-02566-TSH, documents #495 and #503 and 16-40018-TSH, document #12, attachment 1.

prosecute claims against the Net Winners because neither the money he seeks to recover nor the claims by which a recovery may be effected qualifies as property of the Telexfree entities or their bankruptcy estates. An *amicus curiae* brief supporting Mr. Darr's cross-motion for summary judgment has been filed by a group of Net Winners who comprise a certified class of defendants in a separate adversary proceeding brought in the Telexfree chapter 11 cases.³

Procedural Posture

On January 15, 2016, the United States District Court for the District of Massachusetts withdrew the reference in this adversary proceeding but returned the proceeding to this court "to rule on any preliminary or pretrial matters, hear any dispositive motions, conduct a trial if necessary, and submit [to the district court] proposed findings of fact and conclusions of law with respect to any dispositive motions or trial."⁴ After the parties' unsuccessful attempts at mediation, and upon review and consideration of all the parties' submissions and their very able oral presentations, I now submit to the District Court the following proposed findings of fact and conclusions of law pursuant to its order withdrawing the reference.

Facts

The material facts necessary to support a ruling on the cross motions are not in dispute. They are taken from the admitted portions of the statements of uncontested facts filed by the

³ See *amicus* brief, document #89. See also *Darr v. Argueta et al.* Adv. Proc. No 16-4006. The class is represented by the law firm of Milligan Rona Duran & King LLC.

⁴ See 16-40004-TSH, document #2.

parties in support of their respective motions for summary judgment and from the uncontested statements in the Affidavit of Stephen B. Darr in Opposition to the PIEC Motion for Summary Judgment and in Support of the Trustee's Cross-Motion for Summary Judgment (the "Darr Summary Judgment Affidavit").⁵ I also take judicial notice of the dockets in the Telexfree chapter 11 cases, in this and other adversary proceedings filed in the Telexfree chapter 11 cases, and in the Telexfree cases pending in the District Court.

Telexfree's Scheme

Telexfree, LLC, the lead debtor in these cases, is a Nevada limited liability company with its headquarters in Marlboro, Massachusetts.⁶ Telexfree purported to sell cheap long distance telephone service to over 40 countries using Voice over Internet Protocol or "VoIP".⁷ It targeted immigrant communities in the U.S. as well as their countrymen and many others around the

⁵ Document #49.

⁶ U.S. Securities and Exchange Commission's Motion for Change of Venue, Memorandum of Points and Authorities and Declarations of Mark Albers and Scott Stanley (14-40987, document #67). Telexfree, Inc. is a Massachusetts corporation while Telexfree Financial, Inc. is a Florida corporation that is owned by Telexfree, LLC.

⁷ Trustee's Statement of Undisputed Facts, document #48, at ¶ 1. PIEC's Statement of Uncontested Facts, document #40, ¶ 11. *See also* the Affidavit of Stephen B. Darr filed in support of his motion for class certification in *Darr v. Alecci*, Adversary Proceeding No. 16-4007, document #2 ("Darr's Alecci Affidavit") and ¶¶ 21-35 of the Affidavit of Stephen B. Darr in Support of Chapter 11 Trustee's Motion for Entry of Order that Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief, (the "Ponzi Scheme Affidavit"), which is document #623 of Telexfree's main bankruptcy case (14-40987) and attached as part of Exhibit O in the PEIC's Statement of Uncontested Facts, document #40. The Ponzi Scheme Affidavit is also incorporated by reference in the Darr Summary Judgment Affidavit.

world.⁸ Telexfree's real business and the source of almost all its revenue, however, was the recruitment from these communities of members (also referred to as participants and promoters) to sell memberships and VoIP plan packages to others.⁹ Participants received financial incentives to recruit additional members thereby creating an ever-expanding pyramid with money flowing upstream in a gravity-defying process enriching the upper-level members.¹⁰ Telexfree's "products," the long distance calling plans themselves, were a mere pretext to create the appearance that Telexfree had a business.¹¹ It was the right to sell the products and memberships that generated widespread interest among the communities targeted by Telexfree, both domestic and foreign, who believed that participation in the Telexfree program was a fast track to easy street.¹²

Membership in Telexfree's program was ostensibly governed by a contract—an untitled, 16-page, single-spaced, small-print document.¹³ The contract gives the impression, especially to a layperson, of great formality, solemnity and weight, but in fact much of it is incomprehensible.

⁸ Trustee's Statement of Undisputed Facts, at ¶ 1.

⁹ *Id.* at ¶¶ 1-3.

¹⁰ *Id.*

¹¹ *Id.* See also *id.* at ¶¶ 8 and 9.

¹² *Id.* at ¶¶ 2-4.

¹³ Exhibit C to Trustee's Statement of Undisputed Facts. It is unclear whether and how participants executed the contract, if at all.

For example, section 2.2 entitled “Purpose of the Contract” is followed by subsection 2.2.1 entitled “Synthesis of the legal relationship” [sic] which provides:

The user, by accessing the website of TELEXFREE.com [,] can become a member through payment of the respective fee, which will provide access to the TelexFREE Multilevel Marketing network for the period of one year, without extension or renewal. At this stage, the member is called a PARTNER. The PARTNER will have the right to acquire, at an exclusive discount, products that are offered on the website www.telexfree.com, with the principal VOIP telephony accounts called 99TELEXFREE. The PARTNER, upon acquiring them in the form of a kit (ADCENTRAL or FAMILY kit) assumes the title of PROMOTER and, as such, receives a space on the site www.telexfree.com to promote the products/services that he has acquired. He also receives training and access to materials also made available on the TELEXFREE website so that he can undertake to promote the latter and avail himself of the opportunity to be a PARTNER and PROMOTER to others in his circle of relationships. All activities are performed by the PARTNER/PROMOTER without any employment relationship, and they are able individually to manage the team and the resources it seeks to make available for such purpose, of their own free will. For the promotion of products/services he will receive a bonus in direct proportion to his results, based on the levels explained in a separate section in these GENERAL REGULATIONS. He must obey all the clauses of the GENERAL REGULATIONS so that the name of TELEXFREE and juridical persons associated with it remain unblemished. [sic]

When a new member participant signed on to the Telexfree program, Telexfree opened a user account for the member participant.¹⁴ Each user account was registered to a specific email address, thus allowing Telexfree to track participant activity.¹⁵ Participants could have more than

¹⁴ PIEC’s Statement of Uncontested Facts at ¶ 12.

¹⁵ Exhibit O to PIEC’s Statement of Uncontested Facts at ¶ 39.

one user account and, indeed, many of them did.¹⁶ Based on the trustee's reconstruction of Telexfree's database, there are 10,987,617 identified user accounts.¹⁷

Participants would receive credits to their user accounts from Telexfree for selling memberships or VoIP packages or for posting internet advertisements hawking Telexfree's products.¹⁸ These internet advertisements were prepared by Telexfree and made available to members to post *anywhere* on the internet without regard to whether the ads led to a single sale.¹⁹ Indeed, Telexfree's sales pitch promised participants astronomical returns merely for posting these meaningless advertisements.²⁰ Those returns, mostly in the form of credits, like the credit for selling VoIP plans or memberships, were generally deposited into the participant's user account.²¹

When a participant recruited a new member, Telexfree would issue an invoice to the recruited participant for the fees due for the VoIP plan or membership purchase.²² The recruited

¹⁶ Ponzi Scheme Affidavit at ¶ 39.

¹⁷ *Id.* at ¶ 30 and ¶¶ 37-49.

¹⁸ PIEC's Statement of Uncontested Facts at ¶ 13, citing the amended complaint at ¶ 11.

¹⁹ Darr's Alecci Affidavit at ¶ 14. Trustee's Statement of Undisputed Facts at ¶ 2 and the PIEC's response thereto (document #77).

²⁰ Trustee's Statement of Undisputed Facts at ¶ 2.

²¹ Darr Summary Judgment Affidavit at ¶¶ 5 and 9-10.

²² See PIEC's Statement of Undisputed Facts at ¶ 15 and 16.

participant could pay the invoiced amount either directly to Telexfree or to the member who recruited him or her.²³ The recruiting participant could, and frequently did, retain the fees paid by the recruited participant.²⁴ When this occurred, Telexfree considered its obligation to pay the recruiting participant for outstanding credits in the same amount satisfied, treated the redemption of credits as income to the recruiting participant, issued an Internal Revenue Service (“IRS”) Form 1099 to the recruiting participant for credits redeemed and considered the recruited participant’s invoice paid in full.²⁵

The vast majority of fees paid by recruited participants were retained by the recruiting participants in redemption of their Telexfree credits. The face value of all the invoices associated with the sale of Telexfree membership plans or VoIP packages was \$3,073,461,326, but only \$359,792,242 (approximately 11.7%) of that amount was paid in cash directly to Telexfree.²⁶ Telexfree recorded the cash and credit redemption transactions as separate accounting items. When an invoice was satisfied by a cash payment, the revenue was categorized as “payments through bank” while the redemption of credits owed to a recruiting participant who held on to the recruited participant’s payment was reflected as “payment through system.”²⁷ Telexfree’s 2013

²³ *Id.*

²⁴ *Id.*

²⁵ Darr Summary Judgment Affidavit at ¶¶ 10, 19 and 20.

²⁶ See PIEC’s Statement of Undisputed Facts at ¶ 19.

²⁷ Darr Summary Judgment Affidavit at ¶ 15.

profit and loss statement referred to funds retained by a recruiting participant as “Agent Commissions.”²⁸ Telexfree booked “payments through the system” as income to the company and “agent commissions” as company expenses.²⁹

Telexfree’s scheme was predicated upon recruited participants becoming recruiting participants in their own right, thereby creating the pyramid. By the time the scheme collapsed as all such schemes inevitably do, the trustee estimates that Telexfree had a million participants,³⁰ making it perhaps the largest Ponzi scheme in history in terms of number of victims.

The Bankruptcies

On April 13, 2014, each of the debtors filed a voluntary petition for relief under chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Nevada. By orders dated May 6, 2014, the bankruptcy cases and associated adversary proceedings were transferred to this court. On June 6, 2014, Mr. Darr was appointed the chapter 11 trustee in each case upon the motion of the United States trustee.

Subsequent to his appointment, Mr. Darr filed a motion requesting court rulings, for all purposes in the chapter 11 cases, that Telexfree had engaged in a Ponzi and pyramid scheme, that

²⁸ Trustee’s Statement of Undisputed Facts at ¶ 11.

²⁹ *Id.* at ¶ 10.

³⁰ Mr. Darr has estimated that there are approximately 900,000 unique email addresses that are linked to approximately 11,000,000 user accounts. Ponzi Scheme Affidavit at ¶ 39.

the so-called “Ponzi scheme presumption” would apply,³¹ and that accumulated but unredeemed credits owed to a participant would not be included in the calculation of any participant’s proof of claim filed in the bankruptcy cases (the “Ponzi Motion”). Mr. Darr requested that a participant’s claim be calculated as the total amount of money paid by a participant to either Telexfree or another participant less all amounts received by the participant from Telexfree or another participant. This formula, the so-called “net equity formula,” has been adopted by other courts in calculating the claims of victims of Ponzi and pyramid schemes.³² Using the net equity formula, the total amount a participant paid, whether to Telexfree or to a recruiting participant, minus the amount of money that the participant received, whether from Telexfree or a recruited participant, results in the amount of the participant’s claim. Mr. Darr proposed that all user accounts of a participant be aggregated for this calculation. By applying the net equity formula, participants would fall into two categories—“Net Winners” and “Net Losers.” As these terms suggest, Net Winners are those who received more from Telexfree and other participants than they paid to Telexfree and other participants, while the opposite is true for Net Losers. Mr. Darr maintained that only Net Losers should be entitled to participate as creditors in the bankruptcy cases.

³¹ The Ponzi scheme presumption presumes that all transfers made in furtherance of a Ponzi scheme are made with fraudulent intent. *DeGiacomo v. Sacred Heart Univ. (In re Palladino)*, 556 B.R. 10, 14 (Bankr. D. Mass. 2016).

³² See, e.g., *Marshall v. Picard (Bernard L. Madoff Inv. Securities LLC)*, 740 F.3d 81, 85 (2d Cir. 2014) (“*Madoff II*”); *Donell v. Kowell*, 533 F.3d 762, 772 (9th Cir. 2008).

The PIEC opposed the Ponzi Motion out of a concern that its allowance would bind all parties to Mr. Darr's methodology for determining Net Winners and Losers in the bankruptcy cases, which would result in his competing with them in attempting to recover payments directly between participants.

After an evidentiary hearing on the Ponzi Motion on November 24, 2015, I determined that Telexfree had indeed operated a Ponzi and pyramid scheme, that the Ponzi scheme presumption would apply, and that each of the debtors would be jointly and severally liable for the claims of the victims of the scheme.³³ I reserved on the issues of whether the net equity formula was the appropriate method for calculating claims in the cases and whether the trustee or the PIEC was the appropriate party to bring claims against Net Winners who retained funds paid by recruited participants. After a further hearing on January 26, 2016, I entered an order adopting the net equity formula as the method to be used in calculating a participant's claim.³⁴

Mr. Darr commenced this adversary proceeding on October 7, 2015, with a two-count complaint seeking a declaratory judgment that the defendants' unjust enrichment claims asserted in the District Court violated the automatic stay in effect as a result of the Telexfree bankruptcies

³³ Order dated November 25, 2015, docketed in Telexfree's main bankruptcy case (14-40987) as document #654, subsequently amended by order dated December 21, 2015. See document #668. A transcript of the evidentiary hearing is attached to the PIEC's Statement of Undisputed Facts as Exhibit N and also on the docket in Telexfree's main bankruptcy case as document #658.

³⁴ Order of January 26, 2016, docketed in 14-40987 as document #687.

and seeking an injunction enjoining the defendants from prosecuting those claims. In an amended complaint, Mr. Darr added a third count for damages resulting from the stay violation.

The Dispute

Mr. Darr as trustee wishes to recover from Net Winners for the benefit of the bankruptcy estates payments they received from or on behalf of Telexfree in excess of what they paid in. He has in fact begun to do so by commencing two class action adversary proceedings against thousands of alleged Net Winners, both domestic (Adv. Pro. No. 16-4006) and foreign (Adv. Pro. No. 16-4007).³⁵ Mr. Darr's recovery effort includes preference and/or fraudulent transfer claims against Net Winners to recover monies paid to them directly by recruited participants. He views the defendants' efforts to assert unjust enrichment claims against these Net Winners as interfering with his efforts.

Mr. Darr maintains that a recruiting participant's right to retain the fees received from a recruited participant arose because the recruiting participant had accumulated credits in his or her Telexfree user account. As a result, by retaining the fees, a recruiting participant effectively redeemed a portion of her credits while Telexfree applied the redemption amount to pay the invoice issued to the recruited participant. This Mr. Darr characterizes as a "triangular transaction."³⁶

³⁵ The *amicus* here is the class of domestic Net Winner defendants in Adv. Pro. No. 16-4006.

³⁶ Mr. Darr analogizes this to a bankruptcy trustee's garden-variety recovery action for an indirect fraudulent or preferential transfer where debtor owes or wants A to receive \$100 and B owes \$100 to debtor. Debtor instructs B to pay the \$100 directly to A and considers B's indebtedness to debtor paid in full. Even though debtor never touched the \$100, a bankruptcy

The trustee views all monies paid by a recruited participant to a recruiting participant as property in which Telexfree had an interest and so any attempt by Net Losers to sue Net Winners directly on a theory of unjust enrichment would amount to interference with property of the bankruptcy estates, namely the estates' interest in recovering that property through avoidance actions. This would violate the automatic stay. Mr. Darr maintains that excluding payments by a recruited participant to a recruiting participant from the reach of his trustee avoidance powers would sabotage the net equity formula. He points out that the court has already approved the use of the net equity formula in calculating claim amounts and suggests that this reflects the court's recognition that triangular transaction payments involved Telexfree property.

Mr. Darr asserts that in the aftermath of a Ponzi scheme the overriding concern of the court must be for ratable distribution of funds to all victims. He stresses that victims' claims in the Telexfree fraud were not particularized or susceptible to remedies such as the imposition of a constructive trust. He notes that due to an overriding concern that all Ponzi scheme victims receive equal treatment, a number of courts of appeal, including most recently the Eleventh

trustee may sue A for recovery if the transfer otherwise qualifies for avoidance. *Warsco v. Preferred Technical Group*, 258 F.3d 557, 564 (7th Cir. 2001). "As the explicit language of the Bankruptcy Code makes clear. . . the transfer need not be made directly by the debtor; indirect transfers made by third parties to a creditor on behalf of the debtor may also be avoidable under the Code. *Id.* (quoting *Dean v. Davis*, 242 U.S. 438, 443, 37 S. Ct. 130, 61 L. Ed. 419 (1917) ("Mere circuitry of arrangement will not save a transfer which effects a preference action from being invalid as such"))).

Circuit in *United States v. Ramunno*, 599 F.3d 1269 (11th Cir. 2010), have refused to impose constructive trusts in favor of defrauded victims even when those victims could trace their investments.³⁷

The PIEC couldn't disagree more with Mr. Darr's view of the case. It characterizes the payments by recruited participants to recruiting participants not as triangular transactions but as "participant-to-participant payments." The PIEC argues that Telxfree had no interest whatsoever in those payments so their disposition did not in any way diminish the Telxfree bankruptcy estates, a critical predicate to a trustee's prevailing on avoidance action claims. It views the trustee's triangular transaction construct as absurd because Telxfree was essentially a criminal enterprise and thus all the so-called debits and credits in and out of user accounts and the participant invoices were phony. These phantom transactions, the PIEC declares, had no impact on Telxfree's property as Telxfree never had possession of any of the cash. According to the PIEC all of the reported decisions in which a trustee had standing to bring avoidance-type claims in a Ponzi case involved the debtors' having had physical possession of the property obtained by fraud. Since Telxfree never had physical possession of the participant-to-participant funds, notes the PIEC, Mr. Darr's pursuit of recruiting participants who were Net Winners using his strong arm powers under the Bankruptcy Code will be a waste of time and money.

³⁷ The *amicus* agrees with Mr. Darr's characterization of the claims against recruiting participants as fraudulent transfers. It urges that the causes of action which the PIEC asserts belong to the victims are identical to and derivative of the trustee's fraudulent transfer claims and thus should be enjoined.

The PIEC asserts that it was not Telexfree which suffered losses as a result of the participant-to-participant payments; it was each recruited participant who turned out to be a Net Loser. Thus the losses were particularized to the Net Losers. The PIEC cites, among other decisions, *Caplin v. Marine Midland Grace Tr. Co. of N.Y.*, 406 U.S. 416 (1972), and the third of the Second Circuit’s Madoff trilogy, *Picard v. Fairfield Greenwich Ltd.*, 762 F.3d 199, 211 (2d Cir. 2014) (“*Madoff III*”), for the proposition that Ponzi scheme investors who suffer particularized harm caused by third parties may pursue direct causes of action against those parties while a bankruptcy trustee lacks standing to do so.

The Summary Judgment Standard

A court “shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law.” Fed. R. Civ. P. 56, made applicable by Fed. R. Bankr. P. 7056.

A genuine issue is “one supported by such evidence that ‘a reasonable jury, drawing favorable inferences,’ could resolve [the issue] in favor of the nonmoving party.” *In re McCarthy*, 473 B.R. 485, 491 (Bankr. D. Mass. 2012) (quoting *Triangle Trading Co. v. Robroy Indus., Inc.*, 200 F.3d 1, 2 (1st Cir. 1999)). A material fact is one that might affect the outcome of the case under the governing law. *See id.* at 491.

The moving party in a summary judgment motion bears the initial burden of demonstrating that no genuine issue of material fact exists by pointing to materials of evidentiary quality such as affidavits or depositions that are so one-sided as to warrant judgment as a matter of law. *See Anderson v. Liberty Lobby*, 477 U.S. 242, 252 (1986); *In*

re Varrasso, 37 F.3d 760, 763 (1st Cir. 1994). “Only if the record, viewed in that manner and without regard to credibility determinations, reveals no genuine issue as to any material fact may the court enter summary judgment.” *Cadle Co. v. Hayes*, 116 F.3d 957, 959 (1st Cir. 1997).

Discussion

Whether Mr. Darr has standing to pursue recovery of funds paid by Net Losers directly to Net Winners as fraudulent or preferential transfers begins with determining whether Telexfree had an interest in those funds at the time of their transfer. *See Rine & Rine Auctioneers, Inc. v. Douglas County Bank & Trust Co. (In re Rine & Rine Auctioneers, Inc.)*, 74 F.3d 854, 857 (8th Cir. 1996).³⁸ Putting aside for the moment the

³⁸ Bankruptcy Code section 547 provides in relevant part:

- (b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any *transfer of an interest of the debtor in property*—
 - (1) to or for the benefit of a creditor;
 - (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
 - (3) made while the debtor was insolvent;
 - (4) made—
 - (A) on or within 90 days before the date of the filing of the petition; or
 - (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
 - (5) that enables such creditor to receive more than such creditor would receive if—
 - (A) the case were a case under chapter 7 of this title;
 - (B) the transfer had not been made; and
 - (C) such creditor received payment of such debt to the extent provided by the provisions of this title.
- (Emphasis added).

unique issue of fraud, if Telexfree had an interest in the funds retained by a recruiting participant, then Mr. Darr and only Mr. Darr would have standing to seek to recover those funds using his statutory avoidance powers. *Morley v. Ontos, Inc.* (*In re Ontes, Inc.*), 478 F.3d 427, 431 (1st Cir. 2007) (fraudulent transfer); *In re Bodenstein*, 248 B.R. 808, 817 and n. 39 (Bankr. W.D. Ark.) (collecting cases), *aff'd*, 253 B.R. 46 (B.A.P. 8th Cir. 2000) (preferential transfer).

While the term “interest in property” is not defined in the Bankruptcy Code, it is often equated with the term “property of the estate,” which is. *See Bergquist v. Anderson-Greenwood Aviation Corp. (In re Bellanca Aircraft Corp.)*, 850 F.2d 1275, 1279 and n. 8 (8th Cir. 1988). *See also Rine & Rine Auctioneers*, 74 F.3d at 857 (“The phrase ‘property of the debtor’ in the pre-1984 version of § 547(b), which was replaced by ‘an interest of the debtor in property,’ is equivalent to ‘property of the estate’ for purposes of determining whether the transfer of proceeds derived from the debtor’s sale of transferee’s assets constituted a voidable preference”).

Bankruptcy Code § 548(a)(1) provides in relevant part:

The trustee may avoid any *transfer . . . of an interest of the debtor in property . . .* that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

- (A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted.
- (Emphasis added).

Bankruptcy Code § 541(a) is clear that property of the estate includes, with exceptions not relevant here, all legal or equitable interests of the debtor in property as of the commencement of the case “wherever located and by whomever held.” 11 U.S.C. § 541(a). “The scope of this paragraph is broad. It includes all kinds of property, including tangible or intangible property . . .” S. Rep. No. 95–989, 95th Cong., 1st Sess. 82 (1978), reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5868. *See also United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204–05, 103 S. Ct. 2309, 76 L.Ed.2d 515 (1983). Its intended breadth enables the bankruptcy court to control a debtor’s property, wherever found, for equitable distribution to creditors. *Straton v. New*, 283 U.S. 318, 320–21 (1931).

In determining what is property of the estate, courts look to state law. *Butner v. United States*, 440 U.S. 48, 55 (1979). Neither party has opined as to which state’s law controls in this proceeding. To determine what state’s law applies, a federal court utilizes the choice of law provision of the forum state. *Crellin Technologies, Inc. v. Equipmentlease Corp.*, 18 F.3d 1, 4 (1st Cir. 1994). Massachusetts courts “give effect to the law reasonably chosen by the parties to govern their rights under contracts so long as there is no substantial conflict with Massachusetts public policy and the designated state has some substantial relation to the contract.” *N. Parent, Inc. v. Cotter & Co. (In re N. Parent, Inc.)*, 221 B.R. 609, 620 n. 11 (Bankr. D. Mass. 1998). Here, the Telexfree membership contract designates Nevada law as governing “issues arising from this instrument.” Under Nevada law, fraud in the inducement renders a contract voidable but

not void. *Bishop v. Stewart*, 13 Nev. 25, 42 (Nev. 1878). This principle is neither remarkable nor unique and is the law in many states including Massachusetts. *See Shaw's Supermarkets, Inc. v. Delgiacco*, 410 Mass. 840, 842 (Mass. 1991).

The parties agree that no participant ever took steps to repudiate his or her membership contract with Telexfree. Under the contract Telexfree had the right to collect member fees but allowed a recruiting participant to hold on to those fees in exchange for redemption of credits in his Telexfree user account. That Telexfree treated membership fees as its own is reflected in its financial records and practices. Telexfree recorded participant-to-participant payments as “payments through the system” and booked these payments as a company expense for agents’ commissions. It issued IRS Forms 1099 to recruiting participants who held on to the membership fees.

That the funds retained by a recruiting participant never physically passed through Telexfree’s bank accounts does not matter for purposes of determining whether Telexfree had an interest in the funds. Physical possession is not the foundation upon which a determination of property of the estate rests. Bankruptcy Code § 541 includes property “wherever located and by whomever held.” An entity may have constructive possession of property. Even in the arguably more stringent criminal context, courts hold that “[p]ossession implies ‘control and power,’ exclusive or joint ..., or, in the case of ‘constructive possession,’ knowledge coupled with the ability and intention to exercise dominion and control.” *Com. v. Arias*, 29 Mass. App. Ct. 613, 617, 563 N.E.2d 1379,

1382 (Mass. App. Ct. 1990), *aff'd*, 410 Mass. 1005, 572 N.E.2d 553 (Mass. 1991).

Bankruptcy Code § 101(54) is also instructive. It provides:

“The term ‘transfer’ means— . . .

(D) each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with—

- (i) property; or
- (ii) an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption.”

“This definition is broad and covers not only the everyday buying and selling of goods, but also the transfer of a partial interest or a transfer that is not accompanied by a change of possession.”

Lehtonen v. Time Warner, Inc. (In re PurchasePro.com, Inc.), 332 B.R. 417, 426–27 (Bankr. D. Nev. 2005).

The PIEC does not necessarily disagree with any of this so long as the analysis is applied narrowly to the mill-run debtor actually engaged in business. The PEIC notes, however, that Telexfree was a criminal enterprise, its entire business model was a scam and all the funds involved in the scam were fraudulently obtained. The PIEC argues that when it comes to Ponzi scheme cases, the debtor must have had actual physical possession of the fraudulently generated funds for a bankruptcy trustee to have standing to deploy his or her avoidance powers to recover them. Since payments made directly between participants never came into Telexfree’s possession the PIEC maintains that Mr. Darr has no standing to sue to recover them and further that those funds should be impressed with a constructive trust for the benefit of the defendants. The PIEC also argues that the harm to the recruited participants who were Net Losers was particularized to them and that Mr. Darr lacks standing to compete with them for the same recovery.

While it is indeed the case that all reported decisions in which courts have recognized a bankruptcy trustee's standing to bring avoidance actions to recover funds transferred by a Ponzi scheme debtor involved funds actually in the debtor's possession, there is nothing in the Bankruptcy Code requiring that such possession be physical as opposed to constructive or indirect. The underlying principle upon which a bankruptcy trustee's avoidance power is based is that even as to property fraudulently obtained by a debtor, while unassailable title to such property may not have passed to the debtor, the debtor nevertheless obtains a defeasible interest in the property. *Bailey v. Big Sky Motors, Ltd. (In re Ogden)*, 314 F.3d 1190, 1198 (10th Cir. 2002) (defeasible title held by debtor who obtained funds by fraud). This principle would seem to apply with equal force whether the property is obtained directly or merely remotely or derivatively. By its nature, every triangular transaction underlying a participant-to-participant payment began with the creation of a debt owed by the recruited participant to Telexfree which Telexfree allowed to be repaid by the recruited participant's forwarding money directly to a recruiting participant to whom Telexfree had an obligation. The mere fact that the money flowed directly from a recruited participant to a recruiting participant rather from the recruited participant to Telexfree and then to the recruiting participant should not be the determining factor in Mr. Darr's standing to bring avoidance actions to recover that money for the benefit of all Telexfree's creditors.

The PIEC's claim that the funds paid by recruited participants to recruiting participants are being held in constructive trust for the benefit of the defendants reflects a

common misunderstanding of the nature of such trusts. “Nearly all literature on constructive trusts makes the point that a constructive trust is a remedy, rather than a substantive property right. It is not a trust, but an analogy to a trust employed to correct unjust enrichment.” Emily L. Sherwin, *Constructive Trusts in Bankruptcy*, 1989 U. Ill. L.R. 297, 310 (1989). “A constructive trust is a legal fiction, a common-law remedy in equity that may only exist by the grace of judicial action.” *XL/Datacomp, Inc. v. Wilson*, 16 F. 3d 1443, 1449 (6th Cir. 1994). The fact that a defrauded party has available the remedy of a judicially imposed constructive trust as to certain property does not deprive the party against whom the constructive trust remedy may be imposed from having rights in that property until such time as the trust is imposed. And further, unless the defrauded party can identify the property specifically, the ability to obtain the judicial remedy of constructive trust will be lost once a bankruptcy petition is filed. These principles were laid out nearly a century ago by the United States Supreme Court in the eponymous Ponzi case, *Cunningham v. Brown*, 44 S. Ct. 424 (1924). The defendants in this adversary proceeding cannot trace the funds they paid to the recruiting participants, and so their ability to seek the imposition of a constructive trust at this point has been lost.

“Constructive trusts are anathema to the equities of bankruptcy since they take from the estate, and thus directly from competing creditors, not from the offending debtor.”

XL/Datacomp, Inc., 16 F.3d at 1452.

The very reasoning that mandates denying the constructive trust remedy to the Telexfree victims also explains why their claims are not particularized. While each of the

victims no doubt views his or her loss as unique, from the vantage of the Telexfree bankruptcy estates, the victims are indistinguishable. Allowing one victim to elevate her claim over the claims of others thwarts the policy of ratable distribution at the heart of our bankruptcy system. *Id.* at 1451.

As Mr. Darr emphasizes, many of the defendants who claim no involvement with Telexfree actually had extensive interaction with the company as reflected by their multiple user accounts. For example, defendant Maria Murdoch testified at a November 24, 2015 evidentiary hearing that while she had invested approximately \$25,000 in Telexfree, she never had contact with Telexfree, never became a member of Telexfree, and never received an invoice from Telexfree.³⁹ Telexfree's books and records, however, reflect that Ms. Murdoch maintained seventy-five user accounts.⁴⁰ In fact, all of the named parties in various actions had multiple user accounts with Telexfree. They include: Rita Dos Santos, who had twelve accounts; Angela Batista Jiminez, who had fifty-five; Elisangela Oliveira, who had three; Diogo De Araugo, who had sixty-five; and Celio Da

³⁹ Trustee's Statement of Uncontested Facts at ¶ 41.

⁴⁰ *Id.* at ¶ 42.

Silva, who had one-hundred forty-two.⁴¹ In addition Ms. Dos Santos received \$8,035.91 in payments directly from Telexfree.⁴²

The cases relied upon by the PIEC, such as *Caplin* and *Madoff III*, do not support a finding of particularized harm in this proceeding. This is not a case where the trustee is asserting claims that do not belong to the Telexfree estate as in *Caplin*, where the trustee sought to sue an indenture trustee based on claims belonging not to the debtor but to the debenture holders under the indenture. Nor is it the case that the defendants here seek to assert claims against the recruiting participants that are distinct from the claims of Mr. Darr as in *Madoff III*, where investors who were customers of so-called “feeder funds,” and not Madoff’s funds, sought to sue the feeder funds directly. On the contrary, the relationships here more closely resemble those in the second of the Second Circuit’s Madoff trilogy, *Madoff II*, where Madoff customer/victims sought to sue Jeffrey Picower and his affiliates, who were Madoff’s co-conspirators, for conversion and other non-bankruptcy causes of action. The Second Circuit upheld an injunction issued by the bankruptcy court barring suit. The court ruled that the victims’ suit was nothing more than an attempt to “plead around” claims already being asserted by the Madoff trustee

⁴¹ *Id.* at ¶ 43. Ms. Murdoch, Ms. Batista Jiminez and Mr. Da Silva are no longer plaintiffs in the Oliveira Lawsuit. PIEC’s Response to Trustee’s Statement of Uncontested Facts at ¶ 38.

⁴² Trustee’s Statement of Uncontested Facts at ¶ 44.

and that the claims, despite being framed in non-bankruptcy legal terms, were derivative of the trustee's fraudulent transfer claims.

We have defined so-called “derivative claims” in the context of bankruptcy as ones that “arise[] from harm done to the estate” and that “seek [] relief against third parties that pushed the debtor into bankruptcy.” *Picard v. JPMorgan Chase & Co. (In re Bernard L. Madoff Inv. Sec. LLC)* (“*JPMorgan Chase*”), 721 F.3d 54, 70 (2d Cir. 2013). In assessing whether a claim is derivative, we inquire into the factual origins of the injury and, more importantly, into the nature of the legal claims asserted. See *Johns–Manville Corp. v. Chubb Indem. Ins. Co. (In re Johns–Manville Corp.)* (“*Manville III*”), 517 F.3d 52, 67 (2d Cir. 2008). While a derivative injury is based upon “a secondary effect from harm done to [the debtor],” an injury is said to be “particularized” when it can be “directly traced to [the third party’s] conduct.” *St. Paul Fire & Marine Ins. Co. v. PepsiCo, Inc.*, 884 F.2d 688, 704 (2d Cir. 1989).

Madoff II, 740 F.3d at 89.

Here, Mr. Darr wishes to sue recruiting participant Net Winners on theories of fraudulent and preferential transfer to recover money for the benefit of all the Telexfree victims. The defendants, a class of victims, seek to recover the same monies arising out of the same transactions based on a theory of unjust enrichment. They are in direct competition with the trustee. Viewed through the prism of bankruptcy law and policy, their claims are derivative of those asserted by Mr. Darr.

Recommended Ruling

For the reasons set forth above, I recommend granting Mr. Darr's motion for summary judgment and denying the PIEC's.

At Boston, Massachusetts this 18th day of December, 2017.

By the Court,



Melvin S. Hoffman
U.S. Bankruptcy Judge

Counsel Appearing: Harold B. Murphy, Esq.
Charles R. Bennett, Jr., Esq.
Murphy & King, Professional Corporation
Boston, MA
for Stephen B. Darr, Chapter 11 trustee, plaintiff

William R. Baldiga, Esq.
Brown Rudnick LLP
Boston, MA, and
Robert J. Bonsignore, Esq.
Bonsignore, PLLC
Las Vegas, NV
for the PIEC

Ilyas J. Rona, Esq.
Milligan Rona Duran & King LLC
Boston, MA
for Frantz Balan, class representative
Amicus curiae

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS**

In re:	)	Chapter 11
TELEXFREE LLC., <u>et al.</u> , ¹	)	Case No. 14-40987
Debtors.	)	Jointly Administered
)	
STEPHEN B. DARR AS TRUSTEE OF THE ESTATES OF TELEXFREE, LLC, TELEXFREE, INC. and TELEXFREE FINANCIAL, INC.,)	
Plaintiffs,)	
v.)	
RITA DOS SANTOS, INDIVIDUALLY AND AS PUTATIVE CLASS REPRESENTATIVE, AND MARIA MURDOCH, ANGELA BATISTA JIMINEZ, ELISANGELA OLIVEIRA AND DIOGO DE ARAUGO, AS PUTATIVE CLASS REPRESENTATIVES,	)	Adversary Proceeding No. 15-04055
Defendants.)	

**OBJECTIONS TO THE BANKRUPTCY COURT’S
DECEMBER 19, 2017 PROPOSED FINDINGS OF FACT AND
CONCLUSIONS OF LAW ON CROSS-MOTIONS FOR SUMMARY JUDGMENT**

The Plaintiffs’ Interim Executive Committee (the “PIEC”), appointed by the United States District Court in this District as the representative of the victims of the Debtors’ Ponzi and pyramid scheme by orders entered in the multi-district litigation proceedings captioned *In re TelexFree Securities Litigation*, MDL No. 14-02566 (D. Mass.), submits these objections to the Bankruptcy Court’s December 19, 2017 *Proposed Findings of Fact and Conclusions of Law on*

¹ The debtors (the “Debtors”) in these cases (collectively, the “Chapter 11 Cases”) are TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc.

Cross-Motions for Summary Judgment (the “Proposed Findings and Conclusions”) recommending granting the Trustee’s motion for summary judgment and denying the PIEC’s motion for summary judgment in Darr v. Dos Santos, Adv. Pro. No. 15-4055 (Bankr. D. Mass.) [Docket No. 98] (the “Adversary Proceeding”).

PRELIMINARY STATEMENT

The PIEC objects to the Proposed Findings and Conclusions for three reasons:

1. The Bankruptcy Court erred in concluding that a defeasible interest in property can arise in the absence of actual, physical possession or control, when the “right” to that property is predicated on a fraud;
2. The Court failed to take into account, as the governing law requires, the doctrine of *in pari delicto*, which precludes reliance (i.e., “enforcement”) on the underlying putative “contractual” relationships that were the flesh and bones of the illegal, criminal enterprise; and,
3. The Court misapplied the particularized harm requirement by failing to recognize that a Victim (as defined below) has a direct claim against a non-debtor Promoter (as defined below) based on their direct interaction in which the monies passing from the Victim to the Promoter occurred, which money never thereafter was possessed or controlled by TelexFree.

As the PIEC argued before the Bankruptcy Court, every Ponzi-scheme case in which a Trustee has been granted standing to pursue fraudulent transfer claims, bar none, involved a factual scenario where the monies at issue were in the debtor's possession or control prior to the transfer. See Memorandum in Support of PIEC’s Motion for Summary Judgment [Docket No. 41] (the “PIEC Opening Memorandum”) at 10-14 (and cases cited); *PIEC’s Response to Memorandum of Law in Support of Trustee’s Opposition to PIEC Motion for Summary Judgment and Trustee’s Cross-Motion for Summary Judgment* [Docket No. 76] (the “PIEC Reply Brief”) at 6-9 (and cases cited). The Bankruptcy Court itself acknowledged that there are no reported cases where the debtor did not have prior possession or control. See Proposed Findings and Conclusions at 21. The Court's error was in ignoring this determinative factor, and suggesting

here a dramatic and unprecedented expansion of decades old law by instead concluding that a defeasible interest in property can be created by a fraudster's illegal contract in the absence of the fraudster ever having possession or control of the property. Further, the Bankruptcy Court could only do so by ignoring the doctrine of *in pari delicto*. Thus, the Bankruptcy Court's rationale supporting its proposed holding is fatally flawed.

The Bankruptcy Court's proposed conclusion that the Victims suffered no particularized harm from their direct dealings with the non-debtor Promoters is also erroneous for the following reasons.

1. The ruling is based upon the erroneous assumption (not supported by the argument of either party below) that the PIEC asserted that the victims' monies were held in some sort of constructive trust. Although the Court finds this assumption to be significant, and it is seemingly a foundation of its decision, the PIEC never made any such argument, no "constructive trust" theory was ever proved or even suggested by the PIEC, and in any event the "constructive trust" analysis has no relevance to this dispute.
2. The Court then observes that the individual Victims cannot trace their monies in the hands of the individual non-debtor Promoters. This concept of tracing is not the appropriate inquiry here; issues concerning commingling and tracing apply only to claims regarding monies in the hands of the debtor. The funds at issue never reached the Debtors' hands. Tracing concepts, therefore, are not germane to anything here.
3. Finally, the Court ignores the direct relationship between the Victims and Promoters in proposing the conclusion that Victim claims are identical to the claims of the Trustee. The Trustee stands in the shoes of the wrong-doer/criminal enterprise, and thus in an entirely different position than the "net loser" Victims who have a direct relationship with the relevant Promoters and have no unclean hands at all. This is a corollary to the erroneous proposed conclusion that absence of possession can be overcome by reliance on "legal" rights predicated on an illegal contract.

Because the Bankruptcy Court's proposed conclusions are erroneous on each point, the PIEC respectfully requests that the District Court decline to adopt the Bankruptcy Court's

Proposed Findings and Conclusions, and instead enter an order granting summary judgment in favor of the PIEC.

FACTUAL BACKGROUND

I. The TelexFree Scheme

As the Court noted in its Proposed Findings and Conclusions, the material facts are not in dispute. TelexFree operated a hybrid Ponzi and pyramid scheme that revolved around the sham “sale” of “membership plans” and monthly voice over internet phone (“VoIP”) “packages.” *Local Bankruptcy Rule 7056-1 Statement of Undisputed Material Facts in Support of PIEC’s Motion for Summary Judgment* (“SUF”) [Docket No. 40], ¶ 11, Exhibit M at ¶¶ 11, 14. A person could become a participant (a “Participant”) in the TelexFree scheme by “purchasing” either a membership plan or VoIP package. *See* SUF ¶ 12, Exhibit M at ¶¶ 9, 14. Such purchases were made between individuals. Despite TelexFree’s use of labels such as “memberships,” “participants,” and “credits,” which the Trustee adopts for his arguments, the entire construct was simply an elaborate fraud. The money paid (“Victim Payments”) by participant victims (“Victims”) to other individuals was often paid in cash and almost entirely pocketed by the recipient promoters (the “Promoters”). In fact, after parting with significant sums of money, the Victims received nothing of actual value (except in certain instances the impression that he or she could fleece others in the same way, albeit unknowingly for many). Importantly, most of the money that flowed from Victims to Promoters (that is, the precise funds at issue in this litigation) remained in the pockets of the Promoters. The Debtors never received nor had possession of the Victim Payments paid by the Victims to the Promoters. *See* SUF ¶ 16, Exhibit M at ¶ 17-18.

II. The Civil and Criminal Actions

A. Actions in the District Court

After the collapse of TelexFree and an investigation which uncovered the extent of the fraud, the Department of Justice filed a criminal action against James Merrill and Carlos Wanzeler, the co-conspirators and masterminds behind TelexFree in May, 2014. As this Court is well aware, Wanzeler fled the country before he could be arrested. However, James Merrill was arrested and indicted in 2014. Merrill was charged with wire fraud and conspiracy to commit wire fraud. *Indictment, United States v. Merrill*, Case No. 4:14-CR-40028-TSH, July 23, 2014 [Docket No. 70]. He pled guilty to the charges and “expressly and unequivocally admit[ted] that he committed the crimes charged...and is in fact guilty of those offenses.” *Plea Agreement, United States v. Merrill*, Case No. 4:14-CR-40028-TSH, Oct. 14, 2016 [Docket No. 314]. Merrill was sentenced to six years in prison and three years of probation and forced to forfeit his myriad of assets to the Department of Justice. *Electronic Clerk’s Notes, United States v. Merrill*, Case No. 4:14-CR-40028-TSH, Mar. 22, 2017 [Docket No. 346].

In actions filed in June 2014, victims of TelexFree brought actions in various district courts against the masterminds behind TelexFree and certain other major non-debtor promoters and co-conspirators. *See* SUF ¶ 2, Exhibits B-E. By order dated October 22, 2014, the District Court transferred all of these actions to the District Court for the District of Massachusetts and established the MDL Proceedings. *See* SUF ¶ 3, Exhibit F. The PIEC consolidated the complaints filed in the prior six actions in the *Second Consolidated Amended Complaint*, filed on April 30, 2015 (the “SCAC”). *See* SUF ¶ 4, Exhibit G. In the SCAC, the PIEC named over forty defendants, including masterminds Merrill and Wanzeler, and certain major non-debtor promoters and co-conspirators for fraud, securities fraud, and a variety of other claims. The suit also named various banks, payment processors, attorneys, and accountants for aiding and

abetting these causes of action. See id. The PIEC brought unjust enrichment claims against all defendants, including specifically several Promoters, in the SCAC. On June 6, 2017, the PIEC filed the Fourth Consolidated Amended Complaint (the “FCAC”) to include additional defendants that the PIEC learned of through informal discovery. See In re TelexFree Securities Litigation, MDL No. 14-02566 (D. Mass.) [Docket No. 503].

On February 24, 2016, the PIEC commenced a separate civil action in the United States District Court for the District of Massachusetts asserting claims against forty-seven Promoters, including a claim for unjust enrichment. See Murdoch et al. v. TelexElectric, LLLP et al., No. 4:16-cv-40018 (the “Oliveira Action” and together with the SCAC, the “Unjust Enrichment Claims”).² On June 27, 2016, Plaintiff Oliveira filed an amended complaint in the Promoter action solely to remove certain named parties. See Amended Complaint, Civ. Act. No. 16-40018. On June 26, 2017, the PIEC amended the Amended Complaint to add 199 subsequently-identified defendants to the Oliveira Action.

B. Actions in the Bankruptcy Court

On April 13, 2014, each of the Debtors filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Nevada. The bankruptcy cases and the associated adversary proceedings were transferred to the Bankruptcy Court for the District of Massachusetts in May 2014.

In 2015, the Trustee filed a motion in the main bankruptcy case requesting a ruling that TelexFree had engaged in a Ponzi and pyramid scheme (the “Ponzi Motion”). During the November 24, 2015 hearing on the Ponzi Motion, the Court found that the Debtors engaged in a Ponzi and pyramid scheme. SUF ¶ 18, Exhibit N (Nov. 25, 2015 Hr’g Tr. 117:11-17). The

² The Oliveira Action was amended on June 27, 2016 to remove Maria Murdoch, Angela Batista Jiminez, and Diogo de Araugo as named plaintiffs.

Court relied on the admitted facts that “the investment by consumers; the fact that the company conducted little or no legitimate business; produced little or no profit; that the...predominant source of income from the business was from these...investments by the consumers” and that the “top-down structure whereby individuals were selling or recruiting other participants to go out and find participants and receive awards that were unrelated to the product that the company was purporting to sell” for its finding that the fraudulent “business” was a Ponzi and pyramid scheme. *Id.* (Nov. 25, 2015 Hr’g Tr. 117:11-118:3); *see Amended Order on Motion by Chapter 11 Trustee for Entry of Order Finding that Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief*, Case No. 14-40987 [Docket No. 668] at ¶ 4 (“Each of the Debtors in these jointly administered cases operated a Ponzi and pyramid scheme.”).

At the hearing on the Ponzi Motion, Counsel for the Trustee, and the Trustee himself, testified that the business was a fraudulent scheme.

- Counsel for the Trustee noted that “[t]he credits were fictitious profits.” SUF ¶ 18, Exhibit N (Nov. 25, 2015 Hr’g Tr. 14:6-8).
- When asked if he had made the decision to not attempt to sell the business, the Trustee testified that he “believed at that time that...it was not a viable business, that there was nothing to sell, and that it was an illegal operation and it’s tough to sell an illegal operation.” SUF ¶ 18, Exhibit N (Nov. 25, 2015 Hr’g Tr. 55:25-56:3).
- When asked if the “memberships” sold by TelexFree had no true value, the Trustee testified: “Well, I believe it was a fraudulent enterprise. So I think it would logically flow from that that there was no true value.” SUF ¶ 18, Exhibit N (Nov. 25, 2015 Hr’g Tr. 58:17-22).

Additionally, on January 15, 2016, the Trustee filed two defendant class actions against Promoters seeking to recover the Victim Payments as purported fraudulent transfers and/or preferential payments under Sections 547 and 548 of the United States Bankruptcy Code. *See Darr v. Argueta*, Adv. Proc. No. 16-04006, Case No. 14-40987 (Bankr. D. Mass.); *Darr v.*

Alecci, Adv. Proc. No. 16-04007, Case No. 14-40987 (Bankr. D. Mass.). These cases are currently pending in the Bankruptcy Court.

III. The Adversary Proceeding

On October 7, 2015, the Trustee initiated this Adversary Proceeding seeking (i) a declaratory judgment that the PIEC's unjust enrichment claims asserted in the District Court violated the automatic stay in effect as a result of the TelexFree bankruptcies and (ii) an injunction enjoining the PIEC from prosecuting those claims. See SUF ¶ 9, Exhibit L at ¶¶ 39-48. The Adversary Proceeding is predicated on his allegation that all dollars paid by a Victim directly to a Promoter constitute a fraudulent transfer of TelexFree property which the Trustee has the exclusive authority to recover. See SUF ¶ 10, Exhibit M at ¶¶ 33-43.

On August 5, 2016, the PIEC filed the *PIEC's Motion for Summary Judgment* [Docket No. 39],³ its SUF [Docket No. 40],⁴ and the *PIEC's Opening Memorandum* [Docket No. 41].⁵ On September 2, 2016, the Trustee filed its *Cross-Motion By Trustee for Summary Judgment* [Docket No. 47].⁶ On December 20, 2016, the PIEC filed the *PIEC's Reply Memorandum* [Docket No. 76].⁷ The cross-motions for summary judgment were argued on February 22, 2017.⁸

³ The *PIEC's Motion for Summary Judgment* is attached hereto as Exhibit 1.

⁴ The SUF is attached hereto as Exhibit 2.

⁵ The *PIEC's Opening Memorandum* is attached hereto as Exhibit 3.

⁶ The *Cross-Motion By Trustee for Summary Judgment* is attached hereto as Exhibit 4. The Trustee also filed the *Trustee's Statement of Undisputed Material Facts in Support of His Cross-Motion for Summary Judgment* [Docket No. 48] (attached hereto as Exhibit 5), the *Affidavit of Stephen B. Darr in Opposition to the PIEC Motion for Summary Judgment and in Support of the Trustee's Cross-Motion for Summary Judgment* [Docket No. 49] (attached hereto as Exhibit 6), and the *Memorandum of Law in Support of the Trustee's Opposition to PIEC Motion for Summary Judgment and Trustee's Cross-Motion for Summary Judgment* [Docket No. 51] (attached hereto as Exhibit 7).

⁷ The *PIEC'S Reply Memorandum* is attached hereto as Exhibit 8.

⁸ The transcript from the February 22, 2017 hearing [Docket No. 95] is attached hereto as Exhibit 9.

On December 19, 2017, the Bankruptcy Court issued its Proposed Findings and Conclusions in the Adversary Proceeding.⁹ The Bankruptcy Court recommended granting the Trustee's motion for summary judgment and denying the PIEC's. See Proposed Findings and Conclusions at 26. The Bankruptcy Court submitted to the District Court the Proposed Findings and Conclusions. Id. at 3.

LEGAL STANDARD

Upon submission of a bankruptcy court's proposed findings of fact and conclusions of law, a district court "shall make a de novo review upon the record or, after additional evidence, of any portion of the bankruptcy judge's findings of fact or conclusions of law to which specific written objection has been made in accordance with this rule." Fed. R. Bankr. P. 9033(d). De novo review under Federal Rule of Civil Procedure 72(b)¹⁰ requires that the district court give "fresh consideration" to issues to which a party has objected, and "consider the record which has been developed...and make his own determination on the basis of that record, without being bound to adopt the findings and conclusions of the magistrate." United States. v. Raddatz, 447 U.S. 667, 675 (1980) (quoting H.R. Rep., at 3, U.S. Code Cong. & Admin. News 1976, p. 6163). Upon reviewing a decision de novo, "[t]he district judge may accept, reject, or modify the proposed findings of fact or conclusions of law, receive further evidence, or recommit the matter to the bankruptcy judge with instructions." Fed. R. Bankr. P. 9033(d).

⁹ The Proposed Findings and Conclusions are attached hereto as Exhibit 10.

¹⁰ The Advisory Committee Note to Bankruptcy Rule 9033 provides that Bankruptcy Rule 9033(d) "adopts the de novo review provisions of [Fed. R. Civ. P.] 72(b)."

OBJECTIONS

I. Objection 1: In The Absence of Physical Possession, A Defeasible Interest in Property Cannot Arise Based On An Underlying Illegal Contract

The PIEC asserts two objections with respect to the Bankruptcy Court's finding that the Trustee has a property interest in the Victim Payments. First, the Debtors never had possession of the Victim Payments. As argued below, possession of the funds is necessary to support a finding that the Trustee has an interest in the funds. Second, although the Court ignores the illegality of the scheme and underlying "contract" and "credits" (which the Trustee's counsel noted were "fictitious profits"), such illegality mandates that a court find that the Trustee cannot bring a claim because of *in pari delicto*.

A. The Debtors Never Had Possession of the Victim Payments

Beginning with the Supreme Court's seminal decision, in Caplin v. Marine Midland Grace Tr. Co. of N.Y., 406 U.S. 416 (1972), and continuing uninterrupted through forty-five years of its progeny, the law regarding bankruptcy trustee standing in Ponzi scheme cases is well-established: a trustee has standing to pursue only those fraudulent transfer claims concerning estate assets that were in the debtor's actual possession at the time of the transfer. In its opening and reply briefs before the Bankruptcy Court, the PIEC cited the numerous cases that compel this conclusion. See PIEC Opening Mem. at 10-14; PIEC Reply Br. at 6-8. In response, the Trustee did not cite a single case to the contrary. Indeed, the Bankruptcy Court itself acknowledged that "*all reported decisions in which courts have recognized a bankruptcy trustee's standing to bring avoidance actions to recover funds transferred by a Ponzi scheme debtor involved funds actually in the debtor's possession....*" Proposed Findings and Conclusions at 21 (emphasis added).

Despite the absence of any contrary case law, the Bankruptcy Court proposes that this Court now create out of whole cloth a novel expansion of fraudulent transfer law, unprecedented in the thousands of decided cases over decades. The entirety of this expansion would be based solely upon the existence of contractual relationships which this very Court has found to be a sham and a fraud, so much so that it warrants the loss of liberty for its co-creator. The Bankruptcy Court suggests that those underlying illegal contractual relationships were nonetheless sufficient to create a defeasible interest in property that was never, for a single second, in the Debtors' possession or under their control. There is no basis in law to support such a conclusion. Tellingly, the Bankruptcy Court never characterizes in this particular decision the underlying contracts as illegal (although they indisputably were, as evidenced by Court's own earlier finding that TelexFree conducted "little or no legitimate business" and the fact that Merrill was sentenced by this Court to six years in prison for his role in the scheme), and thereby avoids what would have been the impossible challenge of grappling with the doctrine of *in pari delicto*. Instead, the Bankruptcy Court necessarily tried to escape the inevitable conclusions that would have emanated from those inescapable facts by simply ignoring them and the established law that invariably follows from them.

The Bankruptcy Court cited to a single case to support its ground-breaking conclusion that possession of money procured by fraud is not necessary to its recovery by a bankruptcy trustee: Bailey v. Big Sky Motors, Ltd. (In re Ogden), 314 F.3d 1190, 1198 (10th Cir. 2002). However, aside from containing language as to an undisputed principle not relevant here (that defeasible title can arise from property acquired by fraud), the Bailey case in no way supports the Bankruptcy Court's proposed conclusion. Before turning to Bailey, a brief review of the previously briefed case law is helpful.

Like a fraud claim, in the context of a Ponzi scheme, the property **acquired** by the debtor from the victim bestows upon the debtor voidable title only. See Merrill v. Dietz (In re Universal Clearing House Co.), 62 B.R. 118, 123 (D. Utah 1986) (“An agreement induced by fraud [] is merely voidable, not void.”). But such voidable title only arises from the fact that the fraudster obtains **actual possession** of the property later transferred. See id. at 124 (concluding that money is property of the estate when “a debtor obtains money by fraud and mingles it with other money so as to preclude any tracing”).

Thus, in **every case** involving a Ponzi scheme in which a trustee has successfully brought a fraudulent transfer action, the assets transferred by the debtor were in the debtor’s **actual possession** prior to the transfer. See Floyd v. Dunson (In re Ramirez Rodriguez), 209 B.R. 424, 429 (Bankr. S.D. Tex. 1997) (purchase price for contracts *paid directly by investors to the debtors*, deposited in accounts held or controlled by the debtors, and commingled with other investors’ funds); In re Universal Clearing House Co., 62 B.R. at 123 (payments made pursuant to “investor contracts” *paid directly by the investor to the debtors* and commingled in a common fund controlled by the debtors); Sender v. Buchanan (In re Hedger-Invs. Assocs., Inc.), 163 B.R. 841, 850 (Bankr. D. Colo. 1994) (Ponzi scheme “*debtor came into possession* of all of these funds by the voluntary payment of the investors”) (emphasis added)); Dicello v. Jenkins (In re Int’l Loan Network, Inc.), 160 B.R. 1, 7-8 (Bankr. D.D.C. 1993) (investors purchased memberships by *transferring funds directly to the debtor* at their corporate headquarters, which funds the debtor commingled with its other money); In re Taubman, 160 B.R. 964, 972, 978 (Bankr. S.D. Ohio 1993) (*investors transferred funds directly to the debtors*, which funds were held in bank accounts controlled by the debtor and commingled with the funds of other investors); Raforth v. First Nat’l Bank of Barnesville (In re Baker & Getty Fin. Servs. Inc.), 98

B.R. 300, 306 (Bankr. N.D. Ohio 1989) (*investors transferred funds directly to the debtors and the debtor held and commingled funds in common accounts*); Geltzer v. Barish (In re Geltzer), 502 B.R. 760, 764, 768 (Bankr. S.D.N.Y. 2013) (*investors transferred money directly to the debtor and all investor funds were held in commingled accounts controlled by the debtor*).

The critical element leading to a finding in these cases that the property later transferred by the debtor was property of the estate was *possession*. The reason why actual possession is crucial is because when the "right" to the property is predicated on a fraud, in the absence of possession, the fraudster cannot compel the victim to transfer that property to it. See PIEC Opening Mem. at 14-19; PIEC Reply Br. at 7-8.

The Bailey case relied on by the Bankruptcy Court does not hold differently. In Bailey, Ogden, a real estate developer at the center of the Ponzi real estate scheme, set up discrete escrow accounts into which each defrauded investor's monies were deposited. Those monies were thereafter disbursed by the escrow agent upon Ogden's direction. The escrow company was found to be a mere conduit for the disbursement of the monies with no actual control or title to the deposited funds. As a result of Ogden's control over the deposited monies into accounts which he created and directed, the court found that he had "obtained" the funds and thus acquired defeasible title.¹¹ It was thus Ogden's dominion and control over the funds that resulted in defeasible title. Cases following Bailey affirm the critical principle that possession and control of the funds prior to transfer are the determinative facts. For example, in analyzing the Ponzi scheme in Wagner v. Olivia (In re Vaughan Co.), 500 B.R. 778, 795 (Bankr. D.N.M. 2013), the

¹¹ The particular transfer at issue involved Ogden's direction to the escrow agent to move funds from one investor's escrow account to another's and thereafter to disburse that money to the investor associated with the second escrow account. Bailey, 314 F.3d at 1194-95. The main issue in the case was whether the escrow agent constituted a transferee under §550, such that the second investor was entitled to assert a good faith defense to receipt of the latter disbursement. Id. at 1195. The Court held that the escrow agent was a mere conduit and thus not a transferee. See id. at 1204-05.

court held that “[o]nce the funds were deposited into [the debtor’s] account, [the debtor] obtained a legally recognized interest of defeasible title to the funds.” The court then stated that under Bailey, the funds would have therefore been property of the estate pursuant to Section 541 had the funds not been transferred before the commencement of the case. Id. In Parks v. FIA Card Services, N.A. (In re Marshall), 550 F.3d 1251, 1255 (10th Cir. 2008), the court held that the actual use or control the property established a defeasible interest. Similarly, in Whitley v. First-Citizens Bank & Trust Co. (In re Whitley), Adv. Pro. No. 12-02028, 2013 WL 486782 at *10 (Bankr. M.D.N.C. Feb. 7, 2013) the court held that funds are property of the debtor when transferred into a debtor’s bank account at the defendant bank. Finally, in Wagner v. Wilson (In re Vaughn Co.), Adv. Pro. No. 12-01142 J, 2013 WL 960143 at *4 (Bankr. D. N.M. Mar. 11, 2013) the court held that “by obtaining funds belonging to [investors], [the debtor] obtained a legally recognized interest of defeasible title to the funds.” Neither Bailey nor any case citing it departs from the requirement that in situations where there is a claim to title over property subject to a fraud, physical possession is the only fact that bestows any sort of title (i.e., voidable title) on the fraudster. To hold otherwise would mean the court was, in the first instance, effectively enforcing rights stemming from an illegal contract.

Thus, despite the Bankruptcy Court’s conclusion that possession is not necessary to obtain title to funds in a fraudulent scheme, all prior case law, without exception, finds possession or control to be the determinative factor. The proposed ruling here would be without precedential support, or principled basis, of any type.

B. The Debtors Never Had Valid Legal Title To The Victim Payments

Throughout this case, the Trustee has interposed two arguments to overcome the fatal lack of possession or control over the Victim Payments. First, the Trustee argues that the so-called triangular transactions should be analogized to leveraged buyouts or other collapsible transactions. The PIEC exposed that argument as meritless by noting that all (once again, without ANY exceptions) leveraged buyout cases started with the fact that the target company *had legal title* to the assets pledged to secure the loan that rendered the target insolvent. Thus, the loan proceeds were not the product of a fraud; it was the subsequent transfer out of those legally obtained proceeds that resulted in liability. See PIEC Opening Mem. at 16-19; PIEC Reply Br. at 8-9. In response to this argument, the Trustee switched gears and argued instead that the Promoters were agents of TelexFree and thus monies paid to the Promoters were effectively paid to TelexFree even though TelexFree never possessed or controlled those monies. The Trustee's agency argument was grounded in an unenforceable "contract" between TelexFree and the Promoter that was but one cog in the TelexFree Ponzi-scheme fraud. Again, the PIEC refuted this argument by pointing out that the language in the unenforceable "contract" clearly stated that the Promoters were not employees nor subject to the control of TelexFree, and not able to act in the name of TelexFree. See PIEC Reply Br. at 9-10. More importantly, because the illegal contracts were an integral part of TelexFree's fraudulent and illegal scheme, under the doctrine of *in pari delicto* that contract was unenforceable. That is to say, even if the illegal contracts which served as part of the fraud had created an agency relationship (which to be clear, they did not), the Trustee could not enforce the contract in a suit between the two (i.e., a turnover suit in which TelexFree sought to compel delivery of the collected funds from the Promoters - TelexFree never filed any such suit and never sought to compel the turnover of the near \$2 billion collected). See id. at 6-9.

The Bankruptcy Court appears to implicitly adopt the underlying premise of the Trustee's arguments in its Proposed Findings and Conclusions that TelexFree had some sort of legitimate property right that could be, and later was, transferred by it. Thus, the Bankruptcy Court states, “[b]y its nature, every triangular transaction underlying the participant-to-participant payment ***began with the creation of a debt owed by the recruited participant to Telexfree*** which Telexfree allowed to be repaid by the recruited participant's forwarding money directly to a recruiting participant to whom Telexfree had an obligation.” Proposed Findings and Conclusions at 21 (emphasis added). The highlighted words are the foundation of the court's error. There was never “a debt owed” to TelexFree, at least not a debt legally enforceable in a court of law. The recruited participants (i.e. Victims)¹² so-called “debt” to TelexFree, arose solely from the fraudulent Ponzi scheme. Victims were fraudulently induced into participating in the scheme and paid the so-called membership fee directly to the Promoter. To satisfy the “debt” created to TelexFree, the Promoter transferred worthless and fictitious credits previously issued to the Promoter by TelexFree which were based on defrauding Victims. Thus, the very foundation of each conclusion of the Bankruptcy Court here is a sham “debt” that decades of good case law plainly dictates cannot be the basis for a trustee's right of recovery.

As argued in the PIEC’s earlier briefing, TelexFree could not have sued to enforce the worthless credits or illegal contracts, as both were predicated on fraud, simply part of the illegal scheme, and unenforceable. See PIEC’s Opening Mem. at 15-19; PIEC’s Reply Br. at 7-9; see also Phoenix Techs., Inc. v. TRW, Inc., 834 F. Supp. 148, 151 (E.D. Pa. 1993) (“It is a well settled principle of contract law that if a party is fraudulently induced into entering a contract, the terms of the contract are not enforceable against the defrauded party”); Campco Distrib., Inc. v.

¹² In order to avoid any confusion by use of different labeling, the Court should understand that the Bankruptcy Court's use of the term "recruited participant" is the same as what the PIEC calls "Victim"; and its use of the term "recruiting participant" is what the PIEC calls "Promoter."

Fries, 537 N.E.2d 661, 665 (1987) (“Generally, where there is fraud in the execution of an agreement...the transaction is wholly void.”).

The Bankruptcy Court never analyzed the so-called debt owed by either the Victims or the Promoters to TelexFree, or TelexFree's supposed right to compel the Promoters to turn over payments made to them by Victims under the doctrine of *in pari delicto*. But to suggest that there was a legally cognizable debt, is to say that the underlying contracts and the fictitious credits creating that debt were legal and valid. They were not and could not be enforced by a court, either because the underlying obligation was the product of a fraud, or because to enforce the so-called obligation is to run afoul of the doctrine of *in pari delicto*. Thus, as between TelexFree and the Victims, TelexFree could never have compelled the payment of the membership fee directly from the Victim because it was based on a fraudulently induced contract. See Joint Venture Asset Acquisition v. Zellner, 808 F. Supp. 289, 301 (“The Defendants have established that they were fraudulently induced...as to the terms and conditions of the Notes, and therefore, the Notes are unenforceable.”). As between TelexFree and the Promoters, to suggest that the fictitious credits are a legitimate property interest used to satisfy a legitimate debt means enforcing the relationship between co-conspirators to a massive fraud. This is exactly what the doctrine of *in pari delicto* instructs a court it cannot do. See Shearson Lehman Hutton, Inc. v. Wagoner, 944 F.2d 114, 118 (2d Cir. 1991) (“[W]hen a bankrupt corporation has joined with a third party in defrauding its creditors, the trustee cannot recover against the third party for the damage to the creditors.”); Picard v. JPMorgan Chase & Co. (In re Bernard L. Madoff Invs. Secs. LLC), 721 F.3d 54, 63 (2d Cir. 2013) (“Madoff I”)¹³ (trustee appointed in Madoff Ponzi scheme could not bring claims of creditors against third parties for unjust enrichment, breach of

¹³ The PIEC refers to Madoff I as “Picard I” in the PIEC Opening Brief and PIEC Reply Brief.

fiduciary duty, aiding and abetting fraud and negligence, among others, because, “the doctrine of *in pari delicto* bar[s] a debtor from suing third parties for a fraud in which he participated”); Nisselson v. Lernout, 469 F.3d 143, 157 (1st Cir. 2006) (barring a trustee from bringing an actions against third parties when company was complicit in fraud, but holding that creditors were “free to proceed in their own right”).

How the Bankruptcy Court reached its conclusion without analyzing the so-called underlying debt of a “recruited-participant” (i.e., a “Victim”) under either the law of fraud or the doctrine of *in pari delicto* is difficult to fathom. But that failure is fatal because once confronted with the illegality of the underlying scheme, including the (so-called) debt and fictitious credits, it is plain that the “satisfaction of that unenforceable debt” with illegal and fictitious credits cannot be the basis for finding a defeasible interest was created in monies transferred between two non-debtors and never in the Debtors' possession or control. Most simply put, the Bankruptcy Court's Proposed Findings and Conclusions, while necessary to create some sort of basis for a ruling in favor of the Trustee and against the true Victims here, irreconcilably fly in the face of Merrill's criminal conviction, the Bankruptcy Court's own prior Ponzi scheme finding, and every other ruling and finding in these multiplicity of related proceedings.

II. Objection 2: Objection To Bankruptcy Court’s Conclusion That The Victim Claims Are Not Particularized.

As mandated by the Supreme Court in Caplin, only the Victims have standing to recover the Victim Payments because each Victim suffered direct, particularized harm at the hands of the Promoters to whom he or she made payments. See 406 U.S. at 434. The Bankruptcy Court proposes to differentiate Caplin by concluding that the Victims do not have standing to recover those Payments because they did not suffer a particularized harm. That conclusion was in error.

The Bankruptcy Court begins its analysis by erroneously stating that the PIEC argues that the funds paid to the Promoters are being held in constructive trust for the victims. See Proposed Findings and Conclusion at 21-22. After “reminding” the PIEC that constructive trust is only a remedy and not a claim, the Bankruptcy Court states that a constructive trust “does not deprive the party against whom the trust remedy may be imposed from having rights in that property....” Id. at 22. The court next observes that unless the specific property can be traced, the remedy of constructive trust is lost. Id. Finally, the court opines that the victims cannot trace their monies to the particular non-debtor promoters. Id.

The Court incorrectly uses this argument to support its proposed conclusion of no particularized harm. First, the PIEC never argued for a so-called constructive trust claim, so the entire discussion is a quintessential red-herring. Second, the Promoters would have “rights in the property” as to which a constructive trust could not interfere, not TelexFree. The Promoters’ “rights” would be voidable possessory title. Absent possession, however, TelexFree has no rights whatsoever. Third, the issue of “tracing” in the Ponzi scheme context relates to tracing monies in the actual possession of the debtor, not the non-debtor co-conspirator. That is why the Ponzi scheme cases finding standing in the Trustee routinely note that the monies were “commingled” in debtors’ accounts and thus no longer traceable by the victim. See, e.g., In re Baker & Getty Fin. Servs. Inc., 98 B.R. at 306 (where a debtor obtains money by fraud and mingles it with other money so as to preclude any tracing the money is property of the debtor under sections 547 and 548 of the Bankruptcy Code); In re Universal Clearing House, 62 B.R. at 124 (“[W]here a debtor obtains money by fraud and mingles it with other money so as to preclude any tracing and where the defrauded party does not timely avoid the transaction, the money is ‘property’ of the debtor within the meaning of section 548 of the Code.”). In a one-to-

one, non-debtor to non-debtor situation, tracing has no meaning as the claim is direct between those two parties and commingling is not an issue. There is no dispute that a claim for injury that is particular to certain creditors, rather than general to all creditors, may be brought *only* by the injured creditors. See Picard v. Fairfield Greenwich Ltd., 762 F.3d 199, 211 (2014) (“Madoff III”)¹⁴ (“[W]hen creditors . . . have a claim for injury that is particularized as to them, they are exclusively entitled to pursue that claim, and the bankruptcy trustee is precluded from doing so.”); Wagoner, 944 F.2d at 118 (“It is well-settled that a bankruptcy trustee . . . may only assert claims held by the bankrupt corporation itself.”).

The Bankruptcy Court appears to have concluded that because each Victim's harm is “indistinguishable” from another's, there can be no particularized harm. See Proposed Findings and Conclusion at 22-23. The Bankruptcy Court never expounded on what it meant by indistinguishable; presumably it meant that each was defrauded in the same way under the same Ponzi scheme. To the extent that is what the court meant, that analysis is fallacious. The issue is not “how” the Victims were defrauded; rather, the salient question is by “whom.” Inasmuch as the fraud perpetrated on the Victims was by the non-debtor Promoters who received and kept for themselves the Victims’ monies, the Victims have direct claims against those non-debtor Promoters. As cited in the PIEC's briefing below, the fact that there are non-debtors against whom the Victims have claims based on their direct involvement with one another is in no way impacted by the fact that the Victim may also be a creditor of the estate. That is the holding of Madoff III, 762 F.3d at 211 (“that the plaintiffs in both [state court] Actions are creditors of the

¹⁴ This case is referred to as “Madoff III” in the Proposed Findings and Conclusions and “BLMIS III” in the Trustee’s Memorandum of Law in Support of Trustee’s Opposition to PIEC Motion for Summary Judgment and Trustee’s Cross-Motion for Summary Judgment. The PIEC refers to this as “Picard III” in its Opening Memorandum and “Picard IV” in its Reply Brief.

Madoff estate...[is irrelevant as] the plaintiff's right to enforce duties owed to them is not qualified by the fact that they may also have claims against the Madoff estate").¹⁵

In Madoff III, the Second Circuit addressed the right of victims of the Madoff Ponzi scheme to bring breach of fiduciary duty and other claims against investment funds that invested the victims' assets with Madoff. As the court stated there, "[i]n order to qualify as 'disguised fraudulent transfer actions,' . . . the complaints . . . would have to be contingent on [the debtors'] wrongful transfer of the funds sought" in those actions." Id. at 209. The court found that the victims' claims were not "disguised fraudulent transfer claims" because the claims were independent of the claims against Madoff, and the claims were not dependent on funds wrongfully transferred by the debtors to non-debtor third parties. See id. at 210.

Here, the Victim claims are separate and distinct from the claims against TelexFree. First, these are independent claims against non-debtor third parties that would exist, regardless of the fact that TelexFree is the "but-for" cause of the harm. Second, the claims are not dependent on the transfer of any funds from Debtors to the Promoters, as the Debtors never had possession of the funds. See PIEC's Opening Mem. at 20; PIEC's Reply Br. at 13-15. Thus, for the same reason that claimants in Madoff III could assert claims against third parties, Victims should have the ability to assert claims against third party non-debtors.

Finally, the Bankruptcy Court's analysis of the Madoff cases flounders in its assumption that the fraudulent transfer claims as articulated by the Trustee are valid. See Proposed Findings

¹⁵ Put differently, the Promoters defrauded the Victims in their direct, face-to-face dealings. Even if the Promoters had turned the money over to TelexFree (which, of course, they never did), the Victims still would have direct claims against the Promoters based on the direct interactions between one another. Any Victim's claims against their relevant Promoter are not dependent on any monies transferred by TelexFree to that Promoter. In fact, no transfer of any monies at issue here by TelexFree ever took place. That is the holding of Madoff III. See Madoff III, 762 F.3d at 211 ("The injuries alleged by the plaintiffs...are alleged to have been caused directly by the non-debtor defendants—not by Madoff or BLMIS. That renders them 'particularized' and outside the Trustee's purview.").

and Conclusions at 24. As articulated above, in the absence of physical possession of the property and upon proper application of the doctrine of *in pari delicto* it is clear that the Trustee has no valid claim against the Promoters.

The Bankruptcy Court erroneously relies on Madoff II, 740 F.3d 81 (2d Cir. 2014) (“Madoff II”)¹⁶ to support its finding that the Victim claims are derivative of the Trustee’s. In Madoff II, certain creditors attempted to sue Madoff’s co-conspirators to recover funds that the *defendants had improperly withdrawn from the debtors’ possession* (i.e., BLMIS accounts). Id. at 85. The Second Circuit concluded that the claims were in fact derivative of the estate’s claims and not “particularized” as to the individual creditors because their alleged injuries were “inseparable from, and predicated upon, a legal injury to the estate, namely the [] *defendants’ fraudulent withdrawals from their BLMIS accounts* of what turned out to be other BLMIS customers’ funds.” Id. at 92 (emphasis added). In Madoff II, possession of the funds, which were taken from accounts held by the Debtor, was crucial to the finding that the claims were derivative of the estate’s claims. Without a finding of possession here, Madoff II is inapplicable.

A Victim’s right to recover the monies each paid directly to a non-debtor Promoter as a result of the latter’s fraudulent representations belongs solely to the Victim. Based on the foregoing, the Trustee has no standing to sue to recover the Victim Payments on behalf of TelexFree’s victims.

CONCLUSION

The Bankruptcy Court has proposed a radical expansion of bankruptcy and Ponzi scheme law, for which there is no case support. By ignoring the doctrine of *in pari delicto* and glossing over the illegality of the underlying scheme, the Bankruptcy Court proposes giving the Trustee

¹⁶ The PIEC refers to Madoff II as “Picard II” in its Opening Brief and Reply Brief. The Trustee refers to this as BLMIS I in its brief.

an interest in funds which never entered the TelexFree estates, which it did not control and which TelexFree could never have recovered outside of bankruptcy. Inexplicably, the Bankruptcy Court recognizes but then ignores the determinative fact that in every single case involving fraud, courts have only granted trustees standing to bring claims to recover funds when the estate *possessed* or controlled the funds prior to the transfer.

TelexFree structured its fraudulent scheme as a hybrid Ponzi and pyramid scheme, such that only approximately \$390 million was paid directly to the Debtors, whereas approximately \$2 billion was paid directly by Victims to non-debtor Promoters. As the PIEC argued in its Opening Memorandum and Reply Brief, why the business was structured this way is irrelevant. Because the payments were a product of fraud and one-on-one interactions between Victims and Promoters, TelexFree never had colorable title to such payments.

For the foregoing reasons, the PIEC respectfully requests that the District Court decline to adopt the Proposed Findings and Conclusions, and instead, deny the Trustee's motion for summary judgment, and grant the PIEC's motion.

Dated: January 12, 2018
Boston, Massachusetts

BONSIGNORE, PLLC

/s/ Robert J. Bonsignore

Robert J. Bonsignore

NH Bar 21241

3771 Meadowcrest Drive

Las Vegas, Nevada 89121

Telephone: 781-856-7650

rbonsignore@classactions.us

Interim Lead Counsel

BROWN RUDNICK LLP

/s/ William R. Baldiga

William R. Baldiga (BBO #542125)

James W. Stoll (BBO # 544136)

Kellie W. Fisher (BBO #693590)

One Financial Center

Boston, MA 02111

Telephone: (617) 856-8200

Facsimile: (617) 856-8201

wbaldiga@brownrudnick.com

jstoll@brownrudnick.com

kfisher@brownrudnick.com

For the Plaintiffs' Interim Executive Committee

CERTIFICATE OF SERVICE

The undersigned certifies that on January 12, 2018, the foregoing document was filed electronically, and therefore was sent by email to those receiving CM/ECF notices from the Court's electronic filing system. I further certify that I have caused to be sent by first class mail a copy to the following parties on this 12th day of January, 2018.

Charles R. Bennett, Jr., Esq.
Murphy & King, Professional Corporation
One Beacon Street
Boston, MA 02108

Richard King, Asst. United States Trustee
Office of the United States Trustee
446 Main Street
14th Floor
Worcester, MA 01608

/s/ William R. Baldiga
William R. Baldiga

EXHIBIT 1

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
CENTRAL DIVISION**

In re:	)	Chapter 11
)	
	)	Case No. 14-40987
TELEXFREE LLC., <u>et al.</u> , ¹)	
	)	Jointly Administered
Debtors.)	
)	
STEPHEN B. DARR AS TRUSTEE OF THE ESTATES OF TELEXFREE, LLC, TELEXFREE, INC. and TELEXFREE FINANCIAL, INC.,)	
)	
Plaintiffs,	)	Adversary Proceeding No. 15-04055
)	
v.)	
)	
RITA DOS SANTOS, INDIVIDUALLY AND AS PUTATIVE CLASS REPRESENTATIVE, AND MARIA MURDOCH, ANGELA BATISTA JIMINEZ, ELISANGELA OLIVEIRA AND DIOGO DE ARAUGO, AS PUTATIVE CLASS REPRESENTATIVES,)	
)	
Defendants.)	

PIEC’S MOTION FOR SUMMARY JUDGMENT

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, as incorporated by Rule 7056 of the Federal Rules of Bankruptcy Procedure, and Rule 56.1 of the Local Rules of the United States District Court for the District of Massachusetts, as incorporated by Rule 7056-1 of the Local Bankruptcy Rules of the United States Bankruptcy Court for the District of Massachusetts, the Plaintiffs’ Interim Executive Committee (the “PIEC”), appointed by the

¹ The debtors (the “Debtors”) in these cases (collectively, the “Chapter 11 Cases”) are TelexFree, LLC, TelexFree, Inc., and TelexFree Financial,

United States District Court in this District as the representative of the victims of the Debtors' Ponzi scheme by orders entered in the multi-district litigation proceedings captioned *In re TelexFree Securities Litigation*, MDL No. 14-02566 (D. Mass.), hereby moves (the "Motion") for summary judgment in its favor and against Stephen Darr, as Chapter 11 Trustee, in this action. In support of the Motion, the PIEC relies on the *Statement of Undisputed Facts and attached Exhibits* and *Memorandum in Support of PIEC's Motion for Summary Judgment*, filed contemporaneously herewith.

The Trustee's complaint, which purports to seek injunctive relief against the PIEC for violating the automatic stay by initiating actions in the federal district court, is really an attempt by the Trustee to secure unto himself prosecution of direct claims owned by the numerous victims against certain promoter-participants. The Trustee justifies his attempt by characterizing such claims as fraudulent transfer claims over which the Trustee alone has authority to prosecute.

The Trustee lacks standing to prosecute such claims because the monies at issue were paid by victims directly to non-debtor promoter-participants, were paid as a result of a fraudulent scheme, were never in the Debtors' possession at any time, were never commingled with other assets of the Debtors, and were never actually transferred by the Debtors to said promoters.

There are no material facts in dispute and the PIEC is entitled to judgment as a matter of law dismissing the complaint.

[Remainder of page intentionally left blank]

WHEREFORE, the PIEC respectfully requests that this Court grant the Motion dismissing the Adversary Proceeding in its entirety and with prejudice.

Dated: August 5, 2016
Boston, Massachusetts

BONSIGNORE, PLLC

/s/ Robert J. Bonsignore
Robert J. Bonsignore
NH Bar 21241
3771 Meadowcrest Drive
Las Vegas, Nevada 89121
Telephone: 781-856-7650
rbonsignore@classactions.us
Interim Lead Counsel

BROWN RUDNICK LLP

/s/ William R. Baldiga
William R. Baldiga (BBO #542125)
James W. Stoll (BBO # 544136)
Jill C. Wexler (BBO #691811)
One Financial Center
Boston, MA 02111
Telephone: (617) 856-8200
Facsimile: (617) 856-8201
wbaldiga@brownrudnick.com
jstoll@brownrudnick.com
jwexler@brownrudnick.com
For the Plaintiffs' Interim Executive Committee

CERTIFICATE OF SERVICE

The undersigned certifies that on August 5, 2016, the foregoing document was filed electronically, and therefore was sent by email to those receiving CM/ECF notices from the Court's electronic filing system. I further certify that I have caused to be sent by first class mail a copy to the following parties on this 5th day of August, 2016.

Charles R. Bennett, Jr., Esq.
Murphy & King, Professional Corporation
One Beacon Street
Boston, MA 02108

Richard King, Asst. United States Trustee
Office of the United States Trustee
446 Main Street
14th Floor
Worcester, MA 01608

/s/ Carol S. Ennis
Carol S. Ennis

62527519

EXHIBIT 2

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
CENTRAL DIVISION**

In re:	)	Chapter 11
)	
	)	Case No. 14-40987
TELEXFREE LLC., <u>et al.</u> , ¹)	
	)	Jointly Administered
Debtors.)	
)	
STEPHEN B. DARR AS TRUSTEE OF THE ESTATES OF TELEXFREE, LLC, TELEXFREE, INC. and TELEXFREE FINANCIAL, INC.,)	
)	
Plaintiffs,	)	Adversary Proceeding No. 15-04055
)	
v.)	
)	
RITA DOS SANTOS, INDIVIDUALLY AND AS PUTATIVE CLASS REPRESENTATIVE, AND MARIA MURDOCH, ANGELA BATISTA JIMINEZ, ELISANGELA OLIVEIRA AND DIOGO DE ARAUGO, AS PUTATIVE CLASS REPRESENTATIVES,)	
)	
Defendants.)	

**LOCAL BANKRUPTCY RULE 7056-1 STATEMENT OF UNDISPUTED
MATERIAL FACTS IN SUPPORT OF PIEC’S MOTION FOR SUMMARY JUDGMENT**

The Plaintiffs’ Interim Executive Committee (the “PIEC”), appointed by the United States District Court in this District as the representative of the victims of the Debtors’ Ponzi scheme by orders entered in the multi-district litigation proceedings captioned *In re TelexFree Securities Litigation*, MDL No. 14-02566 (D. Mass.), submits this Statement of Undisputed

¹ The debtors (the “Debtors”) in these cases (collectively, the “Chapter 11 Cases”) are TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc.

Facts in Support of PIEC's Motion for Summary Judgment (hereafter, "SUF"), pursuant to Rule 7056-1 of the Local Bankruptcy Rules of the United States Bankruptcy Court for the District of Massachusetts, adopting Rule 56.1 of the Local Rules of the United States District Court for the District of Massachusetts, in support of its motion for summary judgment. The material facts as to which there is no genuine issue to be tried are as follows:

I. Victims' Claims

1. The PIEC is the authorized representative of the victims of the TelexFree Ponzi and pyramid scheme, charged with prosecuting litigation on their behalf. *See MDL Case Management Order No. 3, In re TelexFree Securities Litigation*, MDL No. 14-02566 (D. Mass) (the "MDL Proceedings") [Docket No. 79], at 1-2.²

2. In June 2014, victims of TelexFree brought several actions against the perpetrators and co-conspirators of the Debtors' scheme. *See Complaint, Guevara v. Merrill, et al.*, C.A. No. 14-22405 (S.D. Fla.) [Docket No. 1]; *Complaint, Cook v. TelexElectric, LLLP, et al.*, C.A. No. 14-00134 (N.D. Ga.) [Docket No. 1]; *Complaint, Githere, et al. v. TelexElectric, LLLP, et al.*, C.A. No. 14-12825 (D. Mass) [Docket No. 1]; *Complaint, Ferguson, et al. v. TelexElectric, LLLP, et al.*, C.A. No. 14-40138 (D. Mass) [Docket No. 1].³

3. On October 22, 2014, the District Court for the District of Massachusetts transferred these actions to MDL No. 14-02566. *See Transfer Order*, MDL No. 14-02566 [Docket No. 1].⁴

4. On April 30, 2015, the PIEC consolidated these prior actions in a single complaint naming over forty (40) defendants, including James Merrill and Wanzeler, the master-minds

² A true and accurate copy is attached hereto as **Exhibit A**.

³ True and accurate copies are attached hereto as **Exhibits B-E**.

⁴ A true and accurate copy is attached hereto as **Exhibit F**.

behind TelexFree, and certain other non-debtor promoters and co-conspirators for fraud, securities fraud, a variety of other torts, and for aiding and abetting these torts. See Second Consolidated Amended Complaint, MDL No. 14-02566 (the “SCAC”) [Docket No. 141], at ¶¶ 39-100, 1004-1098.⁵ The SCAC includes a count of unjust enrichment against all defendants. See id. at ¶¶ 1037-1043.

5. On September 23, 2015, the PIEC filed a complaint in the United States District Court for the District of Arizona (the “Arizona Action”), which substantially mirrored the SCAC, except that the complaint was expanded to include a request for certification of a defendant class of “Net Winners” who received payments from other Participants in the TelexFree scheme. See Complaint, Dos Santos v. TelexElectric LLLP et al., C.A. No. 15-01906 (D. Ariz.) (the “Arizona Action Complaint”) [Docket No. 1] at ¶¶ 1012-1021.⁶

6. The Arizona Action was transferred to the United States District Court for the District of Massachusetts on October 21, 2015. See Conditional Transfer Order (CTO-2), C.A. No. 15-01906 [Docket No. 12] at 1.⁷

7. On February 24, 2016, the PIEC commenced an action in the United States District Court for the District of Massachusetts, asserting an unjust enrichment claim against forty-seven “Net Winner” promoters (the “Oliveira Action” and together with the SCAC and the Arizona Action, the “Unjust Enrichment Claims”). See Complaint, Murdoch et al. v. TelexElectric LLLP et al., C.A. No. 16-40018 (D. Mass) [Docket No. 1].⁸

⁵ A true and accurate copy is attached hereto as **Exhibit G**.

⁶ A true and accurate copy is attached hereto as **Exhibit H**.

⁷ A true and accurate copy is attached hereto as **Exhibit I**.

⁸ A true and accurate copy is attached hereto as **Exhibit J**.

10. The Trustee's proceeding is predicated on his allegation that all dollars paid by a Victim-Participant directly to a Promoter-Participant constitute a fraudulent transfer of TelexFree property for which the Trustee has the exclusive authority to recover. See *id.* at ¶¶ 33-43.

II. The Ponzi and Pyramid Scheme

11. The TelexFree scheme ostensibly revolved around the sale of membership plans and monthly voice over internet phone (“VoIP”) packages. See Amended Complaint at ¶¶ 11, 14.

12. Each time a person purchased a membership plan or VoIP package, they became a participant (“Participant”) in the scheme and the Debtors established a user account (“User Account”) to track the Participant’s activity. *See id.* at ¶¶ 9, 14.

9 A true and accurate copy is attached hereto as **Exhibit K**.

¹⁰ A true and accurate copy is attached hereto as **Exhibit L**.

¹¹ A true and accurate copy is attached hereto as **Exhibit M**.

13. TelexFree had the basic features of both a Ponzi and a pyramid scheme. See Amended Complaint at ¶ 11, 14. Its Ponzi scheme features are the promise of significant returns on investment simply for paying money over to TelexFree (or an existing Participant) and generating credits for posting internet ads for a VoIP product. See id. at ¶ 11. The pyramid features of the scheme are found in the relationship between Participants, where an existing Participant could recruit new Participants and receive payments directly from those Participants. See id. at ¶ 11.

14. A person could gain entry to the TelexFree scheme in one of two ways: (1) making a payment to TelexFree; or (2) making a payment to an existing Participant. See id. at ¶¶ 15-18.

15. In the case of a Participant making a payment to TelexFree, the Participant paid the membership fee to TelexFree, TelexFree received the money from the Participant, and TelexFree opened a User Account that would track the Participant's activity. See id. at ¶ 16.

16. In the case of a new Participant (a "Victim-Participant" or "Victim") making a payment (each, a "Participant-to-Participant Payment") to an existing Participant (a Promoter-Participant"), TelexFree issued an invoice to the Victim-Participant, the Promoter-Participant satisfied the invoice with credits previously accumulated by the Promoter-Participant, the Victim-Participant paid the invoice amount directly to TelexFree, and TelexFree opened a new User Account for the Victim-Participant. See Amended Complaint at ¶¶ 17-18. The Debtors never received or had possession of the money paid by the Victim-Participant to the Promoter Participant. See id. This alternative transaction is characterized by the Trustee as a "Triangular Transaction." See id. at ¶ 17.

17. The Victim-Participants themselves can be broken down into two categories: (1) new Participants who made one or more Participant-to-Participant Payments and did not thereafter recruit additional Participants; and (2) new Participants who made one or more Participant-to-Participant Payments and did thereafter recruit some new Participants but nonetheless ended up on a net basis suffering damage (that is a Victim-Participant who originally paid in \$X and received \$X-Y later, with Y being less than X). See Amended Complaint at ¶¶ 14-18.

18. The credits issued by TelexFree were part of an illegal scheme and in fact worthless. See Case No. 14-40987, November 24, 2015 Hr. Tr. (the “November 24th Hearing Transcript”), at 54:14-16¹²; *Affidavit of Stephen B. Darr* (the “Darr Affidavit”), Exhibit A to *Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* [Docket No. 623], Case No. 14-40987, at ¶ 69.¹³

19. Most of the monies extracted from the Victims were extracted by other individual, non-debtor, non-insider Participants. See Darr Affidavit at ¶ 35. While TelexFree issued invoices associated with the sale of both membership plans and VoIP packages that purported to show a face value of \$3,073,461,326, only \$359,792,242, or approximately twelve percent (11.7%) of that amount, was paid in cash to the Debtors by Victims. See id. The near 90% balance of these invoices, totaling over \$2,713,679,084, were actually Participant-to-Participant cash transactions, with the fictitious invoices and associated credits constituting the only aspects involving the Debtors. See id.

¹² A true and accurate copy is attached hereto as **Exhibit N**.

¹³ A true and accurate copy is attached hereto as **Exhibit O**.

20. The Unjust Enrichment Claims brought by the Victim-Participants are brought only against Promoter-Participants who received those Participant-to-Participant Payments. See SCAC at ¶¶ 51-62; Arizona Action Complaint at ¶¶ 1012-1021; Amended Oliveira Complaint at ¶¶ 18-72.

Dated: August 5, 2016
Boston, Massachusetts

BONSIGNORE, PLLC

/s/ Robert J. Bonsignore

Robert J. Bonsignore
NH Bar 21241
3771 Meadowcrest Drive
Las Vegas, Nevada 89121
Telephone: 781-856-7650
rbonsignore@classactions.us
Interim Lead Counsel

BROWN RUDNICK LLP

/s/ William R. Baldiga

William R. Baldiga (BBO #542125)
James W. Stoll (BBO # 544136)
Jill C. Wexler (BBO #691811)
One Financial Center
Boston, MA 02111
Telephone: (617) 856-8200
Facsimile: (617) 856-8201
wbaldiga@brownrudnick.com
jstoll@brownrudnick.com
jwexler@brownrudnick.com
For the Plaintiffs' Interim Executive Committee

CERTIFICATE OF SERVICE

The undersigned certifies that on August 5, 2016, the foregoing document was filed electronically, and therefore was sent by email to those receiving CM/ECF notices from the Court's electronic filing system. I further certify that I have caused to be sent by first class mail a copy to the following parties on this 5th day of August, 2016.

Charles R. Bennett, Jr., Esq.
Murphy & King, Professional Corporation
One Beacon Street
Boston, MA 02108

Richard King, Asst. United States Trustee
Office of the United States Trustee
446 Main Street
14th Floor
Worcester, MA 01608

/s/ Carol S. Ennis
Carol S. Ennis

EXHIBIT A

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

IN RE: TELEXFREE SECURITIES
LITIGATION

This Document Relates To:

MDL No. 4:14-md-2566-TSH

All Cases

MDL Case Management Order No. 3

December 23, 2014

Hillman, D.J.

1. Plaintiffs' Unopposed Motion For Appointment Of Interim Lead Class Counsel And Steering Committee (Docket No. 20) is allowed as provided in this Order. The court appoints the law firm of Bonsignore, PLLC as Interim Lead Class Counsel.

2. The Court designates Ronald Dardeno of the Law Office of Frank L. Dardeno, LLP, William Baldiga of Brown Rudnick, D. Michael Noonan of Shaheen and Gordon, R. Alexander Saveri of Saveri & Saveri, and William L Coulthard of Kemp, Jones and Coulthard, LLP as members of Plaintiffs' Interim Executive Committee.

3. Plaintiffs' Interim Lead Class Counsel, after appropriate consultation and with the advice and consent of the Executive Committee, shall be responsible for coordinating and organizing Plaintiffs in the conduct of this litigation as to all claims and, in particular, shall have the following responsibilities:

- a. To brief and argue motions and file opposing briefs in proceedings initiated by other parties;
- b. To initiate and conduct discovery proceedings;
- c. To act as spokesperson at pretrial conferences;
- d. To negotiate with defense counsel with respect to settlement and other matters;
- e. To call meetings of Plaintiffs' counsel when appropriate;
- f. To make all work assignments to Plaintiffs' counsel to facilitate the orderly and efficient prosecution of this litigation and to avoid duplicative or unproductive effort;
- g. To assure that all Plaintiffs' counsel are kept informed of the progress of this litigation as necessary;
- h. To conduct trial and post-trial proceedings;
- i. To consult with and employ experts;
- j. To coordinate the filing of any joint fee petition by Plaintiffs' counsel;
- k. To perform such other duties and undertake such other responsibilities as it deems necessary or desirable; and
- l. To coordinate and communicate with Defendants' counsel with respect to matters addressed in this paragraph.

3. The Executive Committee shall be consulted in an appropriate and efficient manner by Interim Lead Class Counsel on substantive issues to assist in the responsible and efficient prosecution of the litigation. Interim Lead Class Counsel

shall seek the advice and consent of the Executive Committee in connection with major decisions regarding the prosecution and/or settlement of the litigation.

4. Interim Lead Class Counsel and the Executive Committee shall together select working groups or committees to further the efficient prosecution of the litigation as is deemed necessary based on their collective judgment and consideration.

5. All counsel representing Plaintiffs shall maintain accurate and contemporaneous records of their time spent in this litigation and shall submit monthly time and expense reports to the Executive Committee no later than the 20 days after the end of each month. The failure to maintain such records and submit timely reports may result in such time or expenses being disallowed for purposes of any fee petition. The Executive Committee shall provide on a monthly basis to Interim Lead Class Counsel an aggregate report of all time spent by Plaintiffs' counsel.

6. Interim Lead Class Counsel, after consultation and with the advice and consent of the Executive Committee, shall assess the amounts necessary for common litigation costs necessary for the efficient and effective prosecution of the litigation and shall collect and maintain assessments from members of the Executive Committee. The failure to timely pay assessments may result in removal from membership on the Executive Committee.

7. No communications between Interim Lead Class Counsel, members of the Executive Committee, and other counsel representing plaintiffs in any cases consolidated or coordinated with this litigation, shall act as a waiver of any privilege or protection to which they are otherwise entitled.

8. The organizational structure of Plaintiffs' counsel established by this Order shall bind Plaintiffs' counsel in the individual cases consolidated under the Master Docket Number, at present and hereafter.

/s/ Timothy S. Hillman
Timothy S. Hillman
United States District Judge

EXHIBIT B

is, BWFC Processing Center, LLC, 3960 Howard Hughes Parkway, Suite 500, Las Vegas, Nevada 89169.

3. TelexFree, Inc., TelexFree, LLC and TelexFree Financial, Inc. are Massachusetts corporations and are not defendants as a result of bankruptcy protection pursuant to Chapter 11 of the U.S. Bankruptcy Code.

4. Defendant JAMES M. MERRILL resides at 1 Coburn Drive in Ashland, Massachusetts 01721 and was President, Secretary, and Director of TelexFree, Inc., Manager of TelexFree, LLC, and President, Secretary, and Director of TelexFree Financial.

5. Defendant CARLOS N. WANZELER, Treasurer and Director of TelexFree, Inc., a Manager of TelexFree, LLC., and Vice-President, Treasurer, and Director of TelexFree Financial resides at .

6. Defendant STEVEN M. LABRIOLA was the sales director of TelexFree and resides at 21 Kiwanis Beach Road, in Upton, Massachusetts.

7. Defendant JOE H. CRAFT, CPA, the CFO of Telex Free, Inc. and TelexFree, LLC, resides at 825 E. Main Street in Boonville, Indiana 47601; CRAFT FINANCIAL SOLUTIONS, LLC is an Indiana limited liability corporation and is Craft's alter ego.

8. Defendant CARLOS COSTA, Manager of TelexFree, LLC resides at 44A McClintock Avenue, Unit A, in Worcester, Massachusetts 01604.

national bank in the United States chartered and has offices in the Commonwealth of Massachusetts 02110.

16. The Defendant, BANK OF AMERICA, N.A., has a principal place of business in Charlotte, North Carolina. Bank of America N.A. is a subsidiary of Bank of America Corporation, and conducts business in the Commonwealth of Massachusetts.

17. Defendant CITIZENS BANK OF MASSACHUSETTS is a subsidiary of Defendant CITIZENS FINANCIAL GROUP, INC., a banking institution with offices in the Commonwealth of Massachusetts and principal offices in Providence, Rhode Island.

18. Defendant FIDELITY CO-OPERATIVE BANK is a Massachusetts Chartered Banking Institution.

19. Defendant MIDDLESEX SAVINGS BANK has its principal offices at 6 Main Street, in Natick, County of Middlesex, Commonwealth of Massachusetts 01760.

20. The Defendant, WELLS FARGO & COMPANY has its principal office in San Francisco, California and conducts business nationally.

21. The Defendant, WELLS FARGO BANK, N.A. has a principal place of business in Sioux Falls, South Dakota and conducts business in the Commonwealth of Massachusetts and nationally.

22. The Defendant, FMR, LLC, a.k.a. FIDELITY INVESTMENTS has its principal offices in Commonwealth of Massachusetts 02110.

23. The Defendant, WADDELL & REED FINANCIAL, INC is a publicly traded corporation with offices in Massachusetts.

24. The Defendant, WADDELL & REED, INC. is a national financial and investment institution in the United States with a principal place of business at 6300 Lamar Avenue, Overland Park, Kansas 66202-4200.

25. Defendant GLOBAL PAYROLL GATEWAY, INC. is a corporation with principal offices at 18662 MacArthur Boulevard, Suite 200, in Irvine, California 92612. GPG processed payments for TelexFree to its Promoters/Investors.

26. Defendant INTERNATIONAL PAYOUT SYSTEMS, INC. has its principal offices at 2500 East Hallandale Beach Boulevard, Suite 800, Hallandale Beach, Florida 33009. IPS also processed payments for TelexFree to its Promoters/Investors.

27. Defendant PROPAY, INC. is a corporation with its principal offices at 3400 North Ashton Boulevard, Lehi, Utah 84043. PROPAY, INC., and also does business as PROPAY.COM and also processed payments for TelexFree to its Promoters and Investors.

28. Defendant BASE COMMERCE, LLC has its principal offices at 7910 S. Kyrene Road, Suite 106, Tempe, Arizona 85284, and also does business as PHOENIX PAYMENTS and also processed payments for TelexFree to its Promoters and Investors.

29. Defendant VANTAGE PAYMENTS, LLC has its principal offices at 8300 N. Hayden Road #A207, Scottsdale, Arizona 85251

4. The Plaintiff was fraudulently induced to "invest" in at least two other business opportunities involving the offer or sale of unregistered securities, namely, 1) TelexFree's passive income scheme, and 2) an offer to invest in TelexFree's hotel program; he was also fraudulently induced to invest as an Associate, then pay more and invest as a Promoter and Manager, where in fact, they were unknowing Investors in a fraudulent Ponzi scheme.

- 8 -

6. These "loans" were in essence fraudulent transfers by TelexFree to evade claims by investors and creditors, and otherwise to unlawfully abscond with funds that rightfully belonged to creditors and investors.

7. At all times material herein, Defendants Merrill, Wanzeler, Labriola, Craft and Costa were responsible for the control and operation of TelexFree and its affiliated entities. TelexFree's Management not only controlled the activities and operations of TelexFree, but also knowingly and willfully conspired to perpetrate, and did in fact perpetrate, the TelexFree Pyramid Ponzi Scheme with full awareness of its fraudulent and illegal nature. Defendant Merrill served as the President, Secretary, and Director of TelexFree, Inc., a Manager of TelexFree, LLC, President, Secretary and Director of TelexFree Financial, General Partner of TelexElectric, and President, Secretary and Director of Telex Mobile Holdings.

8. In his capacities as Officer, Director, Manager and General Partner of the foregoing interrelated companies, Merrill exercised significant control over TelexFree's business operations; that is, the TelexFree Pyramid Ponzi Scheme. AS have other defenadants, Merrill has appeared in videos posted to the internet, in which he can be seen promoting TelexFree as a revenue opportunity for Promoters.

11. The core of the Passive Income Scheme centers on the investment of either \$289.00 or \$1,375.00. A participant who invests \$289.00 receives one advertisement kit and ten VoIP Programs. A participant who invests \$1,375.00 receives five advertisement kits and fifty VoIP Programs.

- 10 -

14. All Defendants knew that TelexFree was an illegal Pyramid Ponzi Scheme which involved the illegal sale of securities, but continued to aid, abet and further such illegal activities. Despite the foregoing knowledge, TelexFree and the other Defendants continued to participate in the attraction and processing of new investors, continued to allow payments to process through TelexFree's accounts, allowed TelexFree to continue to illegally sell securities and further its illegal Pyramid Ponzi Scheme, and otherwise continued to further TelexFree's illegal activities.

- 11 -

- 13 -

17. During the course of the TelexFree Pyramid Ponzi Scheme, Defendants Bank of America, Bank of America, N.A., TD Bank, Citizens Financial, Citizens Bank, Fidelity Bank, Middlesex Savings, Wells Fargo, Wells Fargo Bank, Fidelity Investments, Waddell & Reed Financial, Waddell & Reed, GPG, IPS, ProPay, Base Commerce, and Vantage Payments provided crucial financial services to TelexFree, which enabled TelexFree to carry on its Pyramid Ponzi scheme. TelexFree's financial services providers, including the aforesaid banking institutions, investment service providers, and payment processing services providers, knowingly aided and abetted TelexFree's Pyramid Ponzi Scheme by:

- a. Receiving transfers of funds from, and on behalf of, TelexFree in the course of TelexFree's fraudulent business, despite knowledge of the fraudulent nature of TelexFree's business enterprise;
- b. Receiving transfers of funds from TelexFree, its affiliated entities, and its executive officers, which transfers deepened TelexFree's insolvency, despite having knowledge of TelexFree's actual or imminent insolvency at the time of such transfers;
- c. Processing payments to, and on behalf of, TelexFree, including its affiliated entities and Management, in the course of TelexFree's fraudulent business, despite knowledge of the fraudulent nature of

24. Pursuant to Rule 23 of the Federal Rules of Civil Procedure, Plaintiffs bring this action on their own behalf, and on behalf of all other persons similarly situated ("the Class"). The Class that Plaintiffs seek to represent is:

- 16 -

30. The Defendants have acted or refused to act on grounds that apply generally to the class, as alleged above, and certification is proper under Rule 23(b)(2).

FRAUD

31. All Defendants engaged in:
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; and violations of the Massachusetts General Laws, Chapter 93A, The Consumer Protection Act with the intent to defraud the plaintiff; unlawfully, willfully and knowingly used means and instrumentalities in connection with the purchase and sale of unregistered securities; and used and employed manipulative and deceptive devices and contrivances in violation of, *inter alia*, the Massachusetts Uniform Securities Act, M.G.L. c. 110A, Section 410b, and in the alternative, F.S. Chapter 517, the Florida Securities and Investor Protection Act.

SECOND CLAIM FOR RELIEF

MISREPRESENTATION

The Plaintiff realleges and incorporates by reference the preceding paragraphs.

32. Defendants had actual knowledge of the misrepresentations and omissions of material facts set forth herein, and encouraged the plaintiff to rely on those representations to the detriment of the plaintiff; and/or acted with reckless disregard for the truth in that defendants failed to ascertain and to disclose such facts, even though such facts were available to them. Such misrepresentations and/or omissions were done knowingly or recklessly for the purpose and effect of concealing the true

INTENTIONAL INFLICTION OF EMOTIONAL DISTRESS

33. As a result of the intentional dissemination of materially false and misleading information and the failure to disclose material facts, as set forth above, the plaintiff paid artificially inflated prices for worthless membership interests in the investment during the Class Period and has greatly

suffered as a result of the loss of his life savings, plus money borrowed in reliance on the misrepresented circumstances fabricated by the defendants working together.

FOURTH CLAIM FOR RELIEF

NEGLIGENCE

34. Whereas, to the degree that various defendants individual and entities named herein owes a duty of care to the plaintiff either by statute, by ethical rule, by professional ethical mandates or by creating the precarious circumstances the result of which caused suffering to the plaintiff, the plaintiff should be entitled to punitive damages.

CONCLUSION

WHEREFORE, Plaintiff, on behalf of herself and her Class, pray for judgment as follows:

1. Declaring this action to be a Class Action properly maintained pursuant to the Federal Rules of Civil Procedure and certifying Plaintiffs as the class representatives;

2. Awarding Plaintiffs and Class members rescission and/or compensatory damages against Defendants for all damages sustained as a result of their wrongdoing, in an amount to be proven at trial, including interest;

3. For an award of actual damages, compensatory damages, statutory damages, and statutory penalties, in an amount to be determined;

4. For an award of punitive damages;

5. For an award of costs of suit and attorneys' fees, as allowable by law;

6. For an award of interest;

7. For the appointment of a receiver selected by Class Counsel and an accounting; and

8. For an award to Plaintiffs and the Class such other and further relief as may be just and proper under the circumstances including equitable relief.

DEMAND FOR JURY TRIAL

Plaintiffs hereby demand a jury trial of their claims to the extent authorized by law. However, the Plaintiffs do not consent to trial by jury in the United States Bankruptcy Court.

Respectfully submitted,
For Felicia Guevara
By her attorney,



Adriana Contartese, Esq.
Florida Bar # 0089634
Law Office Of Adriana Contartese
OCN Document Prep Suite 926
19W Flagler Street
Miami, FL 33130
617-268-3557
Adriana911@juno.com

JS 44 (Rev. 12/12)

CIVIL COVER SHEET

The JS 44 civil cover sheet and the information contained herein neither replace nor supplement the filing and service of pleadings or other papers as required by law, except as provided by local rules of court. This form, approved by the Judicial Conference of the United States in September 1974, is required for the use of the Clerk of Court for the purpose of initiating the civil docket sheet. (SEE INSTRUCTIONS ON NEXT PAGE OF THIS FORM.) **NOTICE: Attorneys MUST Indicate All Re-filed Cases Below.**

I. (a) PLAINTIFFS

Felicia Guevara

(b) County of Residence of First Listed Plaintiff Miami-Dade, FL
(EXCEPT IN U.S. PLAINTIFF CASES)

(c) Attorneys (Firm Name, Address, and Telephone Number)

Adriana Contarrese, Esq.
OCN Document Prep Suite 926
19 W. Flagler St.
Miami, FL 33130

(d) Check County Where Action Arose: ☒ MIAMI-DADE ☐ MONROE ☐ BROWARD ☐ PALM BEACH ☐ MAXYEN ☐ ST. LUCIE ☐ INDIAN RIVER ☐ OKEECHOBEE ☐ HIGHLANDS

DEFENDANTS

James M. Merrill et al
(Re Telex Free (non-bankruptcy))

County of Residence of First Listed Defendant Middlesex, MA
(IN U.S. PLAINTIFF CASES ONLY)

NOTE: IN LAND CONDEMNATION CASES, USE THE LOCATION OF THE TRACT OF LAND INVOLVED

Attorneys (If Known)

II. BASIS OF JURISDICTION

(Place an "X" in One Box Only)

- ☐ 1 U.S. Government Plaintiff ☐ 3 Federal Question (U.S. Government Not a Party)
- ☐ 2 U.S. Government Defendant ☒ 4 Diversity (Indicate Citizenship of Parties in Item III)

III. CITIZENSHIP OF PRINCIPAL PARTIES

(Place an "X" in One Box for Plaintiff and One Box for Defendant)

- | PTF | DEF |
|--|---|
| <input checked="" type="checkbox"/> 1 Citizen of This State | <input type="checkbox"/> 1 Incorporated or Principal Place of Business in This State |
| <input type="checkbox"/> 2 Citizen of Another State | <input checked="" type="checkbox"/> 2 Incorporated and Principal Place of Business in Another State |
| <input type="checkbox"/> 3 Citizen or Subject of a Foreign Country | <input type="checkbox"/> 3 Foreign Nation |

IV. NATURE OF SUIT

(Place an "X" in One Box Only)

CONTRACT	TORTS	FORFEITURE/PENALTY	BANKRUPTCY	OTHER STATUTES
<input type="checkbox"/> 110 Insurance <input type="checkbox"/> 120 Marine <input type="checkbox"/> 130 Miller Act <input type="checkbox"/> 140 Negotiable Instrument <input type="checkbox"/> 150 Recovery of Overpayment & Enforcement of Judgment <input type="checkbox"/> 151 Medicare Act <input type="checkbox"/> 152 Recovery of Defaulted Student Loans (Excl. Veterans) <input type="checkbox"/> 153 Recovery of Overpayment of Veteran's Benefits <input type="checkbox"/> 160 Stockholders' Suits <input type="checkbox"/> 190 Other Contract <input type="checkbox"/> 195 Contract Product Liability <input type="checkbox"/> 196 Franchise	PERSONAL INJURY <input type="checkbox"/> 310 Airplane <input type="checkbox"/> 315 Airplane Product Liability <input type="checkbox"/> 320 Assault, Libel & Slander <input type="checkbox"/> 330 Federal Employers' Liability <input type="checkbox"/> 340 Marine <input type="checkbox"/> 345 Marine Product Liability <input type="checkbox"/> 350 Motor Vehicle <input type="checkbox"/> 355 Motor Vehicle Product Liability <input type="checkbox"/> 360 Other Personal Injury <input type="checkbox"/> 362 Personal Injury - Med. Malpractice CIVIL RIGHTS <input type="checkbox"/> 440 Other Civil Rights <input type="checkbox"/> 441 Voting <input type="checkbox"/> 442 Employment <input type="checkbox"/> 443 Housing/Accommodations <input type="checkbox"/> 445 Amer. w/Disabilities - Employment <input type="checkbox"/> 446 Amer. w/Disabilities - Other <input type="checkbox"/> 448 Education PRISONER PETITIONS <input type="checkbox"/> Habeas Corpus <input type="checkbox"/> 463 Alien Detainee <input type="checkbox"/> 510 Motions to Vacate Sentence Other: <input type="checkbox"/> 530 General <input type="checkbox"/> 535 Death Penalty <input type="checkbox"/> 540 Mandamus & Other <input type="checkbox"/> 550 Civil Rights <input type="checkbox"/> 555 Prison Condition <input type="checkbox"/> 560 Civil Detainee - Conditions of Confinement	<input type="checkbox"/> 625 Drug Related Seizure of Property 21 USC 881 <input type="checkbox"/> 690 Other LABOR <input type="checkbox"/> 710 Fair Labor Standards Act <input type="checkbox"/> 720 Labor/Mgmt. Relations <input type="checkbox"/> 740 Railway Labor Act <input type="checkbox"/> 751 Family and Medical Leave Act <input type="checkbox"/> 790 Other Labor Litigation <input type="checkbox"/> 791 Empl. Ret. Inc. Security Act IMMIGRATION <input type="checkbox"/> 462 Naturalization Application <input type="checkbox"/> 465 Other Immigration Actions	<input type="checkbox"/> 422 Appeal 28 USC 158 <input type="checkbox"/> 423 Withdrawal 28 USC 157 PROPERTY RIGHTS <input type="checkbox"/> 820 Copyrights <input type="checkbox"/> 830 Patent <input type="checkbox"/> 840 Trademark SOCIAL SECURITY <input type="checkbox"/> 861 IIIA (1395ff) <input type="checkbox"/> 862 Black Lung (923) <input type="checkbox"/> 863 DIWC/DIWW (405(g)) <input type="checkbox"/> 864 SSID Title XVI <input type="checkbox"/> 865 RSI (405(g)) FEDERAL TAX SUITS <input type="checkbox"/> 870 Taxes (U.S. Plaintiff or Defendant) <input type="checkbox"/> 871 IRS—Third Party 26 USC 7609	<input type="checkbox"/> 375 False Claims Act <input type="checkbox"/> 400 State Reapportionment <input type="checkbox"/> 410 Antitrust <input type="checkbox"/> 430 Banks and Banking <input type="checkbox"/> 450 Commerce <input type="checkbox"/> 460 Deportation <input type="checkbox"/> 470 Racketeer Influenced and Corrupt Organizations <input type="checkbox"/> 480 Consumer Credit <input type="checkbox"/> 490 Cable/Sat TV <input type="checkbox"/> 850 Securities/Commodities/Exchange <input type="checkbox"/> 890 Other Statutory Actions <input type="checkbox"/> 891 Agricultural Acts <input type="checkbox"/> 893 Environmental Matters <input type="checkbox"/> 895 Freedom of Information Act <input type="checkbox"/> 896 Arbitration <input type="checkbox"/> 899 Administrative Procedure Act/Review or Appeal of Agency Decision <input type="checkbox"/> 950 Constitutionality of State Statutes

V. ORIGIN

(Place an "X" in One Box Only)

- ☒ 1 Original Proceeding ☐ 2 Removed from State Court ☐ 3 Re-filed (See VI below) ☐ 4 Reinstated or Reopened ☐ 5 Transferred from another district (specify) ☐ 6 Multidistrict Litigation ☐ 7 Appeal to District Judge from Magistrate Judgment ☐ 8 Remanded from Appellate Court

VI. RELATED/RE-FILED CASE(S)

(See instructions):

a) Re-filed Case ☐ YES ☒ NO b) Related Cases ☒ YES ☐ NO

JUDGE

DOCKET NUMBER

Cite the U.S. Civil Statute under which you are filing and Write a Brief Statement of Cause (Do not cite jurisdictional statutes unless diversity):

VII. CAUSE OF ACTION

28 USC sec 1332(d)(2) CAFA
LENGTH OF TRIAL via days estimated (for both sides to try entire case)

VIII. REQUESTED IN COMPLAINT:

☒ CHECK IF THIS IS A CLASS ACTION UNDER F.R.C.P. 23 DEMAND \$

CHECK YES only if demanded in complaint:
JURY DEMAND: ☒ Yes ☐ No

ABOVE INFORMATION IS TRUE & CORRECT TO THE BEST OF MY KNOWLEDGE
SIGNATURE OF ATTORNEY OF RECORD

DATE

G/26/14

FOR OFFICE USE ONLY

RECEIPT #

AMOUNT

IFP

JUDGE

MAG JUDGE

EXHIBIT C

**IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
GAINESVILLE DIVISION**

TODD COOK, Individually and behalf of
others similarly situated,

Plaintiff,

V.

CIVIL ACTION NUMBER

2:14-CV-00134

**TELEXELECTRIC, LLLP;
TELEX MOBILE HOLDINGS, INC.;
JAMES M. MERRILL;
CARLOS N. WANZELER;
STEVEN M. LABRIOLA;
JOSEPH H. CRAFT, a/k/a Joe H. Craft;
CRAFT FINANCIAL SOLUTIONS, LLC;
CARLOS COSTA;
GERALD P. NEHRA, individually and
doing business as Law Offices of Nehra
And Waak; GERALD P. NEHRA
ATTORNEY AT LAW, PLLC;
RICHARD W. WAAK, individually and doing
business as Law Offices of Nehra
And Waak; RICHARD W. WAAK,
ATTORNEY AT LAW, PLLC; TD BANK, NA;
CITIZENS FINANCIAL GROUP, INC.;
CITIZENS BANK OF MASSACHUSETTS;
FIDELITY CO-OPERATIVE BANK, doing
business as Fidelity Bank; MIDDLESEX
SAVINGS BANK; GLOBAL PAYROLL
GATEWAY, INC.; INTERNATIONAL PAYOUT
SYSTEMS, INC.; PROPAY, INC.,
doing business as PROPAY.COM,**

Defendants.

CLASS ACTION COMPLAINT

COMES NOW Plaintiff Todd Cook, individually and on behalf of others similarly

situated (hereafter “Plaintiffs”), and, pursuant to Fed. R. Civ. P. 23, files this Class Action showing the following:

I. INTRODUCTION

1. Plaintiff and the putative class seek compensation for damages they sustained as a result of Defendants' conduct in carrying out, or aiding in carrying out, an unlawful Ponzi pyramid scheme that included, *inter alia*, Defendants' fraudulent unregistered offer and sale of securities in the form of unregistered investment contracts constituting securities.

2. During all times relevant to this complaint, non-parties TelexFree, Inc., TelexFree, LLC, and TelexFree Financial, Inc.¹ (collectively “TelexFree”), uniformly held itself out as a “multi-level marketing” (or “MLM”) company systematically selling local and international telephone service plans that use "voice over internet protocol" ("VoIP") technology through investors, also called “Promoters.”

3. The TelexFree VoIP was not patented or proprietary.

4. The TelexFree VoIp offered nothing more than what was otherwise available for free through other Internet providers such as Skype.

5. In reality, TelexFree’s offer and sale of investment contracts constituted a pyramid-type Ponzi scheme (the “Pyramid Ponzi Scheme”).

6. To carry out their unlawful enterprise, TelexFree and their officers, agents,

¹ TelexFree, Inc., TelexFree, LLC, and TelexFree Financial, Inc. are presently in Chapter 11 bankruptcy in Nevada and are not parties to this action.

servants and employees sold fraudulent unregistered securities to Plaintiff Todd Cook and to the members of the class he seeks to represent.

7. TelexFree sold unregistered securities in twenty-one states, including Georgia, and internationally from its offices in Marlborough, Massachusetts.

8. TelexFree's unregistered securities were deceptively and uniformly identified to Plaintiff Todd Cook and members of the putative class as "memberships."

9. In exchange for merely copying and placing duplicative and pre-written TelexFree ads on internet sites and for recruiting other investors to pay the membership fees, TelexFree falsely represented to its investors/promoters, that they could receive significant returns of over 200% annually.

10. TelexFree uniformly and systematically did not require its investors/promoters to sell its VoIP product in order to qualify for payments prior to March 9, 2014.

11. TelexFree's scheme constitutes an unlawful pyramid scheme because the proceeds from the sale of TelexFree's VoIP product alone could not sustain the massive pay structure.

12. To keep TelexFree's Pyramid Ponzi Scheme liquid, a constant influx of new participants was required.

13. At all times material herein, TelexFree and its Officers James M. Merrill, Carlos N. Wanzeler, Steven M. Labriola, Carlos Costa, Joseph H. Craft, a/k/a Joe H. Craft (collectively, "Defendant Officers") knew that the Pyramid Ponzi Scheme was not sustainable, and that the representations on TelexFree's website and in its marketing materials

14. Moreover, at all times material herein, Defendants knew that TelexFree was selling unregistered securities to the members of the putative classes.

16. Despite the foregoing knowledge, Defendants continued to participate in the attraction and processing of new investors, continued to allow payments to process through TelexFree's accounts, allowed TelexFree to continue to illegally sell securities and further its illegal Pyramid Ponzi Scheme, and otherwise continued to further TelexFree's illegal activities.

18. At all material times herein, Defendants have violated, *inter alia*, the anti-fraud and securities registration provisions of the federal and state securities laws.

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with the purchase and sale of unregistered securities.

20. TelexFree and the other Defendants violated Title 17, Code of Federal Regulations, Section 240.10b-5 by (a) employing devices, schemes, and artifices to defraud; (b) making untrue statements of material facts and omitting to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and (c) engaging in acts, practices, and courses of business which operated and would operate as a fraud and deceit upon persons.

21. TelexFree and the other Defendants willfully or knowingly established a pyramid-type Ponzi scheme by paying certain investors purported returns on investment.

22. Making use of this sophisticated pyramid scheme, TelexFree defrauded its Promoters out of funds exceeding \$300,000,000.00 dollars in just a few short years.

23. Certain Defendants share joint and severable liability, including certified public accountants and lawyers that specialized in sheltering so-called Multi-Level Marketing schemes having aided and abetted TelexFree's Pyramid Ponzi Scheme by providing TelexFree with legal and financial advice and assistance during the course of the fraud, despite knowledge of the fraudulent nature of TelexFree's operation.

24. The Payment Processing Services Companies and bank Defendants also share joint and several liability having aided and abetted the fraudulent and illegal activity by providing financial and payment processing services, also having knowledge of TelexFree's fraud.

II. PARTIES, JURISDICTION AND VENUE

25. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if as fully restated herein.

26. Plaintiff Todd Cook (hereinafter sometimes referred to as “Cook”), is a citizen of Georgia and resides in this district.

27. Plaintiff Cook, like many other victims of TelexFree's Pyramid Ponzi Scheme, tendered cash in exchange for a membership in TelexFree (a "TelexFree Membership") and its promised return in investment.

28. Defendant TELEXELECTRIC, LLLP (hereinafter sometimes referred to as “TelexElectric”) is a limited liability limited partnership duly organized and existing under the laws of the State of Nevada, and having its registered agent as BWFC Processing Center, LLC, 3960 Howard Hughes Parkway, Suite 500, Las Vegas, Nevada 89169.

29. Defendant TELEX MOBILE HOLDINGS, INC. (hereinafter sometimes referred to as "Telex Mobile") is a corporation duly organized and existing under the laws of the State of Nevada, and having its registered agent as BWFC Processing Center, LLC, 3960 Howard Hughes Parkway, Suite 500, Las Vegas, Nevada 89169.

30. Defendant JAMES M. MERRILL (hereinafter sometimes referred to as "Merrill") is an individual now or formerly of 1 Coburn Drive in Ashland, County of Middlesex, Commonwealth of Massachusetts 01721.

31. At all times material herein, Co-Defendant Merrill was President, Secretary, and Director of TelexFree, Inc.

32. At all times material herein, Co-Defendant, Merrill was a Manager of

TelexFree, LLC, and was listed with the Massachusetts Secretary of State Corporations Division as an authorized person to execute, acknowledge, deliver, and record any recordable instrument purporting to affect an interest in real property.

33. At all times material herein, Co-Defendant Merrill, was President, Secretary, and Director of TelexFree Financial.

34. Defendant CARLOS N. WANZELER (hereinafter sometimes referred to as "Wanzeler") is an individual now or formerly of 373 Howard Street, in Northborough, County of Worcester, Commonwealth of Massachusetts 01532.

35. At all times material herein, Co-Defendant Wanzeler was Treasurer and Director of TelexFree, Inc.

36. At all times material herein, Co-Defendant Wanzeler was a Manager of TelexFree, LLC.

37. At all times material herein, Co-Defendant Wanzeler was Vice-President, Treasurer, and Director of TelexFree Financial, and was listed with the Massachusetts Secretary of State Corporations Division as an authorized person to execute, acknowledge, deliver, and record any recordable instrument purporting to affect an interest in real property.

38. Defendant STEVEN M. LABRIOLA (hereinafter sometimes referred to as "Labriola") is an individual now or formerly of 21 Kiwanis Beach Road, in Upton, County of Worcester, Commonwealth of Massachusetts 01568.

39. Defendant Labriola functions as the international sales director of TelexFree.

40. Defendant JOSEPH H. CRAFT, also known as JOE H. CRAFT, (hereinafter

42. At all material times herein, Defendant Craft serves as the Chief Financial Officer of Telex Free, Inc. and TelexFree, LLC, and was responsible for preparing or approving their financial statements.

44. Defendant Craft Financial is engaged in the business of providing accounting services and financial advice.

46. Defendant CARLOS COSTA, (hereinafter sometimes referred to as "Costa") is an individual now or formerly of 44A McClintock Avenue, Unit A, in Worcester, County of Worcester, Commonwealth of Massachusetts 01604.

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48. Defendant GERALD P. NEHRA (hereinafter sometimes referred to as "Nehra") is an individual now or formerly of Muskegon, Michigan.

49. Defendant Nehra maintains a second place of abode at 2149 Tall Oak Court, Sarasota, Florida 34232

50. Defendant Nehra is an attorney duly licensed to practice law in the State of Michigan with offices at 1710 Beach Street in Muskegon, Michigan 49441.

51. Defendant GERALD P. NEHRA, ATTORNEY AT LAW, PLLC, is a professional limited liability company engaged in the practice of law and duly organized and existing under the laws of the state of Michigan, having a principal place of business at 1710 Beach Street in Muskegon, Michigan 49441.

52. Defendant Gerald P. Nehra, Attorney at Law, PLLC, is engaged in the practice of law.

53. Defendant Nehra is the sole member, manager and registered agent for the Defendant Gerald P. Nehra, Attorney at Law, PLLC.

54. Defendant RICHARD W. WAAK (hereinafter sometimes referred to as "Waak") is an individual now or formerly of Muskegon, Michigan.

55. Defendant Waak is an attorney duly licensed to practice law in the State of Michigan with offices at 11300 East Shore Drive, Delton, Michigan 49046.

56. At all times material herein, Defendant Nehra was engaged in the practice of law with Co-Defendant Richard W. Waak, under the name LAW OFFICES OF NEHRA AND WAAK.

57. Defendant LAW OFFICES OF NEHRA AND WAAK had offices at 1710 Beach Street, Muskegon, Michigan 49441 and 11300 East Shore Drive, Delton, Michigan 49046.

58. At all times material herein, Defendant Waak was engaged in the practice of law with Co-Defendant Nehra, under the name Law Offices of Nehra and Walk, with primary offices at 11300 East Shore Drive, Delton, Michigan 49046, and secondary offices at 1710 Beach Street, in Muskegon, Michigan 49441.

59. Defendant Waak is the "Principal Attorney" of the Law Offices of Nehra and Walk.

60. Defendant RICHARD W. WAAK, ATTORNEY AT LAW, PLLC, is a professional limited liability company engaged in the practice of law and duly organized and existing under the laws of the state of Michigan, having a principal place of business at 11300 East Shore Drive, Delton, Michigan 49046.

61. Defendant Richard W. Waak, Attorney at Law, PLLC, is engaged in the practice of law.

62. Defendant Waak is the sole member, manager and registered agent of Defendant Richard W. Waak, Attorney at Law, PLLC.

63. The Law Offices of Nehra and Walk is a general partnership between Defendants Nehra, Waak, Gerald P. Nehra, Attorney at Law, PLLC, and Richard W. Walk, Attorney at Law, PLLC.

64. Defendant TD BANK, N.A. (hereinafter sometimes referred to as "TD Bank")

is a national banking institution in the United States chartered and supervised by the federal Office of the Comptroller of the Currency.

65. TD Bank has a principal place of business at 15 Broad Street in Boston, County of Suffolk, Commonwealth of Massachusetts 02109.

66. At all times material herein, Defendant TD Bank provided banking services, maintained accounts, and received transfers of funds for or for the benefit of TelexFree.

67. Defendant CITIZENS FINANCIAL GROUP, INC. (hereinafter sometimes referred to as "Citizens Financial") is a corporation duly organized and existing under the laws of the State of Delaware, having its principal offices in Providence, Rhode Island.

68. Citizens Financial is a banking institution with offices at 28 State Street, Boston, County of Suffolk, Commonwealth of Massachusetts 02109.

69. At all times material herein, Defendant Citizens Financial provided banking services, maintained accounts, and received transfers of funds for or for the benefit of TelexFree.

70. Defendant CITIZENS BANK OF MASSACHUSETTS (hereinafter sometimes referred to as "Citizens Bank") is a subsidiary of Citizens Financial.

71. Citizens Bank conducts business in the Commonwealth of Massachusetts at 28 State Street, in Boston, County of Suffolk, Commonwealth of Massachusetts 02109.

72. At all times material herein, Defendant Citizens Bank provided banking services, maintained accounts, and received transfers of funds for or for the benefit of TelexFree.

73. Defendant FIDELITY CO-OPERATIVE BANK doing business as FIDELITY BANK (hereinafter sometimes referred to as "Fidelity Bank") is a Massachusetts Chartered Banking Institution, having its principal offices at 675 Main Street, in Fitchburg, County of Worcester, Commonwealth of Massachusetts 01420.

74. At all times material herein, Defendant Fidelity Bank provided banking services, maintained accounts, and received transfers of funds for or for the benefit of TelexFree.

75. Defendant MIDDLESEX SAVINGS BANK (hereinafter sometimes referred to as "Middlesex Savings") is a Massachusetts Chartered Banking Institution, having its principal offices at 6 Main Street, in Natick, County of Middlesex, Commonwealth of Massachusetts 01760.

76. At all times material herein, Defendant Middlesex Savings provided banking services, maintained accounts, and received transfers of funds for or for the benefit of TelexFree.

77. Defendant GLOBAL PAYROLL GATEWAY, INC. (hereinafter sometimes referred to as "GPG") is a corporation duly organized and existing under the laws of the State of California, having its principal offices at 18662 MacArthur Boulevard, Suite 200, in Irvine, California 92612.

78. Defendant GPG provides payment processing services for companies, and acted as a conduit for payment between TelexFree and its Promoters/Investors.

79. Defendant INTERNATIONAL PAYOUT SYSTEMS, INC. (hereinafter

sometimes referred to as "IPS") is a corporation duly organized and existing under the laws of the State of Florida, having its principal offices at 2500 East Hallandale Beach Boulevard, Suite 800, Hallandale Beach, Florida 33009.

80. Defendant IPS provides payment processing services for companies and acted as a conduit for payment between TelexFree and its Promoters/Investors.

81. Defendant PROPAY, INC. (hereinafter sometimes referred to as "ProPay") is a corporation duly organized and existing under the laws of the State of Utah.

82. Defendant ProPay has its principal offices at 3400 North Ashton Boulevard, Lehi, Utah 84043 and also does business as PROPAY.COM.

83. Defendant ProPay provides payment-processing services for companies and acted as a conduit for payment between TelexFree and its Promoters/Investors.

84. It is believed that additional payment - processing services aided and abetted in TelexFree's Pyramid Ponzi scheme but their identities are as yet unknown. For ease of reference at this time they can only be referred to herein at this time as Defendant Payment - Processing Services Doe.

85. Plaintiff and the putative class seek to obtain damages and restitution, as defined below, from Defendants.

86. The District Court has original jurisdiction pursuant to 28 U.S.C. § 1332(d)(2). In the aggregate, Plaintiff's claims and the claims of the Putative Class exceed \$5,000,000.00 exclusive of interest and costs, and there are numerous class members who are citizens of states other than TelexElectric, LLLP's and TelexFree Mobile Holdings, Inc.'s state of

citizenship, which is Nevada.

87. Venue is also proper pursuant to 28 U.S.C. § 1391 because acts and transactions giving rise to this action occurred in this district.

88. James Merrill, Carlos Wanzeler, Steven Labriola, Carlos Costa, Joseph H. Craft conducted some of the unlawful business of TelexFree, LLC referenced and detailed in this complaint in Georgia during all material relevant times herein beginning on February 15, 2012 through approximately April 2014.

89. The District Court also has jurisdiction over this action pursuant to Sections 20(b), 20(d)(l) and 22(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77t(b), 77t(d)(l) & 77v(a)], Sections 21(d)(l), 21(d)(3)(A), 21(e) and 27 of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §§ 78u(d)(l), 78u(d)(3)(A), 78u(e) and 78aa]. Defendants have, directly or indirectly, made use of the means of instrumentalities of interstate commerce and of the mails in connection with the transactions, acts, practices, and courses of business alleged in this complaint.

90. Venue is also proper in this district pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Section 27 of the Exchange Act, 15 U.S.C. § 78aa, because certain of the transactions, acts, practices, and courses of conduct constituting violations of the federal securities laws occurred within this district. Defendants transacted business and offered and sold the securities that are the subject of this action to investors in this district.

91. Furthermore, venue is proper under Section 1965 of the Racketeer Influenced and Corrupt Organizations Act [18 U.S.C. § 1965], as the Defendants have agents and/or

otherwise transact business material to this Complaint in this district.

III. FACTUAL ALLEGATIONS

92. Non-parties TelexFree, LLC or TelexFree, Inc. (hereafter collectively referred to as "TelexFree") is a marketer of telecommunications and advertising primarily targeting the hard-working Brazilian-American and Dominican-American communities.

93. Other minority groups have also been victimized.

94. TelexFree's business purportedly centers on the sale of its VoIP Program, 99 TelexFree, despite the fact that TelexFree's president testified to having limited knowledge of VoIP and never having been in the telecom business.

95. A VoIP computer program, such as 99TelexFree, allows an individual to place phone calls over the Internet.

96. In effect, an individual can use VoIP as a substitute for traditional landline phone services.

97. Using technology borrowed from Disk A Vontade, a nearly identical venture with common management, TelexFree rebranded the VoIP Program, offering it for a flat monthly fee of \$49.90.

98. Unlike Disk A Vontade operations, however, TelexFree coupled the VoIP Program with a wildly lucrative and fraudulent scheme (hereinafter the "Passive Income Scheme").

99. The core of the Passive Income Scheme centers on the investment of either \$289.00 or \$1,375.00.

more than place five advertisements per day can receive profit of at least \$3,675.00 - a return in excess of 250%.

110. This feature alone has attracted thousands of individuals to invest in TelexFree.

111. The Passive Income Scheme generates further returns for participants through various bonus structures and recruitment commissions.

112. TelexFree tailors each of the additional income streams to incentivize recruitment.

113. By merely recruiting one individual into the TelexFree scheme, a participant can receive as much as \$100.00.

114. By recruiting multiple individuals, TelexFree participants become eligible for revenue sharing bonuses of up to 3% of the TelexFree's VoIP Program sales.

115. Hidden among TelexFree's bonus structure and recruitment commissions is the fact that TelexFree participants may self-qualify.

116. Indeed, as testified by participants, a participant may invest in more than one advertisement kit and personally purchase the VoIP Program to earn bonuses.

117. Thus, a participant may purchase a VoIP Program, never use the program, and still qualify for additional income.

118. Without ever selling any VoIP Program, the participant receives a return far in excess of the 200-250% guaranteed return.

119. To drum up interest in recruiting, TelexFree held extravaganzas complete with a rock concert atmosphere and wild cheering, including the "wave."

122. Through such fantasies, reserved only for those at the top of the Passive Income Scheme, TelexFree induced investments drawn from participants' earnest earnings and savings.

124. TelexFree's revenue from VoIP Programs sales alone is inadequate to satisfy participant returns.

126. Net revenue received by TelexFree from VoIP Program sales was significantly less due to substantial commission payments.

128. Wanzeler provided wildly varied estimates when challenged to identify the number of VoIP Programs sold to non-participants.

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130. Assuming that each participant invested only \$289.00 and did no more than post one advertisement per day, TelexFree owed participants a total of \$799,446,420.00.

131. Alternatively, if each participant invested only \$1,375.00 and did no more than post five advertisements per day, TelexFree owed \$3,997,232,100.00 to its participants.

132. According to data provided by TelexFree, \$1,375.00 investments accounted for 88% of transactions through Massachusetts-based participants.

133. Even assuming that only 50% of all participant investments were for \$1,375.00, TelexFree would still owe \$2,398,897,200.00 - a number that far exceeds TelexFree's reported total revenues over the same period.

134. This figure of almost \$2.4 billion does not even include further bonuses, recruitment commissions, and revenue sharing.

135. The inclusion of these additional payments would create an even greater disparity between the VoIP Program revenue and guaranteed money paid out of the Passive Income Scheme to participants.

136. In addition to the Passive Income Scheme, TelexFree, through a Brazilian affiliate, offered an investment in a Best Western Hotel.

137. As described by TelexFree's president, the Best Western Hotel opportunity was an important marketing tool to bolster TelexFree credibility worldwide.

138. TelexFree management facilitated the offer of the Best Western Hotel opportunity through the inclusion of the Best Western Hotel opportunity on the front page of the TelexFree website accessible in the Commonwealth.

139. Through a prominently placed website banner and video, TelexFree presented an investment opportunity with a guaranteed yearly return of over 8%.

140. The Best Western Hotel opportunity video remained on the United States-based TelexFree website for months despite the fact that the president of TelexFree was aware of the video and requested TelexFree's website staff to remove the video.

141. In fact, the difference between U.S. TelexFree operations and Brazilian operations is a distinction without a difference.

142. As described by TelexFree management, the ownership interests in TelexFree, Inc. (Massachusetts-based), TelexFree LLC (Nevada-based) and Ympactus (Brazilian-based), overlap.

143. Both Defendants Merrill and Wanzeler, self-proclaimed founders of TelexFree, hold 50% ownership interest in the United States entities and 20% and 40% interests, respectively, in the Brazilian entity.

144. Defendant Costa, head of Brazilian operations and longtime friend of Wanzeler, was an owner of TelexFree, LLC.

145. In late 2013, Costa withdrew his ownership for what Merrill characterized as “legal reasons.”

146. Furthermore, TelexFree entities use the same website and back office support, merely providing identical information in multiple languages.

147. Perhaps most telling, both Merrill and Wanzeler testified to transferring at least \$3,000,000.00 to Costa long after Brazilian authorities shut down Ympactus operations.

148. Over two years of operations, TelexFree has employed multiple financial accounts, including domestic and international bank accounts and various online payment processors, to facilitate the fraudulent offer or sale of securities.

151. Using various interrelated business operations, fraudulent practices, schemes, bank accounts and entities, TelexFree claims it has raised nearly \$1,000,000,000.00 worldwide.

152. TelexFree has not received \$1,000,000,000.00 worldwide.

153. As with all Ponzi or pyramid Schemes, TelexFree operations are untenable without a continuous influx of new capital.

154. Indeed, the financial basis of the TelexFree scheme centers on the recruitment of additional participants and placing online advertisements - not the sales of TelexFree Voice over Internet Protocol computer programs (hereinafter "VoIP Program(s)").

155. Class Members were fraudulently induced to invest in at least two other "scam" business opportunities involving the offer or sale of unregistered securities in Massachusetts, namely, 1) TelexFree's passive income scheme, and 2) an offer to invest in TelexFree's hotel program.

156. Despite the fact that upon the advise of their legal counsel, TelexFree referred to the members of the putative class as Associates and Promoters, Plaintiff Cook and all members of the putative class member are considered under federal and state securities law as "Investors".

157. In January 2013, the Brazilian Bureau of Consumer Protection (known as

Procon), began a investigation into TelexFree. In its January 11, 2013 press release, Procon indicated that it had "detected evidence of crimes":

The investigation initiated by civil prosecution of Consumer Protection (no. 01/2013) shows several controversial issues and possible crimes that put consumers at risk in time to accept that kind of deal. Among the possibilities, there is a breach in the Federal Law No. 1.521/51, art. 2, according to which the following is a crime:

"Obtaining or attempting to obtain illicit gains at the expense of the people or of undetermined number of people through speculation or processes fraudulent ('snowball', 'chains', 'pichardismo' and any other equivalent)" including Ponzi pyramid".

There is also the possible violation of the Code of Consumer Protection (CDC), with false advertising, failure of product information and company, abuse of weakness or ignorance of consumers and conditions unreasonable disadvantage, among others.

158. Procon subsequently initiated an official complaint and notified the "State Prosecutors Office, the Minister of Finance and the Federal Police." The Ministry of Finance, after its investigation, declared that:

The Telexfree business of selling packages of internet telephony (VoIP, its acronym in English), is not sustainable and suggests a Ponzi scheme, which is a crime against the popular economy.

159. As the matter processed through the Brazilian Court System, the Ministry of Finance was ordered to refrain from issuing further statements about the matter. In a

blatantly misleading and deceptive act, TelexFree circulated through its affiliates the following misrepresentation of the order:

It's official! The investigation on TelexFree has been absolved of what Behind MLM has researched and posted.

160. On June 19, 2013, the Brazilian Court in Acre issued an injunction putting "a stop to TelexFree's business operations, including the registration of new affiliate investors, acceptance of new investments and paying any returns owed on existing affiliate investments."

161. At all times material herein, the other Defendants knew that TelexFree was and illegal Pyramid Ponzi Scheme which involved the illegal sale of securities, but continued to aid, abet and further such illegal activities. Despite the foregoing knowledge, TelexFree and the other Defendants continued to participate in the attraction and processing of new investors, continued to allow payments to process through TelexFree's accounts, allowed TelexFree to continue to illegally sell securities and further its illegal Pyramid Ponzi Scheme, and otherwise continued to further TelexFree's illegal activities.

162. On March 9, 2014, TelexFree changed its compensation plan, thereby requiring Promoters 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 were unable to recover their money.

163. On April 1, 2014, dozens of Investors descended upon TelexFree's Marlborough, Massachusetts office to protest this change and attempt to regain access to

their money. Local media covering interviewed one Investor who admitted that the VoIP service is "almost impossible to sell". On April 14, 2014, Defendants TelexFree, Inc., TelexFree, LLC and TelexFree Financial abruptly sought bankruptcy protection in Nevada under Chapter 11, admitting that they cannot meet their obligations from VoIP revenues and seeking authority to reject all its current obligations to promoters.

164. At all relevant times herein, Defendants 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.

165. Almost all financial institutions have terminated their relationship with TelexFree after only a few months of business.

166. Recently, frantic emails between TelexFree management and financial institutions paint an entirely bleak picture of continuing TelexFree financial operations.

167. TelexFree operations have become a risk that financial institutions are no longer willing to bear.

168. As described by one financial institution, "[n]o US Bank or Processor . . . will accept your [TelexFree] business given that you are on month five of the Visa Chargeback monitoring program. You are one of only three merchants in the USA on month five so you are a real hot-potato as they say."

169. Recently, on March 9, 2014, TelexFree management made several changes to its once wildly popular Passive Income Scheme.

170. A central component of the new changes affect the ease of participant withdrawals.

171. TelexFree participants are no longer able to withdraw money, even money already "earned," without making a specified number of retail sales and recruiting a number of new investors.

172. Certain TelexFree participants have frantically contacted the Division suspecting that these changes are the harbinger of TelexFree's collapse.

173. Not only is it now more difficult to withdraw money from TelexFree, TelexFree has also switched its compensation plan from one that pays participants in dollars to one that operates on TelexFree "credits."

174. These credits appear to be nothing more than IOUs.

175. In furtherance of their unlawful enterprise, TelexFree mailed fraudulent and inaccurate 1099 (Miscellaneous Income) forms to investors, possibly to create the illusion that they had made payments to investors.

176. The 1099 forms were provided long after the mandated January 31, 2014 deadline, and some after the April 15, 2014 federal tax filing deadline.

177. TelexFree falsely represented that investors had received income that they had in fact never received.

178. TelexFree did not generate sufficient funds from sales of their phone service

to pay the returns on investments that they had contracted to pay.

179. Instead, the funds TelexFree used to pay the purported returns on investments were the principal investment funds (membership fees) tendered by subsequent TelexFree investors.

180. To this end, on April 14, 2014, TelexFree filed for Chapter 11 bankruptcy protection in Nevada.

181. Defendant TelexElectric is a Nevada limited liability limited partnership formed on December 2, 2013 by Co-Defendants Merrill and Wanzeler.

182. According to its filings with the State of Nevada Secretary of State Office, Co-Defendants Merrill and Wanzeler are listed as the General Partners of TelexElectric.

183. Co-Defendants Merrill and Wanzler further list their address as 4705 S. Durango Drive, #100-J1 (a post office box), Las Vegas, Nevada 89147, which is the same location as TelexFree, LLC.

184. TelexElectric also lists as its address 4705 S. Durango Drive, #100-J1 (a post office box), Las Vegas, Nevada 89147.

185. Defendant Telex Mobile is a Nevada corporation formed on November 26, 2013.

186. According to its filings with the State of Nevada Secretary of State Office, Telex Mobile identifies its officers and directors as:

- I. Co-Defendant James M. Merrill is President, Secretary and Director, having an address at 4705 S. Durango Drive, #100-J1 (a post office

box), Las Vegas, Nevada 89147.

- ii. Co-Defendant Carlos Wanzeler is Treasurer and Director, having an address at 4705 S. Durango Drive, #100-J1 (a post office box), Las Vegas, Nevada 89147.

187. According to filings with the State of Nevada Secretary of State Office, both TelexElectric and Telex Mobile Holdings identify as their registered agent BWFC Processing Center, LLC, 3960 Howard Hughes Parkway, Suite 500, Las Vegas, Nevada 89169.

188. TelexFree, LLC, TelexFree, Inc., TelexFree Financial, Defendants TelexElectric and TelexFree Mobile Holdings are alter ego entities, which combine to form a single enterprise.

189. TelexFree's financial statements reveal that TelexFree Electric received a \$2,022,329.00 "loan" from TelexFree during the class period.

190. TelexFree's financial statements further reveal that TelexFree Mobile received a \$500,870 "loan" from TelexFree during the class period.

191. TelexElectric was fraudulently set up for the purpose of sheltering funds rightfully belonging to the putative class.

192. These "loans" were in essence fraudulent transfers by TelexFree to evade claims by investors and creditors, and otherwise to unlawfully abscond with funds that rightfully belonged to creditors and investors.

193. At all times material herein, Defendants Merrill, Wanzeler, Labriola, Craft and Costa (hereinafter sometimes collectively "TelexFree's Management") were responsible for

the control and operation of TelexFree and its affiliated entities.

194. Moreover, TelexFree's Management not only controlled the activities and operations of TelexFree, but also knowingly and willfully conspired to perpetrate, and did in fact perpetrate, the TelexFree Pyramid Ponzi Scheme with full awareness of its fraudulent and illegal nature.

195. At all times material herein, Defendant Merrill served as the President, Secretary, and Director of TelexFree, Inc., a Manager of TelexFree, LLC, President, Secretary and Director of TelexFree Financial, General Partner of TelexElectric, and President, Secretary and Director of Telex Mobile Holdings.

196. In his capacities as Officer, Director, Manager and General Partner of the foregoing interrelated companies, Merrill exercised significant control over TelexFree's business operations.

197. More particularly, Merrill exercised significant control over the TelexFree Pyramid Ponzi Scheme.

198. Defendant Merrill has appeared in videos posted to the internet, in which he can be seen promoting TelexFree as a revenue opportunity for Promoters.

199. As of March 28, 2014, the TelexFree website included a biography of Merrill, which stated that Merrill was a 1985 graduate of Westfield State University in economics.

200. Also, as of March 28, 2013, the TelexFree website stated that Merrill is "well versed in one of the new technologies of the era (VoIP) [sic]."

201. As of April 28, 2014, the TelexFree Canadian website continued to state that

Merrill is a 1985 graduate of Westfield State University in economics and "[k]nowledgeable about a new era of technology (VOIP)."

202. According to testimony obtained by the Office of the Secretary of the Commonwealth of Massachusetts (hereinafter sometimes referred to as "SOC"), Merrill attended Westfield State University for a mere two years, without either receiving a degree or declaring a major.

203. Furthermore, in direct contravention to the representations of the TelexFree websites, Merrill testified to SOC that he had only a basic understanding of VoIP technology.

204. At all times material herein, Defendant Wanzeler served as Treasurer and a Director of TelexFree, Inc., a Manager of TelexFree, LLC, Vice President, Treasurer, and a Director of TelexFree Financial, General Partner of TelexElectric and Treasurer and Director of Telex Mobile Holdings.

205. According to corporate filings on record with SOC, at all times material herein, Wanzeler has also served as the Chief Executive Officer of TelexFree, Inc.

206. In his capacities as Officer, Director, Manager and General Partner of the foregoing interrelated companies, Wanzeler exercised significant control over TelexFree's business operations.

207. More particularly, Wanzeler exercised significant control over the TelexFree Pyramid Ponzi Scheme.

208. Defendant Wanzeler has also participated in marketing TelexFree to potential investors, appearing in videos posted to the Internet in which he can be seen promoting

TelexFree as a revenue opportunity for Promoters.

209. At all times material herein, Defendant Labriola, served as the International Marketing Director for TelexFree, Inc.

210. Labriola was one of the original Directors of Common Cents Communications, Inc., and at all material times herein exercised significant control over TelexFree's business operations and the operations of its interrelated companies.

211. Defendant Labriola has also appeared in several videos promoting TelexFree which were posted on the internet, and has acted as TelexFree's spokesman to Investors during post-bankruptcy petition conference calls.

212. As a Director of TelexFree, Inc., Defendant Labriola, has exercised significant control over the TelexFree Pyramid Ponzi Scheme.

213. As International Marketing Director for TelexFree, Inc., Labriola has also actively and knowingly perpetrated the TelexFree fraud through the dissemination of false and misleading advertising and marketing communications.

214. At all times material herein, Defendant Craft, also known as Joe H. Craft, has been a certified public accountant and served as the Chief Financial Officer ("CFO") of Telex Free, Inc and TelexFree, LLC.

215. In his capacity as CFO of TelexFree, Craft has been responsible for, inter alia, preparing or approving TelexFree's financial statements, overseeing TelexFree's accounting methods and records, and otherwise exercising significant supervision and control over TelexFree.

216. On April 23, 2013, in response to a request for a profit-and-loss statement issued by the SOC, TelexFree produced a document purporting to be TelexFree's 2012 profit-and-loss statement.

217. TelexFree did not make use of usual and accepted Multi-Level Marketing accounting practices. For example they did not separate out income generated by sales of VoIP from income generated by other means.

218. On February 5, 2014, the SOC requested a second profit-and-loss statement from TelexFree for 2012, which TelexFree produced on February 26, 2014.

219. A comparison of these two profit-and-loss statements - each purporting to be TelexFree's profit-and-loss statement for 2012 - reveals massive discrepancies.

220. For example, the first statement provided by TelexFree lists Total Income for 2012 at \$1,864,939.70, while the second lists Total Income for 2012 at \$2,834,835.70.

221. As further examples, Agent Commission is listed at \$520,582.95 in the first, versus \$2,105,925.61 in the second; Total Expenses are listed as \$784,899.22 in the first, versus \$2,333,893.09 in the second; Net Operating Income is listed as \$1,080,040.48 in the first, versus \$478,251.56 in the second; and Net Income is listed as \$1,066,313.39 in the first, versus \$477,652.23 in the second.

222. The existence of duplicative accounting records containing egregious discrepancies is clear indicia of TelexFree's falsification of accounting records and failure to adhere to Generally Accepted Accounting Principals ("GAAP").

223. As Chief Financial Officer for TelexFree, Inc. and TelexFree, LLC, as well as

a certified public accountant, Defendant Craft, knowingly perpetrated the TelexFree fraud by, inter alia:

- a. Overseeing TelexFree's creation of falsified accounting records;
- b. Failing to ensure that GAAP accounting methods were adopted and adhered to;
- c. Fraudulently certifying TelexFree's business operations and accounting practices as good and lawful, despite actual knowledge of their unlawful and illegitimate nature;
- d. Concealing the fact that the AdCentral Packages purveyed by TelexFree were actually securities; and
- e. Concealing and absconding with investor assets.

224. At all times material herein, Defendant Costa, was listed as Manager of TelexFree, LLC with the Massachusetts Secretary of State Corporations Division.

225. Costa is one of the original founders of TelexFree.

226. At all times material herein, Costa was involved in the day-to-day management and oversight of TelexFree and was actively involved in and managed its Brazilian operations.

227. Costa has appeared on numerous websites and videos posted on the Internet promoting TelexFree and touting its huge financial return.

228. Costa was an outspoken advocate against the Brazilian Court's decision to enjoin TelexFree's Brazilian activities, and publicly supported TelexFree's illegal and corrupt

235. Attorney Nehra's extensive experience in multi-level marketing, and particularly his involvement with the Ponzi schemes involving AdSurfDaily and Zeek Rewards, armed him with the knowledge of what constitutes violations of United States securities law. Indeed, Attorney Nehra was well aware that the use of semantics and obscured phraseology to obfuscate securities laws fails to legitimize TelexFree's illegal Pyramid Ponzi Scheme.

236. Attorney Waak also claims to have more than thirty years of experience in counseling MLM and direct-selling enterprises.

237. Attorney Waak claims to have managed the legal defense of multiple class action lawsuits involving claims for "pyramiding, securities fraud, false advertising and civil RICO."

238. Attorney Nehra and Attorney Waak are together the general partners of the Law Offices of Nehra and Waak.

239. On the website of the Law Offices of Nehra and Waak, Defendant Attorneys Nehra and Waak claim to specialize in counseling "domestic and foreign companies operating MLM (multi-level marketing) businesses in the United States."

240. Also, on the website of the Law Offices of Nehra and Waak, Attorneys Nehra and Waak boast "No Company that retained this firm BEFORE LAUNCH has been shut down by a regulator."

241. As general partners of the Law Offices of Nehra and Waak, Attorney Nehra and Attorney Waak are jointly and severally liable for torts and obligations of the firm.

242. During the time that the Law Offices of Nehra and Waak provided legal counsel to TelexFree, Attorney Waak was Principal Attorney of the law firm.

243. During this time, Attorney Waak, as Principal Attorney of the Law Offices of Nehra and Waak, was charged with oversight of the daily activities of the law firm.

244. TelexFree's Contract at Section 2.6.5 (m) mandates that Promoters are not to use the term investment with respect to the registration costs.

245. Specifically, TelexFree's Contract at Section 2.6.5 (m) specifically provides that the Promoter must not "use terms that distort the real meaning of products or the mechanism and functioning of multilevel marketing, including, without limitation, expressions that convey the idea of instant wealth for nothing in exchange, as well as speaking of registration costs as a 'financial investment.' Similarly, it is expressly prohibited to use the term 'INVESTMENT' at meetings and in promotional materials in general, orally or in writing."

246. Co-Defendant and Company Counsel Attorney Gerald P. Nehra, through his affiliated companies (Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC, and Richard W. Waak, Attorney at Law, PLLC), and under the direct supervision of Co-Defendants Richard W. Waak and Richard W. Waak Attorney at Law, PLLC provided this deceitful advice for the purpose of furthering perpetuating Defendants' unlawful Pyramid Ponzi Scheme.

247. During this time, Attorneys Nehra and Waak also maintained the Defendant Professional Limited Liability Companies, Gerald P. Nehra, Attorney at Law, PLLC and

Richard W. Waak, Attorney at Law, PLLC, which, upon information and belief, also provided legal and counseling services to TelexFree.

248. Among the Attorney Defendants, and during the course of TelexFree's scheme, there was no clear distinction among the services provided to TelexFree by the Law Offices of Nehra and Waak, the individual Defendants, and their respective Professional Limited Liability Companies.

249. The Attorney Defendants' role and involvement in the TelexFree Pyramid Ponzi Scheme exceeded merely providing legal counsel because they knowingly acted to further and perpetuate TelexFree's illegal Pyramid Ponzi Scheme, which caused Plaintiffs Waldemara Martins and Leandro Valentim and the similarly situated Putative class members to suffer economic loss.

250. The Attorney Defendants had actual knowledge that the TelexFree Business Model was a fraudulent Pyramid Ponzi Scheme.

251. Seeking to personally profit from TelexFree's exploitation of the members of the putative class, Defendant Gerald P. Nehra drew upon his prior experience to aid, abet and play an integral part in TelexFree's unlawful, unfair and deceptive acts and practices during times relevant to this complaint.

252. Attorney Nehru counseled TelexFree on methods to evade United States securities laws that were intended to offer, in part, protection from pyramid Ponzi schemes; all to enrich himself financially and serve his own selfish interests.

253. Attorney Nehra further encouraged TelexFree Investors to unknowingly

participate in the evasion of federal and state securities laws.

254. Defendant Nehra accomplished this by representing that his extensive experience as an MLM expert and his thorough research of TelexFree's business model allowed him to form a legal opinion that TelexFree was a legitimate business.

255. In making this professional opinion Defendant Nehra misrepresented TelexFree as a legitimate business concern.

256. For instance, by instructing Investors to avoid using the terms "investment" with reference to AdCentral Package (See TelexFree Contract, Paragraph 2.6.5(m)), he attempted to conceal, and encouraged others to conceal, the fact that TelexFree was involved in the sale of securities, and further attempted to strip Investors of the rights afforded them by federal and state securities laws.

257. In advising TelexFree Investors to act to avoid the protections offered by federal and state securities laws, Attorney Nehra never once advised the putative class member TelexFree Investors that so acting presented a risk to them, including the risk of participating in an unlawful scheme.

258. In advising TelexFree Investors to act to avoid the protections offered by federal and state securities laws, Attorney Nehra never once advised the putative class member TelexFree Investors that so acting was against their own interests or that it better served TelexFree and himself.

259. Attorney Nehra's acts of aiding, abetting and playing an integral part in TelexFree's unlawful, unfair and deceptive acts and practices exceed the scope of zealously

269. Notwithstanding the fact that TelexFree's Brazilian bank accounts were frozen and all their Brazilian recruiting and Return on Investment payments had been suspended by court order in their largest affiliate market, Attorney Nehra advised attendees that the shut-down in Brazil would have no bearing on TelexFree's U.S. operations.

271. In fact when asked by a concerned affiliate about the injunction granted against the company, Attorney Nehra first deflected its relevance by stating: "Okay, I am the MLM specialist and attorney for TelexFree in the United States only. So I gotta duck the question."

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to TelexFree to assist them in insuring their U.S. operations were lawfully conducted, knowing that, in fact, these operations were nothing more than an illegal Pyramid Ponzi Scheme.

273. Although, at all times material herein, Attorney Nehra emphatically assured Investors and potential Investors that, in his professional opinion, the TelexFree business model was legitimate and lawful, he had actual knowledge that TelexFree's operation was unlawful and illegitimate.

274. Furthermore, at all times material herein, Attorney Nehra assured Investors and potential Investors that, in his professional opinion, the TelexFree business model was legitimate, although he had actual knowledge that TelexFree Multilevel Marketing Network "Partnerships" involving TelexFree's AdCentral marketing packages were in fact unregistered securities. Attorney Nehra even provided advice on how to unlawfully circumvent federal and state securities laws.

275. In addition, and at all times material herein, Attorney Nehra assured Investors and potential Investors that, in his professional opinion, the TelexFree business model was legitimate and lawful, even though Attorney Nehra had specific knowledge of the ruling of the Brazilian Court and knowledge of and access to TelexFree's United States operations and their composition.

276. In fact, and more particularly, Attorney Nehra knew that:

a. TelexFree used the exact same business model in Brazil as they do in the United States and throughout the world;

- b. The Brazilian court had made a specific finding of fraud and that TelexFree's United States operations and composition was an unlawful venture;
- c. The Brazilian court described Telex business operations in terms of the quintessential pyramid scheme after TelexFree's own lawyers unwittingly admitted as much;
- d. TelexFree's lawyer Djacir Falcão stated to the Brazilian court that if the injunction continues the company may enter into bankruptcy: "Running the company really becomes difficult because of the court decision, so we will appeal," said Falcão ;
- e. Falcão tried to appeal to the Brazilian judges on the grounds that "should the company spend a few more days being prohibited from signing up new investors, they would have no money to pay the old ones;"
- f. A Brazilian judge rejected this argument and denied TelexFree's injunction appeal;
- g. TelexFree's other appeals were rejected by the Brazilian courts;
- h. One Brazilian judge remarked that the issue is that the earnings will be exhausted when the main source of revenue of the group (new affiliate registrations) stops;
- I. The above scenario is typically the result of a pyramid scheme;
- j. Judge Samoel Evangelista, 2nd Civil Chamber of the Court of Acre (TJ-AC), entered an order to keep the TelexFree funds frozen, to block future payments

k. According to Brazilian Judge Thais Kalil, how TelexFree earnings are paid out was advantageous to the prosecutor's argument, in that adding publishers to the network is of more importance than actually trying to sell the VoIP product;

l. Judge Thais Kalil also wrote that "(t)he issue is that the earnings will be exhausted when the main source of revenue of the group (new affiliate registrations) stops. Many (affiliates) do not even have the opportunity to recover their initial investment (minimum U.S. \$339) and this is detrimental."

277. Defendant Nehra's own comments make clear that he knew that TelexFree was

278. Defendant Nehra knew at all times relevant to his providing legal opinions and

279. Defendant Nehra knew at all times relevant to his providing legal opinions and

280. Defendant Nehra knew at all times relevant to his providing legal opinions at

continuing and perpetuating the ongoing fraud.

281. TelexFree in fact did, with his knowledge, use Attorney P. Nehra and his legal opinions supporting their business model as lawful prominently as a marketing tool on both their localized Brazilian (Portuguese) and Spanish (Spanish) website portals.

282. Defendant Nehra, in order to serve his own pecuniary self-interests, willfully aided, abetted, counseled, induced, and/or procured TelexFree's violations of law regarding the proper segregation and maintenance of customer funds, and acted in concert and combination with Defendant TelexFree in such violations.

283. Defendant Nehra gave substantial assistance to TelexFree in accomplishing a tortious result, and Nehra's own conduct, separately considered, constitutes a breach of duty to Investors because, inter alia, he:

- a. Knowingly misrepresented the legality and sustainability of TelexFree's operations to the detriment of Investors, and received fees from TelexFree for doing so;
- b. Knowingly obscured and obfuscated the illegal nature of TelexFree's scheme by the manipulative use of language, including, e.g., advising TelexFree that the use of the term "investment" must be avoided;
- c. Breached his duty of professional care to investors, by failing to exercise proper due diligence in investigating the legality of TelexFree's operations;
- d. Advised and encouraged Investors to evade United States securities laws to the benefit of TelexFree and detriment of the Investors and the public; and

- e. Engaged in a civil conspiracy to defraud TelexFree's investors by means of a Pyramid Ponzi Scheme, and, in fact, took a leading role in the scheme.

284. Attorney Waak, as general partner and Principal Attorney of the Law Offices of Nehra and Waak, was aware of, oversaw, and, upon information and belief, participated in Attorney Nehra's tortious conduct with respect to the TelexFree Pyramid Ponzi Scheme.

285. Attorney Waak, as general partner and Principal Attorney of the Law Offices of Nehra and Waak, was aware of, oversaw, and, upon information and belief, participated in TelexFree Pyramid Ponzi Scheme.

286. As the Chief Financial Officer of TelexFree, Inc. and TelexFree, LLC, Defendant Craft, also known as Joe H. Craft, has been a certified public accountant and served as the Chief Financial Officer ("CFO") of Telex Free, Inc. and TelexFree, LLC.

287. Defendant Craft is also the sole Member and Manager of Craft Financial, an Indiana-based limited liability company.

288. Defendants Craft and Craft Financial are indistinguishable with regards to their involvement with the TelexFree Pyramid Ponzi Scheme.

289. Defendants Craft and Craft Financial knowingly participated in and perpetuated TelexFree's illegal Pyramid Ponzi Scheme.

290. In his dual capacity as CFO and certified public accountant of TelexFree, Defendants Craft and Craft Financial have been responsible for, inter alia, preparing or approving TelexFree's financial statements, overseeing TelexFree's accounting methods and records, and otherwise exercising significant supervision and control over TelexFree.

291. On April 23, 2013, in response to a request for a profit-and-loss statement issued by the SOC, TelexFree produced a document purporting to be TelexFree's 2012 profit-and-loss statement.

292. As stated, on February 5, 2014, the SOC requested a second profit-and-loss statement from TelexFree for 2012, which TelexFree produced on February 26, 2014.

293. As stated, a comparison of these two profit-and-loss statements - each purporting to be TelexFree's profit-and-loss statement for 2012 - reveals massive discrepancies.

294. For example, the first statement provided by TelexFree lists Total Income for 2012 at \$1,864,939.70, while the second lists Total Income for 2012 at \$2,834,835.70.

295. As further examples, Agent Commission is listed at \$520,582.95 in the first, versus \$2,105,925.61 in the second; Total Expenses are listed as \$784,899.22 in the first, versus \$2,333,893.09 in the second; Net Operating Income is listed as \$1,080,040.48 in the first, versus \$478,251.56 in the second; and Net Income is listed as \$1,066,313.39 in the first, versus \$477,652.23 in the second.

296. The existence of duplicative accounting records containing egregious discrepancies is clear indicia of TelexFree's falsification of accounting records and failure to adhere to GAAP.

297. As CFO and certified public accountant for TelexFree, Inc. and TelexFree, LLC, as well as a certified public accountant, Defendants Craft and Craft Financial, knowingly perpetrated the TelexFree fraud by, inter alia:

- a. Overseeing TelexFree's creation of falsified accounting records;
- b. Failing to ensure that GAAP accounting methods were adopted and adhered to;
- c. Fraudulently certifying TelexFree's business operations and accounting practices as good and lawful, despite actual knowledge of their unlawful and illegitimate nature; and
- d. Conspiring with TelexFree's Officers to structure and perpetuate an illegal pyramid Ponzi scheme designed to defraud Investors and enrich themselves.

298. Defendants Craft and Craft Financial disseminated, and otherwise allowed to be disseminated, false and inaccurate financial information among Investors, knowing that such information was false and designed to continue and perpetuate the illegal Pyramid Ponzi Scheme.

299. In particular, Defendants Craft and Craft Financial authorized TelexFree to provide Investors with inaccurate and fraudulent 1099 (Miscellaneous Income) forms, in many cases long after the January 31, 2014 required deadline, and in an effort to misrepresent payments made to Investors and conceal assets.

300. The fact that these inaccurate 1099's are expected to be filed with the Internal Revenue Service and State Revenue Offices will impose further an undue and massive hardship upon investors.

301. Defendants also prepared false financial documents for affiliated TelexFree entities and prepared false tax returns for the affiliated TelexFree entities.

302. During the course of the TelexFree Pyramid Ponzi Scheme, Defendants TD Bank, Citizens Financial, Citizens Bank, Fidelity Bank, Middlesex Savings, GPG, IPS, and ProPay and the Does provided crucial financial services to TelexFree, which enabled TelexFree to carry on its Pyramid Ponzi scheme.

303. TelexFree's financial services providers, including the aforesaid banking institutions and payment processing services providers, knowingly aided and abetted TelexFree's Pyramid Ponzi Scheme by, inter alia:

- a. Receiving transfers of funds from, and on behalf of, TelexFree in the course of TelexFree's fraudulent business, despite knowledge of the fraudulent nature of TelexFree's business enterprise;
- b. Receiving transfers of funds from TelexFree, its affiliated entities, and its executive officers, which transfers deepened TelexFree's insolvency, despite having knowledge of TelexFree's actual or imminent insolvency at the time of such transfers;
- c. Processing payments to, and on behalf of, TelexFree, including its affiliated entities and Management, in the course of TelexFree's fraudulent business, despite knowledge of the fraudulent nature of TelexFree's business enterprise; and
- d. Otherwise enabling the TelexFree Pyramid Ponzi Scheme to expand and continue by providing necessary financial services to TelexFree, despite actual knowledge of fraud on the part of TelexFree.

304. Defendants, TD Bank, Citizens Financial, Citizens Bank, Fidelity Bank, and Middlesex Savings (hereinafter sometimes collectively referred to as "Banking Institution Defendants") possessed actual knowledge of the fraudulent nature of TelexFree's business operation, since at least June 2013.

305. Despite knowledge of the fraudulent nature of TelexFree's business operations, the Banking Institution Defendants continued to provide TelexFree with banking services.

306. In particular, upon information and belief, the Banking Institution Defendants received funds from Investors, which funds were then held for the benefit of TelexFree, its affiliated entities, and its Management.

307. Furthermore, the Banking Institution Defendants also received large transfers of funds from TelexFree, its affiliated entities, and its Management, during which time TelexFree was insolvent, despite knowledge of the fraudulent nature of TelexFree's business operations, thereby deepening TelexFree's insolvency and assisting TelexFree and its Management in concealing assets.

308. Defendants GPG, IPS, and ProPay (hereinafter sometimes collectively referred to as "Payment Processing Services Companies" or "PPSC Defendants") possessed actual knowledge of the fraudulent nature of TelexFree's business operations since at least June 2013.

309. Despite knowledge of the fraudulent nature of TelexFree's business operations, the PPSC Defendants continued to provide TelexFree with payment processing services.

310. More particularly, the PPSC Defendants processed payments by Investors to

TelexFree in the course of TelexFree's fraudulent business operations, which funds were then held for the benefit of TelexFree, its affiliated entities, and its Management.

311. Upon information and belief, the PPSC Defendants also processed large transfers of funds from TelexFree, its affiliated entities, and its Management, to Banking Institution Defendants and other receivers, during which time TelexFree was insolvent, despite knowledge of the fraudulent nature of TelexFree's business operations, thereby deepening TelexFree's insolvency and assisting TelexFree and its Management in concealing assets.

312. The PPSC Defendants received payment of substantial fees in return for providing these services.

313. More particularly, IPS provided TelexFree with a service titled "e-Wallet," which was used by TelexFree to process electronic transfers of funds by Investors to TelexFree.

314. According to a TelexFree balance sheet, dated December 31, 2013, posted by the Washington State Utilities and Transportation Commission, as of December 31, 2013, TelexFree claimed \$31,640,192.30 in assets then held by IPS (under the brand name "e-Wallet") on behalf of TelexFree.

315. Defendant GPG also processed electronic transfers of funds by Investors to TelexFree.

316. Defendant ProPay, which also does business as Propay.com, also processed such electronic transfers of funds on behalf of TelexFree.

317. Furthermore, upon information and belief, ProPay processed transfers of funds by and on behalf of TelexFree, its affiliated entities, and its Management, during which time TelexFree was insolvent, despite knowledge of the fraudulent nature of TelexFree's business operations, thereby deepening TelexFree's insolvency and assisting TelexFree and its Management in concealing assets.

318. Defendants Merrill and Wanzeler are the general partners of Defendant TelexElectric.

319. Defendant TelexElectric received a fraudulent \$2,022,329.00 "loan" from TelexFree following the closure of TelexFree Brazil by the Brazilian Courts.

320. Defendant TelexFree Mobile received a fraudulent \$500,870 "loan" from TelexFree.

IV. CLASS ACTION ALLEGATIONS

321. Pursuant to Rule 23 of the Federal Rules of Civil Procedure, Plaintiff Cook brings this action on his own behalf, and on behalf of all other persons similarly situated ("the Class"). The Class that Plaintiff seeks to represent is:

All Georgia residents who tendered funds to TelexFree between January 1, 2012 and April 15, 2014 and who did not recoup the amount of money they originally invested. Excluded from the Class are the Defendants and their officers, directors, and employees of Defendant; any entity in which Defendant have a controlling interest; the co conspirators, so called insider promoters, legal representatives, attorneys, heirs, and assigns of the Defendants.

322. Plaintiff meets the requirements of Federal Rules of Civil Procedures 23(a) because the members of the Class are so numerous that the joinder of all members is impractical. While the exact number of Class members is unknown to Plaintiff at this time, based on information and belief, it is in the hundreds of thousands.

323. Plaintiff meets the requirements of Federal Rules of Civil Procedures 23(a) because there is a well-defined community of interest among the members of the Class, common questions of law and fact predominate, Plaintiff's claims are typical of the members of the Class, and Plaintiff can fairly and adequately represent the interests of the Class.

324. This action satisfies the requirements of Federal Rule of Civil Procedure 23(b)(3) because it involves questions of law and fact common to the member of the Class that predominate or any questions affecting only individual members, including, but not limited to:

- a. Whether the contract under which TelexFree claims to invoke the application of Nevada law is illegal and unenforceable as a matter of law.
- b. Whether the contract under which TelexFree claims to invoke the application of Nevada law is otherwise void and unenforceable as a matter of law.
- c. Whether TelexFree ran a Pyramid Ponzi Scheme;
- d. Whether TelexFree ran a lawful Multi-Level Marketing program;
- e. Whether TelexFree offered and sold securities in the form of unregistered investment contracts constituting securities.

- f. Whether the Defendants aided and abetted TelexFree in the sale of
unregistered securities in violation of the law;
- g. Whether Georgia's Blue Sky Laws will apply to the claims of the Putative
Class;
- h. Whether Massachusetts' Blue Sky Laws will apply to the claims of the
Putative Class;
- I. Whether Defendant Officers, Banks, Payment Processing Services Companies,
and Retained Licensed Professionals knew that TelexFree was an illegal
pyramid-type Ponzi scheme which involved the illegal sale of securities,
continued to aid, abet and further such illegal activities or are otherwise liable
for the economic loss suffered by the Putative Class.
- j. Whether TelexFree's financial services providers, including the aforesaid
banking institutions and payment processing services providers, knowingly
aided and abetted TelexFree's Pyramid Ponzi Scheme
- k. Whether TelexFree and Defendants also violated Title 17, Code of Federal
Regulations, Section 240.10b-5 by (a) employing devices, schemes, and
artifices to defraud; (b) making untrue statements of material facts and
omitting to state material facts necessary in order to make the
statements made, in the light of the circumstances under which they were
made, not misleading, and (c) engaging in acts, practices, and courses of
business which operated and would operate as a fraud and deceit upon persons.

- l. Whether Defendants violated Section 1965 of the Racketeer Influenced and Corrupt Organizations Act [18 U.S.C. § 1965];
- m. Whether TelexFree mailed fraudulent and inaccurate 1099 (Miscellaneous Income) forms to investors;
- n. Whether the 1099 (Miscellaneous Income) forms should be declared void as a matter of law or otherwise because they were provided long after the mandated January 31, 2014 deadline, and some after the April 15, 2014 filing deadline.
- o. Whether Plaintiff and the Class are entitled to damages, civil penalties, punitive damages, and/or injunctive relief.

325. The prosecution of separate actions by individual members of the Class would create a risk of inconsistent or varying adjudications with respect to individual members of the Class, which would establish incompatible standards of conduct for Defendants and would lead to repetitive adjudication of common questions of law and fact. Accordingly, class treatment is superior to any other method for adjudicating the controversy. Plaintiff knows of no difficulty that will be encountered in the management of this litigation that would preclude its maintenance as a class action under Rule 23(b)(3).

326. Damages for any individual class member are likely insufficient to justify the cost of individual litigation, so that in the absence of class treatment, Defendants' violations of law inflicting substantial damages in the aggregate would go un-remedied without certification of the Class.

327. Defendants have acted or refused to act on grounds that apply generally to the class, as alleged above, and certification is proper under Rule 23(b)(2).

V. CAUSES OF ACTION

COUNT I - VIOLATION OF GEORGIA SECURITIES LAW

(Against Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, and Gerald P. Nehra, Attorney at Law, PLLC)

328. Plaintiffs incorporate by reference the allegations contained in the preceding as if fully restated herein.

329. During the time in which Plaintiff and putative class invested in TelexFree (the “Class Period”), Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, and Gerald P. Nehra, Attorney at Law, PLLC and others, directly and indirectly, engaged and participated in a scheme and a continuous course of conduct to make materially false and misleading statements about the TelexFree investment dealings, financial condition and operations and to conceal adverse material information about these investments.

330. Said Defendants employed devices, schemes, and artifices to defraud, while in possession of material adverse non-public information and engaged in acts, practices, and courses of conduct, as alleged herein, including the following: (1) making or participating in the making of untrue statements of material facts; (2) omitting to state the material facts necessary to make the statements about the investments not misleading; and (3) engaging in transactions, practices, and a course of business which operated as a fraud and deceit upon

investors during the Class Period.

331. Each of the said Defendants offered and sold securities by means of fraudulent misrepresentations and intentional omissions of material facts concerning the securities.

332. Said Defendants had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose such facts, even though such facts were available to them. Such misrepresentations and/or omissions were done knowingly or recklessly for the purpose and effect of concealing the true information about the investments, including their financial condition and operations.

333. Defendants received information reflecting the true facts regarding the investment and TelexFree's business practices, exercised control over and/or receipt of the materially misleading misstatements and/or their association with the investment and made them privy to confidential proprietary information concerning these investments. Because of their control and/or association with the investment, Defendants were active and culpable participants in the fraudulent scheme.

334. Defendants knew and/or recklessly disregarded the falsity and misleading nature of the information that they caused to be disseminated to Investors.

335. The ongoing fraudulent scheme described herein could not have been perpetrated over a substantial period of time, without the knowledge and complicity of Defendants.

336. As a result of the dissemination of materially false and misleading information

and the failure to disclose material facts, as set forth above, Investors paid artificially inflated prices for worthless membership interests in the investment during the Class Period.

337. In ignorance of the materially false and misleading nature of the reports and statements described above, Plaintiff and the other Class members relied, to their detriment, on Defendants for complete and accurate information about these investments.

338. By virtue of the foregoing, Defendants have violated the Georgia Uniform Securities Act of 2008 (O.C.G.A. § 10-5-1, *et seq.*), and Plaintiff and the Class have been damaged thereby, in an amount to be proven at trial.

COUNT II - FEDERAL SECURITIES VIOLATIONS

*(Against Defendants Merrill,
Wanzeler, Labriola, Craft, Costa, and Others)*

339. Plaintiffs incorporate by reference the allegations contained in the preceding as if fully restated herein.

340. During the time in which Plaintiff and putative class invested in TelexFree (the “Class Period”), Defendants Merrill, Wanzeler, Labriola, Craft, Costa, and others, directly and indirectly, by the use of means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a scheme and a continuous course of conduct to make materially false and misleading statements about the TelexFree investment dealings, financial condition and operations and to conceal adverse material information about these investments.

341. Defendants employed devices, schemes, and artifices to defraud, while in

342. Each of the said Defendants offered and sold securities by means of fraudulent misrepresentations and intentional omissions of material facts concerning the securities.

344. Defendants received information reflecting the true facts regarding the investment and TelexFree's business practices, exercised control over and/or receipt of the materially misleading misstatements and/or their association with the investment and made them privy to confidential proprietary information concerning these investments. Because of their control and/or association with the investment, Defendants were active and culpable participants in the fraudulent scheme.

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nature of the information that they caused to be disseminated to Investors.

346. The ongoing fraudulent scheme described herein could not have been perpetrated over a substantial period of time, without the knowledge and complicity of Defendants.

347. As a result of the dissemination of materially false and misleading information and the failure to disclose material facts, as set forth above, Investors paid artificially inflated prices for worthless membership interests in the investment during the Class Period.

348. In ignorance of the materially false and misleading nature of the reports and statements described above, Plaintiff and the other Class members relied, to their detriment, on Defendants for complete and accurate information about these investments.

349. By virtue of the foregoing, Defendants have violated Section 10(b) of the Exchange Act, and Rule 10 b-5 promulgated thereunder, and Plaintiff and the Class have been damaged thereby, in an amount to be proven at trial.

COUNT III - FEDERAL SECURITIES VIOLATIONS

(Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, and Gerald P. Nehra, Attorney at Law, PLLC)

350. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if as fully restated herein.

351. At the time of the wrongs alleged herein, Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, and Gerald P. Nehra, Attorney at Law, PLLC, were each a controlling person of TelexFree within

the meaning of Section 20(a) of the Exchange Act.

352. By reason of their respective positions of authority, Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, and Gerald P. Nehra, Attorney at Law, PLLC had the power and authority to influence and control, and did influence and control, the decision-making and activities of TelexFree and the affiliated TelexFree Entities and caused them to engage in the wrongful conduct described herein. Defendants, Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Nehra, Law Offices of Nehra and Waak, and Gerald P. Nehra, Attorney at Law, PLLC, exercised control to cause the dissemination of false and misleading statements and omissions of material facts.

353. Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, and Gerald P. Nehra, Attorney at Law, PLLC also materially aided in the sale of TelexFree AdCentral packages, which constitute securities, by actively promoting such

354. By virtue of their positions as controlling persons, and as a result of the aforementioned conduct, Defendants are liable under Section 20(a) of the Exchange Act.

COUNT IV - FEDERAL SECURITIES VIOLATIONS

*(Against Defendants Merrill, Wanzeler, Labriola,
Craft, Costa, and Others)*

355. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if fully restated.

356. The Securities Act prohibits sale or delivery after sale of an unregistered

security.

357. Defendants Merrill, Wanzeler, Labriola, Craft, Costa, and others failed to file a true Registration Statement for TelexFree under the 1933 Act.

358. A Registration Statement must include the following: (1) the entity's properties and business, (2) a full description of the offered security, (3) information about the management of the entity, and (4) a financial statement certified by an independent auditor. None of these were provided.

359. By omitting this information, Defendants filed a false Form D.

360. Defendants Merrill, Wanzeler, Labriola, Craft, Costa, and others also did not apply for or receive an exemption under Regulation D.

361. Defendants Merrill, Wanzeler, Labriola, Craft, Costa, and others failed to provide to Plaintiff access to the information that they were required to provide, including audited financial statements.

362. Plaintiff purchased these securities without knowledge of the failure of Defendants Merrill, Wanzeler, Labriola, Craft, Costa, and others to file the required Registration Statement or receive an exemption therefrom.

363. Plaintiff would not have purchased the securities if Defendants Merrill, Wanzeler, Labriola, Craft, Costa, and others provided the information required in a Registration Statement.

364. By virtue of the foregoing, Plaintiff and the putative class have been damaged and are entitled to damages, including rescission, and other relief for violations by

Defendants Merrill, Wanzeler, Labriola, Craft, Costa, and others of Sections 5 and 12(a)(1) of the Securities Act of 1933 alleged herein.

COUNT V - FEDERAL SECURITIES VIOLATION

(Against Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, and Gerald P. Nehra, Attorney at Law, PLLC)

365. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if fully restated herein.

366. During the class period, Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, and Gerald P. Nehra, Attorney at Law, PLLC, fraudulently failed to convey facts material to the TelexFree AdCentral investment packages by failing to produce and file a Registration Statement.

367. In particular, the said Defendants intentionally avoided the requirement to produce a Registration Statement, and intentionally avoided disclosing that the AdCentral packages were, in fact, investments, and that financial returns on the AdCentral investments were derived from the proceeds received from the purchase of such investments, and not from the sale of the VoIP product.

368. Said Defendants had actual knowledge of the misrepresentations and omissions of material facts set forth herein.

369. Such misrepresentations and/or omissions were done knowingly for the purpose and effect of concealing the true information about the investments, including their

financial condition and operations.

370. Said Defendants received information reflecting the true facts regarding the investment and TelexFree's business practices, exercised control over and/or receipt of the materially misleading misstatements and/or their association with the investment and made them privy to confidential proprietary information concerning these investments.

371. Because of their control and/or association with the investment, Defendants were active and culpable participants in the fraudulent scheme.

372. Said Defendants knew and recklessly disregarded the falsity and misleading nature of the information that they caused to be disseminated to Investors.

373. The ongoing fraudulent scheme described herein could not have been perpetrated over a substantial period of time without the knowledge and complicity of the Defendants.

374. As a result of failure to disclose material facts, as set forth above, including their failure to file the requisite registration material, Investors paid artificially inflated prices for worthless membership interests in the investment during the Class Period.

375. By virtue of the foregoing, said Defendants have violated Section 11 of the Securities Act, and Plaintiff and the putative class have been damaged thereby, in an amount to be proven at trial.

COUNT VI - FEDERAL SECURITIES VIOLATIONS

(Against Defendants Merrill, Wanzeler, Labriola, Craft, Costa, and Others)

376. Plaintiff incorporates by reference the allegations contained in the preceding

Paragraphs as if fully restated herein.

377. Defendants Merrill, Wanzeler, Labriola, Craft, Costa, and others participated in the sale of securities to Plaintiff and the putative class that were unregistered and not exempt from registration.

378. At the time of their investments, Plaintiff and the putative class had no knowledge that the investments offered by Defendants Merrill, Wanzeler, Labriola, Craft, Costa, and others were subject to registration requirements.

379. In fact, Defendants Merrill, Wanzeler, Labriola, Craft, Costa, and others knew or reasonably should have known that the TelexFree Agreement Contract and investment scheme was subject to the registration requirement of the Securities Act.

380. Both the Telex Contract and related materials distributed to Plaintiff and the putative class and the oral communications with Plaintiff and the putative class contained material omissions and misstatements.

381. Plaintiff and the putative class had no knowledge of the falsity of these statements or of the material omissions in the written materials including, but not limited to, Monthly Accounting Statements prepared by the accounting Defendants and other misrepresentations made by Defendants Merrill, Wanzeler, Labriola, Craft, Costa, and others as described above. Plaintiff and the putative class reasonably believed such statements were true.

382. Defendants Merrill, Wanzeler, Labriola, Craft, Costa, and others knew, or in the exercise of reasonable diligence, should have known, of the untruths and omissions.

383. Plaintiff and the putative class would not have purchased the securities if they had this knowledge.

384. As a result of these investments, Plaintiff and the putative class have been damaged.

385. Plaintiff and the putative class are entitled to rescind their purchases and recover the value of their interest in TelexFree. Plaintiff and the putative class seek rescission of their purchase of membership interests in TelexFree.

COUNT VII - NEGLIGENCE

(Against all Defendants)

386. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if fully restated herein.

387. At all times material herein, Defendants owed a duty to Plaintiff and the putative class to act with a level of care to avoid misstating TelexFree's financial information or its returns; and to comply with all applicable laws concerning TelexFree, including, without limitation, federal and state securities laws.

388. By virtue of misstating and omitting relevant financial information, including the returns to Promoter/Investors, Defendants breached the duty of care owed to Plaintiff and the putative class.

389. As a direct and proximate result of Defendants' negligence and carelessness, Plaintiffs and the putative class have been caused to suffer and sustain damages and losses.

COUNT VIII - NEGLIGENT MISREPRESENTATION

(Against Defendants Merrill, Wanzeler, Labriola, Costa, Craft, Craft Financial, Costa, Nehra, Law Offices of Nehra and Waak, and Gerald P. Nehra, Attorney at Law, PLLC)

390. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if fully restated herein.

391. Defendants Merrill, Wanzeler, Labriola, Costa, Craft, Craft Financial, Costa, Nehra, Law Offices of Nehra and Waak, and Gerald P. Nehra, Attorney at Law, PLLC, and others, directly and through their agents, servants, employees and/or representatives, did negligently make false representations of material fact to the said Plaintiff and the class, with said misrepresentations being made for the purpose of obtaining and/or wrongfully appropriating and converting money from Plaintiff and the class.

392. Said Defendants made negligent representations although said Defendants knew, or should have known, that such representations were false.

393. Said representations and statements were material and were relied upon by Plaintiff and the class, inducing them to furnish money to Defendants.

394. In consequence of said reliance on the negligent misrepresentations, Plaintiff and the class have suffered great financial losses, and have also incurred considerable expenses and loss of income, and have otherwise been greatly damaged.

COUNT VIII - INTENTIONAL MISREPRESENTATION

(Against Defendants Merrill, Wanzeler, Labriola, Costa, Craft, Craft Financial, Costa, Nehra, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC)

395. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if fully restated herein.

396. Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC, and others directly and through their agents, servants, employees and/or representatives, did intentionally make false representations of material fact to the said Plaintiff and the class with said misrepresentations being made for the purpose of obtaining and/or wrongfully appropriating and converting money from Plaintiff and the class.

397. Said Defendants made said intentional misrepresentations although Defendants knew that such representations were false.

398. Said representations and statements were material and were relied upon by Plaintiff and the class, inducing them to furnish money to Defendants.

399. In consequence of said reliance on the intentional misrepresentations, Plaintiff and the class have suffered great financial losses, and have also incurred considerable expenses and loss of income, and have otherwise been greatly damaged.

COUNT X - PROFESSIONAL MALPRACTICE

*(Against Defendants Craft, Craft Financial, Nehra, Waak, Law Offices of
Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC
and Richard W. Waak, Attorney at Law, PLLC)*

400. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if fully restated herein.

401. At all times material herein, Defendants Craft, Craft Financial, Nehra, Waak, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC and Richard W. Waak, Attorney at Law, PLLC, were the providers of professional accounting and legal

services.

402. The said Defendants had a duty to perform these services in conformance with the skill and knowledge normally possessed by members of the accounting and legal professions, using good, known, and accepted customs and practices of the these professions.

403. Said Defendants breached their duty to Plaintiff and the class by negligently certifying and representing to Plaintiff and the public that the business model and operations of TelexFree were legal, proper, and economically viable and sustainable, when in fact TelexFree's business model and operations constituted an illegal and unsustainable Ponzi scheme.

404. Said Defendants further failed to exercise proper due diligence in the discharge of their investigatory duties as certified public accountants and attorneys of TelexFree.

405. Furthermore, Defendants Craft and Craft Financial negligently failed to ensure that TelexFree maintained proper accounting records.

406. As a result of the professional negligence of said Defendants, Plaintiffs and the public were misled to believe that TelexFree was legal, proper, and economically viable and sustainable.

407. As a direct and proximate consequence of the aforementioned negligence of the said Defendants, Plaintiff and the class sustained injuries and losses.

COUNT XI - BREACH OF FIDUCIARY DUTY

(Against Defendants Merill, Wanzeler, Labriola, Costa, Craft, Craft Financial, Costa, Nehra, Waak, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC and Richard W. Waak, Attorney at Law, PLLC)

409. Defendants Merrill, Wanzeler, Labriola, Costa, Craft, Craft Financial, Costa, Nehra, Waak, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC and Richard W. Waak, Attorney at Law, PLLC and others owe to Plaintiff and the class, a duty of utmost good faith and fair dealing.

- (a) Providing false and misleading information as to the nature of TelexFree business operation;
- (b) Misrepresenting the financial statements;
- (c) Providing false and misleading information as to the value of the AdCentral Package;
- (d) Providing false and misleading information as to the method and source from which income was derived;
- (e) Providing false and misleading information as to the legality of TelexFree's business model;
- (f) Providing false and misleading information as to the sustainability of the returns to Promoter/Investors;
- (g) Providing false and misleading information regarding the investigation in

Brazil and subsequent closure of TelexFree's Brazilian operations,

- (h) Knowingly participating in false and deceptive information televised over the internet and other media;
- (I) Concealing the fact that the AdCentral Packages were actually securities;
- (j) Failing to comply with federal and state securities laws; and
- (k) Employing legal and accountant counsel to mask their illegal and fraudulent activities in an effort to further and perpetuate such illegal fraudulent activities.

411. Said Defendants had actual knowledge of the fraudulent and deceptive misrepresentations and omissions of material facts set forth herein.

412. Such misrepresentations and/or omissions were done knowingly for the purpose and effect of concealing the true information about the investments, including their financial condition and operations.

413. Said Defendants received information reflecting the true facts regarding the investment and TelexFree's business practices, exercised control over and/or receipt of the materially misleading misstatements and/or their association with the investment and made them privy to confidential proprietary information concerning these investments.

414. Because of their control and/or association with the investment, Defendants were active and culpable participants in the fraudulent scheme.

415. Said Defendants knew and recklessly disregarded the falsity and misleading nature of the information that they caused to be disseminated to Investors.

416. Said Defendants, through the aforesaid fraudulent and deceptive

misrepresentations and omissions of material facts, breached their fiduciary duties of care and loyalty to Plaintiff and the class.

417. As a result of the foregoing breach of fiduciary duty by Defendants, Investors paid artificially inflated prices for worthless membership interests in the investment during the Class Period.

COUNT XII - BREACH OF THE COVENANT OF GOOD FAITH AND FAIR DEALING

(Against Defendants TelexElectric, TelexFree Mobile Holdings, Merrill, Wanzeler, Labriola, Costa, Craft, Craft Financial, Costa, Nehra, Waak, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC and Richard W. Waak, Attorney at Law, PLLC)

418. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if fully restated herein.

419. Defendants owed to Plaintiff and the class a duty of utmost good faith and fair dealing, and thereby were obligated to consider the welfare of Plaintiff and the class and refrain from acting for purely selfish motives or private gain.

420. Defendants violated their duty by actively misrepresenting and fraudulently failing to convey facts material to the TelexFree AdCentral investment packages, including:

- (a) Providing false and misleading information as to the nature of TelexFree business operation;
- (b) Misrepresenting the financial statements;
- (c) Providing false and misleading information as to the value of the AdCentral

Package;

- (d) Providing false and misleading information as to the method and source from which income was derived;
- (e) Providing false and misleading information as to the legality of TelexFree's business model;
- (f) Providing false and misleading information as to the sustainability of the returns to Promoter/Investors;
- (g) Providing false and misleading information regarding the investigation in Brazil and subsequent closure of TelexFree's Brazilian operations,
- (h) Knowingly participating in false and deceptive information televised over the internet and other media;
- (I) Concealing the fact that the AdCentral Packages were actually securities;
- (j) Failing to comply with federal and state securities laws; and
- (k) Employing legal and accountant counsel to mask their illegal and fraudulent activities in an effort to further and perpetuate such illegal fraudulent activities.

421. Said Defendants had actual knowledge of the fraudulent and deceptive misrepresentations and omissions of material facts set forth herein.

422. Such misrepresentations and/or omissions were done knowingly for the purpose and effect of concealing the true information about the investments, including their financial condition and operations.

423. Said Defendants received information reflecting the true facts regarding the

investment and TelexFree's business practices, exercised control over and/or receipt of the materially misleading misstatements and/or their association with the investment and made them privy to confidential proprietary information concerning these investments.

424. Because of their control and/or association with the investment, Defendants were active and culpable participants in the fraudulent scheme.

425. Said Defendants knew and recklessly disregarded the falsity and misleading nature of the information that they caused to be disseminated to Investors.

426. Said Defendants, through the aforesaid fraudulent and deceptive misrepresentations and omissions of material facts, breached their covenant of good faith and fair dealing owed to the Plaintiff and the class.

427. As a result of the foregoing breach of the covenant of good faith and fair dealing by Defendants, Investors paid artificially inflated prices for worthless membership interests in the investment during the Class Period.

COUNT XIII - UNJUST ENRICHMENT

*(Against Defendants TelexElectric, TelexFree Mobile Holdings,
Merrill, Wanzeler, Labriola, Craft, Costa, and Others)*

428. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if fully restated herein.

429. Plaintiff and the class furnished funds, directly or indirectly, to Defendants TelexElectric, TelexFree Mobile Holdings, Merrill, Wanzeler, Labriola, Craft, Costa, and others, which funds were accepted by Defendants without protest or defect.

430. Said Defendants have unlawfully and in bad faith denied Plaintiff and the class access to such funds, and have instead retained the benefit of such funds for themselves.

431. As a direct and proximate result of the foregoing actions of Defendants, as hereinabove set forth, the said Defendants are, and continue to be, unjustly enriched.

COUNT XIV - FRAUD

(Against Defendants Merrill, Wanzeler, Labriola, Costa, Craft, Craft Financial, Costa, Nehra, Waak, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC and Richard W. Waak, Attorney at Law, PLLC)

432. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if fully restated herein.

433. Defendants Merrill, Wanzeler, Labriola, Costa, Craft, Craft Financial, Costa, Nehra, Waak, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC and Richard W. Waak, Attorney at Law, PLLC, and others fraudulently misrepresented and intentionally failed to convey to Plaintiff and the class facts material to the TelexFree AdCentral investment packages.

434. Said Defendants' fraudulent misrepresentations and omissions include, *inter alia*:

- (a) Providing false and misleading information as to the nature of TelexFree business operation;
- (b) Misrepresenting the financial statements;
- (c) Providing false and misleading information as to the value of the AdCentral Package;

- (d) Providing false and misleading information as to the method and source from which income was derived;
- (e) Providing false and misleading information as to the legality of TelexFree's business model;
- (f) Providing false and misleading information as to the sustainability of the returns to Promoter/Investors;
- (g) Providing false and misleading information regarding the investigation in Brazil and subsequent closure of TelexFree's Brazilian operations,
- (h) Knowingly participating in false and deceptive information televised over the internet and other media;
- (I) Concealing the fact that the AdCentral Packages were actually securities;
- (j) Failing to comply with federal and state securities laws; and
- (k) Employing legal and accountant counsel to mask their illegal and fraudulent activities in an effort to further and perpetuate such illegal fraudulent activities.

435. Said Defendants had actual knowledge of the fraudulent and deceptive misrepresentations and omissions of material facts set forth herein.

436. Such misrepresentations and/or omissions were done knowingly for the purpose and effect of concealing the true information about the investments, including their financial condition and operations.

437. Defendants received information reflecting the true facts regarding the

investment and TelexFree's business practices, exercised control over and/or receipt of the materially misleading misstatements and/or their association with the investment and made them privy to confidential proprietary information concerning these investments.

438. Because of their control and/or association with the investment, Defendants were active and culpable participants in the fraudulent scheme.

439. Defendants knew and recklessly disregarded the falsity and misleading nature of the information that they caused to be disseminated to Investors.

440. The ongoing fraudulent scheme described herein could not have been perpetrated over a substantial period of time, without the knowledge and complicity of Defendants.

441. As a result of the foregoing fraud perpetrated by Defendants, Investors paid artificially inflated prices for worthless membership interests in the investment during the Class Period.

COUNT XV - AIDING AND ABETTING FRAUD

(Against Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Nehra, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC, TD Bank, Citizens Financial, Citizens Bank, Fidelity Bank, Middlesex Savings, GPG, IPS, and Propay)

442. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if fully restated herein.

443. Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC, TD Bank,

Citizens Financial, Citizens Bank, Fidelity Bank, Middlesex Savings, GPG, IPS, and ProPay actively and substantially assisted in the commission of the TelexFree fraud.

444. Said Defendants rendered such substantial assistance despite their knowledge that TelexFree's operations constituted an illegal and unsustainable pyramid Ponzi scheme and financial fraud.

445. Such substantial assistance rendered by said Defendants despite their knowledge of the fraudulent nature of TelexFree's operations, include, inter alia:

- (a) Managing and controlling TelexFree and its affiliated entities;
- (b) Providing accounting services to TelexFree;
- (c) Providing legal services to TelexFree;
- (d) Publicly certifying that TelexFree's business model and operations were legal, proper, and economically viable and sustainable;
- (e) Providing banking services for TelexFree and its management;
- (f) Promoting TelexFree AdCentral packages;
- (g) Processing payments to, from, and on behalf of TelexFree and its affiliated entities; and
- (h) Process payments for transfers of funds which deepened TelexFree's insolvency.

446. As a direct and proximate result of TelexFree's fraud, to which the said Defendants provided substantial assistance, Plaintiff and the class sustained damages and losses.

COUNT XVI - COMMON LAW FRAUDULENT TRANSFER

(Against Defendants TelexElectric, Telex Mobile Holdings, Merrill, Wanzeler, Labriola, Craft, Costa, TD Bank, Citizens Financial, Citizens Bank, Fidelity Bank, Middlesex Savings, GPG, IPS, and Propay)

447. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if fully restated herein.

448. Plaintiff and the class, at all times material herein, were and are creditors of TelexFree.

449. Defendants Telexelectric, Telex Mobile Holdings, Merrill, Wanzeler, Labriola, Craft, Costa, TD Bank, Citizens Financial, Citizens Bank, Fidelity Bank, Middlesex Savings, GPG, IPS, and ProPay have knowingly made or accepted transfers of funds owed to Plaintiff and the class.

450. Such transfers were made or accepted with intent to hinder, delay, and/or defraud Plaintiff and the class.

451. More particularly, such transfers were made in an attempt to dissipate, convert and conceal funds that are lawfully due to Plaintiff and the class.

452. As a result of such fraudulent transfers, Plaintiff and the class have suffered, or will imminently suffer, damages and losses.

COUNT XVII - CIVIL CONSPIRACY

(Against Defendants TelexElectric, Telex Mobile Holdings, Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Waak, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC and Richard W. Waak, Attorney at Law, PLLC)

453. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if fully restated herein.

454. Defendants have combined to enter into a civil conspiracy, for an unlawful purpose and using unlawful means, with the intent of so combining to unlawfully defraud Plaintiff and the class out of funds.

455. In consequence of the foregoing, Plaintiff and the class sustained damages and losses.

COUNT XVIII - CONVERSION

(Against Defendants Merrill, Wanzeler, Labriola, Craft, and Costa)

456. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if fully restated herein.

457. Said Defendants have unlawfully converted Plaintiffs and the class' funds, by obtaining the same through knowing misrepresentations made to Plaintiffs and the public.

458. Said Defendants continue to retain funds unlawfully converted from Plaintiff and the class.

459. In consequence of the foregoing, Plaintiff and the class sustained damages and losses.

COUNT XIX - VIOLATIONS OF MASSACHUSETTS SECURITIES LAW

(Against Defendants Merrill, Wanzeler, Labriola, Craft, Costa)

460. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if fully restated herein.

461. During the Class Period, Defendants Merrill, Wanzeler, Labriola, Craft, Costa, and others offered and sold securities to the Plaintiff and the putative class by means of a scheme and a continuous course of conduct to make materially false and misleading statements about the TelexFree investment dealings, financial condition and operations and to conceal adverse material information about these investments.

462. Said Defendants employed devices, schemes, and artifices to defraud, while in possession of material adverse non-public information and engaged in acts, practices, and courses of conduct, as alleged herein, including the following: (1) making or participating in the making of untrue statements of material facts; (2) omitting to state the material facts necessary to make the statements about the investments not misleading; and (3) engaging in transactions, practices, and a course of business which operated as a fraud and deceit upon investors during the Class Period.

463. Each of the said Defendants offered and sold securities by means of fraudulent misrepresentations and intentional omissions of material facts concerning the securities.

464. Defendants had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose such facts, even though such facts were available to them. Such misrepresentations and/or omissions were done knowingly or recklessly for the purpose and effect of concealing the true information about the investments, including their financial condition and operations.

465. Defendants received information reflecting the true facts regarding the

investment and TelexFree's business practices, exercised control over and/or receipt of the materially misleading misstatements and/or their association with the investment and made them privy to confidential proprietary information concerning these investments. Because of their control and/or association with the investment, Defendants were active and culpable participants in the fraudulent scheme.

466. Defendants knew and/or recklessly disregarded the falsity and misleading nature of the information that they caused to be disseminated to Investors.

467. The ongoing fraudulent scheme described herein could not have been perpetrated over a substantial period of time without the knowledge and complicity of the said Defendants.

468. As a result of the dissemination of materially false and misleading information and the failure to disclose material facts, as set forth above, Investors paid artificially inflated prices for worthless membership interests in the investment during the Class Period.

469. In ignorance of the materially false and misleading nature of the reports and statements described above, Plaintiff and the other Class members relied, to their detriment, on Defendants for complete and accurate information about these investments.

470. By virtue of the foregoing, Defendants have violated Section 410(a) of the Massachusetts Uniform Securities Act, M.G.L. c. 110A, and Plaintiff and the putative class have been damaged thereby, in an amount to be proven at trial.

COUNT XX - VIOLATION OF MASSACHUSETTS SECURITIES LAW

(Against Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Nehra,

Law Offices of Nehra and Waak, and Gerald P. Nehra, Attorney at Law, PLLC)

471. Plaintiff incorporates by reference the allegations contained in the preceding Paragraphs as if as fully restated herein.

472. At the time of the wrongs alleged herein, Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC, and others were each a controlling person, partner, officer, director, person occupying a similar status, or employee materially aiding in the sale of securities of TelexFree within the meaning of Section 410(b) of the Massachusetts Uniform Securities Act, M.G.L. c. 110A.

473. By reason of their respective positions of authority, Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC, and others had the power and authority to influence and control, and did influence and control, the decision-making and activities of TelexFree and the affiliated TelexFree entities and caused them to engage in the wrongful conduct described herein. Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, and Gerald P. Nehra, Attorney at Law, PLLC exercised control to cause the dissemination of false and misleading statements and omissions of material facts.

474. By virtue of their positions as controlling person and top-level promoters, and as a result of the aforementioned conduct, Defendants are liable under Section 20(a) of the Exchange Act.

475. Plaintiff seeks the award of actual damages on behalf of the Class.

WHEREFORE, Plaintiff, individually and behalf of the putative class, pray for the following:

- A) Certification of this action as a Class Action properly maintained pursuant to the Federal Rules of Civil Procedure and certifying Plaintiff and his counsel as the class representatives and class counsel;
- B) For an award to Plaintiffs and Class members of compensatory damages against Defendants for all damages sustained as a result of their wrongdoing, in an amount to be proven at trial, including interest;
- C) For an award of actual damages, compensatory damages, statutory damages, and statutory penalties, in an amount to be determined;
- D) For an award of punitive damages;
- E) For an award of costs of suit and attorneys' fees, as allowable by law;
- F) For an award of interest;
- G). For all other and further relief as may be just and proper under the circumstances including equitable relief.

DEMAND FOR JURY TRIAL

Plaintiff and the putative class hereby demand a jury trial of their claims to the extent authorized by law.

This 24th day of June, 2014.

TATE LAW GROUP, LLC

/s/ Mark A. Tate
Mark A. Tate
Georgia Bar No. 698820
tlgservice@tatelawgroup.com

2 East Bryan Street, Suite 600
Post Office Box 9060
Savannah, Georgia 31401
(912) 234-3030
(912) 234-9700 Fax

I. (a) PLAINTIFF(S)

Todd Cook, Individually and behalf of others similar situated

(b) COUNTY OF RESIDENCE OF FIRST LISTED PLAINTIFF
(EXCEPT IN U.S. PLAINTIFF CASES)

DEFENDANT(S)

Telexelectric, LLLP
Telex Mobile Holdings, Inc.;
James M. Merrill;
Carlos N. Wanzeler;
Steven M. Labriola;
Joseph H. Craft aka Joe H. Craft;
Craft Financial Solutions,LLC;
Carlos Costa;
Gerald P. Nehra, individually and dba Law Offices of Nehra and Waak;
Gerald P. Nehra Attorney at Law, PLLC;
Richard W. Waak, individually and dba Law Offices of Nehra and Waak;
Richard W. Walk, Attorney at Law, PLLC;
TD Bank, N.A.; Citizens Financial Group, Inc.;
Citizens Bank of Massachusetts; Fidelity Co-Operative Bank,
dba Fidelity Bank; Middlesex Savings Bank; Globel Payroll Gateway, Inc.;
International Payout Systems, Inc.; Propay, Inc. dba Propay.Com

COUNTY OF RESIDENCE OF FIRST LISTED DEFENDANT
(IN U.S. PLAINTIFF CASES ONLY)

NOTE: IN LAND CONDEMNATION CASES, USE THE LOCATION OF THE TRACT OF LAND INVOLVED

(c) ATTORNEYS (FIRM NAME, ADDRESS, TELEPHONE NUMBER, AND E-MAIL ADDRESS)

Mark A. Tate
Tate Law Group, LLC
2 East Bryan Street, Suite 600
Savannah, Georgia 31401
912-234-3030
tlgservice@tatelawgroup.com

ATTORNEYS (IF KNOWN)

II. BASIS OF JURISDICTION
(PLACE AN "X" IN ONE BOX ONLY)

- ☐ 1 U.S. GOVERNMENT PLAINTIFF
☐ 2 U.S. GOVERNMENT DEFENDANT
☐ 3 FEDERAL QUESTION (U.S. GOVERNMENT NOT A PARTY)
☒ 4 DIVERSITY (INDICATE CITIZENSHIP OF PARTIES IN ITEM III)

III. CITIZENSHIP OF PRINCIPAL PARTIES
(PLACE AN "X" IN ONE BOX FOR PLAINTIFF AND ONE BOX FOR DEFENDANT)
(FOR DIVERSITY CASES ONLY)

- | PLF | DEF | PLF | DEF |
|---------------------------------------|----------------------------|----------------------------|---------------------------------------|
| <input checked="" type="checkbox"/> 1 | <input type="checkbox"/> 1 | <input type="checkbox"/> 4 | <input type="checkbox"/> 4 |
| <input type="checkbox"/> 2 | <input type="checkbox"/> 2 | <input type="checkbox"/> 5 | <input checked="" type="checkbox"/> 5 |
| <input type="checkbox"/> 3 | <input type="checkbox"/> 3 | <input type="checkbox"/> 6 | <input type="checkbox"/> 6 |
- CITIZEN OF THIS STATE
CITIZEN OF ANOTHER STATE
CITIZEN OR SUBJECT OF A FOREIGN COUNTRY
INCORPORATED OR PRINCIPAL PLACE OF BUSINESS IN THIS STATE
INCORPORATED AND PRINCIPAL PLACE OF BUSINESS IN ANOTHER STATE
FOREIGN NATION

IV. ORIGIN (PLACE AN "X" IN ONE BOX ONLY)

- ☒ 1 ORIGINAL PROCEEDING
☐ 2 REMOVED FROM STATE COURT
☐ 3 REMANDED FROM APPELLATE COURT
☐ 4 REINSTATED OR REOPENED
☐ 5 TRANSFERRED FROM ANOTHER DISTRICT (Specify District)
☐ 6 MULTIDISTRICT LITIGATION
☐ 7 APPEAL TO DISTRICT JUDGE FROM MAGISTRATE JUDGE JUDGMENT

V. CAUSE OF ACTION (CITE THE U.S. CIVIL STATUTE UNDER WHICH YOU ARE FILING AND WRITE A BRIEF STATEMENT OF CAUSE - DO NOT CITE JURISDICTIONAL STATUTES UNLESS DIVERSITY)

28 U.S.C. Section 1332(d)2; 28 U.S.C. Section 1391; Sections 20(b), 20(d)(1) and 22(a) of the Securities Act of 1933 [15 U.S.C. Sections 77t(b), 77t(d)(1) & 77v(a); Sections 21(d)(1), 21(d)(3)(A), 21(e) and 27 of the Security Exchange Act of 1934 [15 U.S.C. Sections 78u(d)(1); 78u(d)(3)(A), 78u(e) and 78aa]; Section 1121 of the Lanham Act [15 U.S.C. Section 1121] and Section 1965 of the Racketeer Influenced and Corrupt Organizations Act [18 U.S.C. Section 1965]

(IF COMPLEX, CHECK REASON BELOW)

- | | |
|---|---|
| <input checked="" type="checkbox"/> 1. Unusually large number of parties. | <input type="checkbox"/> 6. Problems locating or preserving evidence |
| <input type="checkbox"/> 2. Unusually large number of claims or defenses. | <input type="checkbox"/> 7. Pending parallel investigations or actions by government. |
| <input checked="" type="checkbox"/> 3. Factual issues are exceptionally complex | <input type="checkbox"/> 8. Multiple use of experts. |
| <input type="checkbox"/> 4. Greater than normal volume of evidence. | <input type="checkbox"/> 9. Need for discovery outside United States boundaries. |
| <input type="checkbox"/> 5. Extended discovery period is needed. | <input type="checkbox"/> 10. Existence of highly technical issues and proof. |

CONTINUED ON REVERSE

FOR OFFICE USE ONLY

RECEIPT # _____	AMOUNT \$ _____	APPLYING IFP _____	MAG. JUDGE (IFP) _____
JUDGE _____	MAG. JUDGE _____ (Referral)	NATURE OF SUIT _____	CAUSE OF ACTION _____

CONTRACT - "0" MONTHS DISCOVERY TRACK

- ☐ 150 RECOVERY OF OVERPAYMENT & ENFORCEMENT OF JUDGMENT
☐ 152 RECOVERY OF DEFAULTED STUDENT LOANS (Excl. Veterans)
☐ 153 RECOVERY OF OVERPAYMENT OF VETERAN'S BENEFITS

CONTRACT - "4" MONTHS DISCOVERY TRACK

- ☐ 110 INSURANCE
☐ 120 MARINE
☐ 130 MILLER ACT
☐ 140 NEGOTIABLE INSTRUMENT
☐ 151 MEDICARE ACT
☐ 160 STOCKHOLDERS' SUITS
☐ 190 OTHER CONTRACT
☐ 195 CONTRACT PRODUCT LIABILITY
☐ 196 FRANCHISE

REAL PROPERTY - "4" MONTHS DISCOVERY TRACK

- ☐ 210 LAND CONDEMNATION
☐ 220 FORECLOSURE
☐ 230 RENT LEASE & EJECTMENT
☐ 240 TORTS TO LAND
☐ 245 TORT PRODUCT LIABILITY
☐ 290 ALL OTHER REAL PROPERTY

TORTS - PERSONAL INJURY - "4" MONTHS DISCOVERY TRACK

- ☐ 310 AIRPLANE
☐ 315 AIRPLANE PRODUCT LIABILITY
☐ 320 ASSAULT, LIBEL & SLANDER
☐ 330 FEDERAL EMPLOYERS' LIABILITY
☐ 340 MARINE
☐ 345 MARINE PRODUCT LIABILITY
☐ 350 MOTOR VEHICLE
☐ 355 MOTOR VEHICLE PRODUCT LIABILITY
☐ 360 OTHER PERSONAL INJURY
☐ 362 PERSONAL INJURY - MEDICAL MALPRACTICE
☐ 365 PERSONAL INJURY - PRODUCT LIABILITY
☐ 367 PERSONAL INJURY - HEALTH CARE/ PHARMACEUTICAL PRODUCT LIABILITY
☐ 368 ASBESTOS PERSONAL INJURY PRODUCT LIABILITY

TORTS - PERSONAL PROPERTY - "4" MONTHS DISCOVERY TRACK

- ☒ 370 OTHER FRAUD
☐ 371 TRUTH IN LENDING
☐ 380 OTHER PERSONAL PROPERTY DAMAGE
☐ 385 PROPERTY DAMAGE PRODUCT LIABILITY

BANKRUPTCY - "0" MONTHS DISCOVERY TRACK

- ☐ 422 APPEAL 28 USC 158
☐ 423 WITHDRAWAL 28 USC 157

CIVIL RIGHTS - "4" MONTHS DISCOVERY TRACK

- ☐ 441 VOTING
☐ 442 EMPLOYMENT
☐ 443 HOUSING/ ACCOMMODATIONS
☐ 444 WELFARE
☐ 440 OTHER CIVIL RIGHTS
☐ 445 AMERICANS with DISABILITIES - Employment
☐ 446 AMERICANS with DISABILITIES - Other
☐ 448 EDUCATION

IMMIGRATION - "0" MONTHS DISCOVERY TRACK

- ☐ 462 NATURALIZATION APPLICATION
☐ 465 OTHER IMMIGRATION ACTIONS

PRISONER PETITIONS - "0" MONTHS DISCOVERY TRACK

- ☐ 463 HABEAS CORPUS- Alien Detainee
☐ 510 MOTIONS TO VACATE SENTENCE
☐ 530 HABEAS CORPUS
☐ 535 HABEAS CORPUS DEATH PENALTY
☐ 540 MANDAMUS & OTHER
☐ 550 CIVIL RIGHTS - Filed Pro se
☐ 555 PRISON CONDITION(S) - Filed Pro se
☐ 560 CIVIL DETAINEE: CONDITIONS OF CONFINEMENT

PRISONER PETITIONS - "4" MONTHS DISCOVERY TRACK

- ☐ 550 CIVIL RIGHTS - Filed by Counsel
☐ 555 PRISON CONDITION(S) - Filed by Counsel

FORFEITURE/PENALTY - "4" MONTHS DISCOVERY TRACK

- ☐ 625 DRUG RELATED SEIZURE OF PROPERTY 21 USC 881
☐ 690 OTHER

LABOR - "4" MONTHS DISCOVERY TRACK

- ☐ 710 FAIR LABOR STANDARDS ACT
☐ 720 LABOR/MGMT. RELATIONS
☐ 740 RAILWAY LABOR ACT
☐ 751 FAMILY and MEDICAL LEAVE ACT
☐ 790 OTHER LABOR LITIGATION
☐ 791 EMPL. RET. INC. SECURITY ACT

PROPERTY RIGHTS - "4" MONTHS DISCOVERY TRACK

- ☐ 820 COPYRIGHTS
☐ 840 TRADEMARK

PROPERTY RIGHTS - "8" MONTHS DISCOVERY TRACK

- ☐ 830 PATENT

SOCIAL SECURITY - "0" MONTHS DISCOVERY TRACK

- ☐ 861 HIA (1395ff)
☐ 862 BLACK LUNG (923)
☐ 863 DIWC (405(g))
☐ 863 DIWW (405(g))
☐ 864 SSID TITLE XVI
☐ 865 RSI (405(g))

FEDERAL TAX SUITS - "4" MONTHS DISCOVERY TRACK

- ☐ 870 TAXES (U.S. Plaintiff or Defendant)
☐ 871 IRS - THIRD PARTY 26 USC 7609

OTHER STATUTES - "4" MONTHS DISCOVERY TRACK

- ☐ 375 FALSE CLAIMS ACT
☐ 400 STATE REAPPORTIONMENT
☐ 430 BANKS AND BANKING
☐ 450 COMMERCE/ICC RATES/ETC.
☐ 460 DEPORTATION
☐ 470 RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS
☐ 480 CONSUMER CREDIT
☐ 490 CABLE/SATELLITE TV
☐ 891 AGRICULTURAL ACTS
☐ 893 ENVIRONMENTAL MATTERS
☐ 895 FREEDOM OF INFORMATION ACT
☐ 950 CONSTITUTIONALITY OF STATE STATUTES
☐ 890 OTHER STATUTORY ACTIONS
☐ 899 ADMINISTRATIVE PROCEDURES ACT / REVIEW OR APPEAL OF AGENCY DECISION

OTHER STATUTES - "8" MONTHS DISCOVERY TRACK

- ☐ 410 ANTITRUST
☒ 850 SECURITIES / COMMODITIES / EXCHANGE

OTHER STATUTES - "0" MONTHS DISCOVERY TRACK

- ☐ 896 ARBITRATION
(Confirm / Vacate / Order / Modify)

*** PLEASE NOTE DISCOVERY TRACK FOR EACH CASE TYPE. SEE LOCAL RULE 26.3**

VII. REQUESTED IN COMPLAINT:

☒ CHECK IF CLASS ACTION UNDER F.R.Civ.P. 23 DEMAND \$ _____

JURY DEMAND ☒ YES ☐ NO (CHECK YES ONLY IF DEMANDED IN COMPLAINT)

VIII. RELATED/REFILED CASE(S) IF ANY

JUDGE _____ DOCKET NO. _____

CIVIL CASES ARE DEEMED RELATED IF THE PENDING CASE INVOLVES: (CHECK APPROPRIATE BOX)

- ☐ 1. PROPERTY INCLUDED IN AN EARLIER NUMBERED PENDING SUIT.
☐ 2. SAME ISSUE OF FACT OR ARISES OUT OF THE SAME EVENT OR TRANSACTION INCLUDED IN AN EARLIER NUMBERED PENDING SUIT.
☐ 3. VALIDITY OR INFRINGEMENT OF THE SAME PATENT, COPYRIGHT OR TRADEMARK INCLUDED IN AN EARLIER NUMBERED PENDING SUIT.
☐ 4. APPEALS ARISING OUT OF THE SAME BANKRUPTCY CASE AND ANY CASE RELATED THERETO WHICH HAVE BEEN DECIDED BY THE SAME BANKRUPTCY JUDGE.
☐ 5. REPETITIVE CASES FILED BY PRO SE LITIGANTS.
☐ 6. COMPANION OR RELATED CASE TO CASE(S) BEING SIMULTANEOUSLY FILED (INCLUDE ABBREVIATED STYLE OF OTHER CASE(S)):

- ☐ 7. EITHER SAME OR ALL OF THE PARTIES AND ISSUES IN THIS CASE WERE PREVIOUSLY INVOLVED IN CASE NO. _____, WHICH WAS DISMISSED. This case ☐ IS ☐ IS NOT (check one box) SUBSTANTIALLY THE SAME CASE.

/s/ Mark A. Tate

6/24/14

SIGNATURE OF ATTORNEY OF RECORD Mark A. Tate

DATE

EXHIBIT D

1

CLASS ACTION COMPLAINT

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VI. CLAIMS FOR RELIEF77

A. First Claim For Relief For Violations Of Section 10(b) Of The Securities

iii

iv

v

VII. CONCLUSION110

I.

6. TelexFree was a fraudulent investment operation. TelexFree's standard form contract and uniform marketing ommitted material facts and misrepresented other material fcats. TelexFree based the returns it promised to pay its investors solely on new capital paid to it by new investors. It did not earn a penny profit from its sale of VOIP product. TelexFree uniformly and through its standaard adds and marketing programs enticed new investors by offering higher returns than any other investments. TelexFree promised short-term returns that were abnormally high and unusually consistent.

2

sales of TelexFree VOIP alone;

- b. the sale of promoter memberships accounted for over 99 % of Telexfree's income;
- c. TelexFree Promoters were guaranteed compensation in exchange for recruiting other investors to pay the membership fees.

14. Defendants also concede that between August 2012 and March 2014:

- a. less than one-half of one percent of TelexFree's total revenue came from sales of TelexFree's VOIP;
- b. TelexFree received approximately \$1.3 million from the sale of about 26,300 VoIP Programs;
- c. TelexFree promised to pay Promoters returns of over \$1.1 billion⁴;
- d. TelexFree had 783,771 investments of either \$289.00 or \$1,375.00 totaling \$880,189,455.32.

15. TelexFree's scheme constitutes an unlawful pyramid scheme in large part because the proceeds from the sale of TelexFree's VoIP products alone could not possibly sustain the massive pay structure. TelexFree did not generate sufficient funds from sales of their phone service to pay the returns on investments that they had contracted to pay. Instead, the funds TelexFree used to pay the purported returns on investments were the principal investment funds (membership fees) tendered by subsequent TelexFree investors

16. To keep TelexFree's Pyramid Ponzi Scheme liquid, a constant influx of new participants was required, and, true to a Pyramid Ponzi Scheme, new investments would often pay older investors.

⁴ \$1.1 billion is approximately one thousand times the amount of revenue derived from sales of the VoIP Programs.

19. Plaintiffs also make the following allegations upon information and belief and the investigation of their counsel, except on their own actions and the facts that are a matter of public record:

II.

JURISDICTION AND VENUE

20. The District Court has original jurisdiction pursuant to 28 U.S.C. § 1332(d)(2). In the aggregate, Plaintiffs' claims and the claims of the other members of the Class exceed \$5,000,000.00 exclusive of interest and costs, and there are numerous Defendants who are citizens of states other than Plaintiff Reverend Jeremiah Githere's state of citizenship, which is Massachusetts.

21. The District Court has original subject-matter jurisdiction over the federal claims in this action pursuant to 28 U.S.C. 1331.

22. The District Court also has jurisdiction over this action under Sections 20(b), 20(d)(1) and 22(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77t(b),

⁵ Brazilian Court Suspends TelexFree's Operations, Behind MLM (June 20, 2013), <http://behindmlm.com/companies/telexfree/brazilian-court-suspends-telexfree-operations/>.

a. Defendants Merrill, Labriola, John Merrill, Vasconcelos, De La Rosa and certain other Defendants including WWW Global Business, Inc. reside in this district;

c. Multiple Defendants are subject to personal jurisdiction in this district⁷;

25. Venue is proper under Section 1965 of the Racketeer Influenced and Corrupt Organizations Act [18 U.S.C. § 1965], as the Defendants reside, have agents, or otherwise get business material to this Complaint in this district.

⁷ On April 13, 2014, related entities TelexFree, LLC, TelexFree, Inc. and TelexFree Financial, Inc. sought bankruptcy protection in Nevada (See United States Bankruptcy Court, District of Nevada, Case No.: BK-S-14-12524-ABL). On May 6, 2014, The United States Bankruptcy Court, District of Nevada ordered that “all the debtor’s [TelexFree’s] jointly administered cases are transferred to the U.S. Bankruptcy Court, District of Massachusetts, Central Division.

26. With respect to the state law claims, this Court has jurisdiction under 28 U.S.C. § 1367 and principles of pendent jurisdiction.

III.

THE PARTIES

A. Plaintiffs

27. Plaintiff Reverend Jeremiah Githere, (“Shik Reverend Githere”, “Plaintiff” or Putative Class Representative”) is an individual who resides in Massachusetts. Reverend Githere tendered valid consideration for membership(s) in TelexFree (a “TelexFree Membership”) and its promised return in investment and suffered ascertainable economic loss.

28. Plaintiff Joseph Shikhman (“Shikhman”, “Plaintiff” or Putative Class Representative”) is an individual who resides in New York. Shikhman tendered valid consideration for TelexFree Membership(s) and its promised return on investment and suffered ascertainable economic loss.

29. Plaintiff Christopher McCormick (“McCormick”, “Plaintiff” or Putative Class Representative”) is an individual who resides in Georgia. McCormick tendered valid consideration for TelexFree Membership(s) and its promised return on investment and suffered ascertainable economic loss.

B. TelexFree Defendants

i. TelexFree Companies⁸

⁸ Three TelexFree related entities have filed for bankruptcy and are not named. TelexFree, Inc. is a corporation duly organized and existing under the laws of the Commonwealth of Massachusetts, having a last known principal place of business at 225 Cedar Hill Street, Suite 200, in Marlborough, County of Middlesex, Commonwealth of Massachusetts 01752. TelexFree, LLC is a limited liability company duly organized and existing under the laws of Nevada, having a purported place of business at 4705 S. Durango Drive, #100-J51 (a post office box in an unnamed Indian bodega), Las Vegas, Nevada 89147. TelexFree, LLC also

32. Disc Martix is a d/b/a/ of Defendants James Merrill and Carlos Wanzeler that they operated from their offices in 225 Cedar Hill Street, Suite 200, in Marlborough, County of Middlesex, Commonwealth of Massachusetts 01752. Merrill and Wanzeler formed Disk Matrix after Brazilian authorities shut down TelexFree Brazil.

ii. Owners, Officers and Directors and Various Businesses Associated with those Individuals

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36. Steven M. Labriola (“Labriola”) is an individual with a last known usual place of abode located at 21 Kiwanis Beach Road, in Upton, County of Worcester, Commonwealth of Massachusetts 01568. Labriola is identified as a Director of Common Cents Communications, Inc. in its filed Articles of Incorporations with the Massachusetts Secretary of State Office. Labriola also functions as the International sales Director of TelexFree. Labriola

¹⁰ Wanzeler was Treasurer and Director of TelexFree, Inc. and Manager of TelexFree, LLC. Wanzeler was Vice-President, Treasurer, and Director of TelexFree Financial and was listed with the Massachusetts Secretary of State Corporations Division as an authorized person to execute, acknowledge, deliver, and record any recordable instrument purporting to affect an interest in real property.

was also an integral part of Disk Matrix in New York. Labriola has never registered with the Commonwealth of Massachusetts as a broker or dealer of securities.

37. Joseph “Joe” H. Craft (“Craft”) is an individual with a last known usual place of abode located at 333 W. Tennyson Road, Boonville, Indiana 47601certified At times material to this complaint, Craft served as the Chief Financial Officer of TelexFree Inc. and TelexFree, LLC. Craft was also hired to serve as TelexFree, LLC’s Chief Financial Officer on or before December, 2013.¹¹ Craft has never registered with the Commonwealth of Massachusetts as a broker or dealer of securities.

38. John F. Merrill is an individual with a last known usual place of abode located at 7 Kinnicutt Rd. Worcester, MA 01602-1528. John Merrill serves as President of Fidelity Bank. John Merrill is the brother of TelexFree founder and owner James M. Merrill and at all times acted in concert with him and provided him with advise and encouragement related to TelexFree’s unlawful operation.

39. Carlos Costa (“Costa”) is an individual with an as yet uncertain last known place of abode in Worcester, County of Worcester, Commonwealth of Massachusetts 01604. Costa was listed as Manager of TelexFree, LLC with the Massachusetts Secretary of State Corporations Division. Costa has never registered with the Commonwealth of Massachusetts as a broker or dealer of securities

40. Paralegal Doe served as TelexFree, LLC’s agent, servant or employee to this complaint. She is identified at this time only by an email address. Paralegal Doe served as TelexFree’s person on the ground and administrator in Las Vegas, Nevada.

iii. Insider Promoters including Insider Promoter Does 1-63

¹¹ See Omnibus Declaration of William H. Runge, Case 14-1552-abl, Doc. 13, ¶ 31, Exhibit 6. This was prior to the appointment of TelexFree Trustee Darr. Exhibit 7

44. Insider Promoter Randy N. Crosby (“Crosby”) is an individual with a last known usual place of abode located at 30 Club Court, in Alpharetta, Georgia 30005. Crosby appears in internet videos promoting TelexFree and is one of TelexFree’s most successful

promoters, having recruited numerous other Promoters/Investors for Telexfree – especially through a website known as “everybodygetspaidweekly.biz”. Crosby has never registered with the Commonwealth of Massachusetts or with any other authority anywhere in the world as a broker or dealer of securities.

45. Insider Promoter Faith R. Sloan (“Sloan”) is an individual with a last known usual place of abode located at 515 E. End Avenue, Unit 105, in Calumet City, Illinois 60409. Sloan appears in internet videos promoting TelexFree, and is one of TelexFree’s most successful Promoters, having recruited numerous Promoters/Investors for Telexfree – especially through a website known as “telexfreepower.com”. Sloan has never registered with the Commonwealth of Massachusetts or with any other authority anywhere in the world as a broker or dealer of securities.

iv. Attorneys

46. Retained Licensed Professional (“RLP”) Gerald P. Nehra (“Nehra”) is an individual with a last known usual place of abode located at 1322 Peck St, Muskegon, MI 49441. Nehra maintains a second last known place of abode at 2149 Tall Oak Court, Sarasota, Florida 34232. Nehra is sued individually, as a lawyer and as a member of law firms referenced herein.

37. RLP Nehra is an attorney duly licensed to practice law in the State of Michigan with offices at 1710 Beach Street in Muskegon, Michigan 49441. Nehra is the sole member, manager, and registered agent for defendant

38. Retained Licensed Professional Gerald P. Nehra, Attorney at Law, PLLC, a professional limited liability company engaged in the practice of law and duly organized and

37. RLP Waak is an attorney duly licensed to practice law in the State of Michigan with offices at 11300 East Shore Drive, Delton, Michigan 49046. Waak is the sole member, manager and registered agent for

39. Retained Licensed Professional Law Offices of Nerha and Waak is a law firm with usual places of business located at 11300 East Shore Drive, Delton, Michigan 49046, and 1710 Beach Street, in Muskegon, Michigan 49441. The Law Offices of Nehra and Walk is a general partnership between Defendants Nehra, Waak, Gerald P. Nehra, Attorney at Law, PLLC, and Richard W. Waak, Attorney at Law, PLLC.

40. Retained Licensed Professional Joseph H. Craft is certified public accountant who maintains regular places of business located at 333 W. Tennyson Road, Boonville, Indiana 47601 and 825 E. Main Street, Boonville, Indiana 47601-1885. Craft is sued individually, as a lawyer and as a member or owner of the accounting businesses referenced herein. Also as an officer of TelexFree entities as set forth above.

43. Retained Licensed Professional Financial Solutions, LLC (“Craft Financial”) is a limited liability company duly organized and existing under the laws of Indiana, with a principal place of business at 825 E. Main Street in Boonville, Indiana 47601-1885. Craft Financial is engaged in the business of providing accounting services and financial advice. Defendant Joseph H. Craft is the sole member, manager, and registered agent of defendant Craft Financial.

C. Financial Institution Defendants

i. Banks

44. Fidelity Co-operative Bank doing business as Fidelity Bank, (“Fidelity Bank”) is a Massachusetts Chartered Banking Institution, having its principal offices at 675 Main Street, in Fitchburg, County of Worcester, Commonwealth of Massachusetts 01420. At all times material herein, Defendant Fidelity Bank provided banking services, maintained accounts, and received transfers of funds from or for the benefit of TelexFree after they knew of the findings of the Brazilian Court in Acre issued and the June 19, 2013 Injunction.

45. Middlesex Savings Bank (“Middlesex Savings”) is a Massachusetts Chartered Banking Institution, having its principal offices at 6 Main Street, in Natick, County of Middlesex, Commonwealth of Massachusetts 01760. At all times material herein, Defendant

¹² See Omnibus Declaration of William H. Runge, Case 14-1552-abl, Doc. 13, ¶ 31, Exhibit 6. Runge served as TelexFree's Chief Restructuring Officer prior to the appointment of TelexFree Trustee Darr. Exhibit 7

50. Citizens Bank of Massachusetts (“Citizens Bank”) is a subsidiary of Citizens Financial and conducts business in the Commonwealth of Massachusetts at 28 State Street, in Boston, County of Suffolk, Commonwealth of Massachusetts 02109. At all times material herein, Defendant Citizens Bank provided banking services, maintained accounts, and received transfers of funds from or for the benefit of TelexFree after they knew of the findings of the Brazilian Court in Acre issued and the June 19, 2013 Injunction.

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53. Global Payroll Gateway, Inc. (“GPG”) is a corporation duly organized and existing under the laws of the State of California, having its principal offices at 18662 MacArthur Boulevard, Suite 200, in Irvine, California 92612. GPG provided payment processing services for companies and acted as a conduit for payment between TelexFree and its Promoters/Investors even after they knew of the findings of the Brazilian Court in Acre issued and the June 19, 2013 Injunction.

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55. Propay, Inc. (“ProPay”) is a corporation duly organized and existing under the laws of the State of Utah with its principal offices at 3400 North Ashton Boulevard, Lehi, Utah 84043 and also does business as PROPAY.COM. ProPay provided provided payment processing services for companies and acted as a conduit for payment between TelexFree and its Promoters/Investors even after they knew of the findings of the Brazilian Court in Acre issued and the June 19, 2013 Injunction.

56. Base Commerce, LLC (“Base Commerce”) is a limited liability company duly organized and existing under the laws of the State of Arizona with its principal offices at 7910 S. Kyrene Road, Suite 106, Tempe, Arizona 85284, and it also does business as Phoenix Payments. Base Commerce provided provided payment processing services for companies and acted as a conduit for payment between TelexFree and its Promoters/Investors even after they knew of the findings of the Brazilian Court in Acre issued and the June 19, 2013 Injunction.

57. Vantage Payments, LLC (“Vantage Payments”) is a limited liability company duly organized and existing under the laws of the State of Arizona, having its principal offices at 8300 N. Hayden Road #A207, Scottsdale, Arizona 85251. Defendant Vantage Payments provided payment processing services for companies and acted as a conduit for payment between TelexFree and its Promoters/Investors even after they knew of the findings of the Brazilian Court in Acre issued and the June 19, 2013 Injunction.

58. It is believed that additional payment – processing services aided and abetted in TelexFree’s Pyramid Ponzi Scheme by providing payment processing services for companies and acted as a conduit for payment between TelexFree and its Promoters/Investors even after they knew of the findings of the Brazilian Court in Acre issued and the June 19, 2013

IV.

A. Securities Defined

64. The United States Securities Exchange Act of 1934 defines a security as: "Any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

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89. TelexFree and the other Defendants willfully or knowingly established a pyramid-type Ponzi scheme. TelexFree and the other Defendants paid certain investors, including the Insider Promoters and Doe Insider Promoters unlawful, pyramid scheme returns on investment while wrongfully causing the Plaintiffs and similarly situated members of the class to suffer ascertainable economic loss in an amount in excess of \$300 million.

90. TelexFree and its Officers James M. Merrill, Carlos N. Wanzeler, Steven M. Labriola, Carlos Costa, Joseph H. Craft, a/k/a Joe H. Craft (collectively, “Defendant Officers”), Sanderley Rodrigues de Vasconcelos; WWW Global Business, Inc.; Santiago de La Rosa; Randy N. Crosby; Faith R. Sloan (collectively sometimes referred to as the “Named Insider Promoters”), the Doe Insider Promoters, TelexFree’s retained licensed professionals¹⁶ including the Attorney Defendants, Paralegal Doe, Banking Institution Defendants¹⁷, Investment Service Provider Defendants¹⁸ and Payment Processing Services Companies¹⁹ knew that the Pyramid

¹⁹ Global Payroll Gateway Inc., International Payout Systems, Inc., Propay, Inc., doing business as Propay.com, Base Commerce, LLC, doing business as Phoenix Payments, and Vantage Payments, LLC are referred to herein as “Payment Process Services Companies” or “PPSC

141. At least between February 15, 2012 and approximately April 15, 2014, TelexFree, LLC's registered agent for the Commonwealth of Massachusetts was James Merrill whose address is identified as 225 Cedar Hill St. Suite 200, Marlborough, MA 01752.

143. TelexFree caused a copy the Business Entity Summary for TelexFree, LLC to be filed with the Corporations Division of the Secretary of the Commonwealth of Massachusetts.

145. Tens of millions of additional investor funds received by TelexFree are unaccounted for.

146. TelexFree, Inc.²⁴, of which co-defendants Merrill and Wanzeler are officers and directors, is a domestic profit corporation registered with the Corporations Division of the Secretary to the Commonwealth of Massachusetts (Identification Number 000832397).

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149. Co-Defendant Joseph H. Craft incorporated TelexFree Financial on December 26, 2013.

151. At all material times, Co-Defendants James M. Merrill and Carlos N. Wanzeler are officers and directors of TelexFree Financial, and Co-Defendant Carlos N. Wanzeler is its registered agent.

153. On April 14, 2014, Defendants TelexFree, Inc., TelexFree, LLC and TelexFree Financial, Inc. abruptly sought bankruptcy protection in Nevada under Chapter 11, admitting that they cannot meet their obligations from VoIP revenues, and sought authority to reject all their current obligations to Promoters.

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I. Relationship Between Defendants TelexFree Mobile Holding, Inc. and TelexElectric, LLP's and TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc.

154. At least since February 15, 2012, there has been a high degree of operational interdependence among all the TelexFree entities and the individuals who acted as Operators for them. The operations of these entities, and the individual actions of the Operators to line their own individual pockets are indistinguishable.

155. All shared common management and ownership and physical location of their operations right down to stamps, phone lines and copy paper. The TelexFree entities have also shared common financial, strategic, legal, and human resources.

156. Since February 15, 2012, Defendants Merrill, Wanzeler, Labriola, Craft and Costa have together owned and operated the TelexFree entities with no distinction among these entities.

157. At least between February 15, 2012 and approximately April 15, 2014, funds were freely transferred between the TelexFree entities with no distinction among these entities.

158. Between February 15, 2012 and at least April 15, 2014, the TelexFree entities have.

- a. Conducted business from the same business addresses;
- b. Retained the same employees;
- c. Conducted business using the same telephone lines;
- d. Utilized the same copy machines in business;
- e. Utilized the same banks and bank accounts in business;
- f. Utilized the same payment processing services companies in business;
- g. Sought and received professional services from the same accountants; and
- h. Sought and received professional services from the same attorneys.

Vontade”), TelexFree rebranded Disc A Vontade’s VoIP Program, offering it for a flat monthly fee of \$49.90.

180. Unlike Disk A Vontade operations, however, TelexFree coupled the VoIP Program with the wildly lucrative and fraudulent scheme (the “Passive Income Scheme”).

181. The core of the Passive Income Scheme centers on the investment of either \$289.00 or \$1,375.00.

182. The “AdCentral” program costs \$289.00 (plus a fifty dollar membership), for a one year contract. Promoters under this program received ten one-month packages of the VoIP service and had to place one internet advertisement a day. For every week where they placed these advertisements, they received one additional VoIP package and were promised a weekly payment of \$20 (\$1040 for the entire year), a 207% return on the original investment.

183. The “AdCentral Family” program costs \$1375.00 (plus the \$50 membership fee) for a one-year contract. Promoters in this program received fifty one-month VoIP packages and had to post five advertisements on the internet daily. Those who posted the advertisements received a five addition VoIP packages and a promised weekly payment of \$100 (\$5,200 over the year), an annual return of 265%.

184. The TelexFree advertisement kit enables participants to generate a return by posting pre-written advertisements, to pre-determined websites, through an automated TelexFree system.

185. A participant's daily use of the advertisement kits generates investment returns with no VoIP Program sales.

186. As testified to, posting advertisements is an effortless process that takes only a few minutes per advertisement.

193. Hidden among TelexFree's bonus structure and recruitment commissions is that TelexFree participants may self-qualify for sales and commissions.

195. TelexFree's revenue from sales of VoIP Programs sales alone is inadequate to satisfy participant returns. During telexfree's scheme, revenue from sales of VoIP Programs has constituted only a tiny fraction of TelexFree's revenue and funds promised to Promoters.

197. According to the SEC, during this period, TelexFree promised to pay Promoters returns of over \$1.1 billion – nearly a thousand times the revenue derived from sales of the VoIP Programs – an amount TelexFree has not produced in revenue.

199. Net revenue received by TelexFree from VoIP Program sales was significantly less due to substantial commission payments.

acceptance of new investments and paying any returns owed on existing affiliate investments.”³⁰

233. In addition, following a court order in Brazil by Judge Borges for Telexfree to turn over “data relating to the registration and operation of the accounts of each of the affiliates, including twelve months of retroactive data”, Telexfree claimed they had no access to registrations and transfers accounts of the promoters of the company. This claim is in direct contention with an internet video in which Costa is surrounded by stacks of books which he claims hold the requested affiliate data.³¹

M. Collapse of Telexfree's United States' Operations

234. Over two years of operations, TelexFree has employed multiple financial accounts, including domestic and international bank accounts and various online payment processors, to facilitate the fraudulent offer or sale of securities in the Commonwealth of Massachusetts.

235. Almost all financial institutions have eventually terminated their relationship with TelexFree as their operations have become a risk that financial institutions are no longer willing to bear.

236. Recently, frantic emails between TelexFree management and financial institutions paint an entirely bleak picture of continuing TelexFree financial operations.

237. As described by one financial institution, “[n]o US Bank or Processor . . . will accept your [TelexFree] business given that you are on month five of the Visa Chargeback monitoring program. You are one of only three merchants in the USA on month five so you

30 *Id.*

³¹ See “TelexFree claim no affiliate data, fined again” Behind MLM (Jan. 1, 2014) (explaining Judge Borges’ request and Telexfree’s contentious response).

245. In furtherance of their unlawful enterprise, TelexFree mailed fraudulent and inaccurate 1099 (Miscellaneous Income) forms to investors, possibly to create the illusion they had made payments to investors when no such payments were made.

247. TelexFree falsely represented that investors had received income they had not received.

249. The other Defendants knew that TelexFree was an illegal Pyramid Ponzi Scheme which involved the illegal sale of securities, but continued to aid, abet and further such illegal activities. Despite the foregoing knowledge, TelexFree and the other Defendants continued to participate in the attraction and processing of new investors, continued to allow payments to process through TelexFree's accounts, allowed TelexFree to continue to illegally sell securities and further its illegal Pyramid Ponzi Scheme, and otherwise continued to further TelexFree's illegal activities.

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252. Also on April 15, 2014, the U.S. Securities and Exchange Commission (sometimes referred to as the “SEC”) filed a civil Complaint and Jury Demand against TelexFree, Inc. and TelexFree, LLC and Merrill, Wanzeler, Labriola, Craft, Rodrigues, De La Rosa, Crosby, and Sloan, alleging violations of the Securities Act of 1933, the Securities Exchange Act of 1934, and SEC Regulations.³⁷¹ The SEC requested and was granted a preliminary injunction and an order freezing assets of TelexFree. The SEC is also seeking disgorgement of profits and additional civil penalties.

254. During this raid by the FBI and DHS, the Defendant, Craft, was caught by federal agents attempting to leave the building with a laptop and approximately \$38 million in cashier's checks in a bag, to abscond with ill-gotten funds.

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258. During hearings, conducted on May 2, 2014, William H. Runge, III, Chief Restructuring Officer of TelexFree, estimated that, as of TelexFree's Bankruptcy filing, TelexFree had assets of \$31 million in its bank accounts, \$28 million in brokerage accounts, and nearly \$30 million held by payment processing companies.

259. Defendants Merrill, Wanzeler, Labriola, Craft and Costa (sometimes collectively as the “Defendant Officers” or “TelexFree’s Management”) were responsible for the control and operation of TelexFree and its affiliated entities.

261. Defendant Merrill served as the President, Secretary, and Director of TelexFree, Inc., a Manager of TelexFree, LLC, President, Secretary and Director of TelexFree Financial, General Partner of TelexElectric, and President, Secretary and Director of Telex Mobile Holdings

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273. More particularly, Wanzeler exercised significant control over the TelexFree Pyramid Ponzi Scheme.

274. Defendant Wanzeler has also participated in marketing TelexFree to potential investors, appearing in videos posted to the Internet in which he can be seen promoting TelexFree as a revenue opportunity for Promoters.⁴⁰⁷ Among the other material misrepresentations made by TelexFree and its Defendant Officers include a website photograph of Merrill standing in front of a building in Marlborough, Massachusetts, with the caption “*Mr. Merrill in front of the headquarters of TelexFree in the USA*”, when they only occupied one suite which they shared with 28 other companies. Merrill further misrepresented, in a press release on March 21, 2014, that TelexFree had “*been in VoIP telecommunications for more than a decade.*”

275. Defendant Labriola, served as the International Marketing Director for TelexFree, Inc.

276. Labriola was one of the original Directors of Common Cents Communications, Inc., and at all material times exercised significant control over TelexFree's business operations and the operations of its interrelated companies.

277. Defendant Labriola has also appeared in several videos promoting TelexFree posted on the internet, and has acted as TelexFree's spokesman to Investors during post-bankruptcy petition conference calls.

278. As a Director of TelexFree, Inc., Defendant Labriola, has exercised significant control over the TelexFree Pyramid Ponzi Scheme.

279. As International Marketing Director for TelexFree, Inc., Labriola has also actively and knowingly perpetrated the TelexFree fraud through the dissemination of false and misleading advertising and marketing communications.

315. The Attorney Defendants had actual knowledge that the TelexFree Business Model was a fraudulent Pyramid Ponzi Scheme.

317. Attorney Nehra counseled TelexFree on methods to evade United States securities laws intended to offer, in part, protection from Pyramid Ponzi schemes; all to enrich himself financially and serve his own selfish interests.

319. Defendant Nehra accomplished this by representing that his extensive experience as an MLM expert and his thorough research of TelexFree's business model allowed him to form a legal opinion that TelexFree was a legitimate business.

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340. In addition Attorney Nehra assured Investors and potential Investors that, in his professional opinion, the TelexFree business model was legitimate and lawful, even though Attorney Nehra had knowledge of the ruling of the Brazilian Court and knowledge of and access to TelexFree's United States operations and their composition.

- a. TelexFree used the exact same business model in Brazil as they do in the United States and throughout the world;
- b. The Brazilian court had made a finding of fraud and that TelexFree's United States operations and composition was an unlawful venture;
- c. The Brazilian court described Telex business operations in terms of the quintessential pyramid scheme after TelexFree's own lawyers unwittingly admitted as much;
- d. TelexFree's lawyer Djacir Falcão stated to the Brazilian court that if the injunction continues the company may enter into bankruptcy: *"Running the company really becomes difficult because of the court decision, so we will appeal,"* said Falcão⁴⁹;

telephone accounts called 99TELEXFREE. The PARTNER, upon acquiring them in the form of a kit (ADCENTRAL or FAMILY kit) assumes the title of PROMOTER and, as such, receives a space on the site www.telexfree.com to promote the products/services that he has acquired. He also receives training and access to materials also made available on the TELEXFREE website so that he can undertake to promote the latter and avail himself of the opportunity to be a PARTNER and PROMOTER to others in his circle of relationships. All activities are performed by the PARTNER/PROMOTER without any employment relationship, and they are able individually to manage the team and the resources it seeks to make available for such purpose, of their own free will. For the promotion of products/services he will receive a bonus in direct proportion to his results, based on the levels explained in a separate section in these GENERAL REGULATIONS.

⁴⁹ Upon information and belief based upon quote in the newspaper Rio Branco, Tribuna da Bahia so reported.

- e. Falcão tried to appeal to the Brazilian judges because “*should the company spend a few more days being prohibited from signing up new investors, they would have no money to pay the old ones;*”
- f. A Brazilian judge rejected this argument and denied TelexFree’s injunction appeal;
- g. TelexFree’s other appeals were rejected by the Brazilian courts;
- h. One Brazilian judge remarked that the issue is that the earnings will be exhausted when the main source of revenue of the group (new affiliate registrations) stops;
- i. The above scenario is typically the result of a pyramid scheme;
- j. Judge Samoel Evangelista, 2nd Civil Chamber of the Court of Acre (TJ-AC), entered an order to keep the TelexFree funds frozen, to block future payments to TelexFree in Brazil and to enjoin TelexFree from signing on new investors in Brazil;
- k. According to Brazilian Judge Thais Kalil, how TelexFree earnings are paid out was advantageous to the prosecutor’s argument, in that adding publishers to the network is of more importance than trying to sell the VoIP product;
- l. Judge Thais Kalil also wrote that “*(t)he issue is that the earnings will be exhausted when the main source of revenue of the group (new affiliate registrations) stops. Many (affiliates) do not even have the opportunity to recover their initial investment (minimum U.S. \$339) and this is detrimental.*”

342. Defendant Nehra's own comments clarify that he knew that TelexFree was an unlawful pyramid Ponzi scheme.

343. Defendant Nehra knew to his providing legal opinions and counsel at the request of TelexFree that TelexFree's conduct constituted a breach of duty to its Investors.

345. Defendant Nehra knew to his providing legal opinions at the request of TelexFree that TelexFree intended to use Nehra prominently as a marketing tool on both their localized Brazilian (Portuguese) and Spanish (Spanish) website portals, in an effort to make TelexFree's illegal Pyramid Ponzi Scheme appear legitimate, continuing and perpetuating the ongoing fraud.

347. The Defendant Nerha and the other Attorney Defendants know these legal opinions were false, and these false opinion were used by TelexFree to promote and perpetuate TelexFree's illegal Pyramid Ponzi Scheme.

349. Defendant Nehra gave substantial assistance to TelexFree in accomplishing a tortious and illegal result, and Nehra's own conduct, separately considered, constitutes a breach of duty to Investors since he:

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350. As the Chief Financial Officer of TelexFree, Inc. and TelexFree, LLC, Defendant Craft, also known as Joe H. Craft, has been a certified public accountant and served as the Chief Financial Officer (“CFO”) of Telex Free, Inc. and TelexFree, LLC.

⁵⁰ As stated by Justice William O. Douglas, “just as a fine natural football player needs coaching in the wiles of the sport, so, too, it takes a corporation lawyers with a heart for the game to organize a great stock swindle or income tax dodge and drill the financiers in all the precise details of their play.” William O. Douglas, “*Directors Who Do Not Direct*,” 47 Harv.L.Rev. 1305, 1329 (1934).

- a. Overseeing TelexFree's creation of falsified accounting records;
- b. Failing to ensure that GAAP accounting methods were adopted and adhered to;
- c. Fraudulently certifying TelexFree's business operations and accounting practices as good and lawful, despite actual knowledge of their unlawful and illegitimate nature; and
- d. Conspiring with TelexFree's Officers to structure and perpetuate an illegal pyramid Ponzi scheme designed to defraud Investors and enrich themselves.

363. Defendants Craft and Craft Financial authorized TelexFree to provide Investors with inaccurate and fraudulent 1099 (Miscellaneous Income) forms, in many cases long after the January 31, 2014 required deadline, and to misrepresent payments made to Investors and conceal assets.

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- entities and Management, in telexfree’s fraudulent business, despite knowledge of the fraudulent nature of TelexFree’s business enterprise; and
- d. Otherwise enabling the TelexFree Pyramid Ponzi Scheme to expand and continue by providing necessary financial services to TelexFree, despite actual knowledge of fraud by TelexFree.

368. Defendants Bank of America, Bank of America, N.A., TD Bank, Citizens Financial, Citizens Bank, Fidelity Bank, Middlesex Savings, Wells Fargo, Wells Fargo Bank, (sometimes collectively referred to as “Banking Institution Defendants”) possessed actual knowledge of the fraudulent nature of TelexFree’s business operation, since at least June 2013.

369. Despite knowledge of the fraudulent nature of TelexFree’s business operations, the Banking Institution Defendants continued to provide TelexFree with banking services.

370. Upon information and belief, the Banking Institution Defendants received funds from Investors, which funds were then held for the benefit of TelexFree, its affiliated entities, and its Management.⁵¹

371. TelexFree’s investors were directed by TelexFree, as part of TelexFree’s “*signup procedures*,” to transfer investment funds to accounts held by TelexFree at Bank of America and TD Bank.⁵²

372. Wells Fargo Bank maintained a depository account for TelexFree until March 14, 2014, long after TelexFree’s Brazilian operation had been publicly exposed as a Pyramid

⁵¹ See, e.g., check deposited by TelexFree into its account with Fidelity Bank, to wit, account number 211370707, attached herewith as Exhibit 14.

⁵² See “*Signup procedures for TelexFREE*,” attached herewith as Exhibit 15, also available at http://www.buysellproducts.net/down/sign_up_procedures_for_telexfree.pdf; See also PatrickPretty.com, “*TelexFree Affiliates Gave AdSurfDaily-Like Coaching Tips, Instructed Prospects to Make Deposits at Bank of America[...]TelexFree Also May Have TD Bank Account*,” <http://patrickpretty.com/2013/07/08/telexfree-affiliates-gave-adsurfdaily-like-coaching-tips-instructed-prospects-to-make-deposits-at-bank-of-america-and-to-copy-slips-to-team-leaders-gmail-address-for-expedited-service-t/> (July 8, 2013) (including screen shot of TelexFree bank transfer instructions).

374. Despite knowledge of the fraudulent nature of TelexFree's business operations, the Investment Service Provider Defendants continued to provide TelexFree and the Officer Defendants with both personal and business investment services.⁵⁴

376. Defendants GPG, IPS, Propay, Base Commerce, Vantage Payments, and the Doe Payment Processors (sometimes collectively referred to as “Payment Processing Services Companies” or “PPSC Defendants”) possessed actual knowledge of the fraudulent nature of TelexFree’s business operations since at least June 2013.

⁵³ See Declaration of Stuart A. MacMillan, Case No. 14-125234-ABL, Doc. 121, par. 12, attached herewith as Exhibit 16.

⁵⁵ *Id.*

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379. Upon information and belief, the PPSC Defendants also processed large transfers of funds from TelexFree, its affiliated entities, and its Management, to Banking Institution Defendants and other receivers, during which TelexFree was insolvent, despite knowledge of the fraudulent nature of TelexFree's business operations, deepening TelexFree's insolvency and assisting TelexFree and its Management in concealing assets.

381. More particularly, IPS provided TelexFree with a service titled “e-Wallet,” which was used by TelexFree to process electronic transfers of funds by Investors to TelexFree.

383. Defendants GPG, Base Commerce, and Vantage Payments, also processed electronic transfers of funds by Investors to TelexFree.

385. Upon information and belief, ProPay processed transfers of funds by and on behalf of TelexFree, its affiliated entities, and its Management, during which TelexFree was

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393. Damages for any individual class member likely can not justify the cost of individual litigation, so that absent class treatment, the Defendants' violations of law inflicting substantial damages in the aggregate would go un-remedied without certification of the Class.

VI.

FIRST CLAIM FOR RELIEF

(Against Defendants Merrill, Wanzeler, Labriola, Craft, Costa, Rodrigues, WWW Global Business, Inc., De La Rosa, Crosby, Sloan, Doe Insider Promoters And Others)

396. Plaintiffs and the similarly situated members of the class purchased from the

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399. During the Class Period, the Defendant TelexFree Companies, Owners, Officers, Directors, Various Businesses Associated With Those Individuals, and Insider Promoters, including Insider Promoter Does 1-63, directly and indirectly, by means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a scheme and a continuous course of conduct to make false and misleading material statements about the TelexFree Company's business, its business opportunities, its financial condition and operations, its investment dealings, financial condition and operations, and to conceal adverse material

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FOURTH CLAIM FOR RELIEF

(Against Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices Of Nehra And Waak, Gerald P. Nehra, Attorney At Law, PLLC And Richard W. Waak, Attorney At Law, PLLC)

443. Due to their control and/or association with the investment, Defendants were

NEGLIGENCE

485. As a direct and proximate result of Defendants' negligence and carelessness, Plaintiffs and the Putative Class have been caused to suffer and sustain damages and losses.

NEGLIGENT MISREPRESENTATION

487. The stated Defendants directly, and through their agents, servants, employees and/or representatives, negligently made misrepresentations of material fact to Plaintiffs and the Putative Class with the misrepresentations being made to obtain and/or wrongfully appropriating and converting money from Plaintiffs and the Putative Class.

TWELFTH CLAIM FOR RELIEF

BREACH OF FIDUCIARY DUTY

(Against Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Nehra, Waak, Law Offices Of Nehra And Waak, Gerald P. Nehra, Attorney At Law, PLLC And Richard W. Waak, Attorney At Law, PLLC)

505. Plaintiffs incorporate by reference all allegations in all previous paragraphs, as though fully set forth here.

506. Defendants Merrill, Wanzeler, Labriola, Costa, Craft, Craft Financial, Costa, Nehra, Waak, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC and Richard W. Waak, Attorney at Law, PLLC and others owe to Plaintiffs and the Putative Class a duty of utmost good faith and fair dealing. They breached that duty and each personal benefited.

507. Said Defendants violated their duty by actively misrepresenting and fraudulently failing to convey facts material to the TelexFree AdCentral investment packages, including:

- a. providing false and misleading information on the nature of TelexFree's business operation;
- b. misrepresenting the financial statements;
- c. providing false and misleading information on the value of the AdCentral Package;
- d. providing false and misleading information on the method and source from which income was derived;
- e. providing false and misleading information on the legality of TelexFree's business model;
- f. providing false and misleading information on the sustainability of the returns to Promoter/Investors;
- g. providing false and misleading information regarding the investigation in Brazil and subsequent closure of TelexFree's Brazilian operations,
- h. knowingly participating in false and deceptive information televised over the internet and other media;
- i. concealing that the AdCentral Packages were securities and were unregistered;

509. Such misrepresentations and omissions were done knowingly for the purpose and effect of concealing the true information about the investments, including their financial condition and operations.

511. Because of their control and/or association with the investment, the stated Defendants were active and culpable participants in the fraudulent scheme.

513. Stated Defendants, through the aforesaid fraudulent and deceptive misrepresentations and omissions of material facts, breached their fiduciary duties of care and loyalty to Plaintiffs and the Putative Class.

515. As a direct and proximate consequence of the aforementioned breach of fiduciary duty of said Defendants, Plaintiffs and the Putative Class sustained injuries and losses.

FOURTEENTH CLAIM FOR RELIEF

UNJUST ENRICHMENT

(Against Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, John Merrill, Costa, Rodrigues, WWW Global Business, Inc., De La Rosa Crosby, Sloan, Doe Insider Promoters And Others)

528. Plaintiffs incorporate by reference all allegations in all previous paragraphs, as as though fully set forth here.

529. Plaintiffs and the Putative Class furnished funds, directly or indirectly, to the stated Defendants, who accepted them without protest or defect and unjustly retained and benefitted from them .

530. Said Defendants have knowingly and unlawfully and in bad faith denied Plaintiffs and the Putative Class access to such funds, and have instead retained the benefit of such funds for themselves.

531. As a direct and proximate result of said Defendants, as hereinabove set forth, said Defendants are, and continue to be, unjustly enriched.

532. As a direct and proximate consequence of the aforementioned breach of fiduciary duty of said Defendants, Plaintiffs and the Putative Class sustained ascertainable economic loss.

FIFTEENTH CLAIM FOR RELIEF

FRAUD

(Against Defendants Merrill, Wanzeler, Labriola, Costa, Craft, Craft Financial, Costa, Nehra, Waak, Law Offices Of Nehra And Waak, Gerald P. Nehra, Attorney At Law, PLLC And Richard W. Waak, Attorney At Law, PLLC, Rodrigues, WWW Global Business, Inc., De La Rosa, Crosby, Sloan And Others)

533. Plaintiffs incorporate by reference all allegations in all previous paragraphs, as though fully set forth here.

551. These stated Defendants provided substantial assistance or encouragement to the fraudulent parties, and did so with unlawful intent by way of knowing the fraudulent parties were selling unregistered securities yet continuing to substantially assist or encourage.

552. Defendants rendered this substantial assistance despite their knowledge that TelexFree's operations constituted an unlawful, unfair, deceptive and unsustainable Pyramid Ponzi Scheme and financial fraud.

553. Such substantial assistance rendered by Defendants despite their knowledge of, or with reasonable diligence should have known, the fraudulent nature of TelexFree's operations, include, but are not limited to :

- a. managing and controlling TelexFree and its affiliated entities;
- b. providing accounting services to TelexFree;
- c. providing legal services to TelexFree;
- d. publicly certifying that TelexFree's business model and operations were legal, proper, and economically viable and sustainable;
- e. providing banking, investment and asset management services for TelexFree and its management;
- f. promoting TelexFree AdCentral packages;
- g. continuing to provide financial services following the Brazilian Court's injunction to stop TelexFree's business in Brazil;
- h. processing payments to, from, and on behalf of TelexFree and its affiliated entities; and
- i. processing payments for transfers of funds which deepened TelexFree's insolvency.

554. Plaintiffs and the Putative Class relied upon such fraudulent statements and omissions.

555. As a direct and proximate result of TelexFree's fraud, to which the stated Defendants provided substantial assistance, Plaintiffs and the Putative Class sustained ascertainable economic loss.

SEVENTEENTH CLAIM FOR RELIEF

COMMON LAW FRAUDULENT TRANSFER

(Against Defendants TelexElectric, Telex Mobile, Merrill, Wanzeler, Labriola, Craft, Craft Financial, John Merrill, Costa, Fidelity Bank, And Others)

556. Plaintiffs incorporate by reference all allegations in all previous paragraphs, as though fully set forth here.

557. Plaintiffs and the Putative Class were and are creditors of TelexFree Entities.

558. Defendants TelexElectric, Telex Mobile, Merrill, Wanzeler, Labriola, Craft, Craft Financial, John Merrill, Costa, Fidelity Bank, and Others have knowingly made or accepted transfers of funds owed to Plaintiffs and the Putative Class.

559. Such transfers were made or accepted with intent to hinder, delay, and/or defraud Plaintiffs. Each defendant made a transfer or incurred an obligation with an intent to hinder, delay, or defraud any creditors of the debtor and without receiving a reasonable equivalent value in exchange for the transfer or obligation

560. More particularly, such transfers were made to dissipate, convert and conceal funds lawfully due to Plaintiffs and the Putative Class.

561. Because of such fraudulent transfers, Plaintiffs and the Putative Class sustained ascertainable economic loss.

562. As a direct and proximate consequence of the aforementioned breach of fiduciary duty of said Defendants, Plaintiffs and the Putative Class sustained ascertainable economic loss.

CONVERSION

(Against Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Rodrigues, WWW Global Business, De La Rosa, Crosby, Sloan, Doe Insider Promoters And Others)

575. Plaintiffs incorporate by reference all allegations in all previous paragraphs, as though fully set forth here.

576. Defendants Telex Electric, Telex Mobile, Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Rodrigues, WWW Global Business, De La Rosa, Crosby, Sloan, Doe Insider Promoters and others have unlawfully converted Plaintiffs' funds, by obtaining the same through knowing misrepresentations made to Plaintiffs, the Putative Class and the public.

577. Said Defendants continue to retain funds unlawfully converted from Plaintiffs. Plaintiffs and the Putative Class had clear legal ownership or right to possession of thier money at the time of each conversion. Defendant's uniformly converted those funds by a uniform system wide protocol which consisted of wrongful acts and the wrongful disposition of property rights.

578. In consequence of the foregoing, Plaintiffs and the Putative Class sustained ascertainable economic loss.

579. As a direct and proximate consequence of the aforementioned breach of fiduciary duty of said Defendants, Plaintiffs and the Putative Class sustained ascertainable economic loss.

The JS 44 civil cover sheet and the information contained herein neither replace nor supplement the filing and service of pleadings or other papers as required by law, except as provided by local rules of court. This form, approved by the Judicial Conference of the United States in September 1974, is required for the use of the Clerk of Court for the purpose of initiating the civil docket sheet. (SEE INSTRUCTIONS ON NEXT PAGE OF THIS FORM.)

I. (a) PLAINTIFFS *Reverend Jeremiah Githere, et al.*

DEFENDANTS

TelexElectric, LLP, et al.

(b) County of Residence of First Listed Plaintiff

(EXCEPT IN U.S. PLAINTIFF CASES)

County of Residence of First Listed Defendant

(IN U.S. PLAINTIFF CASES ONLY)

NOTE: IN LAND CONDEMNATION CASES, USE THE LOCATION OF THE TRACT OF LAND INVOLVED.

(c) Attorneys (Firm Name, Address, and Telephone Number)

*Robert J. Bonsignore, # 547880
Bonsignore, LLC
193 Plummer Hill Rd, Belmont, NH*

Attorneys (If Known)

II. BASIS OF JURISDICTION (Place an "X" in One Box Only)

- ☐ 1 U.S. Government Plaintiff
- ☒ 3 Federal Question (U.S. Government Not a Party)
- ☐ 2 U.S. Government Defendant
- ☐ 4 Diversity (Indicate Citizenship of Parties in Item III)

III. CITIZENSHIP OF PRINCIPAL PARTIES (Place an "X" in One Box for Plaintiff and One Box for Defendant)

(For Diversity Cases Only)

- | | PTF | DEF | | PTF | DEF |
|---|---------------------------------------|---------------------------------------|---|---------------------------------------|---------------------------------------|
| Citizen of This State | <input type="checkbox"/> 1 | <input type="checkbox"/> 1 | Incorporated or Principal Place of Business In This State | <input checked="" type="checkbox"/> 4 | <input checked="" type="checkbox"/> 4 |
| Citizen of Another State | <input checked="" type="checkbox"/> 2 | <input checked="" type="checkbox"/> 2 | Incorporated and Principal Place of Business in Another State | <input checked="" type="checkbox"/> 5 | <input checked="" type="checkbox"/> 5 |
| Citizen or Subject of a Foreign Country | <input type="checkbox"/> 3 | <input type="checkbox"/> 3 | Foreign Nation | <input type="checkbox"/> 6 | <input type="checkbox"/> 6 |

IV. NATURE OF SUIT (Place an "X" in One Box Only)

CONTRACT	TORTS	FORFEITURE/PENALTY	BANKRUPTCY	OTHER STATUTES	
<input type="checkbox"/> 110 Insurance <input type="checkbox"/> 120 Marine <input type="checkbox"/> 130 Miller Act <input type="checkbox"/> 140 Negotiable Instrument <input type="checkbox"/> 150 Recovery of Overpayment & Enforcement of Judgment <input type="checkbox"/> 151 Medicare Act <input type="checkbox"/> 152 Recovery of Defaulted Student Loans (Excludes Veterans) <input type="checkbox"/> 153 Recovery of Overpayment of Veteran's Benefits <input type="checkbox"/> 160 Stockholders' Suits <input type="checkbox"/> 190 Other Contract <input type="checkbox"/> 195 Contract Product Liability <input type="checkbox"/> 196 Franchise	PERSONAL INJURY <input type="checkbox"/> 310 Airplane <input type="checkbox"/> 315 Airplane Product Liability <input type="checkbox"/> 320 Assault, Libel & Slander <input type="checkbox"/> 330 Federal Employers' Liability <input type="checkbox"/> 340 Marine <input type="checkbox"/> 345 Marine Product Liability <input type="checkbox"/> 350 Motor Vehicle <input type="checkbox"/> 355 Motor Vehicle Product Liability <input type="checkbox"/> 360 Other Personal Injury <input type="checkbox"/> 362 Personal Injury - Medical Malpractice	<input type="checkbox"/> 365 Personal Injury - Product Liability <input type="checkbox"/> 367 Health Care/Pharmaceutical Personal Injury Product Liability <input type="checkbox"/> 368 Asbestos Personal Injury Product Liability PERSONAL PROPERTY <input checked="" type="checkbox"/> 370 Other Fraud <input checked="" type="checkbox"/> 371 Truth in Lending <input checked="" type="checkbox"/> 380 Other Personal Property Damage <input type="checkbox"/> 385 Property Damage Product Liability	<input type="checkbox"/> 625 Drug Related Seizure of Property 21 USC 881 <input type="checkbox"/> 690 Other LABOR <input type="checkbox"/> 710 Fair Labor Standards Act <input type="checkbox"/> 720 Labor/Management Relations <input type="checkbox"/> 740 Railway Labor Act <input type="checkbox"/> 751 Family and Medical Leave Act <input type="checkbox"/> 790 Other Labor Litigation <input type="checkbox"/> 791 Employee Retirement Income Security Act IMMIGRATION <input type="checkbox"/> 462 Naturalization Application <input type="checkbox"/> 465 Other Immigration Actions	<input type="checkbox"/> 422 Appeal 28 USC 158 <input type="checkbox"/> 423 Withdrawal 28 USC 157 PROPERTY RIGHTS <input type="checkbox"/> 820 Copyrights <input type="checkbox"/> 830 Patent <input type="checkbox"/> 840 Trademark SOCIAL SECURITY <input type="checkbox"/> 861 JIA (1395ff) <input type="checkbox"/> 862 Black Lung (923) <input type="checkbox"/> 863 DIWC/DIWW (405(g)) <input type="checkbox"/> 864 SSID Title XVI <input type="checkbox"/> 865 RSI (405(g)) FEDERAL TAX SUITS <input type="checkbox"/> 870 Taxes (U.S. Plaintiff or Defendant) <input type="checkbox"/> 871 IRS—Third Party 26 USC 7609	<input type="checkbox"/> 375 False Claims Act <input type="checkbox"/> 400 State Reapportionment <input type="checkbox"/> 410 Antitrust <input type="checkbox"/> 430 Banks and Banking <input type="checkbox"/> 450 Commerce <input type="checkbox"/> 460 Deportation <input type="checkbox"/> 470 Racketeer Influenced and Corrupt Organizations <input type="checkbox"/> 480 Consumer Credit <input type="checkbox"/> 490 Cable/Sat TV <input checked="" type="checkbox"/> 850 Securities/Commodities/Exchange <input type="checkbox"/> 890 Other Statutory Actions <input type="checkbox"/> 891 Agricultural Acts <input type="checkbox"/> 893 Environmental Matters <input type="checkbox"/> 895 Freedom of Information Act <input type="checkbox"/> 896 Arbitration <input type="checkbox"/> 899 Administrative Procedure Act/Review or Appeal of Agency Decision <input type="checkbox"/> 950 Constitutionality of State Statutes
REAL PROPERTY <input type="checkbox"/> 210 Land Condemnation <input type="checkbox"/> 220 Foreclosure <input type="checkbox"/> 230 Real Lease & Ejectment <input type="checkbox"/> 240 Torts to Land <input type="checkbox"/> 245 Tort Product Liability <input type="checkbox"/> 290 All Other Real Property	CIVIL RIGHTS <input type="checkbox"/> 440 Other Civil Rights <input type="checkbox"/> 441 Voting <input type="checkbox"/> 442 Employment <input type="checkbox"/> 443 Housing/Accommodations <input type="checkbox"/> 445 Amer. w/Disabilities - Employment <input type="checkbox"/> 446 Amer. w/Disabilities - Other <input type="checkbox"/> 448 Education	PRISONER PETITIONS Habeas Corpus: <input type="checkbox"/> 463 Alien Detainee <input type="checkbox"/> 510 Motions to Vacate Sentence <input type="checkbox"/> 530 General <input type="checkbox"/> 535 Death Penalty Other: <input type="checkbox"/> 540 Mandamus & Other <input type="checkbox"/> 550 Civil Rights <input type="checkbox"/> 555 Prison Condition <input type="checkbox"/> 560 Civil Detainee - Conditions of Confinement			

V. ORIGIN (Place an "X" in One Box Only)

- ☒ Original Proceeding
- ☐ 2 Removed from State Court
- ☐ 3 Remanded from Appellate Court
- ☐ 4 Reinstated or Reopened
- ☐ 5 Transferred from Another District (specify)
- ☐ 6 Multidistrict Litigation

VI. CAUSE OF ACTION

Cite the U.S. Civil Statute under which you are filing (Do not cite jurisdictional statutes unless diversity):

28 U.S.C. 1332 (a) (2)

Brief description of cause:

Classwide Ponzi Scheme

VII. REQUESTED IN COMPLAINT:

☒ CHECK IF THIS IS A CLASS ACTION UNDER RULE 23, F.R.Cv.P.

DEMAND \$

\$300,000,000.00

CHECK YES only if demanded in complaint:

JURY DEMAND: ☐ Yes ☒ No

VIII. RELATED CASE(S) IF ANY

(See instructions):

JUDGE

DOCKET NUMBER

DATE

FOR OFFICE USE ONLY

SIGNATURE OF ATTORNEY OF RECORD

Robert J. Bonsignore

1. Title of case (name of first party on each side only) Reverend Jeremiah Githere, et al,
v. TelexElectric, LLP, et al.

2. Category in which the case belongs based upon the numbered nature of suit code listed on the civil cover sheet. (See local rule 40.1(a)(1)).



I. 410, 441, 470, 535, 830*, 891, 893, 895, R.23, REGARDLESS OF NATURE OF SUIT.



II. 110, 130, 140, 160, 190, 196, 230, 240, 290, 320, 352, 370, 371, 380, 430, 440, 442, 443, 445, 446, 448, 710, 720, 740, 790, 820*, 840*, 850, 870, 871.



III. 120, 150, 151, 152, 153, 195, 210, 220, 245, 310, 315, 330, 340, 345, 350, 355, 380, 365, 367, 368, 375, 385, 400, 422, 423, 450, 460, 462, 463, 465, 480, 490, 510, 530, 540, 550, 555, 525, 690, 751, 791, 861-865, 890, 896, 899, 950.

*Also complete AO 120 or AO 121. for patent, trademark or copyright cases.

3. Title and number, if any, of related cases. (See local rule 40.1(g)). If more than one prior related case has been filed in this district please indicate the title and number of the first filed case in this court.

4. Has a prior action between the same parties and based on the same claim ever been filed in this court?

YES ☐

NO ☒

5. Does the complaint in this case question the constitutionality of an act of congress affecting the public interest? (See 28 USC §2403)

YES ☐

NO ☒

If so, is the U.S.A. or an officer, agent or employee of the U.S. a party?

YES ☐

NO ☒

6. Is this case required to be heard and determined by a district court of three judges pursuant to title 28 USC §2284?

YES ☐

NO ☒

7. Do all of the parties in this action, excluding governmental agencies of the united states and the Commonwealth of Massachusetts ("governmental agencies"), residing in Massachusetts reside in the same division? - (See Local Rule 40.1(d)).

YES ☐

NO ☒

A. If yes, in which division do all of the non-governmental parties reside?

Eastern Division ☐

Central Division ☒

Western Division ☐

B. If no, in which division do the majority of the plaintiffs or the only parties, excluding governmental agencies, residing in Massachusetts reside?

Eastern Division ☒

Central Division ☐

Western Division ☐

8. If filing a Notice of Removal - are there any motions pending in the state court requiring the attention of this Court? (If yes, submit a separate sheet identifying the motions)

YES ☐

NO ☒

(PLEASE TYPE OR PRINT)

ATTORNEY'S NAME Robert J. Bonsignore, Bonsignore, LLC
ADDRESS 193 Plummer Hill Rd, Belmont, NH 03220
TELEPHONE NO. 781-856-7650

Case No. _____

CLASS ACTION COMPLAINT
FOR, *INTER ALIA*, VIOLATIONS
OF STATE AND FEDERAL
SECURITIES LAWS

DEMAND FOR TRIAL BY JURY

V.

TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; JAMES M. MERRILL; CARLOS N. WANZELER; ; STEVEN M. LABRIOLA; JOSEPH H. CRAFT, a/k/a JOE H. CRAFT; CRAFT FINANCIAL SOLUTIONS, LLC; CARLOS COSTA; SANTIAGO DE LA ROSA; RANDY N. CROSBY; FAITH R. SLOAN; GERALD P. NEHRA, individually and doing business as LAW OFFICES OF NERHA AND WAAK; GERALD P. NEHRA ATTORNEY AT LAW, PLLC; RICHARD W. WAAK, individually and doing business as LAW OFFICES OF NERHA AND WAAK; RICHARD W. WAAK, ATTORNEY AT LAW, PLLC; BANK OF AMERICA CORPORATION, BANK OF AMERICA, NA; TD BANK, NA; CITIZENS FINANCIAL GROUP, INC.; CITIZENS BANK OF MASSACHUSETTS; FIDELITY CO-OPERATIVE BANK, doing business as FIDELITY BANK; MIDDLESEX SAVINGS BANK; WELLS FARGO & COMPANY; WELLS FARGO BANK, NA; FMR, LLC, also known as FIDELITY INVESTMENTS; WADDELL & REED FINANCIAL, INC.; WADDELL & REED, INC.; GLOBAL PAYROLL GATEWAY INC.; INTERNATIONAL PAYOUT SYSTEMS, INC.;

6. In exchange for placing duplicative and pre-written TelexFree ads on internet sites and for recruiting other investors to pay the membership fees, TelexFree held out that its investors, or “Promoters,” could receive returns of 200% annually.

7. To keep TelexFree's Pyramid Ponzi Scheme

8. On June 19, 2013, the Brazilian Court in Acre issued an injunction putting “a stop to TelexFree’s business operations, including the registration of new affiliate investors, acceptance of new investments and paying any returns owed on existing affiliate investments.”

9. TelexFree and its Officers James M. Merrill, Carlos N. Wanzeler, Steven M. Labriola, Carlos Costa, Joseph H. Craft, a/k/a Joe H. Craft (collectively, “Defendant Officers”), Sanderley Rodrigues de Vasconcelos; WWW Global Business, Inc.; Santiago de La Rosa; Randy N. Crosby; Faith R. Sloan TelexFree’s Retained Licensed Professionals, Paralegal Doe, Banking Institution Defendants², Investment Service Provider Defendants and Payment Processing Services Companies knew that the Pyramid Ponzi Scheme was not sustainable, and that the representations on TelexFree’s website and in its marketing materials were false and deceptive including, but not limited to, those concerning the guaranteed returns.

10. TelexFree and its Defendant Officers, the Named Insider Promoters, the Doe Insider Promoters, Retained Licensed Professionals, Paralegal Doe, Banking Institution Defendants, Investment Service Provider Defendants and Payment Processing Services Companies knew that TelexFree was selling unregistered securities to the members of the putative classes.

11. After the Defendant Officers, the Insider Promoters, the Retained Licensed Professionals, the Banking Institution Defendants, Investment Service Provider Defendants and

² Fidelity Co-Operative Bank, Bank Of America Corporation, Bank Of America, N.A., TD Bank, N.A., Citizens Financial Group, Inc., Citizens Bank of Massachusetts, Middlesex Savings Bank, Wells Fargo & Company, Wells Fargo Bank, N.A., Bank Of America Corporation, Bank Of America, N.A., and others are referred to herein as the “Banking Institution Defendants.”

13. Defendants have violated the antifraud and securities registration provisions of the federal and state securities laws.

15. TelexFree and the other Defendants also violated Title 17, Code of Federal Regulations, Section 240.10b-5 by (a) employing devices, schemes, and artifices to defraud; (b) making untrue statements of material facts and omitting to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and (c) engaging in acts, practices, and courses of business which operated and would operate as a fraud and deceit upon persons.

17. The Banking Institution Defendants, Investment Services Provider Defendants, and Payment Processing Services Companies and Banking share joint and several liability

JURISDICTION AND VENUE

19. Venue is proper pursuant to 28 U.S.C. § 1409(a).

In the aggregate, Plaintiffs' claims and the claims of the other members of the Class exceed \$5,000,000.00 exclusive of interest and costs, and there are numerous class members who are citizens of states other than TelexFree, Inc's state of citizenship, which is Massachusetts.

22. Venue is also proper pursuant to 28 U.S.D. §. 1391

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24. Furthermore, venue is proper under Section 1965 of the Racketeer Influenced and Corrupt Organizations Act [18 U.S.C. § 1965], as the Defendants reside, have agents, or otherwise transact business material to this Complaint in this district.

THE PARTIES

25. Plaintiff MADUAKO FERGUSON, Sr. (hereinafter sometimes referred to as “Ferguson”) is an individual who resides in North Carolina. Ferguson, like many other victims of TelexFree’s Pyramid Ponzi Scheme, tendered cash in exchange for a TelexFree Membership and its promised Pre-March 9, 2014 -Return in Investment (the Pre-March 9, 2014 Return on Investment”).

26. Defendant TELEXFREE, INC. is a corporation duly organized and existing under the laws of the Commonwealth of Massachusetts, having a last known principal place of business at 225 Cedar Hill Street, Suite 200, in Marlborough, County of Middlesex, Commonwealth of Massachusetts 01752.³

27. TelexFree, Inc. was formerly known as COMMON CENTS COMMUNICATIONS, INC.

28. TELEXFREE, LLC is a limited liability company duly organized and existing under the laws of the state of Nevada, having a purported place of business at 4705 S. Durango Drive, #100-J51 (a post office box), Las Vegas, Nevada 89147.

29. Defendant Paralegal Doe served as TelexFree, LLC's agent, servant or employee at all times relevant to this complaint.

30. At all times material herein, TelexFree, LLC also maintained offices in the Commonwealth of Massachusetts at 225 Cedar Hill Street, Suite 200, in Marlborough, County of Middlesex, Commonwealth of Massachusetts 01752 between 2012 and this date.

³ See Office of the Secretary of the Commonwealth of Mass., Corporations Div., Corporate Summary for TelexFree, Inc., attached hereto as Exhibit 1.

33. Defendant TELEXELECTRIC, LLLP (hereinafter sometimes referred to as "TelexElectric") is a limited liability limited partnership duly organized and existing under the laws of the State of Nevada, and having its registered agent as BWFC Processing Center, LLC, 3960 Howard Hughes Parkway, Suite 500, Las Vegas, Nevada 89169.

35. Defendant JAMES M. MERRILL (hereinafter sometimes referred to as "Merrill") is an individual now or formerly of 1 Coburn Drive in Ashland, County of Middlesex, Commonwealth of Massachusetts 01721. Co-Defendant Merrill was President, Secretary, and Director of TelexFree, Inc. Co-Defendant, Merrill was a Manager of TelexFree, LLC, and was listed with the Massachusetts Secretary of State Corporations Division as an authorized person to execute, acknowledge, deliver, and record any recordable instrument purporting to affect an interest in real property. Co-Defendant Merrill, was President, Secretary, and Director of TelexFree Financial.

37. Defendant STEVEN M. LABRIOLA (hereinafter sometimes referred to as "Labriola") is an individual now or formerly of 21 Kiwanis Beach Road, in Upton, County of Worcester, Commonwealth of Massachusetts 01568. Labriola was the sales director of TelexFree.

39. Defendant CRAFT FINANCIAL SOLUTIONS, LLC (hereinafter sometimes referred to as “Craft Financial”) is a limited liability company duly organized and existing under

41. The Defendant, SANTIAGO DE LA ROSA (hereinafter sometimes referred to as "De La Rosa"), is an individual now or formerly of 189 Beacon Hill Avenue, Unit 2, in Lynn, County of Essex, Commonwealth of Massachusetts 01902. De La Rosa, has also appeared in videos promoting TelexFree which were posted on the internet.

43. The Defendant, FAITH R. SLOAN (hereinafter sometimes referred to as "Sloan"), is an individual now or formerly of 515 E. End Avenue, Unit 105, in Calumet City, Illinois 60409. Sloan, is one of TelexFree's most successful Promoters, and has recruited numerous other Promoters/Investors for TelexFree, especially through a website known as "telexfreepower.com".

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67. Defendant BASE COMMERCE, LLC has its principal offices at 7910 S. Kyrene Road, Suite 106, Tempe, Arizona 85284, and also does business as PHOENIX PAYMENTS.

68. Defendant VANTAGE PAYMENTS, LLC has its principal offices at 8300 N. Hayden Road #A207, Scottsdale, Arizona 85251.

69. Additional payment – processing services aided and abetted in TelexFree’s Pyramid Ponzi scheme but their identities are as yet unknown. For ease of reference at this time they are referred to herein at this time as Defendant Payment – Processing Services Doe.

GENERAL ALLEGATIONS

A. TELEXFREE, LLC

70. Telex Free, LLC was organized under the laws of the State of Nevada on July 19, 2012. There is no distinction between the business operations of TelexFree, LLC and TelexFree, Inc. Between February 15, 2012 and approximately April 15, 2014, TelexFree, LLC’s registered agent for the Commonwealth of Massachusetts was James Merrill whose address is identified as 225 Cedar Hill St. Suite 200, Marlborough, MA 01752. Between February 15, 2012 and approximately April 15, 2014, Co-Defendants James Merrill, Carlos Wanzeler, Steven Labriola, Joseph H. Craft and Carlos Costa conducted the business of TelexFree, LLC in TelexFree’s Massachusetts office. Hundreds of millions of investor funds received by TelexFree are unaccounted for.

B. TELEXFREE, INC f/k/a COMMON CENTS COMMUNICATIONS, INC.

71. TelexFree, Inc.⁵ is a domestic profit corporation registered with the Corporations Division of the Secretary to the Commonwealth of Massachusetts (Identification Number

⁵ Paragraph 2.1.2 of the standard TelexFree contract states “TELEXFREE INC, from its headquarters in, Marlboro, Massachusetts (U.S.), on the basis of an operating contract between the latter and the CONTRACTOR (YMPACTUS), has as its primary activity VOIP telephony, using its equipment installed at its headquarters in Massachusetts, where it makes the necessary connections for these calls; it also provides virtual media, through the website www.telexfree.com to associates and to the PROMOTERS that YMPACTUS/TELEXFREE coordinates and controls, including the respective publicity channels.”

E. TELEXFREE'S UNLAWFUL, UNFAIR AND DECEPTIVE PYRAMID PONZI SCHEME

178. TelexFree and the other Defendants unlawfully, willfully and knowingly used means and instrumentalities in connection with the purchase and sale of unregistered securities; and used and employed manipulative and deceptive devices and contrivances in violation of, *inter alia*, the Massachusetts Uniform Securities Act, M.G.L. c. 110A, Section 410b.

180. Class Members were fraudulently induced to invest in at least two other “scam”

181. Upon the advice of their legal counsels, TelexFree referred to the members of the putative class as “*Associates*,” “*Members*,” and “*Promoters*,” Plaintiffs Cellucci, Lake and Pacheco and all other members of the putative class are “Investors” under federal and state securities law.

183. The TelexFree advertisement kit enables participants to generate a return by posting pre-written advertisements, to pre-determined websites, through an automated TelexFree system. A participant's daily use of the advertisement kits generates investment returns without the need for any VoIP Program sales. Posting advertisements is an effortless process that takes only a few minutes per advertisement. Many participants pay third parties to post advertisements – completely outsourcing any required work at a minimal cost.

185. The Passive Income Scheme generates further returns for participants through various bonus structures and recruitment commissions. By recruiting multiple individuals,

190. TelexFree's Contract at Section 2.6.5 (m) mandates that Promoters are not to use the term investment with respect to the registration costs. Co-Defendant and Company Counsel Attorney Gerald P. Nehra, through his affiliated companies (Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC, and Richard W. Waak, Attorney at Law, PLLC), and under the direct supervision of Co-Defendants Richard W. Waak and Richard W. Waak Attorney at Law, PLLC provided this deceitful advice for the purpose of furthering perpetuating Defendants unlawful Pyramid Ponzi Scheme. Specifically, TelexFree's Contract at Section 2.6.5 (m) provides that the Promoter must not "use terms that distort the real meaning of products or the mechanism and functioning of multilevel marketing, including, without limitation, expressions that convey the idea of instant wealth for nothing in exchange, as well as speaking of registration costs as a 'financial investment.' Similarly, it is expressly prohibited to use the term 'INVESTMENT' at meetings and in promotional materials in general, orally or in writing.

191. As early as 2005, Wanzeler had been operating purported telecommunications businesses in the United States and Brazil, under the names “Brazilian Help” and “Disk A Vontade Telefonica,” respectively. Disk A Vontade Telefonica, Ltda, also known as Diskavontade, also known as Disk (hereinafter sometimes referred to as “Disk A Vontade”), is a Brazilian Limited Liability Company, now or formerly having its principal offices as Rua Jose Luiz Gabeira, NRO 170, APTO 103 Barro Vermelho, and now or formerly having a Massachusetts office as 225 Cedar Hill Street, Suite 200, in Marlborough, Massachusetts 01752. Disk A Vontade’s Massachusetts office is located in the same building in Marlborough, Massachusetts as TelexFree. Carlos Wanzeler is the Chief Executive Officer of Disk A Vontade. Merrill is Vice

President and a Signatory of Disk A Vontade.

192. Brazilian Help, Inc. (“hereinafter sometimes referred to as “Brazilian Help”) is a Domestic Profit Corporation organized and existing under the laws of the Commonwealth of Massachusetts, now or formerly having a principal place of business at 225 Cedar Hill Street, Suite 118, in Marlborough, Massachusetts 01752. Wanzeler is the President, Secretary, Treasurer, and Registered Agent of Brazilian Help. Brazilian Help’s Massachusetts office is located in the same building in Marlborough, Massachusetts as TelexFree.

193. Brazilian Help and Disk A Vontade were, at all times, the American and Brazilian branches, respectively, of the same enterprise. Acting on Costa’s proposal, Wanzeler and Merrill changed the name of Common Cents Communications, Inc. to TelexFree, Inc., and Wanzeler and Costa together created a website, “telexfree.com.” Disk A Vontade was the registered owner of the Telexfree.com domain name.

194. In July 2012, Wanzeler, Merrill and Costa together formed TelexFree, LLC.

G. TELEXFREE’S OFFER AND SALE OF UNREGISTERED INVESTMENTS IN BEST WESTERN HOTEL

195. TelexFree, through Ympactus and Costa, offered an investment in a Best Western Hotel. TelexFree management facilitated the offer of the Best Western Hotel opportunity through the inclusion of the Best Western Hotel opportunity on the front page of the TelexFree website accessible in the Commonwealth.

196. TelexFree never registered this security offering with the SEC or released any prospectus or investor disclosure.

H. INVESTIGATION OF, AND INJUCTION AGAINST, TELEXFREE’S BRAZILIAN OPERATIONS IN BRAZIL

197. In January, 2013, the Brazilian Bureau of Consumer Protection (known as

one that operates on TelexFree “credits,” which are, in essence, nothing more than IOUs.

203. These rule changes generated protests from Promoters who were unable to recover their money. On April 1, 2014, dozens of Promoters descended upon TelexFree’s Massachusetts office to regain access to their money.

204. On April 14, 2014, Defendants TelexFree, Inc., TelexFree, LLC and TelexFree Financial abruptly sought bankruptcy protection in Nevada under Chapter 11, admitting that they cannot meet their obligations from VoIP revenues and seeking authority to reject all its current obligations to promoters.

J. EVENTS SINCE TELEXFREE’S BANKRUPTCY FILING

205. In furtherance of their unlawful enterprise, TelexFree also mailed fraudulent 1099 forms to investors, possibly to create the illusion that they had made payments to investors when, in fact, no such payments were made. The 1099 forms were provided long after the mandated January 31, 2014 deadline, and some after the April 15, 2014 filing deadline. TelexFree falsely represented that investors had received income that they had in fact never received.

206. TelexFree’s former officers or employees stated to the TelexFree bankruptcy transition team that under the pre-March 2014 standard form contract TelexFree owes its promoters over \$5 billion dollars. All Defendants knew that TelexFree was an illegal Pyramid Ponzi Scheme which involved the illegal sale of securities, but continued to aid, abet and further such illegal activities. Despite the foregoing knowledge, TelexFree and the other Defendants continued to participate in the attraction and processing of new investors, continued to allow payments to process through TelexFree’s accounts, allowed TelexFree to continue to illegally sell securities and further its illegal Pyramid Ponzi Scheme, and otherwise continued to further TelexFree’s illegal activities.

207. On April 15, 2014, the Securities Division of the Office of the Secretary of the Commonwealth of Massachusetts (hereinafter sometimes referred to as the “SOC”) filed an

Administrative Complaint against TelexFree, Inc. and TelexFree, LLC, alleging violations of the Massachusetts Uniform Securities Act, MASS. GEN. LAWS, ch. 110A.

208. Also on April 15, 2014, the U.S. Securities and Exchange Commission (hereinafter sometimes referred to as the “SEC”) filed a civil Complaint and Jury Demand against TelexFree, Inc. and TelexFree, LLC as well as Merrill, Wanzeler, Labriola, Craft, Rodrigues, De La Rosa, Crosby, and Sloan, alleging violations of the Securities Act of 1933, the Securities Exchange Act of 1934, and SEC Regulations.³⁷¹ In its Complaint, the SEC requested and was granted a preliminary injunction and an order freezing assets of TelexFree. The SEC is also seeking, *inter alia*, disgorgement of profits and additional civil penalties.

209. On Tuesday, April 15, 2014, the Federal Bureau of Investigation (hereinafter sometimes referred to as the “FBI”) and the U.S. Department of Homeland Security (hereinafter sometimes referred to as the “DHS”) conducted a raid of TelexFree’s Marlborough, Massachusetts office.

210. During this raid by the FBI and DHS, the Defendant, Craft, was caught by federal agents trying to leave the building with a laptop and approximately \$38 million in cashier’s checks in a bag. When questioned, Craft misrepresented to said federal agents that he was merely a “consultant”, and claimed that the checks and computer were “personal”.

211. The following day, the Nevada Bankruptcy Court, on Motion by the SEC, transferred the matter to the Federal District Court in Massachusetts, Central Division. TelexFree is now active and operating their Pyramid Ponzi Scheme in Canada, with offices in Richmond, British Columbia, but is being closely monitored by the B.C. Securities Commission.

212. During hearings in this case, conducted on May 2, 2014, William H. Runge, III, Chief Restructuring Officer of TelexFree, estimated that, as of TelexFree’s Bankruptcy filing, TelexFree had assets of \$31 million in its bank accounts, \$28 million in brokerage accounts, and

303. At all times material herein, Defendants Merrill, Wanzeler, Labriola, Craft and Costa (hereinafter sometimes collectively as the “Defendant Officers” or “TelexFree’s Management”) were responsible for the control and operation of TelexFree and its affiliated entities. TelexFree’s Management not only controlled the activities and operations of TelexFree, but also knowingly and willfully conspired to perpetrate, and did in fact perpetrate, the TelexFree Pyramid Ponzi Scheme with full awareness of its fraudulent and illegal nature. Defendant Merrill served as the President, Secretary, and Director of TelexFree, Inc., a Manager of TelexFree, LLC, President, Secretary and Director of TelexFree Financial, General Partner of TelexElectric, and President, Secretary and Director of Telex Mobile Holdings

305. At all times material herein, Defendant Wanzeler served as Treasurer and a Director of TelexFree, Inc., a Manager of TelexFree, LLC, Vice President, Treasurer, and a Director of TelexFree Financial, General Partner of TelexElectric and Treasurer and Director of Telex Mobile Holdings. According to corporate filings on record with SOC, at all times material herein, Wanzeler has also served as the Chief Executive Officer of TelexFree, Inc.

306. In his capacities as Officer, Director, Manager and General Partner of the foregoing interrelated companies, Wanzeler exercised significant control over TelexFree's business operations. Wanzeler exercised significant control over the TelexFree Pyramid Ponzi Scheme. Defendant Wanzeler has also participated in marketing TelexFree to potential investors, appearing in videos posted to the Internet in which he can be seen promoting TelexFree as a revenue opportunity for Promoters.

307. At all times material herein, Defendant Labriola, served as the International Marketing Director for TelexFree, Inc. Labriola was one of the original Directors of Common Cents Communications, Inc., and at all material times herein exercised significant control over TelexFree's business operations and the operations of its interrelated companies. Defendant Labriola has also appeared in several videos promoting TelexFree which were posted on the internet, and has acted as TelexFree's spokesman to Investors during post-bankruptcy petition conference calls. As a Director of TelexFree, Inc., Defendant Labriola, has exercised significant control over the TelexFree Pyramid Ponzi Scheme. As International Marketing Director for TelexFree, Inc., Labriola has also actively and knowingly perpetrated the TelexFree fraud through the dissemination of false and misleading advertising and marketing communications.

308. At all times material herein, Defendant Craft, also known as Joe H. Craft, has been a certified public accountant and served as the Chief Financial Officer ("CFO") of Telex Free, Inc and TelexFree, LLC. In his capacity as CFO of TelexFree, Craft has been responsible for, *inter alia*, preparing or approving TelexFree's financial statements, overseeing TelexFree's accounting methods and records, and otherwise exercising significant supervision and control over TelexFree. On April 23, 2013, in response to a request for a profit-and-loss statement issued by the SOC, TelexFree produced a document purporting to be TelexFree's 2012 profit-and-loss statement.

309. TelexFree did not make use of usual and accepted Multi Level marketing accounting practices. For example they did not separate out income generated by sales of VoIP from income generated by other means. On February 5, 2014, the SOC requested a second profit-and-loss statement from TelexFree for 2012, which TelexFree produced on February 26, 2014. A comparison of these two profit-and-loss statements – each purporting to be TelexFree’s profit-and-loss statement for 2012 – reveals massive discrepancies. For example, the first statement provided by TelexFree lists Total Income for 2012 at \$1,864,939.70, while the second lists Total Income for 2012 at \$2,834,835.70. Also, Agent Commission is listed at \$520,582.95 in the first, versus \$2,105,925.61 in the second; Total Expenses are listed as \$784,899.22 in the first, versus \$2,333,893.09 in the second; Net Operating Income is listed as \$1,080,040.48 in the first, versus \$478,251.56 in the second; and Net Income is listed as \$1,066,313.39 in the first, versus \$477,652.23 in the second. The existence of duplicative accounting records containing egregious discrepancies is clear indicia of TelexFree’s falsification of accounting records and failure to adhere to Generally Accepted Accounting Principles (“GAAP”). As Chief Financial Officer for TelexFree, Inc. and TelexFree, LLC, as well as a certified public accountant, Defendant Craft, knowingly perpetrated the TelexFree fraud.

310. Defendant Costa, was Manager of TelexFree, LLC. Costa is one of the original founders of TelexFree. Costa was involved in the day-to-day management and oversight of TelexFree and was actively involved in and managed its Brazilian operations. Costa has appeared on numerous websites and videos posted on the Internet promoting TelexFree and touting its huge financial return. Costa is videoed displaying an Insurance Notification representing that it was proof of coverage for investors’ returns; however, in actuality the document was a notification denying coverage.⁶

⁶ See <http://www.youtube.com/watch?v=q2A2IsAPd0I>.

M. TELEXFREE’S LAWYERS AIDED, ABBETTED AND PLAYED AN INTERGRAL PART IN TELEXFREE’S UNLAWFUL, UNFAIR AND DECEPTIVE PYRAMID PONZI SCHEME

311. Defendants Gerald P. Nehra and Richard W. Waak, along with the entities Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC, and Richard W. Waak, Attorney at Law, PLLC (hereafter sometimes collectively referred to as “Attorney Defendants”) are self-proclaimed multi-level marketing (“MLM”) specialist attorneys. During the course of TelexFree’s fraudulent scheme, the above-named Attorney Defendants acted as legal counsel to TelexFree. Attorney Nehra had previously acted as counsel to other multi-level marketing firms, which were forced, closed by federal and/or state authorities due to fraudulent pyramid and Ponzi schemes, including ZeekRewards and AdSurfDaily.⁷

312. Attorney Nehra’s extensive experience in multi-level marketing, and particularly his involvement with the Ponzi schemes involving AdSurfDaily and Zeek Rewards, armed him with the knowledge of what constitutes violations of United States securities law. Indeed, Attorney Nehra was well aware that the use of semantics and obscured phraseology to obfuscate securities laws fails to legitimize TelexFree’s illegal Pyramid Ponzi Scheme.

313. Attorney Waak also claims to have more than thirty years of experience in counseling MLM and direct-selling enterprises. Attorney Waak claims to have managed the legal defense of multiple class action lawsuits involving claims for “*pyramiding, securities fraud, false advertising and civil RICO.*”

314. Attorney Nehra and Attorney Waak are together the general partners of the Law Offices of Nehra and Waak. On the website of the Law Offices of Nerha and Waak, Defendant Attorneys Nehra and Waak claim to specialize in counseling “*domestic and foreign companies operating MLM (multi-level marketing) businesses in the United States.*” Also, on the website of

⁷ *Id.*

315. As general partners of the Law Offices of Nehra and Waak, Attorney Nehra and Attorney Waak are jointly and severally liable for torts and obligations of the firm. During the time that the Law Offices of Nehra and Waak provided legal counsel to TelexFree, Attorney Waak was Principal Attorney of the law firm. Attorney Waak, as Principal Attorney of the Law Offices of Nehra and Waak, was charged with oversight of the daily activities of the law firm.

317. The Attorney Defendants' role and involvement in the TelexFree Pyramid Ponzi Scheme exceeded merely providing legal counsel since they knowingly acted to further and perpetuate TelexFree's illegal Pyramid Ponzi Scheme, which caused Plaintiffs Cellucci, Lake and Pacheco and the similarly situated Putative class members to suffer economic loss. The Attorney Defendants had actual knowledge that the TelexFree Business Model was a fraudulent Pyramid Ponzi Scheme.

⁸ *Id.*

States securities laws that were intended to offer, in part, protection from Pyramid Ponzi schemes; all to enrich himself financially and serve his own selfish interests. Attorney Nehra further encouraged TelexFree Investors to unknowingly participate in the evasion of federal and state securities laws. Defendant Nehra accomplished this by representing that his extensive experience as an MLM expert and his thorough research of TelexFree's business model allowed him to form a legal opinion that TelexFree was a legitimate business. In making this professional opinion Defendant Nehra misrepresented TelexFree as a legitimate business concern.

319. For instance, by instructing Investors to avoid using the terms "investment" with reference to AdCentral Package (See TelexFree Contract, Paragraph 2.6.5(m)), he attempted to conceal, and encouraged others to conceal, the fact that TelexFree was involved in the sale of securities, and further attempted to strip Investors of the rights afforded them by federal and state securities laws. Advising TelexFree Investors to act to avoid the protections offered by federal and state securities laws, Attorney Nehra never once advised the putative class member TelexFree Investors that so acting presented a risk to them, including the risk of participating in an unlawful scheme. Advising TelexFree Investors to act to avoid the protections offered by federal and state securities laws, Attorney Nehra never once advised the putative class member TelexFree Investors that so acting was against their own interests or that it better served TelexFree and himself. Attorney Nehra's acts of aiding, abetting and playing an integral part in TelexFree's unlawful, unfair and deceptive acts and practices exceed the scope of zealously representing TelexFree.

320. Defendant Gerald Nehra contributed in an indispensable way to TelexFree's continued unlawful operation in the United States because, as a duly licensed member of the bar, he publicly stated to Investors that, in his professional opinion, TelexFree's business model and operations complied with federal and state laws. TelexFree and its Officers knowingly used

Attorney Nehra's false legal opinions and misrepresentations as a marketing tool to unfairly and deceptively further and advance their illegal Pyramid Ponzi Scheme. Attorney Nehra knew that his legal opinions were false, and that his representations would be used by TelexFree as a marketing tool to further and advance their business model and illegal activities. Attorney Nehra's opinions were packaged and promoted as part of TelexFree's total "post Brazilian shut down package" to the members of the putative class.

321. As described in greater detail throughout, in the early spring of 2013 TelexFree Brazil was found to be an illegal pyramid and Ponzi scheme. TelexFree suffered a financial crisis when the funds of hundreds of thousands of Brazilian affiliate investors were frozen in company accounts by order of the Brazilian Court. To keep its Pyramid Ponzi Scheme ongoing, TelexFree needed a constant influx of new investor cash. In spring 2013, TelexFree was forced to focus on new markets, including new Investors from the United States and Canada, because their Brazilian operation had been shuttered and all Brazilian assets were frozen. To enhance the credibility and marketability of their United States operation, TelexFree employed the Attorney Defendants to make their illegal and fraudulent methods, operation and business plan appear legitimate. On the weekend of July 26th and 27, 2013, TelexFree held an event, which they dubbed a "super weekend," in Newport Beach, California. The focus of TelexFree's "super weekend" event included considerable efforts intended to reassure Investors that its United States operations and program were legitimate, lawful and worth putting their money behind.

322. Notwithstanding the fact that TelexFree's Brazilian bank accounts were frozen and all their Brazilian recruiting and Return on Investment payments had been suspended by court order in their largest affiliate market, Attorney Nehra advised attendees that the shut-down in Brazil would have no bearing on TelexFree's U.S. operations. At this "super weekend" event, Attorney Nehra spoke at length to attending investors, assuring them of the legality of

involvement with the TelexFree Pyramid Ponzi Scheme. Defendants Craft and Craft Financial knowingly participated in and perpetuated TelexFree's illegal Pyramid Ponzi Scheme. In his capacity as CFO and certified public accountant of TelexFree, Defendants Craft and Craft Financial have been responsible for preparing or approving TelexFree's financial statements, overseeing TelexFree's accounting methods and records, and otherwise exercising significant supervision and control over TelexFree.

330. On April 23, 2013, in response to a request for a profit-and-loss statement issued by the SOC, TelexFree produced a document purporting to be TelexFree's 2012 profit-and-loss statement. On February 5, 2014, the SOC requested a second profit-and-loss statement from TelexFree for 2012, which TelexFree produced on February 26, 2014. A comparison of these two profit-and-loss statements – each purporting to be TelexFree's profit-and-loss statement for 2012 – reveals massive discrepancies.

331. The existence of duplicative accounting records containing egregious discrepancies is clear indicia of TelexFree's falsification of accounting records and failure to adhere to GAAP.

332. As CFO and certified public accountant for TelexFree, Inc. and TelexFree, LLC, as well as a certified public accountant, Defendants Craft and Craft Financial, knowingly perpetrated the TelexFree fraud.

333. Defendants Craft and Craft Financial disseminated, and otherwise allowed to be disseminated, false and inaccurate financial information among Investors, knowing that such information was false and designed to continue and perpetuate the illegal Pyramid Ponzi Scheme. Defendants Craft and Craft Financial authorized TelexFree to provide Investors with inaccurate and fraudulent 1099 (Miscellaneous Income) forms, in many cases long after the January 31, 2014 required deadline, and in an effort to misrepresent payments made to Investors and conceal

assets. Defendants also prepared false financial documents for affiliated TelexFree entities and prepared false tax returns for the affiliated TelexFree entities.

O. THE BANKING INSTITUTION AND FINANCIAL SERVICES PROVIDER DEFENDANTS KNOWINGLY AIDED AND ABETTED TELEXFREE'S SCHEME AND RECEIVED FRAUDULENT TRANSFERS OF FUNDS

334. During the course of the TelexFree Pyramid Ponzi Scheme, Defendants Bank of America, Bank of America, N.A., TD Bank, Citizens Financial, Citizens Bank, Fidelity Bank, Middlesex Savings, Wells Fargo, Wells Fargo Bank, Fidelity Investments, Waddell & Reed Financial, Waddell & Reed, GPG, IPS, ProPay, Base Commerce, Vantage Payments, and the Doe Banks and Doe Payment Processors provided crucial financial services to TelexFree, which enabled TelexFree to carry on its Pyramid Ponzi scheme. TelexFree's financial services providers, including the aforesaid banking institutions, investment service providers, and payment processing services providers, knowingly aided and abetted TelexFree's Pyramid Ponzi Scheme by:

- a. Receiving transfers of funds from, and on behalf of, TelexFree in the course of TelexFree's fraudulent business, despite knowledge of the fraudulent nature of TelexFree's business enterprise;
- b. Receiving transfers of funds from TelexFree, its affiliated entities, and its executive officers, which transfers deepened TelexFree's insolvency, despite having knowledge of TelexFree's actual or imminent insolvency at the time of such transfers;
- c. Processing payments to, and on behalf of, TelexFree, including its affiliated entities and Management, in the course of TelexFree's fraudulent business, despite knowledge of the fraudulent nature of TelexFree's business enterprise; and

Defendants with both personal and business investment services. The Banking Institution Defendants and Investment Service Provider Defendants also received large transfers of funds from TelexFree, its affiliated entities, and its Management, during which time TelexFree was insolvent, despite knowledge of the fraudulent nature of TelexFree's business operations, thereby deepening TelexFree's insolvency and assisting TelexFree and its Management in concealing assets.

340. Defendants GPG, IPS, Propay, Base Commerce, Vantage Payments, and the Doe Payment Processors (hereinafter sometimes collectively referred to as "Payment Processing Services Companies" or "PPSC Defendants") possessed actual knowledge of the fraudulent nature of TelexFree's business operations since at least June 2013.

341. Despite knowledge of the fraudulent nature of TelexFree's business operations, the PPSC Defendants continued to provide TelexFree with payment processing services. The PPSC Defendants processed payments by Investors to TelexFree in the course of TelexFree's fraudulent business operations, which funds were then held for the benefit of TelexFree, its affiliated entities, and its Management. The PPSC Defendants also processed large transfers of funds from TelexFree, its affiliated entities, and its Management, to Banking Institution Defendants and other receivers, during which time TelexFree was insolvent, despite knowledge of the fraudulent nature of TelexFree's business operations, thereby deepening TelexFree's insolvency and assisting TelexFree and its Management in concealing assets. The PPSC Defendants received payment of substantial fees in return for providing these services.

342. IPS provided TelexFree with a service titled "e-Wallet," which was used by TelexFree to process electronic transfers of funds by Investors to TelexFree. According to a TelexFree balance sheet, dated December 31, 2013, posted by the Washington State Utilities and Transportation Commission, as of December 31, 2013, TelexFree claimed \$31,640,192.30 in

While the exact number of Class members is unknown to Plaintiffs at this time, based on information and belief, it is in the hundreds of thousands.

446. Plaintiffs meet the requirements of Federal Rules of Civil Procedures 23(a) because there is a well-defined community of interest among the members of the Class, common questions of law and fact predominate, Plaintiffs' claims are typical of the members of the Class, and Plaintiffs can fairly and adequately represent the interests of the Class.

447. This action satisfies the requirements of Federal Rule of Civil Procedure 23(b)(3) because it involves questions of law and fact common to the member of the Class that predominate or any questions affecting only individual members, including, but not limited to:

- a. Whether TelexFree ran a Pyramid Ponzi Scheme;
- b. Whether TelexFree ran a lawful Multi-Level Marketing program;
- c. Whether TelexFree offered and sold securities in the form of unregistered investment contracts constituting securities.
- d. Whether the other Defendants aided and abetted TelexFree in the sale of unregistered securities in violation of the law;
- e. Whether Defendant Officers, Named Insider Promoters, Doe Inside Promoters, Doe Paralegal, Banks and Financial Institutions, Payment Processing Services Companies, Retained Licensed Professionals and Doe Banks knew that TelexFree was an illegal pyramid-type Ponzi scheme which involved the illegal sale of securities, continued to aid, abet and further such illegal activities or are otherwise liable for the economic loss suffered by the Putative Class;
- h. Whether TelexFree's financial services providers, including the aforesaid banking institutions and payment processing services providers, knowingly aided and abetted TelexFree's Pyramid Ponzi Scheme;

450. Damages for any individual class member are likely insufficient to justify the cost of individual litigation, so that in the absence of class treatment, the Defendants' violations of

LAW, PLLC)

463. Plaintiffs incorporate by reference all allegations set forth in all previous paragraphs, as if the same were specifically set forth herein.

464. At the time of the wrongs alleged herein, Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC and Richard W. Waak, Attorney at Law, PLLC, were each a controlling person of TelexFree within the meaning of Section 20(a) of the Exchange Act.

465. By reason of their respective positions of authority, Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, Richard W. Waak, Attorney at Law, PLLC and Gerald P. Nehra, Attorney at Law, PLLC had the power and authority to influence and control, and did influence and control, the decision-making and activities of TelexFree and the affiliated TelexFree Entities and caused them to engage in the wrongful conduct described herein. Defendants, Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Nehra, Law Offices of Nehra and Waak, Richard W. Waak, Attorney at Law, PLLC and Gerald P. Nehra, Attorney at Law, PLLC, exercised control to cause the dissemination of false and misleading statements and omissions of material facts.

466. Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, Richard W. Waak, Attorney at Law, PLLC and Gerald P. Nehra, Attorney at Law, PLLC also materially aided in the sale of TelexFree AdCentral packages, which constitute securities, by actively promoting such

467. By virtue of their positions as controlling persons, and as a result of the
aforementioned conduct, Defendants are liable under Section 20(a) of the Exchange Act.

THIRD CLAIM FOR RELIEF
(FOR VIOLATIONS OF SECTIONS 5 AND 12(A)(L) OF
THE SECURITIES ACT OF 1933 AGAINST DEFENDANTS TELEXELECTRIC, LLLP;
TELEX MOBILE, HOLDINGS, INC.; MERRILL, WANZELER, LABRIOLA, CRAFT,
COSTA, AND OTHERS)

468. Plaintiffs incorporate by reference all allegations set forth in all previous paragraphs, as if the same were specifically set forth herein.

469. The Securities Act prohibits sale or delivery after sale of an unregistered security.

470. Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Costa, the Insider Promoter Does and others failed to file a true Registration Statement for TelexFree under the 1933 Act.

471. A Registration Statement must include the following: (1) the entity's properties and business, (2) a full description of the offered security, (3) information about the management of the entity, and (4) a financial statement certified by an independent auditor. None of these were provided.

472. By omitting this information, Defendants filed a false Form D.

473. Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Costa, the Insider Promoter Does and others also did not apply for or receive an exemption under Regulation D.

474. Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Costa, the Insider Promoter Does and others failed to provide to Plaintiffs access to the information that they were required to provide, including audited financial statements.

475. Plaintiffs purchased these securities without knowledge of the failure of Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Costa, the Insider Promoter Does and others to file the required Registration Statement or receive an exemption therefrom.

476. Plaintiffs would not have purchased the securities if Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Costa, the Insider Promoter Does and others provided the information required in a Registration Statement.

477. By virtue of the foregoing, Plaintiffs have been damaged and are entitled to damages, including rescission, and other relief for violations by Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Costa, the

Insider Promoter Does and others of Sections 5 and 12(a)(1) of the Securities Act of 1933 alleged herein.

FOURTH CLAIM FOR RELIEF
(FOR VIOLATIONS OF SECTION 11 OF THE SECURITIES ACT OF 1933
AGAINST DEFENDANTS TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS,
INC.; MERILL, WANZELER, LABRIOLA, CRAFT, CRAFT FINANCIAL, COSTA,
WAAK, NEHRA, LAW OFFICES OF NEHRA AND WAAK, GERALD P. NEHRA,
ATTORNEY AT LAW, PLLC AND RICHARD W. WAAK, ATTORNEY AT LAW,
PLLC)

478. Plaintiffs incorporate by reference all allegations set forth in all previous paragraphs, as if the same were specifically set forth herein.

479. During the class period, Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, Richard W. Waak, Attorney at Law, PLLC and Gerald P. Nehra, Attorney at Law, PLLC, fraudulently failed to convey facts material to the TelexFree AdCentral investment packages by failing to produce and file a Registration Statement.

480. In particular, they said Defendants intentionally avoided the requirement to produce a Registration Statement, and intentionally avoided disclosing that the AdCentral packages were, in fact, investments, and that financial returns on the AdCentral investments were derived from the proceeds received from the purchase of such investments, and not from the sale of the VoIP product.

481. Said Defendants had actual knowledge of the misrepresentations and omissions of material facts set forth herein.

482. Such misrepresentations and/or omissions were done knowingly for the purpose and effect of concealing the true information about the investments, including their financial condition and operations.

483. Said Defendants received information reflecting the true facts regarding the investment and TelexFree's business practices, exercised control over and/or receipt of the materially misleading misstatements and/or their association with the investment and made them

privity to confidential proprietary information concerning these investments.

484. Because of their control and/or association with the investment, Defendants were active and culpable participants in the fraudulent scheme.

485. Said Defendants knew and recklessly disregarded the falsity and misleading nature of the information that they caused to be disseminated to Investors.

486. The ongoing fraudulent scheme described herein could not have been perpetrated over a substantial period of time without the knowledge and complicity of the Defendants.

487. As a result of failure to disclose material facts, as set forth above, including their failure to file the requisite registration material, Investors paid artificially inflated prices for worthless membership interests in the investment during the Class Period.

488. By virtue of the foregoing, said Defendants have violated Section 11 of the Securities Act, and Plaintiffs and the Class have been damaged thereby, in an amount to be proven at trial.

FIFTH CLAIM FOR RELIEF
(FOR VIOLATIONS OF SECTION 12(A)(2) OF
THE SECURITIES ACT OF 1933 AGAINST DEFENDANTS TELEXELECTRIC, LLLP;
TELEX MOBILE, HOLDINGS, INC.; MERRILL, WANZELER, LABRIOLA, CRAFT,
COSTA, AND OTHERS)

489. Plaintiffs incorporate by reference all allegations set forth in all previous paragraphs, as if the same were specifically set forth herein.

490. Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Costa and others participated in the sale of securities to Plaintiffs that were unregistered and not exempt from registration.

491. At the time of their investments, Plaintiffs had no knowledge that the investments offered by TelexFree or Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Costa, the Insider Promoter Does and others were subject to registration requirements.

492. In fact, Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS,

INC.; Merrill, Wanzeler, Labriola, Craft, Costa and others knew or reasonably should have known that the TelexFree Agreement Contract and investment scheme was subject to the registration requirement of the Securities Act.

493. Both the TelexFree Contract and related materials distributed to Plaintiffs and the oral communications with Plaintiffs contained material omissions and misstatements.

494. Plaintiffs had no knowledge of the falsity of these statements or of the material omissions in the written materials including, but not limited to, Accounting Statements prepared by the accounting Defendants and other misrepresentations made by Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Costa and others as described above. Plaintiffs reasonably believed such statements were true.

495. Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Costa and others knew, or in the exercise of reasonable diligence, should have known, of the untruths and omissions.

496. Plaintiffs would not have purchased the securities if they had this knowledge.

497. As a result of these investments, Plaintiffs have been damaged.

498. Plaintiffs are entitled to rescind their purchases and recover the value of their interest in TelexFree. Plaintiffs seek rescission of their purchase of membership interests in TelexFree.

SIXTH CLAIM FOR RELIEF
(FOR VIOLATIONS OF MASSACHUSETTS GE TELEXELECTRIC, LLLP; TELEX
MOBILE, HOLDINGS, INC.; NERAL LAWS, CHAPTER 110A, SECTION 410(A)
AGAINST DEFENDANTS MERRILL, WANZELER, LABRIOLA, CRAFT, COSTA,
RODRIGUES, WWW GLOBAL BUSINESS, INC., DE LA ROSA, CROSBY, SLOAN,
AND THE DOE INSIDER PROMOTERS)

499. Plaintiffs incorporate by reference all allegations set forth in all previous paragraphs, as if the same were specifically set forth herein.

500. During the Class Period, Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Costa, Rodrigues, WWW

507. As a result of the dissemination of materially false and misleading information and the failure to disclose material facts, as set forth above, Investors paid artificially inflated prices for worthless membership interests in the investment during the Class Period.

509. By virtue of the foregoing, said Defendants have violated Section 410(a) of the Massachusetts Uniform Securities Act, M.G.L. c. 110A, and Plaintiffs have been damaged thereby, in an amount to be proven at trial.

SEVENTH CLAIM FOR RELIEF

511. At the time of the wrongs alleged herein, Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, Richard W. Waak, Attorney at Law, PLLC, Gerald P. Nehra, Attorney at Law, PLLC and others were each a controlling person, partner, officer, director, person occupying a similar status, or employee materially aiding in the sale of securities, of TelexFree within the meaning of Section 410(b) of the Massachusetts Uniform Securities Act, M.G.L. c. 110A.

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activities of TelexFree and the affiliated TelexFree entities and caused them to engage in the wrongful conduct described herein. Defendants Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, Richard W. Waak, Attorney at Law, PLLC and Gerald P. Nehra, Attorney at Law, PLLC exercised control to cause the dissemination of false and misleading statements and omissions of material facts.

513. By virtue of their positions as controlling person and top-level promoters, and as a result of the aforementioned conduct, Defendants are liable under Section 20(a) of the Exchange Act.

514. Plaintiffs seek the award of actual damages on behalf of the Class.

EIGHTH CLAIM FOR RELIEF
(NEGLIGENCE AGAINST ALL DEFENDANTS)

515. Plaintiffs incorporate by reference all allegations set forth in all previous paragraphs, as if the same were specifically set forth herein.

516. At all times material herein, Defendants owned a duty to Plaintiffs to act with a level of care to avoid misstating TelexFree's financial information or its returns; and to comply with all applicable laws concerning TelexFree, including, without limitation, federal and state securities laws.

517. By virtue of misstating and omitting relevant financial information, including the returns to Promoter/Investors, TelexFree breached its duty of care owed to Plaintiffs, the Putative Class Plaintiffs and similarly situated Plaintiffs.

518. As a direct and proximate result of Defendants' negligence and carelessness, Plaintiffs, the Putative Class Plaintiffs and similarly situated Plaintiffs have been caused to suffer and sustain damages and losses.

NINTH CLAIM FOR RELIEF
(NEGLIGENT MISREPRESENTATION AGAINST DEFENDANTS
TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; MERRILL,
WANZELER, LABRIOLA, COSTA, CRAFT, CRAFT FINANCIAL, COSTA, NEHRA,
LAW OFFICES OF NEHRA AND WAAK, RICHARD W. WAAK, ATTORNEY AT LAW,
PLLC AND GERALD P. NEHRA, ATTORNEY AT LAW, PLLC, RODRIGUES, DE LA
ROSA, CROSBY, AND SLOAN)

519. Plaintiffs incorporate by reference all allegations set forth in all previous paragraphs, as if the same were specifically set forth herein.

520. Defendants, TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC, Richard W. Waak, Attorney at Law, PLLC and others, directly and through their agents, servants, employees and/or representatives, did negligently make false representations of material fact to the said Plaintiffs, with said misrepresentations being made for the purpose of obtaining and/or wrongfully appropriating and converting money from Plaintiffs.

521. Said Defendants made negligent representations although Defendants knew, or should have known, that such representations were false.

522. Said representations and statements were material and were relied upon by the said Plaintiffs, inducing them to furnish money to Defendants.

523. In consequence of said reliance on the negligent misrepresentations, the said Plaintiffs have suffered great financial losses, and have also incurred considerable expenses and loss of income, and have otherwise been greatly damaged.

TENTH CLAIM FOR RELIEF
(INTENTIONAL MISREPRESENTATION AGAINST DEFENDANTS
TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; MERILL,
WANZELER, LABRIOLA, COSTA, CRAFT, CRAFT FINANCIAL, COSTA, NEHRA,
LAW OFFICES OF NEHRA RICHARD W. WAAK, ATTORNEY AT LAW, PLLC AND
WAAK, GERALD P. NEHRA, ATTORNEY AT LAW, PLLC RODRIGUES, DE LA
ROSA, CROSBY, AND SLOAN, DOE INSIDER PROMOTERS, AND OTHERS)

524. Plaintiffs incorporate by reference all allegations set forth in all previous paragraphs, as if the same were specifically set forth herein.

525. Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Waak, Nehra, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC, Richard W. Waak, Attorney at Law, PLLC Rodrigues, De La Rosa, Crosby, And Sloan, Doe Insider Promoters and others directly and

526. Defendants made said intentional misrepresentations although Defendants knew that such representations were false.

528. In consequence of said reliance on the intentional misrepresentations, the said Plaintiffs have suffered great financial losses, and have also incurred considerable expenses and loss of income, and have otherwise been greatly damaged.

(PROFESSIONAL MALPRACTICE AGAINST DEFENDANTS CRAFT, CRAFT FINANCIAL, NEHRA, WAAK, LAW OFFICES OF NEHRA AND WAAK, GERALD P. NEHRA, ATTORNEY AT LAW, PLLC AND RICHARD W. WAAK, ATTORNEY AT LAW, PLLC)

530. At all times material herein, Defendant Craft, Craft Financial, Nehra, Waak, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC and Richard W. Waak, Attorney at Law, PLLC, were the providers of professional accounting and legal services.

532. The said Defendants breached their duty to Plaintiffs by negligently certifying and representing to Plaintiffs and the public that the business model and operations of TelexFree were legal, proper, and economically viable and sustainable, when in fact TelexFree's business model and operations constituted an illegal and unsustainable Ponzi scheme.

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discharge of their investigatory duties as certified public accountants and attorneys of TelexFree.

534. Furthermore, Defendants Craft and Craft Financial negligently failed to ensure that TelexFree maintained proper accounting records.

535. As a result of the professional negligence of said Defendants, Plaintiffs and the public were misled to belief that TelexFree were legal, proper, and economically viable and sustainable.

536. As a direct and proximate consequence of the aforementioned negligence of the said Defendants, Plaintiffs sustained injuries and losses.

TWELFTH CLAIM FOR RELIEF

(BREACH OF FIDUCIARY DUTY AGAINST DEFENDANTS TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; MERRILL, WANZELER, LABRIOLA, CRAFT, CRAFT FINANCIAL, COSTA, NEHRA, WAAK, LAW OFFICES OF NEHRA AND WAAK, GERALD P. NEHRA, ATTORNEY AT LAW, PLLC AND RICHARD W. WAAK, ATTORNEY AT LAW, PLLC)

537. Plaintiffs incorporate by reference all allegations set forth in all previous paragraphs, as if the same were specifically set forth herein.

538. Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Costa, Craft, Craft Financial, Costa, Nehra, Waak, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC and Richard W. Waak, Attorney at Law, PLLC and others owe to Plaintiffs, a duty of utmost good faith and fair dealing.

539. The said Defendants violated their duty by actively misrepresenting and fraudulently failing to convey facts material to the TelexFree AdCentral investment packages.

540. Said Defendants had actual knowledge of the fraudulent and deceptive misrepresentations and omissions of material facts set forth herein.

541. Such misrepresentations and/or omissions were done knowingly for the purpose and effect of concealing the true information about the investments, including their financial condition and operations.

542. Said Defendants received information reflecting the true facts regarding the

551. Such misrepresentations and/or omissions were made knowingly for the purpose and effect of concealing the true information about the investments, including their financial condition and operations.

552. Said Defendants received information reflecting the true facts regarding the investment and TelexFree's business practices, exercised control over and/or receipt of the materially misleading misstatements and/or their association with the investment and made them privy to confidential proprietary information concerning these investments.

553. Because of their control and/or association with the investment, said Defendants were active and culpable participants in the fraudulent scheme.

554. Said Defendants knew and recklessly disregarded the falsity and misleading nature of the information that they caused to be disseminated to Investors.

555. Said Defendants, through the aforesaid fraudulent and deceptive misrepresentations and omissions of material facts, breached their covenant of good faith and fair dealing owed to the Plaintiffs.

556. As a result of the foregoing breach of the covenant of good faith and fair dealing by said Defendants, Investors paid artificially inflated prices for worthless membership interests in the investment during the Class Period.

FOURTEENTH CLAIM FOR RELIEF
(UNJUST ENRICHMENT AGAINST DEFENDANTS TELEXELECTRIC, LLLP;
TELEX MOBILE, HOLDINGS, INC.; MERRILL, WANZELER, LABRIOLA, CRAFT,
CRAFT FINANCIAL, COSTA, RODRIGUES, WWW GLOBAL BUSINESS, INC., DE LA
ROSA CROSBY, SLOAN, DOE INSIDER PROMOTERS AND OTHERS)

557. Plaintiffs incorporate by reference all allegations set forth in all previous paragraphs, as if the same were specifically set forth herein.

558. Plaintiffs furnished funds, directly or indirectly, to Defendants TelexFree, Merrill, Wanderer, Labriola, Craft, Craft Financial, Costa, Rodrigues, WWW Global Business, De La Rosa, Crosby, Sloan and others, which funds were accepted by Defendants without protest or defect.

559. Said Defendants have unlawfully and in bad faith denied Plaintiffs access to such funds, and have instead retained the benefit of such funds for themselves.

560. As a direct and proximate result of the foregoing actions of said Defendants, as hereinabove set forth, the said Defendants are, and continue to be, unjustly enriched.

FIFTEENTH CLAIM FOR RELIEF
(FRAUD AGAINST DEFENDANTS TELEXELECTRIC, LLLP; TELEX
MOBILE, HOLDINGS, INC.; MERRILL, WANZELER, LABRIOLA, COSTA, CRAFT,
CRAFT FINANCIAL, COSTA, NEHRA, WAAK, LAW OFFICES OF NEHRA AND
WAAK, GERALD P. NEHRA, ATTORNEY AT LAW, PLLC AND RICHARD W.
WAAK, ATTORNEY AT LAW, PLLC, RODRIGUES, WWW GLOBAL BUSINESS,
INC., DE LA ROSA, CROSBY, SLOAN, AND OTHERS)

561. Plaintiffs incorporate by reference all allegations set forth in all previous paragraphs, as if the same were specifically set forth herein.

562. Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Costa, Craft, Craft Financial, Costa, Nehra, Waak, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC and Richard W. Waak, Attorney at Law, PLLC, Rodrigues, WWW Global Business, De La Rosa, Crosby, Sloan and others repeatedly misrepresented and intentionally failed to convey to Plaintiffs facts material to the TelexFree AdCentral investment packages.

563. Defendants had actual knowledge of the fraudulent and deceptive misrepresentations and omissions of material facts set forth herein.

564. Such misrepresentations and/or omissions were done knowingly for the purpose and effect of concealing the true information about the investments, including their financial condition and operations.

565. Defendants received information reflecting the true facts regarding the investment and TelexFree's business practices, exercised control over and/or receipt of the materially misleading misstatements and/or their association with the investment and made them privy to confidential proprietary information concerning these investments.

566. Because of their control and/or association with the investment, Defendants were active and culpable participants in the fraudulent scheme.

569. As a result of the foregoing fraud perpetrated by Defendants, Investors paid artificially inflated prices for worthless membership interests in the investment during the Class Period.

570. Plaintiffs incorporate by reference all allegations set forth in all previous
phs, as if the same were specifically set forth herein.

572. Said Defendants rendered such substantial assistance despite their knowledge that TelexFree's operations constituted an illegal and unsustainable pyramid Ponzi scheme and financial fraud.

SEVENTEENTH CLAIM FOR RELIEF

PROCESSORS, PARALEGAL DOE AND OTHERS)

EIGHTEENTH CLAIM FOR RELIEF

FINANCIAL, WADDELL & REED, GPG, IPS, PROPAY, BASE COMMERCE,

587. Defendants TelexElectric, Telex Mobile, Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Rodrigues, WWW Global Business, De La Rosa, Crosby, Sloan, Nehra, Waak, Law Offices of Nehra And Waak, Gerald P. Nehra, Attorney at Law, PLLC, Richard W. Waak, Attorney at Law, PLLC, Doe Insider Promoters, and Others have combined to enter into a civil conspiracy, for an unlawful purpose and using unlawful means, with the intent of so combining to unlawfully defraud Plaintiffs out of funds.

588. In consequence of the foregoing, Plaintiffs sustained damages and losses.

TWENTIETH CLAIM FOR RELIEF

(CONVERSION AGAINST DEFENDANTS TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; MERRILL, WANZELER, LABRIOLA, CRAFT, CRAFT FINANCIAL, COSTA, RODRIGUES, WWW GLOBAL BUSINESS, DE LA ROSA, CROSBY, SLOAN, DOE INSIDER PROMOTERS, AND OTHERS)

589. Plaintiffs incorporate by reference all allegations set forth in all previous paragraphs, as if the same were specifically set forth herein.

590. Defendants TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Rodrigues, WWW Global Business, De La Rosa, Crosby, Sloan, Doe Insider Promoters, and Others have unlawfully converted Plaintiffs' funds, by obtaining the same through knowing misrepresentations made to Plaintiffs and the public.

591. Said Defendants continue to retain funds unlawfully converted from Plaintiffs.

592. In consequence of the foregoing, Plaintiffs sustained damages and losses.

TWENTY-FIRST CLAIM FOR RELIEF

(FOR VIOLATIONS OF MASSACHUSETTS GENERAL LAWS, CHAPTER 93A, SECTION 2 AGAINST DEFENDANTS TELEXELECTRIC, TELEX MOBILE, MERRILL, WANZELER, LABRIOLA, CRAFT, CRAFT FINANCIAL, COSTA, RODRIGUES, WWW GLOBAL BUSINESS, INC., DE LA ROSA, CROSBY, SLOAN, NEHRA, WAAK, LAW OFFICES OF NEHRA AND WAAK, GERALD P. NEHRA, ATTORNEY AT LAW, PLLC, RICHARD W. WAAK, ATTORNEY AT LAW, PLLC, BANK OF AMERICA, BANK OF AMERICA, N.A., TD BANK, CITIZENS FINANCIAL, CITIZENS BANK, FIDELITY BANK, MIDDLESEX SAVINGS, WELLS FARGO, WELLS FARGO BANK, FIDELITY INVESTMENTS, WADDELL & REED FINANCIAL, WADDELL & REED, GPG, IPS, PROPAY, BASE COMMERCE, VANTAGE PAYMENTS, AND THE DOE DEFENDANTS)

593. Plaintiffs incorporate by reference all allegations set forth in all previous

599. At all times material herein, Defendants, TelexElectric, Telex Mobile, Merrill, Wanzeler, Labriola, Craft, Craft Financial, Costa, Rodrigues, WWW Global Business, De La Rosa, Crosby, Sloan, Nehra, Waak, Law Offices of Nehra and Waak, Gerald P. Nehra, Attorney at Law, PLLC, Richard W. Waak, Attorney at Law, PLLC, Bank of America, Bank Of America, N.A., TD Bank, Citizens Financial, Citizens Bank, Fidelity Bank, Middlesex Savings, Wells Fargo, Wells Fargo Bank, Fidelity Investments, Waddell & Reed Financial, Waddell & Reed, GPG, IPS, ProPay, Base Commerce, Vantage Payments, and the Doe Defendants were associated in an enterprise as defined by 18 U.S.C. 1961(4).

600. Such enterprise was engaged in unlawful and illegal activities, including, *inter alia*, securities fraud and financial fraud, as set forth more fully throughout this Complaint, and which made use of the means and instrumentalities of interstate commerce and which crossed jurisdictional lines.

601. Throughout their involvement with such enterprise, the said Defendants engaged in a pattern of securities fraud, financial fraud, and other illegal and wrongful behavior, comprising numerous instances of such illegal and wrongful behavior.

602. Such illegal and wrongful behavior constitutes “racketeering activity” as defined by 18 U.S.C. 1961(1).

603. The said Defendants were aware of the illegal and fraudulent nature of the enterprise.

604. The said Defendants each actively participated in the enterprise and its pattern of racketeering activity.

605. The said Defendants each received income, directly or indirectly, as a result of the enterprise and its pattern of racketeering activity.

606. The said Defendants did further conspire to engage in such pattern of racketeering activity.

607. In consequence of the said Defendants’ unlawful enterprise and pattern of racketeering activity Plaintiffs have suffered great financial losses, and have also incurred

CONCLUSION

WHEREFORE, Plaintiffs, on behalf of themselves and the Class, pray for judgment as follows:

1. Declaring this action to be a Class Action properly maintained pursuant to the Federal Rules of Civil Procedure and certifying Plaintiffs as the class representatives;
 2. Awarding Plaintiffs and Class members rescission and/or compensatory damages against Defendants for all damages sustained as a result of their wrongdoing, in an amount to be proven at trial, including interest;
 3. For an award of actual damages, compensatory damages, statutory damages, and statutory penalties, in an amount to be determined;
 4. For an award of punitive damages;
 5. For an award of costs of suit and attorneys' fees, as allowable by law;
 6. For an award of interest;
 7. For the appointment of a receiver selected by Class Counsel and an accounting;
- and
8. For an award to Plaintiffs and the Class such other and further relief as may be just and proper under the circumstances including equitable relief.

DEMAND FOR JURY TRIAL

Plaintiffs hereby demand a jury trial of their claims to the extent authorized by law. However, the Plaintiffs do not consent to trial by jury in the United States Bankruptcy Court.

Respectfully submitted,

This 2nd day of June, 2014

THE CRESCENT LAW PRACTICE

Имя Крестного

Ihuoma Igboanugo, Esq.
North Carolina Bar No. 46618
P.O Box 41333
Raleigh, NC 27629

EXHIBIT F

UNITED STATES JUDICIAL PANEL
on
MULTIDISTRICT LITIGATION

IN RE: TELEXFREE SECURITIES LITIGATION

MDL No. 2566

TRANSFER ORDER

Before the Panel:^{*} Pursuant to 28 U.S.C. § 1407, plaintiffs in one District of Massachusetts action move to centralize this litigation in that district. The litigation consists of six actions pending in three districts, as listed on Schedule A.¹ Since the filing of the motion, the Panel has been notified of six related actions.² Plaintiffs in all actions and all responding defendants³ support or do not oppose centralization in the District of Massachusetts.

On the basis of the papers filed and the hearing session held, we find that the actions listed on Schedule A involve common questions of fact, and that centralization in the District of Massachusetts will serve the convenience of the parties and witnesses and promote the just and efficient conduct of this litigation. These actions share factual questions relating to the allegation that the TelexFree companies⁴ operated a Ponzi pyramid scheme involving the recruitment of investors in marketing TelexFree's telephone service plan and that defendants directly participated in or aided and abetted the alleged scheme. Centralization will eliminate duplicative discovery; prevent inconsistent pretrial rulings, especially with respect to class certification; and conserve the resources of the parties, their counsel and the judiciary.

Weighing all factors, we are persuaded that the District of Massachusetts is the most appropriate location for this litigation. The events giving rise to the alleged claims primarily occurred in Massachusetts, which is the principal place of business of the TelexFree companies. The federal and state enforcement actions against TelexFree and affiliated individuals are pending there. Thus,

* Judge Ellen Segal Huvelle took no part in the decision of this matter.

¹ The *Ferguson* action listed on Schedule A originally was pending in the Eastern District of North Carolina, but recently was transferred to the District of Massachusetts.

² These and any other related actions are potential tag-along actions. See Panel Rules 1.1(h), 7.1 and 7.2.

³ The responding defendants are Citizens Bank of Massachusetts; Citizens Financial Group, Inc.; Fidelity Co-Operative Bank; Fidelity Bank; Middlesex Savings Bank; TD Bank, N.A.; Wells Fargo & Company; Wells Fargo Bank, N.A.; Bank of America Corporation; Bank of America, N.A.; Propay, Inc.; Propay.com; Waddell & Reed Financial, Inc.; Waddell & Reed, Inc.; Global Payroll Gateway, Inc.; and Base Commerce, LLC.

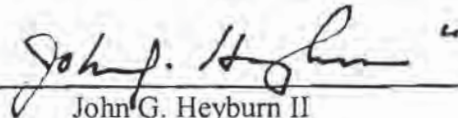
⁴ The TelexFree companies are TelexFree, Inc.; TelexFree, LLC; and TelexFree Financial, Inc.

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the primary witnesses and other evidence likely will be located in Massachusetts. Additionally, transfer of actions to this district will facilitate coordination with the TelexFree bankruptcy cases, which also are pending in this district. The Honorable Timothy S. Hillman, to whom we assign this litigation, presides over the related criminal action and thus is familiar with the factual and legal issues presented by these actions. We are confident he will steer this litigation on a prudent course.

IT IS THEREFORE ORDERED that pursuant to 28 U.S.C. § 1407, the actions listed on Schedule A and pending outside the District of Massachusetts are transferred to the District of Massachusetts and, with the consent of that court, assigned to the Honorable Timothy S. Hillman for coordinated or consolidated pretrial proceedings.

PANEL ON MULTIDISTRICT LITIGATION



John G. Heyburn II
Chairman

Marjorie O. Rendell
Lewis A. Kaplan
R. David Proctor

Charles R. Breyer
Sarah S. Vance

IN RE: TELEXFREE SECURITIES LITIGATION

MDL No. 2566

SCHEDULE A

Southern District of Florida

GUEVARA v. MERRILL, ET AL., C.A. No. 1:14-22405

Northern District of Georgia

COOK v. TELEXELECTRIC, LLLP, ET AL., C.A. No. 2:14-00134

District of Massachusetts

GITHERE, ET AL. v. TELEXELECTRIC, LLLP, ET AL., C.A. No. 1:14-12825
MARTIN, ET AL. v. TELEXFREE, INC., ET AL., Bky. Adv. No. 4:14-04044
CELLUCCI, ET AL. v. TELEXFREE, INC., ET AL., Bky. Adv. No. 4:14-04057
FERGUSON, ET AL. v. TELEXELECTRIC, LLLP, ET AL., C.A. No. 4:14-40138

I hereby certify on 10/22/14 that the
foregoing document is true and correct copy of the
☐ electronic docket in the captioned case
☒ electronically filed original filed on 10/21/14
☐ original filed in my office on _____

Robert M. Farrell
Clerk, U.S. District Court
District of Massachusetts

By: Sherry Jones
Deputy Clerk

EXHIBIT G

UNITED STATES DISTRICT COURT

DISTRICT OF MASSACHUSETTS

IN RE: TELEXFREE SECURITIES LITIGATION

This Document Relates To:

All Cases

MDL No. 4:14-md-2566-TSH

CELIO DA SILVA, RITA DOS SANTOS,
PUTATIVE CLASS REPRESENTATIVES AND
THOSE SIMILARLY SITUATED,
Plaintiffs,

V.

TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.; JAMES M. MERRILL; CARLOS N. WANZELER; STEVEN M. LABRIOLA; JOSEPH H. CRAFT, a/k/a JOE H. CRAFT; CRAFT FINANCIAL SOLUTIONS, LLC; ANN GENET; CARLOS COSTA; KATIA WANZELER; SANDERLEY RODRIGUES DE VASCONCELOS; SANTIAGO DE LA ROSA; RANDY N. CROSBY; FAITH R. SLOAN; DANIIL SHOYFER; SCOTT MILLER; GERALD P. NEHRA, individually and doing business as LAW OFFICES OF NEHRA AND WAAK; GERALD P. NEHRA ATTORNEY AT LAW, PLLC; RICHARD W. WAAK, individually and doing business as LAW OFFICES OF NERHA AND WAAK; RICHARD W. WAAK, ATTORNEY AT LAW, PLLC; OPT3 SOLUTIONS, INC.; JASON A. BORROMEI; PRICEWATERHOUSECOOPERS, LLP; BANK OF AMERICA, NA; TD BANK, NA; RSB CITIZENS, N.A.; FIDELITY CO-OPERATIVE BANK, doing business as FIDELITY BANK; JOHN F. MERRILL; WELLS FARGO BANK, N.A.; SYNOVUS BANK; GLOBAL PAYROLL GATEWAY INC.; INTERNATIONAL PAYOUT SYSTEMS, INC.; PROPAY, INC., doing business as PROPAY.COM; BASE COMMERCE, LLC, doing business as PHOENIX PAYMENTS; JOHN HUGHES; VANTAGE PAYMENTS, LLC; DUSTIN SPARMAN; ALLIED WALLET, LTD; DOE TOP LEVEL PROMOTERS; DOE LICENSED PROFESSIONALS; DOE BANKS; DOE PAYMENT PROCESSING SERVICES AND PARALEGAL DOE.

Defendants.

CLASS ACTION

SECOND CONSOLIDATED AMENDED COMPLAINT

DEMAND FOR TRIAL BY JURY

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1. TelexFree, Inc., TelexFree, LLC, and TelexFree Financial, Inc. (collectively, “TelexFree”) and its related entities and individuals operated an illegal scheme whereby it sold “memberships,” ostensibly paid its “promoters” (“Members” or “Promoters”) for placing advertisements for a “voice over internet protocol” (“VoIP”) product, and in reality paid them to recruit other investors whose new membership fees kept the scheme afloat (the “TelexFree Program”).

3. TelexFree’s business and operations constituted an illegal Pyramid Scheme (the “Pyramid Scheme”). A pyramid scheme is a form of a Ponzi scheme wherein a business enterprise persuades people to invest money into a seemingly legitimate business model and in exchange guarantees profits. The actual sales or services provided, if any, are insufficient to pay the promised returns to investors. The operation of a pyramid scheme relies entirely on additional investment funding by new or existing investors. Once the influx of new investments stops, the pyramid scheme collapses because there are no new funds with which to pay previous investors. Pyramid schemes are lucrative for those who occupy top-level or other like positions and for those who service them.

5. TelexFree raised as much as \$1 billion dollars over the course of eighteen months as follows:

(*Law enforcement authorities shut down TelexFree on April 15, 2014.)

7. TelexFree's founders and principals, executive officers and top level promoters controlled the activities and operations of TelexFree and knowingly, maliciously and willfully conspired to perpetrate, and did perpetrate, the TelexFree Pyramid Scheme with full awareness of its unfair, deceptive, and unlawful nature. Licensed professionals and others were negligent or reckless in providing advice, directly participated in, or otherwise provided essential substantial assistance after knowing the TelexFree business enterprise was unlawful.

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9. The Financial Services Defendants were required by federal law to, and did, maintain robust, sophisticated and thorough due diligence systems at all times.

11. TelexFree was purportedly a contract-based business. All TelexFree Promoters, including Plaintiffs and members of the putative class, were similarly obligated to enter into TelexFree's identical form contract ("TelexFree Pre-March 9 Contract"). A true and correct copy of the Pre-March 9 TelexFree Contract is attached hereto as Exhibit 1.

13. M.G.L., Chapter 93, Section 69(d)(2) prohibits any multi-level distribution company from offering or paying any “finder’s fee, bonus, refund, override, commission, cross-commission, dividend or other consideration” to any participant therein “solely for the solicitation or recruitment of other participants.”

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promising payment merely for recruitment of new Participants¹ as defined by M.G.L., Chapter 93, Section 69, including, but not limited to, the following:

- a. Clause 5.7: “A PROMOTER will achieve TEAM BUILDER status when he is active in an ADCentral FAMILY position (in the marketing network) that has 10 (ten) ADCentral FAMILIES on the incentive plan registered directly by him on his site.”
- b. Clause 5.7.1: “As long as he is fulfilling the qualification in clause 5.9.2² [sic], a TEAM BUILDER will earn a payment of 2% (two percent) of the company’s net billing in the following month...the maximum amount for this earning, by contract, which is for one year, is up to US\$ 39,600.00...” (emphasis added).
- c. Clause 5.8: “THE PROMOTER shall receive as an incentive a bonus of US\$ 20.00 (twenty U.S. dollars), for each VOIP ADCentral kit that his direct lower PARTNER acquires and a US\$ 100.00 (one hundred U.S. dollars) bonus for each VOIP FAMILY kit that his direct lower PARTNER acquires.”
- d. Clause 6.1: “A PROMOTER who directly registers 2 (two) new promoters, with one on the left side and the other on the right side of his marketing network, qualifies for direct and indirect binary earnings, and for 2% (two percent) of the network from the first to the 6th level, assessed only on plans whose owners have at least one active VOIP client, that is, who have at least one active 99TELEXFREE plan.”
- e. Clause 6.1.1: Upon qualifying in the manner described in the clause above by selling 2 (two) new ADCENTRAL kits to people in his network, with 1 (one) on the left side and the other on the right side, he shall receive an additional gratuity of US\$20 (twenty U.S. dollars), called the binary cycle, with the maximum daily earning in this status being US\$ 440.00 (four hundred and forty U.S. dollars), for 22 (twenty-two) binary cycles.”
- f. Clause 6.1.2: If the sale is of 2 (two) VOIP ADCentral FAMILY kits, this cycle will yield an additional US\$ 20.00 (twenty U.S. dollars), for the ADCentral principals, plus US\$ 60 (sixty U.S. dollars), for 3 (three) of the 4 (four) ADCentral additional...”
- g. Clause 8.1: “THE PROMOTER shall be entitled to a payment of 1% (one percent), in the form of ROYALTIES, from the company’s net billing, if within 1 (one) calendar month (from the 1st (first) day – to the last day of the month) the

¹ For ease of reading, the terms “Member,” “Promoter” or “Participant,” regardless of capitalization, are at all times herein to be construed as “Participant” defined by M.G.L. Chapter 93, Section 69.

² The TelexFree Pre-March 9 Contract does not include a clause numbered 5.9.2.

PROMOTER shall have closed 22 (twenty-two) cycles in 20 (twenty) days, which need not necessarily be consecutive days.”

15. The above provisions of the standard TelexFree Pre-March 9 Contract are clear and direct violations of M.G.L. c. 93, § 69(d), as they promise payments, including cash payments, “bonuses,” “gratuities,” “royalties,” and dividends, merely for the recruitment of new TelexFree members/participants (i.e. through the sale of AdCentral membership accounts).

16. Furthermore, M.G.L. Chapter 93, Section 69(d)(3)-(4) also prohibits any multi-level distribution company from offering or paying any “finder’s fee, bonus, refund, override, commission, cross-commission, dividend or other consideration” to any participant therein:

- a. “unless such participant performs a bona fide and essential supervisory, distributive, selling or soliciting function in the sale or delivery of such product or services,”
- b. “where no amount of judgment or skill exercised by the participant has any appreciable effect” upon such payment,” or
- c. “where the participant is without that degree of control over the operation of such plan as to enable him substantially to affect the amount” of such payment.

17. The TelexFree Pre-March 9 Contract, on its face, contains clear, obvious and direct violations of M.G.L. c. 93, § 69(d)(3)-(4), including:

- a. Clause 5.4: “ADCENTRAL PROMOTERS: After setting up his membership, a PARTNER may acquire an “ADCentral” kit consisting of 10 99TELEXFREE VOIP accounts, for which he must pay the equivalent of US\$ 289.00 (two hundred and eighty-nine U.S. dollars).”
- b. Clause 5.4.1: “with this qualification, the PARTNER will become a TELEXFREE PROMOTER and, accordingly, shall have his own active ad central for 12 (twelve) months, counting from the date of his membership (and not from the date of the purchase of the kit).”
- c. Clause 5.4.2: “He must also post 1 (one) announcement (prepared by TELEXFREE) per day on internet announcement sites (whether free of charge or not), so that at the end of each cycle of 7 (seven) announcements for the week, the PROMOTER shall receive one 99TELEXFREE account.”

- d. Clause 5.5: “ADCENTRAL FAMILY MEMBERSHIP – A PROMOTER wishing to attain the status of an “ADCentral FAMILY Member” must pay the equivalent of US\$ 1,375.00 (one thousand three hundred and seventy-five U.S. dollars).”
- e. Clause 5.5.1: “With this membership, a PROMOTER shall have 5 (five) active announcement centrals for 12 (twelve) months, counting from the date of his activation.”
- f. Clause 5.5.2: “He must, in turn, post 1 (one) announcement (prepared by TELEXFREE) per day at internet announcement sites (whether free of charge or not) on each one of the 5 (five) ADCentral sites. At the end of the 35 (thirty-five) announcements the PROMOTER shall receive 5 (five) 99TELEXFREE accounts as remuneration for these announcements.”

18. The above-cited language makes it clear to a sophisticated reader that TelexFree Members were not required to engage in any “bona fide and essential supervisory, distributive, selling or soliciting” nor exercise any “judgment,” “skill” or “control over the operation.”

19. Rather, Members were only required to engage in the activity of cutting-and-pasting spam advertisements, which were “prepared by TELEXFREE,” onto “internet announcement sites,” and would receive “remuneration for these announcements.”

20. Furthermore, VoIP products distributed to Members as remuneration for this mindless spamming activity could be redeemed with TelexFree for cash, resulting in cash remuneration.

21. M.G.L. Chapter 93, Section 69(b) requires as follows: “Every multi-level distribution company shall provide in its contract of participation that such contract may be cancelled for any reason at any time by a participant upon notification in writing to the company of his election to cancel. If the participant has purchased products while the contract of participation was in effect, all unencumbered products in a resaleable condition then in the possession of the participant shall be repurchased ...”

22. The TelexFree Pre-March 9 Contract, on its face, contains egregious, obvious

www.TelexFree.com:



Chapter 93, Section 69:

- a. promising that Members would “[e]arn US\$20 for the direct registration of each new promoter,” in violation of Section 69(d)(2);
- b. promising that Members would “[e]arn US\$20 per cycle each time you register 1 ADCentral in your left and 1 in your right, doesn’t matter if they are direct, indirect, or gotten by transfer,” in violation of Section 69(d)(2);

28. The above violations of M.G.L. Chapter 93, Section 69 were also plain evidence

29. The facts and circumstances set forth herein establish that the sophisticated notice,

30. As a result of their compliance with federal law, each of the Financial Services

Defendants was actually aware of facts and evidence of suspicious, tortious or illegal TelexFree activity (“Red Flags”).

31. When a bank finds out that a client is laundering money or running an unlawful enterprise, it must stop servicing or shut down the accounts, terminate the banking relationship, and file a Suspicious Action Report (“SAR”) with the Financial Crimes Enforcement Network.

32. During the class period, the Financial Services Providers unlawfully failed to timely or sufficiently meet these obligations.

33. Each of the Financial Services Defendants was a substantial and integral cog in TelexFree’s unlawful United States Pyramid Scheme, and, without that assistance, the Scheme would not have been able to get off the ground, develop, maintain or thrive. Each Financial Services Defendant was motivated by substantial profits and other interests at the local and national level gained from its relationship with TelexFree and other Defendants, as well as a desire to maintain their personal and lucrative relationships with the multilevel marketing industry as a whole.

34. Similarly situated Plaintiffs seek compensation for the ascertainable economic loss they were similarly caused to suffer as a result of Defendants’ participation in, or aiding or abetting of, TelexFree’s illegal Pyramid Scheme. They also seek equitable relief.

I. JURISDICTION AND VENUE

35. This Court has subject-matter jurisdiction over the instant matter pursuant to 28 U.S.C. § 1332(d) and the Class Action Fairness Act of 2005 (“CAFA”), 28 U.S.C. §§ 1711, *et seq.*, which vest original jurisdiction in the district courts of the United States for any multi-state class action where the aggregate amount in controversy exceeds \$5,000,000 and where the citizenship of any member of the class of plaintiffs is different from that of any defendant. The

\$5,000,000 amount-in-controversy and diverse citizenship requirements of CAFA are satisfied in this case.

36. Venue is proper under 28 U.S.C. § 1391 since a substantial part of the acts, omissions and transactions giving rise to this action occurred in this district; certain Defendants reside in this district; and TelexFree, LLC, TelexFree, Inc. and TelexFree Financial, Inc. (related entities not named as Defendants) are currently debtors in Chapter 11 proceedings pending in this district.

II. THE PARTIES

A. PLAINTIFFS

37. Plaintiff Rita D. Dos Santos (“Dos Santos”) is an individual who resides in Massachusetts. Dos Santos, like many other victims of TelexFree’s Pyramid Scheme, tendered funds for a TelexFree Membership and its promised pre-March 9, 2014 return on investment (the “Original Return on Investment”).

38. Plaintiff Celio Da Silva (“Da Silva”) is an individual who resides in Massachusetts. Da Silva, like many other victims of TelexFree’s Pyramid Scheme, tendered funds for a TelexFree Membership and its promised Original Return on Investment.

B. DEFENDANTS

1. TELEXFREE DEFENDANTS

a. Third-Party TelexFree Bankrupt Entities

39. TelexFree, Inc., TelexFree, LLC and TelexFree Financial, Inc. are not currently Defendants due to their Chapter 11 bankruptcy protections, but they are third-party participants in the unlawful activities described in this complaint.

40. TelexFree, Inc. is a corporation duly organized and existing under the laws of the Commonwealth of Massachusetts, registered with the Corporations Division of the Secretary to

42. The last unnamed TelexFree entity is TelexFree Financial, Inc. (“TelexFree Financial”). TelexFree Financial, Inc. is a corporation duly organized and existing under the laws of the State of Florida, having its last known principal place of business at 2321 NW 37th Avenue, in Coconut Creek, Florida 33063. TelexFree Financial is a wholly-owned subsidiary of TelexFree, LLC.

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58. Randy N. Crosby (“Crosby”) has a last known usual place of abode of 30 Club Court, in Alpharetta, Georgia 30005. Crosby is a TelexFree Top Level Promoter.

59. Scott Miller (“Miller”) has a last known usual place of adobe of 973 Thornwood Drive, Greenwood, IN 46143. Miller is a TelexFree Top Level Promoter.

60. Faith R. Sloan (“Sloan”) has a last known usual place of abode of 515 E. End Avenue, Unit 105, in Calumet City, Illinois 60409. Sloan is a TelexFree Top Level Promoter.

61. Daniil Shoyfer (“Shoyfer”) has a last known usual place of abode of 123 Arbutus Avenue, in Staten Island, New York 10312. Shoyfer is a TelexFree Top Level Promoter.

62. Rodrigues, De La Rosa, Crosby, Sloan, Shoyfer, and Miller are collectively referred to herein as “Top Level Promoters.”

63. TelexFree’s Founders, Principal, Executive Office, Top Level Promoter Defendants are collectively referred to as “TelexFree’s Executives” or “Executives.”

64. By their acts and omissions, each above Founder, Principal, Executive Office, Top Level Promoter Defendant and Associated Individual Defendants transacted business in the Commonwealth of Massachusetts; contracted to supply services and things in the Commonwealth of Massachusetts; caused tortious injury to the putative class in the Commonwealth of Massachusetts; regularly solicited business and engaged in persistent courses of conduct in the Commonwealth of Massachusetts; made use of the laws, rights, and protections offered by the Commonwealth of Massachusetts; and derived substantial revenue from goods used or consumed or services rendered in the Commonwealth of Massachusetts.

b. Licensed Professionals including Attorneys and Other Professional Services Providers

65. Defendant Gerald P. Nehra, Esq. (“Nehra”) is an individual who now resides or formerly resided at 1710 Beach Street, Muskegon, Michigan, 49441 and also maintains a second

66. Defendant Gerald P. Nehra, Attorney at Law, PLLC (“Nehra Law Firm”) is a professional limited-liability company engaged in the practice of law and duly organized and existing under the laws of Michigan, with offices located at 1710 Beach Street, Muskegon, Michigan, 49441. Nehra is its sole member, manager, and registered agent.

68. Defendant Richard W. Waak, Attorney at Law, PLLC (“Waak Law Firm”) is a professional limited-liability company engaged in the practice of law and duly organized and existing under the laws of Michigan, with offices located at 11300 East Shore Drive, Delton, Michigan, 49046. Waak is its sole member, manager, and registered agent.

70. Nehra, Waak, Nehra Law Firm, Waak Law Firm, Nehra and Waak Law Firm, are collectively referred to herein as “Attorney Defendants.”

72. Defendant Jason A. Borromei, also known as Jay Borromei (“Borromei”), is an

individual with a last known place of abode located at 23952 Catbird Court, Laguna Niguel, California 92677. At all material times, Borromei served as president and authorized representative of Opt3.

73. Borromei and Opt3 are collectively referred to herein as “Other Professional Services Providers.”

74. By their acts and omissions, the Attorney Defendants and Other Professional Services Providers have transacted business in the Commonwealth of Massachusetts; contracted to supply services and things in the Commonwealth of Massachusetts; caused tortious injury to the putative class in the Commonwealth of Massachusetts; regularly solicited business and engaged in persistent courses of conduct in the Commonwealth of Massachusetts; made use of the laws, rights, and protections offered by the Commonwealth of Massachusetts; and derived substantial revenue from goods used or consumed or services rendered in the Commonwealth of Massachusetts.

c. The Accountant Defendants

75. Defendant Craft is a certified public accountant who privately provided accounting services and financial advice to TelexFree and others before he served as the chief financial officer of TelexFree, Inc. and TelexFree, LLC.

76. Defendant Craft Financial Solutions, LLC (“Craft Financial”) is a limited-liability company duly organized and existing under the laws of the State of Indiana with a principal place of business located at 825 E. Main Street, Boonville, Indiana, 47601-1885. Craft Financial provided accounting services and financial advice to TelexFree and others. Craft is also the sole member and manager of Craft Financial.

77. PricewaterhouseCoopers, LLP (“PricewaterhouseCoopers”) is a Registered foreign limited liability partnership, organized and existing under the laws of the State of

84. Wells Fargo Bank, N.A. (“Wells Fargo”) is a national banking institution in the United States chartered and is supervised by the federal Office of the Comptroller of the Currency, with an address at P.O. Box 6995, Portland, Oregon 97228 and a branch at 800 North Magnolia Ave., Orlando, Florida. Wells Fargo conducts business in the Commonwealth of Massachusetts at, *inter alia*, 201 Washington Street, in Boston, County of Suffolk, Commonwealth of Massachusetts. At all times material herein, Defendant Wells Fargo provided banking services, maintained accounts, and received and executed transfers of funds from or for the benefit of TelexFree.

86. John F. Merrill is an individual with a last known usual place of abode of 7 Kinnicutt Road, in Worcester, Massachusetts 01602.

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Commonwealth of Massachusetts.

112. Wanzeler and Merrill formed TelexFree, Inc. with the intent to use the same unlawful Ympactus business model in the United States.

113. After they opened TelexFree in the United States, the Operational Defendants methodically released false or misleading information that was intended to, and did, separate publicly TelexFree and TelexFree Brazil or Ympactus and otherwise shower their Scheme with credibility.⁵ While these calculated information releases were sufficient to mislead members of the class, they were detectable by the robust and sophisticated Financial Services Providers' Know Your Customer (as defined herein) investigations and evaluations.

114. In March 2012, Founders and Principals Costa, Merrill and Wanzeler repurposed Ympactus to front the TelexFree Brazil's VoIP pyramid scheme.

115. In April 2012, Craft was retained to serve as TelexFree's accountant and prepared its financial statements and taxes.⁶

116. As early as July 27, 2012, the multilevel marketing news site BehindMLM.com published a detailed analysis of TelexFree's business operation, concluding that:

The corporate structure of TelexFree and the obvious business relationship between the company and Disk a Vontade and complete lack of disclosure on either company's website is cause for concern...

Personally I believe the ridiculously high membership fee charged by TelexFree (a \$299 fee to publish ads for the company?) and the fact that individual members are able to purchase up to five membership positions strongly indicates a lack of external revenue here.⁷

117. Over the ensuing months, the number of online articles and websites

⁵ See, e.g., ¶¶ 126, 127, 129, 133, 134, 142, 147, 151, 155, 164, 528, *infra*; see also <http://behindmlm.com/companies/telexfree/gerry-nehra-gives-legal-blessing-to-telexfree/>.

⁶ See Omnibus Decl. of William H. Runge, Case 14-1552-abl, Doc. 13, ¶ 31. A true and correct copy of this Declaration is attached hereto as Exhibit 2.

⁷ See Exhibit 3, Decl. of Gray Echavarria at Attachment 5.

135. On June 19, 2013, the Brazilian Court in Acre issued an injunction putting “a stop to TelexFree Brazil’s business operations, including the registration of new affiliate investors, acceptance of new investments and paying any returns owed on existing affiliate investments.”¹¹

137. Labriola stated that “[t]hese things happen to network marketing companies over and over again... Let’s not worry about it.”

139. During or before June 2013 (and within weeks of having their Brazilian operation shuttered), Wanzeler, Merrill, Labriola and Costa, with the participation and assistance of others including the Defendants named in this complaint, placed an increased focus on and rapidly expanded their fraud in the United States under the name TelexFree.

¹¹ *Id.*

141. In July 2013, Newport Beach, California became the staging ground for TelexFree’s first United States-based “Extravaganza.” This was approximately one month after the Brazilian Court in Acre had frozen TelexFree’s Brazilian assets and enjoined TelexFree from any further membership or registration related efforts in Brazil,

143. Thomas More was a key spokesperson and authorized representative for Zeek Rewards. More held out that he had acquired over a million Zeek Rewards VIP points and otherwise greatly profited (from the fraud) while it lasted.

145. During the July 2013 “Super Weekend,” Defendant Miller took the stage and falsely promoted a connection and promotion with Best Western Hotel.

146. During the July 2013 TelexFree “Super Weekend,” Attorney Defendant Nehra gave his “blessing” to TelexFree, representing not only that it was a lawful enterprise and why, but also that he was a duly licensed attorney with extensive specialized skill and experience in MLM.¹⁴

147. During or about August 2013, Attorney Jeffery Babener, of the Law Firm Babener & Associates advised TelexFree Principals, Executive Office, Licensed Professionals

¹³ See Exhibit 4, Decl. Carol L. Harris, Exhibit 14.

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and others that TelexFree's business model, operations and payout scheme were an unlawful MLM and must be changed.

148. During or about August 2013, Attorney Babener advised TelexFree Principals, Executive Office, Licensed Professionals and others that the TelexFree MLM violated M.G.L. c. 93, §69 and, thus, M.G.L. c. 93A.

149. In or about August 2013, Brazilian Judge Braz Aristóteles dos Reis found that, in the public eye, TelexFree (Brazil) and Ympactus are one and the same company.

150. On August 19, 2013, the TelexFree FaceBook page falsely posted the following: "The President of Google involved with Telexfree!! Google's President will be speaking at our next Telexfree event in Brazil....11 year contract with Best Western 23 Millionaires in 1 year and now Google's President at our Next event. Hmmm is he coming to your's [sic]?. Didn't think so.... It's time to get educated. You get what you pay for!"

151. In fall 2013, the Secretary of the Commonwealth of Massachusetts, Securities Division ("SOC") raised questions concerning TelexFree's business model.

152. In late 2013, Costa withdrew his ownership in Ympactus.

153. Between mid-November 2013 and March 2014, TelexFree transferred approximately \$30 million from its operating accounts to its Principals and officers and to affiliate companies with the necessary assistance of the Financial Services Provider Defendants.

154. On or before December 2013, Craft was hired to serve and did thereafter serve as TelexFree, LLC's chief financial officer.

155. In a January 2014 TelexFree promotional video, Labriola misled potential Promoters with the intent that they invest in TelexFree by stating that "[t]here are some people that are making incredible money in this."

156. In January and February 2014, the SOC issued subpoenas.

157. On February 19, 2014, the National Bank of Rwanda, in conjunction with the Ministry of Trade and Industry of Rwanda, issued a report concluding that TelexFree's Rwanda-based affiliate, P.L.I. TelexFree Rwanda, Ltd., was a pyramid scheme and could facilitate money laundering, and that the Ministry of Trade and Industry subsequently banned any further operations in the country by TelexFree.

158. On February 20, 2014, United Kingdom authorities issued a public warning that TelexFree UK was a Ponzi scheme and that its Brazilian operation had been shut down.

159. During late February 2014 through early March 2014, TelexFree Principals, Executive Office, Licensed Professionals and Top Level Promoters developed during teleconferences strategies to siphon off funds and maximize the exploitation of the rank and file TelexFree Promoters.

160. During or about late February 2014 through early March 2014, TelexFree Principals, Executive Office, Licensed Professionals and Top Level Promoters held an invitation-only meeting at TelexFree's Marlborough, Massachusetts headquarters with the intent of siphoning off funds and maximizing the exploitation of the rank and file TelexFree Promoters.

161. On March 9, 2014, TelexFree unilaterally changed its compensation plan, for the first time requiring existing Promoters to actually sell its VoIP product to qualify for the payments that TelexFree had previously promised to pay them. Before making the change, TelexFree informed its highest grossing Top Level Promoters of the impending change in compensation and held a strategy meeting during which they discussed unfair, deceptive and unlawful ways to further fleece the rank and file TelexFree Members and ways to continue to profit from the unlawful business.

Commission (“SEC”) and the SOC for operating a Pyramid Scheme as detailed herein.

170. The DOJ announced at the March 3, 2015 status hearing in the above-captioned MDL 2566 that undisclosed Financial Service Providers are also the subjects of its ongoing investigations.

B. TelexFree's History, Formation and its Brazilian Links

171. In or about 2007, Wanzeler, Merrill, Costa and other Defendants began operating or assisting in the operation of purported telecommunications businesses in the United States and Brazil, under the names “Brazilian Help” and “Disk A Vontade Telefonica,” respectively, charging \$49.90 monthly for VoIP service.

172. Disk A Vontade Telefonica, Ltd., also known as Diskavontade, also known as Disk (“Disk A Vontade”), is a Brazilian limited liability company, now or formerly having its principal offices as Rua Jose Luiz Gabeira, NRO 170, APTO 103 Barro Vermelho.

173. Defendant Wanzeler is the chief executive officer of Disk A Vontade.

174. Defendant Merrill is vice president and a signatory of Disk A Vontade.

175. Disk A Vontade’s domain (“discavontade.com”) is registered to Defendant Wanzeler.

176. Brazilian Help, Inc. (“Brazilian Help”) is a domestic profit corporation, organized and existing under the laws of the Commonwealth of Massachusetts, now or formerly having a principal place of business at 225 Cedar Hill Street, Suite 118, in Marlborough, Massachusetts 01752.

177. Brazilian Help's Massachusetts office is in the same building in Marlborough, Massachusetts as the Bankrupt TelexFree Companies.

178. Defendant Wanzeler is the president, secretary, treasurer, and registered agent of Brazilian Help.

rightfully belonging to Plaintiffs and the putative class.

D. The Bankrupt TelexFree Companies

203. Between mid-November 2013 and April 17, 2014, TelexFree, Inc. and TelexFree, LLC transferred approximately \$30 million from their operating accounts to accounts owned and controlled by TelexFree, its affiliated companies or the individual Defendants.

204. Defendant Ann Genet served as TelexFree's advisor and person on the ground in Nevada.

205. The investment funds of the putative class inflated TelexFree accounts by hundreds of millions of additional dollars.

206. The funds of the putative class remain unaccounted for to date.

E. TelexFree, Inc.

207. Common Cents Communications, Inc. was formed by Merrill, Wanzeler and Labriola in December 2002.

208. Common Cents Communications, Inc. was a predecessor enterprise to TelexFree, Inc.

209. In 2012, Costa suggested to Wanzeler that they begin soliciting customers in the United States through online advertisements.

210. Acting on Costa's proposal, Wanzeler and Merrill changed the name of Common Cents Communications, Inc. to TelexFree, Inc. on February 15, 2012.

211. Wanzeler and Costa also caused the website, “www.telexfree.com” to be created.

212. Disk A Vontade was the registered owner of the telexfree.com domain name.

213. By February 15, 2012 and until approximately April 15, 2014, TelexFree, Inc. maintained a principal office at TelexFree's Marlborough Office.

214. Co-Defendants Merrill and Wanzeler are officers and directors of TelexFree, Inc.,

227. At least between February 15, 2012 and approximately April 15, 2014, Merrill, Wanzeler, Labriola, Craft and Costa conducted the business of TelexFree, LLC in TelexFree's Marlborough Office.

228. Defendant Craft incorporated TelexFree Financial on December 26, 2013.

230. At all material times, Co-Defendants Merrill and Wanzeler were officers and directors of TelexFree Financial, and Co-Defendant Wanzeler is its registered agent.

232. On April 14, 2014, Defendants TelexFree, Inc., TelexFree, LLC and TelexFree Financial abruptly sought bankruptcy protection in Nevada under the United States Bankruptcy Code, Chapter 11, admitting that they could not meet their obligations from VoIP revenues and seeking authority to reject all their current obligations to Promoters.

233. Since at least February 15, 2012, there has been a high degree of operational interdependence among TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, and the

252. Merrill regularly discussed TelexFree's suspicious, tortious or unlawful business operations with his brother Defendant John Merrill who provided him with advice, services and access to banking.

253. At all material times, Wanzeler was:

- Founder and general partner of Defendant Electric and Founder, treasurer and director of Defendant Mobile;
- Founder, treasurer and director of third-party TelexFree, Inc.;
- Founder and manager of third-party TelexFree, LLC; and
- Founder, vice-president, treasurer, and director of third-party TelexFree Financial and was listed with the Massachusetts Secretary of State Corporations Division as an authorized person to execute, acknowledge, deliver, and record any recordable instrument purporting to affect an interest in real property.

254. At all times relevant to this complaint Labriola was:

- Director of Common Cents Communications, Inc., the predecessor of TelexFree, Inc., in its filed Articles of Incorporations with the Massachusetts Secretary of State Office.
- TelexFree's international sales director;
- TelexFree's frequent authorized spokes-person; and
- a member of TelexFree's Executive Office.

255. At all material times Costa:

- was a Founder, Principal, and a member of TelexFree's Executive Office;

- was a Founder of TelexFree, LLC;
- was a manager of TelexFree, LLC with the Massachusetts Secretary of State Corporations Division;
- made use of the laws, rights and protections of the Commonwealth of Massachusetts; and
- attended meetings at TelexFree's Marlborough Office.

256. While at TelexFree's Marlborough Office headquarters, on phone conferences and while located elsewhere, Costa unfairly and deceptively conspired with other Defendants to carry on TelexFree's unlawful enterprises.

257. At times relevant to this complaint, Costa and Craft:

- directly made unfair and deceptive misrepresentations to the putative class;
- transacted business in the Commonwealth;
- contracted to supply services or things in this Commonwealth;
- advanced TelexFree's unlawful enterprise;
- caused tortious injury by an act or omission in this Commonwealth;
- advanced TelexFree's unlawful enterprise;
- otherwise regularly did or solicited business, and engaged in persistent courses of conduct in the Commonwealth of Massachusetts; and
- otherwise derived substantial revenue from TelexFree's and other goods used or consumed or services rendered in this Commonwealth.

258. At times relevant to this complaint, Craft:

- was a certified public accountant who maintained offices in Indiana and in Kentucky under the name Joe H. Craft, CPA/PFS, CFP;
- served as the chief financial officer of third parties TelexFree, Inc. and TelexFree, LLC;
- prepared and approved the financial statements for third parties TelexFree, Inc. and TelexFree, LLC; and

- was a member of TelexFree's Executive Office.

259. Katia Wanzeler was at all times relevant to this complaint Wanzeler's partner and co-conspirator in TelexFree's unlawful enterprise.

260. Katia Wanzeler actively assisted her husband, Carlos Wanzeler, in fraudulently stealing and laundering funds that were derived from the TelexFree Pyramid Scheme, and in converting said funds to their private use.

261. At all times relevant to this complaint, Rodrigues was a TelexFree Top Level Promoter.

262. At all times relevant to this complaint, De La Rosa was one of TelexFree's Top Level Promoters. De La Rosa appears in internet videos promoting the TelexFree Program and is one of its most successful Promoters, having recruited numerous other Promoters within the Dominican community in Massachusetts and elsewhere.

263. At all times relevant to this complaint, Crosby was a TelexFree Top Level Promoter. Crosby appears in internet videos promoting the TelexFree Program and is one of its most successful Promoters, having recruited numerous other Promoters, primarily through a website known as “everybodygetspaidweekly.biz,” in Massachusetts and elsewhere.

264. At all times relevant to this complaint, Defendant Miller was a TelexFree Top Level Promoter. Miller appeared in internet videos promoting the TelexFree program, giving numerous “tutorials,” and was one of its most successful at doing so, having recruited numerous other Promoters, primarily through his personal YouTube page at “<https://www.youtube.com/user/TelexFreeTrainer>” in Massachusetts and elsewhere.

265. At all times relevant to this complaint, Defendant Miller was a career MLM promoter, doing business primarily through his YouTube page at “https://www.youtube.com/user/TelexFreeTrainer” and “www.join-getpaid-period.com,” using

enrolling right up until the time of TelexFree's bankruptcy filing.

271. Filings in the TelexFree bankruptcy case suggest that Shoyfer received nearly \$88,000 from TelexFree in two separate payments just prior to the April 13 bankruptcy filing. The first, for \$9,902.37, occurred on March 21, and the second, for \$78,037.33, occurred on March 28.

272. Opt3 and Borromei have a history of providing technical services within the multilevel marketing industry and hold themselves out as having related specialized knowledge. For example, Borromei previously served as chief information officer of Joystar, Inc., later renamed Travelstar, a multilevel marketing company that collapsed in approximately late 2008, and subsequently entered involuntary chapter 7 bankruptcy.

273. Opt3 and Borromei intentionally, knowingly, unfairly and deceptively set up TelexFree's United States-based servers in Brazil with the intent of directly furthering, aiding or abetting their unlawful and fraudulent operation, including facilitating the placement of evidence of the Pyramid Scheme beyond the jurisdiction of the United States' courts.

274. Opt3 and Borromei otherwise intentionally, knowingly, unfairly and deceptively set up TelexFree's United States-based servers and electronic data systems with the intent of directly furthering, aiding or abetting their unlawful and fraudulent operation.

275. Opt3 presently holds itself out as providing substantial technical services to multilevel marketing companies Healthient, Inc. and Travelstar, Inc. Borromei serves as chief information officer of Healthient, Inc.

276. At times relevant to this complaint, Opt3 and Borromei:

- directly made unfair and deceptive misrepresentations to the putative class;
- transacted business in the Commonwealth;

277. John F. Merrill is the brother of TelexFree Founder and Principal, Defendant

- served as president and chief operating officer of Fidelity Bank;
- personally performed integral services and provided essential advice and assistance, and access to banking services that was used to further TelexFree's unlawful business; and
- personally ensured TelexFree was given access to Fidelity Bank's banking services as well as the national banking system, and those banking services were used to further TelexFree's unlawful business.

- personally performed integral services and provided essential assistance that was used to further TelexFree's unlawful business;
- personally ensured TelexFree was given access to payment-processing and banking services and those services were used to further TelexFree's unlawful business; and
- personally ensured banking services that were used to further TelexFree's unlawful business, as well as access to the national banking system, were made available to TelexFree.

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280. Despite having knowledge that TelexFree was an enterprise carrying out unlawful, unfair, or deceptive acts or practices, James Merrill, Carlos Wanzeler, Steven Labriola, Carlos Costa, Joseph Craft, Ann Genet, Opt 3 Solutions Inc., Jason Borromei, Katia Wanzeler, Sanderley Rodrigues de Vasconcelos, Santiago de la Rosa, Randy Crosby, Faith Sloan, Daniil Shoyfer, Scott Miller, John Merrill, John Hughes and Dustin Sparman all personally performed integral services and provided essential advice and assistance that was used to further TelexFree's unlawful business and fully and knowingly furthered TelexFree's unlawful Pyramid Scheme.

281. A pyramid scheme is a fraudulent business operation whereby an individual or organization guarantees and sometimes pays returns to its investors from new money paid into the operation by new victims, rather than from profit earned by the operator.

283. Pyramid schemes inevitably fail when new investors are not recruited quickly enough to pay the promised returns to the earlier investors. Typically, this is when the

290. As referenced herein, TelexFree made use of virtually all of the pyramid-scheme techniques recognizable or known to the Financial Services Provider Defendants. For example, TelexFree first had Defendant Nehra, an attorney who also heavily promoted himself as having specialized MLM experience, guarantee that TelexFree was a legitimate business enterprise. It

292. **Initial Investors Paid Off:** In most pyramid schemes, some initial investors will receive the promised return. This trick is used to convince victims that the investment is not risky and that a return will be received. The scammers use smaller payouts to bring in bigger ones. Payouts are also used to prompt victims to bring in the investment cash of their family, friends, co-workers and others. It is also used to turn the \$100 dollar investor into a \$1,000 or \$10,000 investor. Pyramid schemes succeed because the majority of victims invest over and over with larger amounts of cash. They also unwittingly recommend the scheme to their family, friends, and business associates, as the scam appears to provide them with benefits early on. This is all part of the scammers' deliberate plan. Scam artists will pay the initial investment money to the investors, plus the specified interest rate or return, to lure in more and greater investments. Many of TelexFree's Promoters initially invested small sums and then after receiving the above normal rate of return on investment invested a great deal more. Many

314. TelexFree purported to sell internet telephone services but, in actuality, generated its income almost exclusively through its recruitment of “Members” (also referred to interchangeably herein as “Promoters”).

315. TelexFree promised its Promoters a guaranteed return on investment in excess of 200% annually, purportedly in exchange for promoting TelexFree’s business.

316. TelexFree created memberships, known as “AdCentral” packages, which entitled Promoters to be paid for cutting-and-pasting spam advertisements on the Internet, creating the illusion that they were performing valuable services in exchange for compensation.

317. TelexFree promised its Promoters a guaranteed financial return in exchange for their participation in a passive income scheme.

318. Promoters were financially motivated to recruit and “build” their own network of new Members because they were promised additional compensation when they did. TelexFree did not monitor the futile make-work activity of cutting-and-pasting of spam advertisements by its Promoters.

319. At all times relevant to this complaint, TelexFree and each of its Executives and Top Level Promoters, knew that the purported requirement made upon TelexFree Members to place ads was a sham, yet an integral part of the unfair and deceptive acts and practices necessary to carry out and further their unlawful business enterprise.

320. At times relevant to this complaint, TelexFree and each of its Licensed Professionals, and Financial Services Providers also knew that the purported requirement made upon TelexFree Members to place ads was economically worthless, yet an integral part of TelexFree’s business enterprise.

321. Though TelexFree was purportedly a separate and distinct legal entity from

323. Contrary to the malicious, false, unfair and deceptive representations made by TelexFree, the TelexFree VoIP service was not groundbreaking, and offered nothing more than what was and is otherwise available for free. In fact, the TelexFree VoIP technology was not patented or proprietary.

325. TelexFree similarly used its membership fees ploy to further grow its unlawful and fraudulent enterprise as well as to unjustly and unfairly line the pockets of the Defendants with profits earned through the victimization of the putative class representatives and the other members of the putative class they seek to represent.

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operation, Ympactus, and many other indicators of unlawful business operations, each of the Defendants chose to earn handsome fees for providing services to TelexFree's suspicious and unlawful enterprise.

327. Over time, TelexFree's revenue from sales of its VoIP service plans only accounted for only approximately \$1.3 million (or approximately 0.1%) of the nearly \$1.1 billion needed to honor its promises to Promoters. This was because TelexFree had virtually no legitimate business, and almost all of its receipts were simply new investments of more people duped into expecting sizeable returns.

328. Financial Services Providers who performed the Know Your Customer investigations and analysis were aware of this because the Red Flags directed them to the suspicious, tortious and unlawful activity referenced herein.

329. The Financial Services Providers who performed the Know Your Customer investigations and analysis were able to recognize with the help of their robust or sophisticated systems or personnel that TelexFree's actual business was the unlawful recruitment of new Promoters.

330. With hundreds of thousands of victims, TelexFree appears to be one of the largest, if not the largest, pyramid schemes in history by number of members.

331. New Promoters generated no income by placing advertisements on the Internet. New Promoters did, however, generate income for TelexFree through the recruitment of more new Promoters who paid its membership fees. TelexFree's operations were unsustainable without a continuous influx of new capital coming from the recruitment of additional participants.

332. The income-generating activity that drove TelexFree's unlawful passive income

355. As represented in the TelexFree website and promotional materials mailed out and handed to participants at TelexFree's "Extravaganzas" by Defendant Principals, Executive Office and Top Level Promoters, a Promoter was allowed to invest in more than one advertisement kit and purchase the VoIP Program to earn bonuses.

357. A Promoter was allowed to purchase a VoIP program, never use the program, and still qualify for additional income.

359. TelexFree's revenue from sales of VoIP programs alone was entirely inadequate to satisfy the payments it promised to Promoters.

34 *Id.*

March 2014, TelexFree received slightly more than \$1.3 million from the sale of approximately 26,300 VoIP programs, while receiving more than \$302 million in investments by Promoters, less than one-half of one percent of total revenue during this period from sales of its purported product.

361. During this period, TelexFree, the Defendant Founders and Top Level Promoters promised to pay Promoters over \$1.1 billion.

362. TelexFree did not produce anywhere near \$1.1 billion dollars in VoIP revenue.

363. According to an investigation by the SOC, in 2012 and 2013 TelexFree identified 4,845,576 VoIP program transactions totaling \$238,395,353.80.

364. Net revenue received by TelexFree from VoIP program sales was inhibited by substantial commission payments.

365. In other words, only a trivial number, if any, of non-Promoters purchased the VoIP product. In his statement to the Massachusetts SOC, TelexFree Founder Wanzeler could not identify the number of individuals who purchased only a VoIP program without also becoming a participant, and provided wildly varied estimates when challenged to identify the number of VoIP programs sold to non-participants.

366. Over the same period, TelexFree received 783,771 package purchases of either \$289 or \$1,375 totaling \$880,189,455.32.

367. Under this compensation plan, if each of the 783,771 Promoters invested in only one AdCentral package at \$289 and only posted one advertisement per day, TelexFree would have owed Promoters \$799,446,420.

368. Under this compensation plan, if each of the 783,771 Promoters invested in the AdCentral Family package at \$1,375 and only posted five advertisements per day, TelexFree

would have owed \$3,997,232,100 to Promoters.

369. According to data provided by TelexFree, the \$1,375 AdCentral Family memberships accounted for 88% of the transactions by Massachusetts-based participants.

370. Even assuming that only 50% of all participant memberships were at the AdCentral Family level, TelexFree would still have owed \$2,398,897,200, a number that far exceeded TelexFree's reported total revenues over the same period.

371. This figure of almost \$2.4 billion omits further bonuses, recruitment commissions and revenue sharing; including these additional payments would create an even greater disparity between the VoIP program revenue and the guaranteed money paid out of the passive income scheme to Promoters.

372. At no time during the class period did TelexFree generate sufficient funds from sales of their phone service to make the payments they had contracted to pay to existing Promoters. Those funds came from the registration fees of subsequent TelexFree Promoters.

L. Gallery of Rogues Assembled

1. The Seasoned Scam Artists

373. TelexFree, Wanzeler, Merrill, Costa, Labriola and others enlisted the involvement of persons and entities that operated or otherwise had highly publicized involvement in business models that were later found to be fraudulent and unlawful Ponzi Schemes.

374. For example, prior to his involvement with TelexFree, Rodrigues was charged by the SEC with operating a fraudulent pyramid scheme under the name of Universo FoneClub Corporation, another Massachusetts corporation formed by Rodrigues, in which he acted as officer and director.

375. Rodrigues settled these charges in 2007. As a condition of his settlement, Rodrigues 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 Act.

376. As a condition of his settlement, Rodrigues was further ordered disgorged of approximately \$1.8 million of related ill-gotten gains.

377. Rodrigues formed and organized WWW Global Business, Inc. (“WWW Global Business”) on or about February 7, 2013, to market and sell TelexFree Memberships. WWW Global Business was and is a “shell” corporation holding no, or virtually no, assets and having no employees beyond its principal, Defendant Rodrigues, who served as its sole director, officer, and agent for service. WWW Global Business was organized for the sole purpose of marketing and selling TelexFree Memberships, *i.e.* AdCentral packages, and did not engage in the sale of TelexFree’s purported VoIP product.

378. At all times material herein, WWW Global Business was effectively an alter ego of Defendant Rodrigues, and furthermore, had no legitimate business purpose, failed to maintain corporate formalities, had no independent board of directors and otherwise served as a “façade” for the sole benefit of Defendant Rodrigues.

379. Rodrigues attended meetings at TelexFree's Marlborough Office headquarters. While at TelexFree's headquarters, on phone conferences and while located elsewhere, he unfairly and deceptively conspired with other Defendants to carry on TelexFree's unlawful enterprises. Despite having knowledge that TelexFree was an enterprise carrying out unlawful, unfair, or deceptive acts or practices, Rodrigues personally performed integral services and provided substantial and essential advice and assistance that were used to further TelexFree's unlawful business.

380. Rodrigues’s SEC and criminal related history was available to the Financial Services Provider Defendants while they were carrying out Know Your Customer due diligence

381. TelexFree and the Defendant Founders and Principals willfully and knowingly utilized Rodrigues. Rodrigues was allowed to join and market the program despite his previous criminal convictions. In fact, Rodrigues was selected for a prominent role in TelexFree because he had experience running a related scam.

AddWallet was a successor to Zeek Rewards, an infamous Ponzi scheme. Zeek Rewards ran from January 2011 into August 2012 when the SEC shut it down. The Zeek Rewards Ponzi scheme bilked investors out of a purported \$850 million dollars. Prior to being shut down, Zeek Rewards was alleged to have paid out \$350 million dollars to early investors.

384. In March 2013, AddWallet held a conference call intended to assure investors. During the call, AddWallet representatives assured investors that it was an offshore company and immune from the SEC.

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- [4:52] “After the fall of the major player Zeek (Rewards), we. . . saw a lot of things there.”
- [13:34] “It’s unfortunate what happened, a lot of good people got hurt. I thought Zeek was doing a fantastic job.”
- [5:26] “We put a base operating system down. Yes, it’s very much like Zeek when you go into the retail profit pool earnings, you see something that you’ve seen before.”

386. In August 2013, as the AddWallet scheme dwindled, Bradshaw abruptly left his position with AddWallet, without providing any reason to members. Almost immediately, Bradshaw was a TelexFree spokesperson.

387. Bradshaw spoke during a September 6, 2013 TelexFree conference call hosted by Labriola, during which Bradshaw promoted sales of TelexFree memberships and instructed and otherwise provided advice to Promoters and potential Promoters on behalf of TelexFree that furthered its unlawful enterprise.

388. During the September 6, 2013 TelexFree conference call, Bradshaw advised those on the call of the fastest way to transfer payments of membership fees to TelexFree. Bradshaw directly made other unfair and deceptive misrepresentations to the putative class that furthered TelexFree's unlawful enterprise.

389. In 2014, Bradshaw became a co-founder of another pyramid scheme, Genesis Global Network, which was characterized in online promotional materials as “operat[ing] just like Zeek and Add Wallet. The early members in Zeek earned over \$1 Million and this one is better and completely offshore.”³⁵

390. Another example is Defendant Miller, another big player in the infamous \$850 million Zeek Rewards Ponzi scheme, which had a component similar to TelexFree's AdCentral.

³⁵ See <https://www.facebook.com/mlmsuccessgroup/posts/772337832778294>; see also Exhibit 3, Decl. of Gray Echavarria, Attachment 25.

391. According to a video playing on YouTube, Miller was one of the featured TelexFree speakers at the Newport Beach event. Members of his group claim in videos that, if one sends \$15,125 to TelexFree to purchase a “contract,” one will emerge with guaranteed earnings of at least \$1,100 a week for a year. The math of the claim is basically this: \$1,100 a week for 52 weeks equals \$57,200. Subtract the original outlay of \$15,125, and emerge with \$42,075 on the plus side.

.2. The Professional Legitimizers' Roles

³⁶ See Exhibit 4, Decl. of Carol L. Harris, Exhibit 14.

402. All of this served as “Red Flags” to the sophisticated Financial Services Defendants and Licensed Professionals Defendants who had sophisticated Know Your Client protocols and systems as well as expertise in MLM.

404. Defendants Nehra, Waak, Nehra Law Firm, Waak Law Firm, and Nehra and Waak Law Firm each provided legal services to TelexFree. There was no clear distinction between Nehra, Waak, Nehra Law Firm, Waak Law Firm, and Nehra and Waak Law Firm with regard to the legal services that they provided to TelexFree.

406. The Attorney Defendants each boast on their respective websites that they have vast knowledge and experience representing MLM and direct-sales clients.⁴⁰

407. The Attorney Defendants each boast on their respective websites that they have specialized knowledge and experience and can discern between legitimate and lawful MLM and direct-sales ventures and illegitimate and unlawful pyramid or Ponzi scheme ventures.⁴¹

408. Nehra represented or advised ventures that had been shuttered by state or federal

⁴⁰ *See id.*

⁴¹ *See id.*

experience to substantially aid, abet, and play an integral role in TelexFree's unlawful, unfair, and deceptive acts and practices during the times relevant to this complaint.

418. Despite their actual knowledge, rather than decline or cease rendering services to TelexFree, the Attorney Defendants failed to adequately provide even minimally acceptable legal counsel.

419. In spring 2013, TelexFree was forced to focus on new markets, including the United States and Canada, because its Brazilian operations had been shut down and all of its Brazilian assets frozen. TelexFree used the presence, representations and statements of the Attorney Defendants to perpetuate and advance the Pyramid Scheme in those new markets.

420. Nehra's representations and statements that TelexFree's operations in the United States were legitimate and lawful were part of its total "post Brazilian shut down package."

421. Nehra was aware of how his representations and statements were being used by TelexFree, yet willingly spoke on behalf of TelexFree at an event dubbed a "Super Weekend" in Newport Beach, California on July 26 and 27, 2013. His focus at the "Super Weekend" event was to reassure Promoters that TelexFree's United States operations were legitimate, lawful and worthy of investment.

422. Although at the time of the "Super Weekend," TelexFree's Brazilian bank accounts had been frozen and all of TelexFree's Brazilian recruiting and payments had been suspended by court order in its largest affiliate market, Nehra advised attendees that the shutdown in Brazil would not affect TelexFree's operations in the United States.

423. Nehra spoke at length during that "Super Weekend" and reassured the attendees of the legality and legitimacy of TelexFree's operations in the United States, stating "It is legally designed . . . you are on very solid legal ground," and that TelexFree's operations had been

444. Shortly after January 11, 2013, Procon's investigation of TelexFree was widely reported online by English-language media.

445. On February 15, 2013, the MLM news site BehindMLM.com reported that TelexFree was under criminal investigation in Brazil for having operated an illegal Ponzi scheme.⁴⁵

446. On February 17, 2013, A (MLM) Skeptic, an MLM blog, reported that Brazil's Bureau of Consumer Protection had investigated TelexFree upon suspicion of operating a Ponzi scheme, and had subsequently forwarded the case to the State Prosecutor's office for filing of formal charges.⁴⁶

447. On March 9, 2013, the Ministry of Finance, after its investigation, declared that:

The TelexFree business of selling packages of internet telephony (VoIP, its acronym in English), is not sustainable and suggests a Ponzi scheme, which is a crime against the popular economy.

That is the conclusion of the Secretariat for Economic Monitoring of the Ministry of Finance (Seae / MF) in a statement on Thursday (14).⁴⁷

448. As the matter progressed through the Brazilian court system, the Ministry of Finance was ordered not to issue further statements about the matter.

449. TelexFree and the Defendant Founders seized upon that fact and circulated through its affiliates the following misleading misrepresentation of the order:

It's official! The investigation on TelexFree has been absolved of what Behind MLM has researched and posted.⁴⁸

450. On June 19, 2013, the Brazilian Court in Acre issued an injunction putting "a stop to TelexFree's business operations, including the registration of new affiliate investors,

⁴⁵ See Exhibit 3, Decl. of Gray Echavarria, Attachment 6.

⁴⁶ See, Exhibit 3, Decl. of Gray Echavarria, Attachment 27.

⁴⁷ *Id.*

⁴⁸ See, Exhibit 3, Decl. of Gray Echavarria, Attachment 7.

451. In addition, following a court order in Brazil by Judge Borges for TelexFree to turn over “data relating to the registration and operation of the accounts of each of the affiliates, including twelve months of retroactive data,” TelexFree claimed it had no access to registrations and transfer accounts of the company’s Promoters.

453. At no point did TelexFree sell VoIP products legally in Brazil.

O. TelexFree's Continued United States' Operations

456. In late summer or fall of 2013, TelexFree retained a consulting group, The Sheffield Group, which also markets itself as having extensive MLM expertise and experience, to review its business plan. At this time, the advice provided by Sheffield Group and whether it was followed is unknown.

49 *Id.*

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P. Collapse of TelexFree's United States Operations

461. At least six banks, not named here as Defendants, rejected TelexFree's business.

463. At least three banks, not named here as Defendants, terminated their relationship with TelexFree as its illegal and tortious operations became apparent.

465. In an August 28, 2013 email to Defendants Merrill, Craft and Wanzeler, Defendant Hughes, President of Base Commerce, a payment processing company serving TelexFree, clearly stated “[n]o US Bank or Processor . . . will accept your [TelexFree] business given that you are on month five of the Visa Chargeback monitoring program. You are

478. TelexFree's former officers or employees stated to the TelexFree bankruptcy transition team that under the TelexFree Pre-March 9 Contract, TelexFree owed its Promoters over \$5 billion dollars.

R. Events Since TelexFree's Bankruptcy Filing

479. On April 15, 2014, the SOC filed an Administrative Complaint against TelexFree, Inc. and TelexFree, LLC, alleging violations of the Massachusetts Uniform Securities Act, MASS. GEN. LAWS, c. 110A.

480. The SOC sought injunctions and orders requiring TelexFree, Inc. and TelexFree, LLC to cease and desist from further conduct violating Massachusetts securities laws and regulations, to provide an accounting of all proceeds received because of TelexFree's fraud, to provide restitution to Promoters for losses attributable to the fraud operations, and to disgorge all profits.

481. Also on April 15, 2014, the SEC filed a civil Complaint and Jury Demand against TelexFree, Inc. and TelexFree, LLC as well as Defendants Merrill, Wanzeler, Labriola, Craft, Rodrigues, De La Rosa, Crosby, and Sloan, alleging violations of the Securities Act of 1933, the Securities Exchange Act of 1934, and SEC Regulations. The SEC requested and was granted a preliminary injunction and an order freezing the assets of TelexFree. The SEC is also seeking disgorgement of profits and additional civil penalties.

482. Additionally on April 15, 2014, the FBI and the DHS conducted a raid of TelexFree's Marlborough Office.

483. During this raid by the FBI and DHS, federal agents apprehended Defendant Craft as he attempted to leave the building with a laptop and approximately \$38 million in cashier's checks in a bag. He also tried to leave with TelexFree computer equipment containing incriminating data.

484. When questioned, Craft stated to the federal agents he was merely a “consultant,” and claimed that the checks and computer were “personal.”

485. Defendant Katia Wanzeler was apprehended as she attempted to board a flight to Brazil, on which she had a one-way ticket, cash and seventy pounds of luggage.

486. On or about May 1, 2014, the Montana Securities Commissioner filed a cease and desist order against TelexFree.

487. The following day, the United States Bankruptcy Court for the District of Nevada, on motion by the SEC, transferred the matter to the federal district court in Massachusetts, Central Division.

488. During hearings conducted on May 2, 2014, William H. Runge, III, former Chief Restructuring Officer of TelexFree, estimated that as of TelexFree's bankruptcy filing TelexFree had assets of \$31 million in its bank accounts, \$28 million in brokerage accounts, and nearly \$30 million held by payment processing companies.

489. The location of hundreds of millions of dollars received by TelexFree from Promoters remains unknown.

S. TelexFree's Principals, Founders and Executive Office Controlled TelexFree, Knowingly Perpetrated the Unlawful, Unfair, and Deceptive Pyramid Scheme and Made False Representations about TelexFree

490. Defendants Merrill, Wanzeler, Labriola, Craft and Costa were responsible for the control and operation of TelexFree.

491. These Defendants, TelexFree's Founders and Principals, Executive Office and Top Level Promoters knowingly and willfully conspired to perpetrate, and did perpetrate, the TelexFree Pyramid Scheme with full awareness of its unfair, deceptive, and unlawful nature.

492. Defendant Merrill served as the president, secretary, and director of TelexFree, Inc.; a manager of TelexFree, LLC; president, secretary and director of TelexFree Financial;

general partner of Defendant Electric, and president, secretary and director of Defendant Mobile, and in those capacities, exercised significant control over TelexFree's business operations.

493. Merrill exercised significant control over the TelexFree Pyramid Scheme. Merrill has appeared in videos posted to the internet – including, among numerous others, a November 3, 2012 YouTube video entitled “TelexFree James Merrill Brasil,”⁵³ a June 20, 2013 YouTube video entitled “James Merrill Speaks About TelexFREE BR Investigation,”⁵⁴ and the highly promoted “TelexFree 1st Extravaganza” video made available on www.TelexFree.com in which he can be seen promoting TelexFree as a revenue opportunity for Promoters.

494. Merrill also otherwise made numerous false representations in furtherance of the Pyramid Scheme.

495. In a March 21, 2014 press release, Merrill misrepresented that TelexFree had been “in the VoIP business for more than a decade.”

496. Through to at least March 28, 2014, the TelexFree website included a biography of Merrill, which falsely stated that Merrill was a 1985 graduate of Westfield State University in economics, and that he is “well versed in one of the new technologies of the era (VoIP).”

497. According to testimony obtained by the SOC, Merrill attended Westfield State University for a mere two years, without either receiving a degree or declaring a major.

498. In further direct contravention to the representations made on the TelexFree websites, Merrill also testified to the SOC on March 25, 2014 that he had only a basic understanding of VoIP technology.

499. Defendant Merrill received \$3,136,200 on December 26 and 27, 2013 from one of the named Financial Service Provider Defendants.

⁵³ Available at <https://www.youtube.com/watch?v=8hYuvWNIL2M>.

⁵⁴ Available at <https://www.youtube.com/watch?v=zO4xe-0tE-4>.

502. Wanzeler exercised significant control over the TelexFree Pyramid Scheme and participated in marketing TelexFree to potential investors.

- promoted TelexFree as a revenue opportunity for Promoters;
- detailed the, unlawful and fraudulent TelexFree Program; and
- made false representations regarding returns.

505. Defendant Labriola served as the international marketing director for TelexFree, Inc.

507. At all material times, Labriola exercised significant control over TelexFree's business operations and the operations of its interrelated companies.

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TelexFree for 2012, which TelexFree produced on February 26, 2014.⁵⁶

518. A comparison of these two profit-and-loss statements – each purporting to be TelexFree’s profit-and-loss statement for 2012 – reveals massive discrepancies (and “conflicting statements”).

519. The first statement provided by TelexFree lists total income for 2012 at \$1,864,939.70, while the second lists total income for 2012 at \$2,834,835.70.⁵⁷

520. As further examples, agent commission is listed at \$520,582.95 in the first, versus \$2,105,925.61 in the second; total expenses are listed as \$784,899.22 in the first, versus \$2,333,893.09 in the second; net operating income is listed as \$1,080,040.48 in the first, versus \$478,251.56 in the second; and net income is listed as \$1,066,313.39 in the first, versus \$477,652.23 in the second.⁵⁸

521. The existence of duplicative accounting records containing egregious discrepancies indicates TelexFree’s falsification of accounting records and negligent failure to adhere to Generally Accepted Accounting Principles (“GAAP”).

522. As CFO for TelexFree, Inc. and TelexFree, LLC, and a certified public accountant, Defendant Craft negligently or recklessly perpetuated the TelexFree unlawful enterprise by:

- overseeing TelexFree’s creation of accounting records;
- failing to ensure that GAAP accounting methods were adopted and adhered to;
- certifying TelexFree’s business operations and accounting practices as good and lawful; and

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

- concealing that the AdCentral packages purveyed by TelexFree were securities.

523. Defendant Costa was listed as manager of TelexFree, LLC with the Massachusetts Secretary of State Corporations Division.

524. Costa is one of the original founders of TelexFree, and was involved in the day-to-day management and oversight of TelexFree and was actively involved in and managed its Brazilian operations.

525. Costa has appeared on numerous websites and videos posted on the Internet promoting TelexFree as a revenue opportunity for Promoters, detailing the fraudulent TelexFree Program and touting its huge financial return.

526. In an August 15, 2013 video, Costa fraudulently claims that TelexFree “never was, never will be” an illegal pyramid scheme because of its VoIP sales. He further misrepresented that “[w]e do not depend on everyone coming in in order to pay the people who are already in.”

527. Costa was an outspoken advocate against the Brazilian Court's decision to enjoin TelexFree's Brazilian activities, and publicly supported TelexFree's illegal and corrupt activities.

528. On June 25, 2013, in an outright misrepresentation, Costa is videoed displaying an insurance notification representing that it was proof of coverage for Promoters' payments; however, in actuality, the document was a notification denying coverage.⁵⁹

T. TelexFree's Top Level Promoters Played an Integral, Essential and Primary Role and also Aided and Abetted the Pyramid Scheme

529. TelexFree conducted its Pyramid Scheme through the use and with the participation of several high profile Promoters referred to herein as "Top Level Promoters," including Defendants Rodrigues, De La Rosa, Crosby, Miller, Sloan, Shoyfer and others.

⁵⁹ See <http://www.youtube.com/watch?v=q2A2IsAPd0I>.

530. TelexFree's Top Level Promoters played a primary role in the Pyramid Scheme and were integral and essential co-conspirators who at all times knew that they were involved in unlawful activities designed to wrongfully take the funds invested by the class. In fact, that is why the Founders, Principals, and Executive Office recruited many of them for involvement in TelexFree.

531. The presence of the Top Level Promoters as well as their suspicious, tortious or unlawful activities were Red Flags for the Financial Services Defendants as identified by the FFIEC.

532. Each Top Level Promoter deceptively, fraudulently and misleadingly promoted and furthered the Pyramid Scheme with knowledge of its illegality.

U. TelexFree's Attorneys Played an Integral Role in and Aided and Abetted the Unlawful, Unfair, and Deceptive Pyramid Scheme

533. TelexFree's Attorney Defendants were a critical component of the TelexFree Pyramid Scheme as their representation of TelexFree went beyond the ordinary attorney-client relationship of delivering legal advice.

534. At times relevant to this complaint, the Attorney Defendants had actual knowledge that the TelexFree business model was a fraudulent Pyramid Scheme.

535. The Attorney Defendants were obligated to advise their clients on how to comply with the law, yet TelexFree's Attorney Defendants negligently, recklessly, willfully, knowingly, unfairly and deceptively advised their clients how to avoid detection, maintain the appearance of legality, and maintain and build the Pyramid Scheme. They knowingly extended their roles to become supporters of the Pyramid Scheme by lending legitimacy to its operation.

536. Throughout TelexFree's profitable Pyramid Scheme, the Attorney Defendants acted as legal counsel to TelexFree, and used their positions of authority, education and respect

545. Seeking to profit from TelexFree's exploitation of the members of the putative class, Defendant Nehra drew upon his prior experience to aid, abet and play a substantial and integral part in TelexFree's unlawful, unfair and deceptive acts and practices during times relevant to this complaint.

547. Attorney Nehra negligently, recklessly, willfully, knowingly, unfairly or deceptively counseled TelexFree on actions that would serve to evade United States securities laws that were intended to offer, in part, to provide the members of the putative class with protection from pyramid schemes, and advised TelexFree Promoters (excluding Top Level Promoters) to unknowingly participate in the evasion of federal and state securities laws, to enrich himself financially and serve his own selfish interests.

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549. Defendant Nehra accomplished this through his reputation as a licensed attorney, his purported experience as an MLM expert and his purported research of TelexFree's business model, which allowed him to hold out TelexFree as a legal business.

551. In company videos, Attorney Nehra failed, refused and neglected to advise prospective TelexFree Promoters, the putative class members, that their participation in TelexFree presented a risk, including the risk of participating in an unlawful scheme, or that his advice was, in fact, against their own interests.

553. Attorney Nehra's actions exceeded the scope of zealous representation of TelexFree. Although he was licensed to practice law and purported to offer legal opinions, active and integral participation in a Pyramid Scheme does not fall within the parameters of the profession in which he was licensed to practice.

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Founders, Principals, Executive Office and Top Level Promoters knowingly used Attorney Nehra's false legal opinions and misrepresentations as a marketing tool to unfairly and deceptively further the illegal Pyramid Scheme.

555. Attorney Nehra’s opinions, and the opinions of other Attorney Defendants, were packaged and promoted as part of TelexFree’s total “post Brazilian shut down package” to the members of the putative class.⁶³

556. On an internet video posted on August 2, 2013, Attorney Nehra provided false and deceptive assurances to Promoters and potential Promoters, stating that “[t]he special ingredient is that you have a real product.”

557. Attorney Nehra assured Promoters on internet postings, in writing, and in person at marketing promotions that, in his professional opinion, the TelexFree business model was legitimate despite having actual knowledge that TelexFree MLM Network “*Partnerships*”⁶⁴ involving TelexFree’s AdCentral marketing packages were unlawful, as he had actual knowledge of the ruling of the Brazilian Court, knowledge of and access to TelexFree’s United States operations and its composition, and knowledge of United States law.

558. More particularly, when he advised potential participants of the soundness of the venture, Attorney Nehra knew that a Brazilian court had determined that TelexFree's activity was fraudulent, and that its Brazilian attorneys essentially admitted it was a pyramid scheme.

559. Defendant Nehra's own comments suggest that when providing legal opinions at the request of TelexFree and Defendant Founders, he knew that TelexFree intended to use his advice and likeness prominently as a marketing tool on both their localized Brazilian

⁶⁴ See Exhibit 1 - Standard TelexFree Contract at ¶2.2.1 ¶

- negligently misrepresented the legality and sustainability of TelexFree's operations to the detriment of Promoters, and received fees from TelexFree;
- negligently obscured and obfuscated the illegal nature of TelexFree's Scheme by the manipulative use of language, including, e.g., advising TelexFree that using the term "investment" must be avoided;
- breached his duty of professional care to Promoters by failing to exercise proper due diligence in investigating the legality of TelexFree's operations;
- breached his duty of care by encouraging and advising individuals to become and remain Promoters to their detriment, despite his knowledge of the illegality of TelexFree's operations; and
- engaged in a civil conspiracy to defraud TelexFree's Promoters with a Pyramid Scheme, and took a leading role in the Scheme.⁶⁵

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564. With their specialized knowledge of the laws governing MLM and direct-sales ventures and their personal knowledge of TelexFree's product, business model, and operations which were identical to its Brazilian product, business model, and operations, the following publicly available information caused or should have caused the Attorney Defendants to recognize that TelexFree was an unlawful pyramid or Ponzi scheme and decline or cease providing services to it or provide advice to change the program and make sure it was promptly changed:

- a Brazilian court found TelexFree’s Brazilian operations to be fraudulent;
- a Brazilian court described TelexFree’s operations in terms of the quintessential pyramid scheme after TelexFree’s own Brazilian lawyers unwittingly admitted as much;
- TelexFree’s Brazilian lawyer Djacir Falcão (“Falcão”) advised the Brazilian court that an injunction would cause the company to enter bankruptcy: “Running the company really becomes difficult because of the court decision, so we will appeal”;
- Falcão informed the Brazilian court that “should the company spend a few more days being prohibited from signing up new investors, they would have no money to pay the old ones”;
- all of TelexFree’s appeals in the Brazilian courts were denied;
- a Brazilian court remarked that the problem is that the earnings will be exhausted when the main source of revenue—new member registrations—stops;
- a Brazilian court remarked that adding new Members was more important to TelexFree than trying to sell its VoIP product;
- a Brazilian court remarked that it is detrimental that many affiliates do not even have the opportunity to recover their initial payment to Telexfree; and

565. Despite having knowledge that TelexFree was an enterprise carrying out unlawful, unfair, or deceptive acts or practices, Nehra and Defendant Nehra Law Firm performed integral services and provided essential advice and substantial assistance that was used to further TelexFree's unlawful business.

- belatedly advised TelexFree that its compensation plan required amendment;
- advised TelexFree on how to avoid detection from state and federal agencies;
- advised TelexFree on how to maintain the appearance of legality, including to avoid using the term “investment” regarding the AdCentral Packages (TelexFree Pre-March 9 Contract, Paragraph 2.6.5(m)), which was an attempt to conceal, and encourage others to conceal, TelexFree’s sale of securities in an attempt to strip Promoters of the rights afforded them by federal and state securities laws;
- advised TelexFree on how to maintain and advance TelexFree;
- advised TelexFree on how to avoid United States securities laws intended to offer, in part, protection from pyramid and Ponzi schemes;
- advised TelexFree Promoters (excluding Top Level Promoters) to unknowingly participate in the evasion of federal and state securities laws;
- advised TelexFree on laws concerning the proper segregation and maintenance of consumer funds;
- failed to inform the putative class that the Attorney Defendants’ web-published professional “advice” was intended to serve the interests of TelexFree and the Attorney Defendants;

567. The acts and omissions of the Attorney Defendants were integral for TelexFree to perpetuate and further the Pyramid Scheme and constitute substantial assistance in that Scheme

discrepancies.

575. As the CFO and CPA for TelexFree, Inc. and TelexFree, LLC, Craft and Craft Financial negligently assisted in perpetuating TelexFree's fraudulent Pyramid Scheme by:

- directing or overseeing TelexFree's creation of inaccurate, false or falsified accounting records;
- failing to ensure that GAAP was adopted and adhered to by TelexFree;
- certifying TelexFree's business operations and accounting practices as good and lawful;
- preparing inaccurate financial documents for the affiliated TelexFree entities;
- preparing inaccurate tax returns for the affiliated TelexFree entities;
- knowingly disseminating or allowing to be disseminated inaccurate financial information among and between Promoters; and
- conspiring with TelexFree's Officers to structure and perpetuate the TelexFree business model while enriching TelexFree, Craft Financial and Craft.

576. Defendants Craft and Craft Financial knew when providing their financial assistance that their roles would give substantial assistance or encouragement to the Pyramid Scheme.

577. Defendant PricewaterhouseCoopers ("PwC") also negligently provided accounting and consulting services to TelexFree during the Pyramid Scheme.

578. More particularly, TelexFree retained PwC in January 2014, several months after TelexFree had been shuttered by government authorities in Brazil, to provide tax and financial consultation, including assistance with the development of international tax structures.

579. PwC negligently advised TelexFree to prepare and issue unfair, deceptive, inaccurate, suspicious, and unlawful 1099 (Miscellaneous Income) forms.

580. In an effort to maintain the illusion that it had made payments to its members and

continue its unlawful business model and would further the illegal Scheme.

589. Craft Financial, Craft and PwC knew their representations and statements were false and misleading and that they would be and were used by TelexFree as a marketing tool to further advance its business model and illegal activities.

590. At all times relevant to this complaint, Craft Financial, Craft and PwC acted subject to pervasive control of TelexFree and were subject to TelexFree's will. Despite having actual knowledge that TelexFree's Brazilian operations had been found fraudulent and enjoined by Brazilian courts, Craft Financial, Craft and PwC, at the direction of and with information provided by TelexFree, negligently crafted financial statements and negligently made representations designed to misrepresent and hide the true nature of TelexFree's product, business model, and operations in the United States and the effect of the Brazilian courts' findings and orders.

591. At all times relevant to this complaint, Craft Financial, Craft, and PwC consented to be agents of TelexFree. Craft Financial, Craft and PwC knowingly allowed TelexFree to utilize their deceptive and misleading financial statements and representations regarding TelexFree as propaganda to retain and maintain members in the Pyramid Scheme.

592. As agents of TelexFree, Craft Financial, Craft and PwC owed a duty to the putative class not to make deceptive statements or misrepresentations in order to induce the putative class to buy into TelexFree's Pyramid Scheme.

593. Craft Financial, Craft and PwC committed their respective acts and omissions with the knowledge of assisting TelexFree to perpetuate and advance the Pyramid Scheme to the benefit of TelexFree and Craft Financial, Craft and PwC, but to the detriment and loss of the putative class.

601. By email dated September 27, 2013, Borromei petitioned GPG to allow TelexFree's continued use of its electronic gateway for transmitting Member credit card data.

602. By email dated September 27, 2013, in response to Borromei’s email earlier that same day, Jayme Amirie, President of GPG, indicated to Borromei that, although TelexFree represented a “reputational risk” for GPG, GPG would continue to allow TelexFree to use GPG’s electronic gateway to transfer electronic data to Defendant Allied Wallet for processing Members’ credit card payments.

603. Borromei also worked with Defendants Sparman and Vantage Payments to establish TelexFree's payment processing through Allied Wallet.

604. Opt3 and Borromei continued to provide services to TelexFree until the time of TelexFree's bankruptcy petition.

605. Opt3 is listed as a trade creditor in TelexFree's initial bankruptcy filings.

606. Borromei was also copied on numerous emails between and among TelexFree, Defendant Base Commerce's John Hughes, and GPG's Jayme Amirie, discussing the transition of TelexFree's payment processing to Allied Wallet and transfers of funds.

607. Through their close relationship with co-Defendants Merrill, Wanzeler and Craft, and through their providing TelexFree with technological oversight and support, Borromei and Opt3 had actual knowledge of TelexFree's illegal and fraudulent activities yet continued to provide substantial assistance in the furtherance thereof.

W. The Financial Services Providers Were Required to Comply With Various Statutory and Regulatory Investigation and Monitoring Obligations

608. Each of the Financial Services Provider Defendants is a “financial institution” under the terms of the Bank Secrecy Act, 31 U.S.C. § 5312.

609. Each of the Financial Services Provider Defendants is required to implement in

611. At least six financial institutions not named in this action turned TelexFree away before opening an account.

613. Other banks not named in this action discharged TelexFree within weeks of opening a financial service relationship with them.

615. Given TelexFree’s unlawful business operation and the “Know Your Customer” and AML regulations, each Financial Services Provider was obligated to refuse to open any accounts or process any transactions for the benefit of TelexFree.

617. During times relevant to the complaint, each of the Defendant Financial Services

Regulations”) to perform a reasonable investigation of TelexFree to determine and understand:

- the true identity of its management;
- the true nature of its business activities;
- the true nature of its customer base;
- the true nature of its product offerings; and
- prior to agreeing to provide any financial services or access to the federally regulated banking system.⁶⁷

622. Specifically, pursuant to the KYC analysis mandated by 31 C.F.R. § 103.121 and amended 31 C.F.R. § 1020, et seq. (the “Know-Your-Customer Regulations”), each of the Financial Services Providers Defendants was required to collect information sufficient to determine whether TelexFree, or any other customer of the Defendant involved with TelexFree, posed a threat of criminal or other improper conduct.

623. KYC controls typically include the following:

- collection and analysis of basic identity information (referred to in U.S. regulations and practice as “Customer Identification Program” or CIP);
- name matching against lists of known parties;
- determination of the customer’s risk in terms of propensity to commit money laundering, terrorist finance, or identity theft;
- creation of an expectation of a customer’s transactional behavior;
- monitoring of a customer’s transactions against its expected behavior and recorded profile; and
- monitoring of a customer’s transactions against that of the customer’s peers.

624. In addition, at all times relevant to this complaint, the Defendant Financial Services Providers were mandated to conduct due diligence prior to opening an account pursuant

⁶⁷ See also Federal Financial Institution Examination Council, BANK SECRECY ACT ANTI-MONEY LAUNDERING EXAMINATION MANUAL (June 2005).

of their relationship with TelexFree.

630. The Obligation to file a SAR with the Financial Crimes Enforcement Network of the U.S. Department of the Treasury and other appropriate federal law enforcement agencies was required on an ongoing basis during the course of each Defendant Financial Services Provider's relationship with TelexFree.

631. Each of the Defendant Financial Services Providers performed the above SAR-related investigations at times relevant to this complaint.

632. During times relevant to this complaint, TelexFree's Financial Services Providers knowingly participated in and aided and abetted TelexFree's Pyramid Scheme by, *inter alia*, enabling the TelexFree Pyramid Scheme to operate, expand and continue by providing necessary financial services to TelexFree, the Operational Defendants, and each other, despite actual knowledge that they were engaged in suspicious, tortious or illegal activity.

633. Each of the Defendant Financial Services Providers understood, at a minimum, TelexFree's business models and key personnel prior to opening accounts.

634. Each of the Defendant Financial Services Providers performed the above investigations and understood, at a minimum, TelexFree's business models and key personnel at all times after they opened them and while they were servicing TelexFree's accounts.

635. At times relevant to this complaint, each of the Financial Services Providers Defendants willfully and knowingly acted unfairly, deceptively and in bad faith by failing to timely or properly act on their knowledge of TelexFree's suspicious, tortious or illegal business operation, and to otherwise fulfill their obligations under the BSA, 31 U.S.C. § 5311 *et seq.*; the Patriot Act, § 326, 31 U.S.C. § 5318; and 31 C.F.R. § 1020 *et seq.*, or, in the alternative, by failing to disclose or report the nature of TelexFree's business operations.

636. At all times material herein, the Financial Services Providers maintained departments responsible for ensuring compliance with the investigation, reporting, and procedural requirements contained in, *inter alia*, the Know-Your-Customer Regulations, 31 U.S.C. § 5312 *et seq.*, 31 U.S.C. § 5311 *et seq.*, the Patriot Act, § 326, and 12 CFR § 21.11 (hereinafter, “Regulatory Account Monitoring Department”).

637. Each of the Financial Services Providers maintained a Regulatory Account Monitoring Department.

638. Each of the Financial Services Providers performed the initial investigations required by the foregoing laws.

639. Each of the Financial Services Providers performed the continual monitoring required by the foregoing laws.

640. At all times relevant to this complaint, in the course of complying with their regulatory duties and obligations, the Financial Services Providers and their employees and officers obtained actual knowledge that TelexFree, its Defendant Executive Officers and Top Level Promoters were engaged in suspicious, tortious or illegal activity.

641. In addition to what has already been set forth, actual knowledge of TelexFree's unlawful operation was based in part on the:

- large magnitude and long duration of the Scheme;
- nature and volume of the deposits;
- open association with others known to have been closely tied to past high profile Ponzi and pyramid schemes;
- extensive negative news reports; and
- the fact that the related accounts and transactions bore the classic hallmarks of a Pyramid Scheme.

642. Each of the Financial Service Provider Defendants possess and made use

of highly sophisticated software programs that provided them with background information and financial details about prospective customers that are not available to the general public.

643. Under the federal AML laws, the Defendant Financial Service Providers must investigate the top managers, directors, and principal owners of their clients.

644. The Defendant Financial Service Providers also were aware of many Red Flags of suspicious, tortious, and criminal misconduct by TelexFree.

645. At least eleven major news and watchdog websites covering the MLM industry, Ponzi schemes, and online scams analyzed TelexFree in 2012, 2013 and 2014, including, but not limited to:

- BehindMLM.com, an internet watchdog and journalism site dedicated to the MLM industry;
- PatrickPretty.com, an internet watchdog and journalism site covering Ponzi schemes and internet crime;
- Skeptic.blogspot.com, an internet watchdog and blog covering the MLM industry and online scams;
- ASDUpdates.com, an online journal covering internet scams;
- BusinessForHome.org, an internet news site analyzing direct-selling and MLM opportunities;
- CitizenCorps.com, an internet news site analyzing work-from-home and online income opportunities;
- EthanVanderbuilt.com, an internet watchdog and news site covering online scams;
- MLMHelpDesk.com, a blog and news site dedicated to the MLM industry;
- PonziTracker.com, an internet watchdog and news site covering and analyzing Ponzi schemes;
- Scam.com, a community-operated message board analyzing and discussing internet scams; and

- ScamXPoser.com, an internet watchdog site analyzing online income opportunities.

646. In addition to the above-listed websites dedicated to the MLM industry, the following websites specifically dedicated to Ponzi schemes and other online scams conducted analysis and exposés on TelexFree in 2012, 2013, and 2014, including, but not limited to:

- http://www.dailymotion.com/video/xwbhex_telxfree-has-launched-in-usa-english-presentation_news, - video posted on December 30, 2012 by TelexFree Promoter Kelly Isom Tolar, which shows TelexFree Promoters “showering” cash on each other while on stage at a promotional event, and states that TelexFree began in Brazil in January 2012, that it promises “up to \$15,360” in income per day, that income is guaranteed without any sales of VoIP, and that TelexFree and Best Western Hotels had partnered to build 500 hotels in Brazil;
- <http://www.slideshare.net/growrichteam/telexfree-marketing-plan-english> - slide presentation posted on January 18, 2013, which discusses the pyramid structure of TelexFree’s operation and states that TelexFree promises payment for posting of ads only, with no sales required;
- <http://mmoljbp.blogspot.com/p/telexfree.html> - blog posted on January 24, 2013, which repeatedly characterizes TelexFree as a “passive income opportunity,” with the opportunity for “six generations of passive income,” and discusses the pyramid structure of the operation;
- <http://www.getresponse.com/archive/interestedpeople/Interested-People-TelexFree-Earn-20-a-week-for-a-year-no-recruiting-at-all-10992068.html> - blog posted by a TelexFree Promoter named “Suzanna” on April 27, 2013, which states that TelexFree had been “sued by the Brazilian SEC”; and
- <http://www.realscam.com/f9/telexfree-scam-not-2366/> - inquiry posted on a user-operated message board of the MLM community on May 30, 2013, stating “It looks like a Ponzy [sic] for me,” and requesting feedback, which included a link to BehindMLM.com’s exposé of July 27, 2012.

647. TelexFree's *own website* admitted TelexFree's connection to Brazil, legal problems, and lack of legitimate income in a way intended to deceive its Promoters, but not in a way that would avoid detection by the robust and sophisticated systems and personnel of the Financial Services Defendants. For example:

- As of February 25, 2012, the front page of www.TelexFree.com stated “99 TelexFree grows everyday in Brazil” and also included a slideshow presentation “by our President Mr. Jim Merrill” discussing the pyramid structure of the operation;
- As of January 19, 2013, the front page of www.TelexFree.com included a pop-up which stated as follows: “During this week we have been in contact with several government agencies which was extremely useful to clarify the operation of TelexFree...some [Promoters] are making practices [sic] that go against the law of Brazil...”;
- During 2013, www.TelexFree.com included photographs of Defendants Merrill, Wanzeler, Costa and numerous Promoters together on stage at the “1°Extravaganza” event, at which “jumbo” checks were distributed, and Members were encouraged to become “TelexFree millionaires” through increased promotion;
- During the entirety of 2013 until approximately November 6, 2013, the front page of www.TelexFree.com included a certificate stating that, according to data analyst Alexa Internet, Inc., “we are among the most visited sites in Brazil.” (Importantly, no similar certification with respect to any other country was included); and
- From approximately June 2012 through approximately May 25, 2013, the tab header for www.TelexFree.com announced, “Make money by posting ads.”

648. Moreover, setting aside the highly advanced BSA and AML due diligence programs utilized by the Financial Services Provider Defendants, even the most basic internet investigation of TelexFree's clients or its business model or principals would have revealed to these sophisticated corporate entities with experience in identifying illegal and suspicious operations that TelexFree was running an unlawful Pyramid Scheme in the United States that was essentially identical to its shuttered and enjoined Brazilian operation and was otherwise suspicious, tortious or illegal.

649. At a minimum, the following high-profile English-language Google search results generated simply by entering the search term “telexfree” required the Defendant Financial

board of directors must also approve a written BSA/AML compliance program for the institution.

659. The Financial Services Provider's board of directors must also evaluate the Financial Services Provider's audit and training programs to ensure that the CIP is adequately incorporated.

660. The Financial Services Provider's account opening procedures must mandate that the Provider conduct a risk assessment of prospective customers and classify them as low-risk, medium-risk or higher-risk.

661. This risk assessment classification will affect how intensive the Financial Services Provider's BSA and AML due diligence process must be.

662. The FFIEC Examination Manual states “the bank may determine that a customer poses a higher risk because of the customer’s business activity, ownership structure, anticipated or actual volume and types of transactions, including those transactions involving higher-risk jurisdictions.” If so, the bank should consider obtaining, both at account opening and throughout the relationship, the following information on the customer:

- purpose of the account;
- source of funds and wealth;
- individuals with ownership or control over the account, such as beneficial owners, signatories, or guarantors. *Guidance on Obtaining and Retaining Beneficial Ownership Information* was issued by FinCEN, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, Office of Thrift Supervision, and Securities and Exchange Commission, in consultation with the U.S. Commodity Futures Trading Commission, in May 2010. The guidance consolidates existing regulatory expectations for obtaining beneficial ownership information for certain accounts and customer relationships;
- occupation or type of business (of customer or other individuals with ownership or control over the account);

- financial statements;
- banking references;
- domicile (where the business is organized);
- proximity of the customer's residence, place of employment, or place of business to the bank;
- description of the customer's primary trade area and whether international transactions are expected to be routine;
- description of the business operations, the anticipated volume of currency and total sales, and a list of major customers and suppliers; and
- explanations for changes in account activity.

663. AML experts consider MLM companies such as TelexFree to be higher-risk customers for BSA and AML purposes, partly because they pose the risk of Ponzi schemes and violations of the Securities Act of 1933.

664. AML experts also regard MLMs as higher-risk because those companies have high volumes of sales, high customer dissatisfaction rates, and guaranteed money-back policies.

665. In 2013, the Financial Crimes Enforcement Network (“FinCen”) instituted a BSA proceeding against TD Bank, which assessed a \$37.5 million civil money penalty against that bank for failing to detect and report another Ponzi scheme and was predicated on the theory that Financial Services Providers should treat MLMs as higher-risk for purposes of BSA and AML due diligence.⁷⁰

666. FinCen’s action supports the conclusion that MLM companies should be treated as higher-risk for purposes of BSA and AML compliance.

667. To comply with the requirements in FFIEC Examination Manual, the Defendant

⁷⁰ Concurrently, the Office of the Comptroller of the Currency assessed a second \$37.5 million penalty against TD Bank for related violations and the SEC imposed a \$15 million penalty on that bank for related securities violations.

682. During CDD, the Defendant Financial Services Providers should also pay attention to any Red Flags.

683. FFIEC has identified a long list of BSA and AML Red Flags, including, but not limited to:

- “A customer makes frequent or large transactions and has no record of past or present employment experience.”
- “Many funds transfers are sent in large, round dollar, hundred dollar, or thousand dollar amounts.”
- “Funds transfer activity occurs . . . when the activity is inconsistent with the customer’s business or history.”
- “Many small, incoming transfers of funds are received.”
- “Funds transfer activity is unexplained, repetitive, or shows unusual patterns.”
- “Payments or receipts with no apparent links to legitimate contracts, goods, or services are received.”
- “A large volume of cashier’s checks, money orders, or funds transfers is deposited into, or purchased through, an account when the nature of the account holder’s business would not appear to justify such activity.”
- “Unusual transfers of funds occur among related accounts or among accounts that involve the same or related principals.”
- “Goods or services purchased by the business do not match the customer’s stated line of business.”
- “Payments to or from the company have no stated purpose, do not reference goods or services, or identify only a contract or invoice number.”
- “Customer receives large and frequent deposits from online payments systems yet has no apparent online or auction business.”
- “A large number of incoming or outgoing funds transfers take place through a business account, and there appears to be no logical business or other economic purpose for the transfers, particularly when this activity involves higher-risk locations.”

684. Subsequent to an account opening, the Defendant Financial Services Providers must monitor the account and the customer.

685. Specifically, to comply with FFIEC's Examination Manual, it is not enough to only conduct CDD at account opening.

686. In addition, according to FFIEC, "banks should monitor their lower-risk customers through regular suspicious activity monitoring and customer due diligence processes. If there is indication of a potential change in the customer's risk profile (e.g., expected account activity, change in employment or business operations), management should reassess the customer risk rating and follow established bank policies and procedures for maintaining or changing customer risk ratings."

687. The FFIEC goes on to state that the Defendant Financial Services Provider's CDD processes "should include periodic risk-based monitoring of the customer relationship to determine whether there are substantive changes to the original [CDD] information (e.g., change in employment or business operations)."

688. Furthermore, the FFIEC clearly mandates that higher-risk customers must undergo enhanced due diligence ("EDD") and that higher-risk customers should be reviewed more frequently and intensively than lower-risk customers and particularly if new Red Flags appear.

689. It is generally accepted industry opinion in the financial services industry that customers who have the same amount coming in from hundreds of thousands of people with different last names require closer inquiry and monitoring.

690. When a bank finds out that a client is laundering money or running an unlawful enterprise it should terminate the banking relationship, shut down the accounts and file a SAR.

X. TelexFree's Suspicious, Tortious and Unlawful Operation Displayed Red

Flags Detectable by the Defendant Financial Service Providers

691. After authorities began to shut down TelexFree, Wanzeler, Merrill and Costa's unlawful Pyramid Scheme in Brazil in June of 2013, they simply switched their geographic target market to the United States.

692. During the putative class period, the Financial Services Defendants maintained robust, sophisticated, and effective due diligence systems that detected TelexFree's Red Flags because the components of TelexFree's switch from its Brazil-targeted Pyramid Scheme to its United States-targeted Pyramid Scheme would have been included within their search parameters, including, but not limited to, the following:

- use of the identical business name;
- use of the identical business model;
- use of the same product;
- specifically naming their unlawful business operation in Brazil –Ympactus – in their standard contract as owning the product and as a party to the contract;
- use of the same people to serve as officers, executives and management;
- use of the same address, office space and office equipment;
- use of the same back office support;
- changing its public name to TelexFree;
- indiscriminately transferring money from account to account including business to personal;
- obtaining cashiers checks for millions of dollars from business accounts after changing its compensation and business plan; and
- obtaining cashiers checks for millions of dollars from business accounts after filing for bankruptcy.

693. The following graphics taken from the public areas of both the English and

Spanish TelexFree websites, as well as numerous Promoters’ websites and video “tutorials,” made no secret of the pyramid structure of the business:



Attention: For The First Time In HISTORY...

**Every *SINGLE* Person
Who Joins **Gets Paid**
Weekly. PERIOD**

This Means YOU!

- ✓ CAN'T SPONSOR? CAN'T SELL? NO WORRIES...
- ✓ YOU STILL GET PAID!
- ✓ YOU ARE PAID WEEKLY BY CONTRACT!



694. Sophisticated parties such as the Defendant Financial Services Providers could not have been fooled by the public announcements and key marketing representations advanced by TelexFree, its Principals, Executive Officers and the Operating Defendants.

695. For example, as noted above, in promoting TelexFree and himself, Merrill held himself out, including through direct references on the TelexFree website, as having experience in VoIP and internet phone service and having a college degree. Neither claim was true.⁷¹

696. In carrying out their FFIEC due diligence, the Financial Service Provider Defendants were required under the circumstances to investigate and uncover false facts such as the false past experience and education of a corporate principal.

697. As a result of their compliance with the foregoing laws, each of the Financial Services Providers was actually aware of the facts and evidence of suspicious, tortious, or illegal activity, or Red Flags as follows, as well as those offered elsewhere in the complaint:

- the TelexFree Program violated the express terms of M.G.L. c. 93, § 69 governing multi-level distribution companies (i.e., MLMs), and thereby M.G.L. c. 93A prohibiting unfair or deceptive acts or practices;

⁷¹ In sworn testimony given to the SOC on March 25, 2014, Merrill testified to having limited knowledge of VoIP services and never working in the telecom business.

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- as a MLM company, TelexFree was regarded as a high-risk customer by banks and payment processing companies;
- funds were commingled between TelexFree entities;
- TelexFree failed to keep financial records in accordance with GAAP standards;
- huge wire transfers of funds were made to personal accounts of certain Defendant Founders and shell corporations;
- wire transfers of large sums to foreign entities occurred;
- TelexFree was widely regarded as a fraudulent scheme by the online MLM community;
- TelexFree maintained a Brazilian affiliate, also operating under the name TelexFree, which was under investigation by the Brazilian government as of February 2013 under suspicion of operating an illegal Ponzi scheme;
- in a March 1, 2013 press release available online, Defendant Merrill, president of TelexFree, admitted that “the real ‘secret sauce’ of our [TelexFree’s] success is our compensation plan...We [TelexFree] pay our representatives weekly if they follow our system and advertise our service on the Internet,” while making no mention of any product or service;
- in June 2013, TelexFree’s Brazilian affiliate had publicly falsely claimed that MAPFRE, an international insurance company, served as insurer to TelexFree, prompting MAPFRE to release a public statement online denying any relationship with TelexFree and threatening legal action against TelexFree for making this false statement; and
- in June 2013, TelexFree’s Brazilian affiliate Ympactus, also operating under the name TelexFree, was shut down and enjoined from doing further business by the Brazilian government for operating an illegal Ponzi scheme. This event was promptly reported online in English language news sources as was follow up news.

698. Pursuant to FFEIC guidelines, the payments being deposited into the accounts maintained at the Bank Defendants or processed by the Defendant Payment Processing Service Companies originated in the majority of instances from individuals bearing foreign surnames, raising actionable concerns regarding potential violations of the Patriot Act and other federal banking laws and regulations regarding issues of potential money laundering, terrorism, drug

maintained accounts, and received and executed transfers of funds from or for the benefit of TelexFree.

712. For example, in 2013, Citizens maintained accounts on behalf of TelexFree and processed thousands of transactions amounting to millions of dollars for TelexFree.

713. Similarly, Wells Fargo also maintained accounts on behalf of TelexFree and processed transactions amounting tens of millions of dollars for TelexFree in 2013.

714. Activity undertaken on behalf of TelexFree or the other Operational Defendants generated income to the Financial Services Defendants.

715. At times material herein, the Defendant Banks received investment funds of Plaintiffs.

716. At times material herein, the Defendant Banks profited from their relationship with TelexFree and other Defendants and were unjustly enriched.

717. At diverse times, TelexFree processed through the Defendant Financial Services Providers over 783,771 investments of either \$289 or \$1,375 (including combinations thereof) totaling over \$880,189,455.32.

718. The Financial Service Providers derived substantial income from their services to TelexFree.

719. More particularly, the Defendant Banks earned fees from their participation in the TelexFree Scheme on several levels:

- interest on amounts held on behalf of TelexFree at or above the Federal Funds Rate, currently set at .25%;
- processing fees for each transaction, typically in an amount of 1-4% of the amount transferred per transaction, or, in some cases, \$40 per transaction;
- annual ACH processing charges;
- return deposit item fees;

- chargeback fees; and
- miscellaneous fees and servicing charges.

720. In general, the Defendant Banks possessed a federal regulatory duty to look for certain types of facts or lack thereof, including the identity and purpose of the individuals opening and making payments into their accounts.

721. Even a perfunctory investigation of TelexFree in accordance with their regulatory duties would have revealed the existence of the tortious Pyramid Scheme.

722. Each of the Defendant Banks became aware of the Red Flags surrounding TelexFree and its conduct pursuant to their regulatory duties.

723. Each of the Defendant Banks also became aware of strong evidence of suspicious, tortious or illegal activity including the outright fraud on the part of TelexFree, its Founders and Principals pled with excruciating particularity herein.

724. The overwhelming number of Red Flags and other indicia of fraud established the existence of TelexFree's tortious conduct and the Pyramid Scheme and the Defendant Banks thereby gained actual knowledge of its tortious conduct.

725. In the alternative, if any Defendant Banks failed to perform any of the required investigations and account monitoring, it turned a blind eye to the tortious conduct it actually knew underlied TelexFree's activities despite its general awareness of the unlawful nature of the Scheme.

726. At times material herein, despite having knowledge that TelexFree was an enterprise carrying out suspicious, tortious, or unlawful, unfair or deceptive acts or practices, the Defendant Banks performed integral services and provided essential assistance that was used to further TelexFree's unlawful business.

727. At times material herein, despite having knowledge that TelexFree was an

- maintaining depository accounts containing funds paid by Promoters to TelexFree for AdCentral Package membership fees;
- making payments to certain Promoters as part of TelexFree's purported return on investment;
- transferring funds paid by Promoters to TelexFree among TelexFree entities, Defendant Founders' personal accounts, foreign companies and shell companies; and
- allowing TelexFree to use the bank's name in its promotional materials thereby lending TelexFree the use of the bank's reputation as a large, nationwide banking institution and credibility.

733. Additional facts specific to each Defendant Bank provide additional particulars of its further involvement, participation and aiding and abetting of the TelexFree Pyramid Scheme.

1. Defendant Bank of America

734. As documented in the criminal complaint filed by the DHS dated May 9, 2014, against Defendants Wanzeler and Merrill (¶ 61), Bank of America first opened accounts in TelexFree's name in February 2012.

735. Bank of America’s North American Account Opening Guide (the “Guide”) specifically provides that the opening of accounts is “subject to significant scrutiny by regulators and the bank.”

736. Citing the Know-Your-Customer Requirements, the Guide also states that “[r]egulators require us to be entirely satisfied with our understanding of our clients’ identities, beneficial ownership, management structures and usual transaction flows.”

737. Bank of America performed an investigation of TelexFree prior to agreeing to accept it as a customer and did further comply with its own requirements.

738. At times relevant to this complaint, Bank of America complied with due diligence requirements when opening TelexFree's accounts, including the Know Your Customer Requirements and it was aware of the Pyramid Scheme nature of TelexFree's business plan.

739. Despite Bank of America's knowledge of the illegal nature of TelexFree's business activities, including the fact it obviously violated M.G.L. c. 93, § 69, Bank of America agreed to accept TelexFree as a customer and began to perform banking services for TelexFree, which it continued to perform until at least December 31, 2013.

740. In addition to opening and maintaining accounts for TelexFree, Bank of America was specifically named in TelexFree’s “signup procedures” document which was available online as an entity holding TelexFree accounts into which transfers of membership funds could be made by Members.⁷³

741. As described above, during 2013, TelexFree affiliates were urging recruits to make walk-in deposits at a Bank of America branch in Massachusetts and the instructions given strongly resembled instructions given to recruits in 2008 by another infamous Ponzi scheme, AdSurfDaily.

742. More specifically, Members were directed to transfer their membership fees to a “corporate” account at Bank of America under the name “TelexFREE LLC,” were provided with the applicable account and routing numbers, and were provided with the Bank of America branch address, “188 Bosyon [sic] Tpke Shrewsbury Ma 01545.”⁷⁴

743. Bank of America knowingly permitted TelexFree to identify it in promotional materials as the holder of its accounts and thereby lent an aura of legitimacy and credibility to TelexFree's business operations through TelexFree's connection with a large and well-

⁷³ See “*Signup procedures for TelexFREE*,” attached to Exhibit 3, Decl. of Gray Echavarria, Attachment 37, <http://PatrickPretty.com>, “*TelexFree Affiliates Gave AdSurfDaily-Like Coaching Tips, Instructed Prospects to Make Deposits at Bank of America[...]*TelexFree Also May Have TD Bank Account,” <http://patrickpretty.com/2013/07/08/telexfree-affiliates-gave-adsurfdaily-like-coaching-tips-instructed-prospects-to-make-deposits-at-bank-of-america-and-to-copy-slips-to-team-leaders-gmail-address-for-expedited-service-t/> (July 8, 2013) (including screen shot of TelexFree bank transfer instructions).

⁷⁴ See *id.*; see also TelexFree Recruitment Presentation, available at <http://webopportunities.weebly.com/uploads/1/5/8/5/15857054/telex.pp.2.13.pdf>.

announced during a public conference call with TelexFree Members that payments due-and-owing from Bank of America to members as of July 30, 2013 required manual sorting, since “Bank of America didn’t give them a sorted list” as to which of the payments had already been made by Bank of America.⁷⁷

756. As another example, a document dated November 11, 2013, establishes that Defendant Merrill, on behalf of TelexFree, directed Allied Wallet, a Defendant payment processor, to transfer funds via international wire transfer to a TelexFree account with Bank of America.⁷⁸

757. Furthermore, Bank of America continued to provide credit, via at least two credit cards, at least through December 31, 2013, as indicated on TelexFree's 2013 balance sheet.

758. Bank of America continued to provide credit to TelexFree despite its knowledge of the suspicious, tortious or illegal nature of TelexFree's conduct, also lending an aura of legitimacy and credibility to TelexFree's business operations through TelexFree's connection with a large and well-established financial institution.

759. Although Bank of America possessed knowledge of the tortious nature of TelexFree's business activities from the time of its initial investigation and during its monitoring of TelexFree, it continued to provide TelexFree with credit and depository services integral to the TelexFree Scheme.

760. Through its actions, Bank of America substantially assisted in the perpetration of, and otherwise became an integral part of, TelexFree's fraudulent Scheme.

761. At a minimum, Bank of America's initial investigation and ongoing monitoring of

⁷⁷ See http://teamstelexfree.blogspot.com/p/blog-page_7.html (recruitment website of TelexFree Promoter)

⁷⁸ See, Allied Wallet Bank Information Form for Bank of America, attached herewith as Exhibit 8.

TelexFree, made it aware that TelexFree was engaged in suspicious, tortious or unlawful conduct, but it willfully turned a blind eye to the results of its investigation and monitoring because it refused to suspend service or terminate its banking relationship with them or Operational Defendants and it continued to provide TelexFree with credit and depository services integral to the TelexFree Scheme until at least December 2013.

762. Through its actions, Bank of America knew TelexFree's conduct constituted a breach of duty and violated M.G.L. c. 93, § 69 and M.G.L. c. 93A, and it gave substantial assistance and encouragement to the perpetuation of, and otherwise became an integral part of, TelexFree's unlawful Scheme.

2. Defendant TD Bank

763. Defendant TD Bank, N.A., has over 1,300 domestic locations in 16 states and one foreign branch without a physical location. TD Bank is a large national bank with approximately \$212 billion in assets and approximately 25,000 employees. TD Bank is a member of TD Bank Group and a subsidiary of The Toronto-Dominion Bank of Toronto, Canada. The Toronto-Dominion Bank trades on the NYSE Euronext under the ticker symbol “TD.”

764. TD Bank has previously settled accusations that it provided active assistance to large Ponzi schemes in violation of the BSA and other laws, including Scott Rothstein’s \$1.2 billion Florida-based Ponzi scheme, for which it was civilly prosecuted and fined.

765. The Office of the Comptroller of the Currency (“OCC”) is TD Bank’s federal functional regulator. In September 2013, the OCC determined that TD Bank violated the BSA from April 2008 through September 2009, by failing to file SARs in a timely manner, in violation of 31 C.F.R. § 1020.320 and 31 U.S.C. § 5318(g). TD Bank agreed to a \$37.5 million

civil money penalty assessed by the OCC.⁷⁹

766. The September 22, 2013 consent decree followed several years of active investigation and negotiations. At all times in 2012, 2013, and 2014 that TD Bank was servicing TelexFree, it was under investigation by the OCC because it “willfully violated the Bank Secrecy Act’s reporting requirements by failing to detect and adequately report suspicious activities in a timely manner in violation of 31 U.S.C. § 5318(g) and 31 C.F.R. § 1020.320.”⁸⁰

767. TD Bank violated BSA suspicious activity reporting requirements by failing to detect and report suspicious activity and by filing late SARs in relation to the so-called Rothstein Ponzi scheme. TD Bank failed to properly identify, monitor, and report suspicious activity in Rothstein's accounts. A lack of adequate training for both the business and BSA/AML staff also contributed to TD Banks' failure to recognize this suspicious activity.

768. In May 2010, Coquina Investments filed a lawsuit alleging that TD Bank aided and abetted the Rothstein Ponzi scheme, made fraudulent misrepresentations and engaged in a pattern of racketeering in violation of RICO.

769. In January 2012, a jury returned a verdict against TD on both aiding and abetting and fraudulent misrepresentation, awarding \$32,000,000 in compensatory damages and \$35,000,000 in punitive damages.

770. Evidence showed that TD Bank, through its then-regional vice president, Frank Spinosa, and other employees, aided and abetted the scheme and made fraudulent misrepresentations.

771. Evidence established TD Bank N.A. had in place standard protocols to detect

⁷⁹ See Exhibit 9 – September 20, 2013 OCCurrency Consent Decree.

⁸⁰ *Id.* at 2.

suspicious and/or illegal banking activities. The evidence also established that to facilitate the Ponzi Scheme TD Bank N.A. ignored alerts generated by its standard protocols for years. These protocols included its AML system that would alert it to suspicious activity and a related “Standard Investigative Protocol,” which provided guidance concerning reportable or non-reportable suspicious activity and provided procedures that TD Bank employees were to follow without exception.

772. TD Bank N.A. ignored 17 months of alerts on the AML system. The amount of money moving through the accounts and the speed with which it moved was also a focus of the OCC. TD Bank N.A. also ignored numerous concerns raised by multiple TD Bank, N.A. executives relative to the selling of settlements, the limited banking relationship with various parties seeking to open accounts with significant balance changes, and the large value of wires being received.

773. TD Bank N.A.’s awareness of the Ponzi scheme and the Red Flags associated with Ponzi schemes generally was highlighted not only through the *Coquina* verdict and the evidence supporting it.

774. TD Bank's awareness of the Ponzi scheme and the Red Flags associated with Ponzi schemes generally was also highlighted through TD Bank's actions through counsel and its witnesses because during the course of the litigation TD Bank willfully withheld evidence of Red Flags showing illegal activity.

775. During discovery, Coquina requested documents evidencing potential illegal activity, including documents related to the standard protocols. In response, TD Bank willfully provided only limited documents despite the requirements imposed upon it by the Federal Rules of Civil Procedure.

its counsel.

777. These motions unveiled the following among other things:

- Just before the close of discovery and subsequent to the deposition of the 30(b)(6) corporate representative, Vincent Auletta (vice president of global due diligence), wherein he testified that there were no Rothstein alerts before September 2009 and no more than 5 alerts after, the bank produced 150 pages of AML alerts from September 2009 –November 2009.
- On the eve of trial, TD Bank, N.A. produced 17 months’ worth of AML alerts generated by the Searchspace system for Rothstein accounts which had not been previously disclosed and which were separate and distinct from normal fraud alerts, in addition to numerous communications indicating that TD Bank executives were aware of the investment schemes.
- After the trial had concluded, during the course of different litigation against TD Bank, Coquina learned that TD Bank did in fact have a document called “Standard Investigative Protocol,” which it had repeatedly denied having during discovery and trial and that a document they had received, the CDD (Customer Due Diligence) form generated by the Cash Management Department of TD Bank, was not produced in color, which resulted in the absence of important and relevant information including the presence of a red banner at the top proclaiming that the account was “HIGH RISK.”

the color copy of the CDD and other relevant documents.

accounts on behalf of TelexFree, another Ponzi scheme.

780. TD Bank first opened accounts in TelexFree's name in September 2012.⁸¹

781. TD Bank performed its KYC investigation of TelexFree prior to agreeing to

⁸¹ See DHS Criminal Complaint dated May 9, 2014 against Wanzeler and Merrill at ¶ 62(b).

operations through TelexFree's connection with a large and well-established financial institution.

789. On or about September 6, 2013, TelexFree leadership instructed its members via a public conference call that the fastest way to send money to TelexFree was by direct deposit to TelexFree's accounts with TD Bank.⁸⁵

790. The person speaking on behalf of TelexFree during this conference call was Bradshaw, the above-described high profile pyramid scheme regular formerly active with the now-defunct pyramid schemes Zeek Rewards and AddWallet.

791. The fact that well over ninety percent (90%) of deposits into TD Bank's accounts held in the name of TelexFree, LLC were made for the purchase of an AdCentral package, and not TelexFree's purported VoIP product, was known to TD Bank's Regulatory Compliance Office, employees and officers and was an additional indication that TelexFree was operating an illegal Pyramid Scheme.

792. Specifically, between October 9, 2013, and January 17, 2014, TD Bank account xxxxxx8409 held in the name of TelexFree, LLC received 478 incoming wire transfers ranging from \$309 to \$142,500, totaling \$2,638,712.

793. Of these deposits into account xxxxxx8409, 2,474 were in the amount of \$1,425 – the AdCentral Family package purchase price – totaling \$3,525,450.

794. During this same period, there was only one deposit into account xxxxxx8409 in the amount of \$49.90 – the VoIP purchase price.

795. Notably, TelexFree's marketing materials that were available online made clear to what these sums corresponded.

⁸⁵ See Exhibit 3, Decl. of Gray Echavarria, Attachment 34, BehindMLM.com, "*TelexFree US business plagued with 'rampant fraud'*", Sept. 7, 2013, <http://behindmlm.com/companies/telexfree/telexfree-us-business-plagued-with-rampant-fraud/>.

796. Between September 2012 and July 2013, there were 1,550 deposits by cash, check, money order or wire transfer into TD Bank account xxxxxx2808, held in the name of TelexFree, LLC, in the exact amount of \$1,425, the AdCentral Family package purchase price.

797. During this same period, there was only one deposit into account xxxxxx2808 in the amount of \$49.90 – the VOIP purchase price.

798. Between June 2013 and October 2013, there were 1,800 deposits into TD Bank account TD Bank account xxxxxxx334, held in the name of TelexFree, LLC, in the exact amount of \$1,425, the AdCentral Family package purchase price.

799. During this same period, there was only one deposit into account xxxxxxx334 in the amount of \$49.90 – the VOIP purchase price.

800. While examining TelexFree during the initial account opening process and later while conducting ongoing customer monitoring of TelexFree, TD Bank investigated TelexFree's management, business activities, customer base, and product offerings.

801. While examining TelexFree during the initial account opening process and later during its ongoing customer monitoring of TelexFree, TD Bank's Regulatory Account Compliance Office, other employees or officers discovered the Red Flags and other evidence described throughout this complaint, indicating that TelexFree was engaging in suspicious, tortious or unlawful conduct.

802. At a minimum, TD Bank's initial investigation and ongoing monitoring of TelexFree, made it aware that TelexFree was engaged in suspicious, tortious or unlawful conduct, but it willfully turned a blind eye to the results of its investigation and monitoring because it refused to suspend service or terminate its banking relationship with them or Operational Defendants and it continued to provide TelexFree with credit and depository

services integral to the TelexFree Scheme until at least January 2014.

803. Through its actions, TD Bank knew TelexFree's conduct constituted a breach of duty and violated M.G.L. c. 93, § 69 and M.G.L. c. 93A and gave substantial assistance and encouragement to the perpetuation of, and otherwise became an integral part of, TelexFree's unlawful Scheme.

3. Fidelity Bank

804. Fidelity Bank opened three accounts for TelexFree, two on August 8, 2013 with initial deposits of \$7,123,784.58 and one on September 12, 2013 with deposits of \$2,951,337.12.

805. Fidelity Bank helped TelexFree to conduct its business more easily by using remote deposit capture.

806. Fidelity Bank continued to accept deposits from TelexFree until at least December 26, 2013.

807. Notably, the president and chief operating officer of Fidelity Bank, Defendant John Merrill, is the brother of Defendant James Merrill, one of the Founders of the TelexFree Pyramid Scheme.

808. John Merrill's knowledge is imputed to Fidelity Bank because at all times material he was its president and chief operating officer.

809. This familial relationship facilitated the relationship between TelexFree and Fidelity Bank and made Fidelity Bank privy to information regarding TelexFree and its suspicious, tortious or unlawful conduct.

810. At all material times, through his personal relationship with his brother, Defendant John F. Merrill was fully aware of the fact that TelexFree's business operation was nothing more than a Pyramid Scheme, and that TelexFree's other banking relationships were souring.

813. Fidelity Bank's Regulatory Account Compliance Office did in fact perform an investigation of TelexFree prior to agreeing to accept TelexFree as a customer in or about August 2013.

815. Either through Fidelity Bank's attempts to comply with all banking regulations when opening and maintained its accounts, including the Know-Your-Customer Regulations, or because of the familial relationship between its President and one of TelexFree's masterminds, Fidelity was aware of the Pyramid Scheme characteristics and of TelexFree's unlawful business operation and stopped servicing, terminated its relationship and filed SAR reports but it did not.

817. That investigation resulted in the entry into a Consent Decree, dated September 22, 2014, whereby Fidelity Bank agreed to establish an escrow fund of \$3.5 million for victims of the Scheme.⁸⁶

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818. The SOC alleged, *inter alia*, that Fidelity Bank’s account opening process in 2013 was inadequate and insufficient to handle the voluminous TelexFree deposit accounts.⁸⁷

819. These failures to comply even minimally with mandatory banking regulations allowed the bank's president John F. Merrill to obtain the account services for his brother James Merrill, the other TelexFree Founders and TelexFree itself.

820. The Consent Decree establishes that Fidelity Bank wrongfully permitted TelexFree to deposit funds received from victims of its illegal Pyramid Scheme in Fidelity Bank's accounts between August 8 and December 26, 2013.⁸⁸

821. On or about November 23, 2013, pursuant to Fidelity Bank's obligations to perform ongoing customer monitoring of TelexFree, Fidelity Bank's compliance and BSA officer discovered Red Flags, other evidence of suspicious, tortious or unlawful conduct.

822. That officer also discovered further indicators of fraud in the TelexFree business model, and he notified president Merrill and an outside compliance consultant utilized by Fidelity Bank.

823. The outside consultant advised Fidelity Bank of his conclusions that TelexFree was a high-risk customer based upon its account balance and extensive wire transfers and that TelexFree's accounts would "require the appropriate monitoring level for a high risk customer."

824. Less than two weeks after this initial investigation, Fidelity Bank made a determination it should close TelexFree's accounts.

825. Fidelity Bank notified TelexFree of its determination to close its accounts on December 3, 2013.

826. Despite that determination, Fidelity Bank continued to receive the victims' funds

⁸⁷ *Id.*

⁸⁸ SOC Consent Order E 2014-0073 is herewith attached and marked as Exhibit 10.

847. Through its actions, Synovus provided substantial assistance and encouragement to TelexFree. Synovus also assisted TelexFree and its Principals to further achieve their unfair, deceptive and unlawful Scheme that was at a minimum violative of M.G.L. c. 93, § 69.

848. Defendants GPG, IPS, Propay, Base Commerce, Vantage Payments, Allied Wallet, and the Doe Payment Processors possessed actual knowledge of the suspicious, tortious and unlawful nature of TelexFree's business operations, yet substantially assisted and encouraged them by providing essential payment processing services as early as October 2012.⁸⁹

850. As an integral part of the Pyramid Scheme, the Payment Processing Service Company Defendants processed payments between TelexFree and its Members, provided the electronic gateway used to send and receive such payments, and provided the electronic interface

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services used by both TelexFree and its Members.

851. As set forth below, certain Payment Processing Companies went far beyond this role and became active direct participants in TelexFree's unlawful business enterprise by providing specialized advice and assisting them to skirt the law.

852. The services of the Payment Processing Service Company Defendants, including the capturing, maintenance and transferring of Promoters' funds, was essential and without their integral assistance TelexFree's Pyramid Scheme could not have operated.

853. Each Payment Processing Service Company Defendant possessed a regulatory duty to look for certain types of facts or lack thereof, including the identity and purpose of the individuals opening and making payments into their accounts.

854. In 2012, TelexFree underwent a “several day” period during which they double-billed customers, resulting in a temporary spike in the rate of customer chargebacks, according to an interoffice email of Defendant Base Commerce, dated May 22, 2013.⁹⁰

855. As a result of this period of especially heavy chargebacks, TelexFree was added to MasterCard's MATCH database in 2012, indicating that TelexFree was no longer to receive any credit card processing services due to exceptionally high risk.

856. In addition to the alert from Mastercard’s MATCH database in 2012, each of the Payment Processing Service Company Defendants became aware of other Red Flags and evidence of suspicious, tortious or unlawful activities surrounding TelexFree and pursuant to their regulatory duties they carried out further investigation.

857. Each Payment Processing Service Company Defendant discovered the news reports and other evidence detailed in this complaint that reasonably evidenced TelexFree's

⁹⁰ See email from John Hughes, dated May 22, 2013, attached herewith as Exhibit 11.

858. Each Payment Processing Service Company Defendant performed all of the investigations and monitoring required of it by the federal government yet it:

859. The services provided by each Payment Processing Service Company Defendant included, *inter alia*, the following:

- ## 1. Propay

861. ProPay agreed to accept TelexFree as a customer and began processing

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864. Furthermore, as of December 31, 2012, ProPay held an additional amount of \$279,209.46, which is listed as “on hold” by TelexFree’s 2012 Balance Sheet.

866. According to TelexFree’s July 2013 Balance Sheet, as of July 31, 2013, Propay held a total of \$3,743,049.03 in funds for the benefit of TelexFree.

868. According to TelexFree's December 2013 Balance Sheet, as of December 31, 2013, ProPay continued to hold funds in the amount of \$98,463.24 for the benefit of TelexFree.

870. In the course of providing services to TelexFree, ProPay directly communicated with fellow Defendant Payment Processing Service Companies Base Commerce and GPG regarding the inherent risks and concerns with TelexFree.

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- further the unlawful Pyramid Scheme;
- unfairly, deceptively and unlawfully siphon class member funds;
- unfairly, deceptively and unlawfully convert class member funds;
- continue to provide services integral to the TelexFree Scheme; and
- continue to provide TelexFree with substantial assistance and encouragement essential to their unlawful plan.

891. At a minimum, GPG's initial investigation and ongoing monitoring of TelexFree, made it generally aware that TelexFree was engaged in tortious conduct, but it deliberately and willfully turned a blind eye to the results of its investigation and monitoring.

3. Base Commerce

894. In April 2013, Defendants Merrill and Wanzeler, on behalf of TelexFree, submitted an application for payment processing services to Base Commerce, which also does

[we] have an MLM with a huge amount of negative news and serious accusations. Hence, banks and processors are running away based on what the FTC, Treasury Dept., FDIC and Justice Dept. has done to them lately to include suing them,,[sic] fining them and freezing their settlement funds.⁹⁵

909. In the same email, in which Hughes also characterized TelexFree as “a real hot-potato as they say,” Hughes indicated that Base Commerce had worked, and was continuing to work, to find a replacement processor for TelexFree “such that [TelexFree’s] business was not interrupted” and that he had arranged, via Defendant Vantage Payments, for Defendant Allied Wallet, a United Kingdom-based payment processor, to take over payment processing services for TelexFree.

⁹⁴ See Letter from John Hughes to James Merrill, dated August 20, 2013, attached herewith as Exhibit 15.

⁹⁶ *See id.*

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912. In another email from Defendant Merrill to Hughes, also dated August 28, 2013, Merrill indicated that he believed that Base Commerce's activity in soliciting off-shore banking services on TelexFree's behalf was connected with TelexFree's desire to separate its international, U.S.-based, and Brazil-based business among different banks and processors.

914. More particularly, Hughes asked Vantage Payments to act as a broker on TelexFree's behalf, and to contact banks and processors with whom it had a business relationship to secure payment-processing services for TelexFree, which services Vantage Payments agreed to perform.

“The bank is clearly not happy with me but we are still trying to do the best job we can for you. Their concerns are that if, god forbid, TelexFree came under a publicized FTC investigation, there could be an indeterminate wave of chargeback’s. . . .”⁹⁸

⁹⁸ See email from Hughes to Merrill, dated September 27, 2013, attached herewith as Exhibit 16.

925. Although Base Commerce and Hughes possessed knowledge of the tortious nature of TelexFree's business activities from the time of its initial investigation of TelexFree and during its monitoring of TelexFree, it continued to promote and to provide TelexFree with payment processing services integral to the TelexFree Scheme.

- further the unlawful Pyramid Scheme;
- unfairly, deceptively and unlawfully convert class member funds;
- continue to provide services integral to the TelexFree Pyramid Scheme; and
- continue to provide TelexFree with substantial assistance and encouragement essential to their unlawful business enterprise.

4. Vantage Payments

929. Despite Vantage Payments' knowledge of the suspicious, tortious or unlawful

931. Thereafter, Vantage Payments contacted Defendant Allied Wallet, and applied on TelexFree's behalf for Allied Wallet to provide payment-processing services to TelexFree.

933. Vantage Payments was able to secure Allied Wallet’s agreement to provide payment processing services to TelexFree, pursuant to which agreement Allied Wallet would provide a “processing account” and process both incoming and outgoing payments for the benefit of TelexFree, among other services.⁹⁹

935. Vantage Payments, on behalf of TelexFree, also registered an entity in the United

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Kingdom, known as “TelexFree, LTD,” to serve as TelexFree’s EU-based operation.

936. In fact, as Vantage Payments was aware, “TelexFree, LTD” was a shell company with no physical presence beyond a mere address.

937. On or about October 10, 2013, Allied Wallet informed TelexFree that, due to an increase in both payment volume and chargebacks, it would be increasing the rolling reserve on TelexFree's processing account to 20%.

938. Thereafter, Vantage Payments negotiated extensively with Allied Wallet on TelexFree's behalf, to have this rolling reserve reduced.

939. These negotiations entailed, *inter alia*, Sparman meeting personally with the CEO of Allied Wallet in Los Angeles, California on TelexFree's behalf.

940. Ultimately, after extensive lobbying by Vantage Payments on TelexFree’s behalf, Allied Wallet agreed to reduce its rolling reserve on the TelexFree processing account to 10%, and also agreed to increase the maximum processing volume on the account

941. On or about November 13, 2013, Sparman, on behalf of Vantage Payments, and acting on behalf of TelexFree, once again contacted another United Kingdom-based payment processor in hopes of securing TelexFree additional payment processing volume.¹⁰⁰

942. This effort was ultimately unsuccessful, as this additional United Kingdom-based payment processor declined to perform services for TelexFree in light of the accusations of fraud and illegality surrounding TelexFree.

943. The foregoing activities were beyond the scope of Vantage Payments' role as a Financial Services Provider. By working so in concert with the indicted parties to skirt the law, Vantage Payments and Sparman were active participants in TelexFree's unlawful operation.

¹⁰⁰ See email from Dustin Sparman to James Merrill, dated November 13, 2013, attached hereto and marked as Exhibit 18.

946. This authorized TelexFree to make use of Vantage Payments' online CDRN portal for processing of ACH and credit card transactions.

948. In connection with this Agreement, Merrill authorized Vantage Payments to transmit all incoming payments to the account of TelexFree, Inc. at Fidelity Bank.

950. In an email from Defendant Merrill to Sparman, dated January 15, 2014, Merrill stated, regarding dividing TelexFree’s payment processing between Vantage Payments and IPS, “[T]here will be plenty of business to go around. You deserve your share for getting us started... Whomever treats us best will get most of the business.”¹⁰²

¹⁰¹ See Vantage Payments CDRN Portal Agreement, attached hereto and marked as Exhibit 19.

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5. Allied Wallet

956. Defendant Allied Wallet shared a close business relationship with Defendants Vantage Payments and Sparman, and was kept informed by Sparman of information regarding TelexFree, including public accusations of operating a Pyramid Scheme and the investigation and shutdown of TelexFree's operations in Brazil.

957. Despite Allied Wallet’s knowledge of the suspicious, tortious, or unlawful nature of TelexFree’s business activities and operation, Allied Wallet agreed to accept TelexFree as a customer and began in late August 2013 to perform payment processing services for TelexFree.

958. Allied Wallet had extensive connections with Vantage Payments in facilitating the Scheme.

959. Upon Vantage Payments’ application on behalf of TelexFree, Allied Wallet agreed to provide payment-processing services to TelexFree, pursuant to which agreement Allied Wallet would provide a “processing account” and process both incoming and outgoing payments for the benefit of TelexFree, among other services.¹⁰³

960. In connection with TelexFree's agreement with Allied Wallet, Defendant Merrill instructed Allied Wallet to transfer funds from TelexFree's processing account with Allied Wallet to accounts with Fidelity Bank.

961. On or about October 10, 2013, Allied Wallet informed TelexFree that, due to an increase in both payment volume and chargebacks, it would be increasing the rolling reserve on TelexFree's processing account to 20%.

962. Thereafter, Vantage Payments negotiated extensively with Allied Wallet on TelexFree's behalf, to have this rolling reserve reduced.

¹⁰³ See Allied Wallet Card Payment Processing Agreement, dated August 26, 2013, attached herewith and marked as Exhibit 17.

964. Ultimately, after extensive lobbying by Vantage Payments on TelexFree's behalf, Allied Wallet agreed to reduce its rolling reserve on the TelexFree processing account to 10%, and also agreed to increase the maximum processing volume on the account.

966. Despite having direct knowledge of the shutdown of TelexFree in Brazil and Rwanda, the United Kingdom scam warning against TelexFree, well-publicized accusations of fraud and illegality on the part of TelexFree, and an enormous number of Red Flags and indicia indicating the suspicious, tortious or unlawful nature of TelexFree's operations, Allied Wallet continued to provide processing and processing-related services to TelexFree up to the time that TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc. declared bankruptcy in April 2014.

- further the unlawful Pyramid Scheme;
- unfairly, deceptively and unlawfully convert class member funds;
- continue to provide services integral to the TelexFree Pyramid Scheme; and
- continue to provide TelexFree with substantial assistance and encouragement essential to their unlawful business enterprise.

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encouragement and otherwise became an integral part of TelexFree's Pyramid Scheme. Allied Wallet also assisted TelexFree and its Principals to further achieve their unfair, deceptive and unlawful Scheme that was at a minimum violative of M.G.L. c. 93, § 69.

969. At a minimum, Allied Wallet's initial investigation and ongoing monitoring of TelexFree, made it generally aware that TelexFree was engaged in suspicious, tortious or unlawful conduct, but it deliberately and willfully turned a blind eye to the results of its investigation and monitoring.

970. Although Allied Wallet possessed knowledge of the tortious nature of TelexFree’s business activities from the time of its initial investigation of TelexFree and during its monitoring of TelexFree, it continued to promote and to provide TelexFree with payment processing services integral to the TelexFree Scheme until at least April 2014.

6. IPS

971. In September 2013, Defendant Base Commerce successfully applied to IPS, on TelexFree's behalf, for TelexFree to receive its ACH processing services through IPS.

972. Thereafter, TelexFree's ACH processing was conducted by IPS, also doing business as e-Wallet.

973. In approximately December 2013, TelexFree entered into a further agreement with IPS for additional payment processing services, under the name and address of “TelexFree, LTD,” the shell company established by Vantage Payments.¹⁰⁴

974. Thereafter, beginning in approximately January 2014, IPS provided TelexFree with a service titled “e-Wallet,” which was used by TelexFree for additional processing of funds transferred by Promoters to TelexFree.

¹⁰⁴ See email from Sparman to Merrill, dated December 27, 2013, attached herewith as Exhibit 21.

MLM attorney Kevin Thompson of Thompson Burton, PLLC, to “provide up-to-date compliance guidance to their new and existing clients in the Direct Selling and Multi-Level Marketing industry.”

981. TelexFree was a recipient of such “compliance guidance” services.

982. According to a TelexFree balance sheet, dated December 31, 2013, posted by the Washington State Utilities and Transportation Commission, as of December 31, 2013, TelexFree claimed \$31,640,192.30 in assets then held by IPS (under the name “e-Wallet”) on behalf of TelexFree.¹⁰⁵ The assistance that IPS offered TelexFree was substantial.

983. IPS continued to provide payment-processing services to TelexFree until April 17, 2014, at which time IPS finally disabled its electronic services.

984. Thereafter, in place of the previous e-Wallet online interface, IPS posted a message online stating that TelexFree’s payment processing services had been disabled, and suggested that this could be due to TelexFree having “violated Anti-Money Laundering policies.”

985. Despite having direct knowledge of the shutdown of TelexFree in Brazil and Rwanda, the United Kingdom scam warning against TelexFree, well-publicized accusations of fraud and illegality on the part of TelexFree, and an enormous number of Red Flags and indicia of fraud indicating the fraudulent and illegal nature of TelexFree’s operations, IPS continued to provide processing and processing-related services to TelexFree up to the time that TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc. declared bankruptcy in April 2014.

986. Although Defendant IPS possessed knowledge of the suspicious, tortious or illegal nature of TelexFree’s business activities at all times it received or held TelexFree funds, it

¹⁰⁵ See TelexFree, LLC Balance Sheet as of December 31, 2013, marked as Exhibit 5.

992. Plaintiffs and the putative class representatives seek to obtain damages, restitution and injunctive relief for the Class, as defined, below, from Defendants.

993. Under Rule 23 of the Federal Rules of Civil Procedure, Plaintiffs sue on their own behalf, and on behalf of all other persons similarly situated (“the Class”). The Class that Plaintiffs seek to represent is:

994. Excluded from the Class are Defendants and their officers, directors, and employees; any entity in which any Defendant has a controlling interest; the co-conspirators, the so-called Top Level Promoters, legal representatives, attorneys, heirs, and assigns of Defendants.

996. Plaintiffs meet the requirements of Federal Rules of Civil Procedure 23(a) because there is a well-defined community of interest among the members of the Class, common questions of law and fact predominate, Plaintiffs' claims are typical of the members of the Class,

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and Plaintiffs can fairly and adequately represent the interests of the Class.

997. This action satisfies the requirements of Federal Rule of Civil Procedure 23(b)(3) because it involves questions of law and fact common to the members of the Class that predominate or questions affecting only individual members, including, but not limited to:

- whether the contract under which TelexFree claims to invoke the application of Nevada law is illegal and unenforceable as a matter of law;
- whether TelexFree’s claim to invoke the application of Nevada law is enforceable;
- whether TelexFree ran an unlawful Pyramid Scheme or a legitimate business;
- whether TelexFree ran a lawful MLM program or an unlawful pyramid scheme;
- whether each Defendant knew that TelexFree was an illegal Pyramid Scheme, yet continued to aid, abet and further such illegal activities or are otherwise liable for the economic loss suffered by the Putative Class;
- whether the aid that each Defendant provided was a substantial in the context of aiding and abetting;
- was TelexFree a “multi-level distribution company” as defined by Massachusetts General Laws Chapter 93, Section 69(a);
- did the standard TelexFree Pre-March 9 Contract contain promises to pay merely for the recruitment of new members in violation of Massachusetts General Laws Chapter 93, Section 69(a);
- did the standard TelexFree Pre-March 9 Contract contain offers to pay a “finder’s fee, bonus, refund, override, commission, cross-commission, dividend or other consideration” to Participants in the TelexFree Program in violation of Massachusetts General Laws Chapter 93, Section 69(a);
- did the TelexFree Program offer its Members payment without requiring them to engage in any “bona fide and essential supervisory, distributive, selling or soliciting” nor exercise any “judgment,” “skill,” or “control over the operation in violation of Massachusetts General Laws Chapter 93, Section 69(a);
- did each of the Financial Services Defendants have actual knowledge of TelexFree’s suspicious, tortious or unlawful activities;

1000. The prosecution of separate actions by individual members of the Class would create a risk of inconsistent or varying adjudications regarding individual members of the Class, which would establish incompatible standards of conduct for Defendants and would lead to repetitive adjudication of common questions of law and fact.

1003. Defendants have acted or refused to act on grounds that apply to the Class, as alleged above, and certification is proper under Rule 23(b)(2).

V. CLAIMS FOR RELIEF

FIRST CLAIM FOR RELIEF
VIOLATIONS OF MASSACHUSETTS GENERAL LAWS,
CHAPTER 93, SECTIONS 12 and 69
(Against All Operational Defendants)

1004. Plaintiffs incorporate by reference all allegations in all previous paragraphs, as though fully set forth here.

1005. The Operational Defendants were engaged in acts in violation of Massachusetts General Laws Chapter 93, Section 69.

1006. Massachusetts General Laws Chapter 93, Section 12 provides for a private right of action for violations of Chapter 93, Section 69.

1007. In consequence of said Defendants' violative conduct, Plaintiffs and the Putative Class have suffered great financial losses, and have also incurred considerable expenses and loss of income, and have otherwise been greatly damaged.

1008. In consequence of said Defendants' violative conduct or other unfair and deceptive acts and practices, Plaintiffs and the Putative Class have been similarly caused to

SECOND CLAIM FOR RELIEF
VIOLATIONS OF MASSACHUSETTS GENERAL LAWS,
CHAPTER 93A, SECTIONS 2 AND 11
(Against All Operational Defendants)

1009. Plaintiffs incorporate by reference all allegations in all previous paragraphs, as though fully set forth here.

1010. All Operational Defendants were engaged in “trade” and “commerce” as defined by Massachusetts General Laws Chapter 93A, Section 1.

1011. Plaintiffs and the Putative Class were engaged in “trade” and “commerce” as defined by Massachusetts General Laws Chapter 93A, Section 1.

1012. The transactions, actions or inaction of the Operational Defendants constitute unfair and deceptive acts and practices as defined by, and in violation of, Massachusetts General Laws, Chapter 93A, Sections 2 and 11.

1013. In addition, said Defendants engaged in acts in violation of Massachusetts General Laws Chapter 93, Section 69. Pursuant to Chapter 93, Section 69(g) any violation of the provisions of M.G.L. c. 93, section 69 shall constitute an unlawful method, act or practice within the meaning of clause (a) of section two of chapter ninety-three A.

1014. As a result, the foregoing transactions, actions and inactions of said Defendants thereby constitute per se an unlawful method, act or practice within the meaning of Massachusetts General Laws, Chapter 93A, Section 2(a) by operation of Massachusetts General

and illegal Pyramid Scheme, and yet continued to substantially assist or encourage said Scheme.

1033. Each Defendants rendered this substantial assistance despite their knowledge that TelexFree's operations constituted an unlawful, unfair, deceptive and unsustainable Pyramid Scheme and violated M.G.L. c. 93 § 69 and M.G.L. c. 93A.

1034. Such substantial assistance was rendered by Defendants despite their knowledge of the illegal nature of TelexFree's operations, is detailed within this complaint and includes, but is not limited to:

- a. managing and controlling TelexFree and its affiliated entities;
- b. providing accounting services to TelexFree;
- c. providing legal services to TelexFree;
- d. publicly certifying that TelexFree's business model and operations were legal, proper, and economically viable and sustainable;
- e. providing banking, investment and asset management services for TelexFree and its management;
- f. promoting TelexFree AdCentral packages;
- g. continuing to provide financial services following the Brazilian Court's injunction to stop TelexFree's business in Brazil;
- h. processing payments to, from, and on behalf of TelexFree and its affiliated entities;
- i. processing payments for transfers of funds which deepened TelexFree's insolvency;
- j. making transfers from TelexFree's corporate accounts to private accounts held in the names of Defendant Founders, despite knowledge

- of the fraudulent nature of TelexFree's business enterprise;

1040. Defendants knew of such funds received by them.

1041. Defendants have unlawfully and in bad faith denied Plaintiffs and the putative Class access to such funds, and have instead knowingly retained the benefit of such funds for themselves.

1042. Acceptance or retention by Defendants of the benefit under the circumstances set forth herein would otherwise be inequitable without payment for its value.

1043. As a direct and proximate result of Defendants' actions, as hereinabove set forth, Defendants are, and continue to be, unjustly enriched and Plaintiffs demand they and the Putative Class be made whole.

FIFTH CLAIM FOR RELIEF
CIVIL CONSPIRACY

(Against TelexFree, All Operational Defendants, John Merrill, John Hughes, Dustin Sparman, Fidelity Bank, Base Commerce, GPG, and IPS)

1044. Plaintiffs incorporate by reference all allegations in all previous paragraphs, as though fully set forth here.

1045. TelexFree, the Operational Defendants, Katia Wanzeler, John Merrill, John Hughes, Dustin Sparman, Fidelity Bank, Base Commerce, GPG and IPS have combined by common design to enter into a civil conspiracy.

1046. Said Defendants conspired with each other to operate and maintain in operation a Pyramid Scheme in violation of Massachusetts General Laws Chapter 93, Section 69 and Chapter 93A.

1047. Said Defendants, by agreement or common design, engaged directly in the operation of, or otherwise worked in concert to further the activities of, the unlawful Pyramid Scheme.

1048. As detailed above, each of said Defendants engaged in a tortious act in

1055. By negligently misstating and omitting relevant information, including the source of and sufficiency of funds for payments to Promoters, said Defendants breached the duty of care they owed to Plaintiffs and the Putative Class.

1056. Each of the Licensed Service Provider Defendants owed Plaintiffs and the Putative Class a duty to act with reasonable care and to exercise the ordinary skill and ability commonly exercised by such professionals.

1057. Plaintiffs and the Putative Class relied upon said Defendants' expertise and/or performance of their duties or was similarly affected and similarly caused to incur ascertainable economic loss.

1058. Plaintiffs and the Putative Class reposed faith, confidence and trust in said Defendants' representations and advice.

1059. As a direct and proximate result of said Defendants' negligence and carelessness, Plaintiffs and the Putative Class have been caused to suffer and sustain damages and losses and demand they be made whole.

SEVENTH CLAIM FOR RELIEF
NEGLIGENT MISREPRESENTATION
(Against Operational Defendants Except Katia Wanzeler)

1060. Plaintiffs incorporate by reference all allegations in all previous paragraphs, as though fully set forth here.

1061. The Operational Defendants, except Katia Wanzeler, directly, and through their agents, servants, employees and/or representatives, negligently made false misrepresentations of material fact and omissions to Plaintiffs and the Putative Class in the course of their businesses for the purpose of obtaining and/or wrongfully appropriating and converting money from Plaintiffs and the Putative Class.

1062. The said Operational Defendants made negligent misrepresentations and

1071. The Defendant Founders and Principals, Executive Office and Licensed Professional actively participated in the leadership and decision-making process of the selling entity causing the dissemination of false and misleading statements and omissions of material facts.

1073. In addition, the Defendant Top Level Promoters and Licensed Professionals were agents who materially aided in the sales of the fraudulent securities in violation of Sections 410 (b) of the Massachusetts Uniform Securities Act, Massachusetts General Laws Chapter 110A.

1075. Said Defendants prepared and provided information on, and endorsed and actively promoted the opportunity regarding the securities on websites and at TelexFree events and

detailed above and include, but are not limited to:

- a. providing false and misleading information on the nature of TelexFree's business operation;
- b. misrepresenting the financial statements;
- c. providing false and misleading information on the value of the AdCentral package;
- d. providing false and misleading information on the method and source from which income was derived;
- e. providing false and misleading information on the legality of TelexFree's business model;
- f. providing false and misleading information on the sustainability of the returns to Promoter;
- g. providing false and misleading information regarding the investigation in Brazil and subsequent closure of TelexFree's Brazilian operations;
- h. knowingly participating in false and deceptive information televised over the internet and other media;
- i. failing to comply with federal and state laws;
- j. employing legal and accountant counsel to mask their illegal and fraudulent activities to further and perpetuate such illegal fraudulent activities; and
- k. setting up TelexFree's computer servers in a foreign country with the intent to avoid prosecution, legal service on the benefits of

United States legal process and otherwise with knowledge that
TelexFree was an unlawful Pyramid Scheme.

1084. Said Defendants knew of the fraudulent or reckless deceptive misrepresentations and omissions of material facts set forth.

1085. Said Defendants made these intentional or reckless misrepresentations although Defendants knew that such representations were false for the purpose of inducing Plaintiffs and the Putative Class to purchase initially and to continue to purchase memberships and to recruit new members.

1086. Such misrepresentations and omissions were done knowingly or recklessly for the additional purpose and effect of concealing the true information about the TelexFree Program, including its financial condition and operations.

1087. Said Defendants received information reflecting the facts regarding TelexFree's business practices and exercised control over the materially misleading misstatements.

1088. Because of their control over and/or association with the TelexFree Program, said Defendants were active and culpable participants in the fraudulent Scheme.

1089. Said Defendants knew and recklessly disregarded the false and misleading nature of the information they caused to be disseminated to Promoters and potential Promoters.

1090. The ongoing fraudulent Pyramid Scheme could not have been perpetrated over a substantial period without the knowledge and complicity of said Defendants.

1091. These misrepresentations and statements were material and were relied upon by Plaintiffs as true, inducing them to furnish money, directly or indirectly, to said Defendants and recruit new members.

1092. In consequence of the reliance on the negligent, intentional or reckless

TENTH CLAIM FOR RELIEF
TORTIOUS AIDING AND ABETTING
(Against All Defendants)

- a. managing and controlling TelexFree and its affiliated entities;
- b. providing accounting services to TelexFree;
- c. providing legal services to TelexFree;
- d. publicly certifying that TelexFree's business model and operations were legal, proper, and economically viable and sustainable;
- e. providing banking, investment and asset management services for

TelexFree and its management;

- f. promoting TelexFree AdCentral packages;
- g. continuing to provide financial services following the Brazilian Court's injunction to stop TelexFree's business in Brazil;
- h. processing payments to, from, and on behalf of TelexFree and its affiliated entities;
- i. processing payments for transfers of funds which deepened TelexFree's insolvency; and
- j. setting up TelexFree's computer servers in a foreign country with the intent to avoid prosecution, legal service on the benefits of United States legal process and otherwise with knowledge that TelexFree was an unlawful Pyramid Scheme.

1097. By each Defendant's actions participating in the Pyramid Scheme, as alleged above, each said Defendant aided and abetted the commission of the causes of action alleged herein.

1098. As a direct and proximate result of TelexFree's illegal Pyramid Scheme and all the activities performed in connection therewith, to which Defendants provided substantial assistance, Plaintiffs and the Putative Class sustained damages and losses and demand to be made whole.

VI. PRAYER FOR RELIEF

WHEREFORE, Plaintiffs, on behalf of themselves and the Class, pray for judgment against Defendants as follows:

1. The Court determine that this action be maintained as a class action under Rule

authorized by law.

Respectfully submitted,

Dated this 30th day of April, 2015

/s/ Robert J. Bonsignore
Robert J. Bonsignore, Esq.
(NH Bar #21241)
BONSIGNORE TRIAL LAWYERS, PLLC
2513 Morocco Avenue
North Las Vegas, NV 89031
Telephone: 781-856-7650
Email: rbonsignore@classactions.us

Ronald A. Dardeno, Esq.
(BBO No. 548278)
Alexander D. Wall, Esq.
(BBO No. 688881)
Law Offices of Frank N. Dardeno
424 Broadway
Somerville, MA 02145
Telephone: 617-666-2600
Email: rdardeno@dardeno.com

William R. Baldiga, Esq.
(MA Bar No. 542125)
(NY Bar No. 4813846)
Kiersten Taylor, Esq.
(MA Bar No. 681906)
BrownRudnick LLP
One Financial Center
Boston, MA 02110
Telephone: 617-856-8586
Email: wbaldiga@brownrudnick.com
Email: ktaylor@brownrudnick.com

Evans J. Carter, Esq.
(MA Bar No. 076560)
Evans J. Carter, P.C.
860 Worcester Road, 2nd Floor
P.O. Box 812
Framingham, MA 01701
Telephone: 508-875-1669
Email: ejcatty1@verizon.net
D. Michael Noonan, Esq.
(MA Bar No. 558247)

(NH Bar No. 8214)
(VT Bar No. 4050)
(ME Bar No. 7240)
Christine M. Craig, Esq.
(MA Bar No. 631211)
(NH Bar No. 12842)
(ME Bar No. 8954)
Courtney Hart, Esq.
(ME Bar No. 4127)
Shaheen and Gordon
140 Washington Street
P.O. Box 977
Dover, NH 03821
Telephone: 603-871-4144
Email: mnoonan@shaheengordon.com
[Email: ccraig@shaheengordon.com](mailto:ccraig@shaheengordon.com)
[Email: cmhart@shaheengordon.com](mailto:cmhart@shaheengordon.com)

R. Alexander Saveri, Esq.
(CA Bar No. 173102)
Cadio Zirpoli, Esq.
(CA Bar No. 179108)
Carl N. Hammarskjold, Esq.
(CA Bar No. 280961)
Saveri & Saveri, Inc.
706 Sansome Street
San Francisco, CA 94111
Telephone: 415-217-6810
Email: rick@saveri.com
Email: cadio@saveri.com
Email: carl@saveri.com
Ronald P. Passatempo, Esq.
(MA Bar No. 632508)
Ronald P. Passatempo Law Offices
200 Broadway
Lynnfield, MA 01940
Telephone: 781-596-3100
Email: passatempolaw@comcast.net

William Coulthard, Esq.
(NV Bar No. 3927)
Carol Harris, Esq.
Michael Gayan, Esq.
(NV Bar No. 11135)
Kemp, Jones & Coulthard, LLP
Wells Fargo Tower
3800 Howard Hughes Parkway, 17th Floor
Las Vegas, NV 89169
Telephone: 702-385-6000
Email: w.coulthard@kempjones.com

Mark A. Tate, Esq.
(GA Bar No. 698820)
Tate Law Group, LLC
2 East Bryan Street, Suite 600
P.O. Box 9060
Savannah, GA 31412
Telephone: 912-234-3030
Email: marktate@tatelawgroup.com

Stephen M. Smith, Esq.
(NY Bar No. 277784)
(VA Bar No. 14362)
(NY Bar No. 277784)
(DC Bar No. 230995)
Brain Injury Law Center
2100 Kecoughtan Road
Hampton, VA 23661
Telephone: 877-840-3431
Email: ssmith@braininjurylawcenter.com

Lisa Sleboda, Esq.
(PA No. 71580)
Ernesto Ganaden, Esq.
(HI Bar No. 8948)
Bonsignore Trial Lawyers, PLLC
193 Plummer Hill Road
Belmont, NH 03220
Telephone: 781-856-7650
Email: lsleboda@class-actions.us
Email: sganadan@class-actions.us

Kevin Barry, Esq.
(BBO #690595)
Bonsignore Trial Lawyers, PLLC
23 Forest Street
Medford, MA 02155
Telephone: 781-350-0000
Email: kbarry@class-actions.us

Robert J. Bonsignore

EXHIBIT H

Steven J. German – (#014789)
ADELMAN GERMAN, P.L.C.
8245 North 85th Way
Scottsdale, AZ 85258
Telephone (480) 607-9166
Facsimile (480) 607-9031
steve@adelmangerman.com

UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA

RITA DOS SANTOS, PUTATIVE CLASS
REPRESENTATIVES AND THOSE
SIMILARLY SITUATED,

Plaintiffs,

v.

TELEXELECTRIC, LLLP; TELEX MOBILE,
HOLDINGS, INC.; JAMES M. MERRILL;
CARLOS N. WANZELER; STEVEN M.
LABRIOLA; JOSEPH H. CRAFT, a/k/a JOE
H. CRAFT; CRAFT FINANCIAL
SOLUTIONS, LLC; ANN GENET; CARLOS
COSTA; KATIA WANZELER;
SANDERLEY RODRIGUES DE
VASCONCELOS; SANTIAGO DE LA
ROSA; RANDY N. CROSBY; FAITH R.
SLOAN; DANIIL SHOYFER; SCOTT
MILLER; GERALD P. NEHRA, individually
and doing business as LAW OFFICES OF
NEHRA AND WAAK; GERALD P. NEHRA
ATTORNEY AT LAW, PLLC; RICHARD W.
WAAK, individually and doing business as
LAW OFFICES OF NERHA AND WAAK;
RICHARD W. WAAK, ATTORNEY AT
LAW, PLLC; OPT3 SOLUTIONS, INC.;
JASON A. BORROMEI;

Case No. _____

CLASS ACTION

COMPLAINT

DEMAND FOR TRIAL BY JURY

PRICEWATERHOUSECOOPERS, LLP;
BANK OF AMERICA, NA; TD BANK, NA;
RSB CITIZENS, N.A.; FIDELITY CO-
OPERATIVE BANK, doing business as
FIDELITY BANK; JOHN F. MERRILL;
WELLS FARGO BANK, N.A.; SYNOVUS
BANK; GLOBAL PAYROLL GATEWAY
INC.; INTERNATIONAL PAYOUT
SYSTEMS, INC.; PROPAY, INC., doing
business as PROPAY.COM; BASE
COMMERCE, LLC, doing business as
PHOENIX PAYMENTS; JOHN HUGHES;
VANTAGE PAYMENTS, LLC; DUSTIN
SPARMAN; ALLIED WALLET, LTD; DOE
TOP LEVEL PROMOTERS; DOE
LICENSED PROFESSIONALS; DOE
BANKS; DOE PAYMENT PROCESSING
SERVICES, PARALEGAL DOE, and a
Defendant Class of Direct Victim Payment
Recipients,

Defendants.

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**VIOLATIONS OF MASSACHUSETTS GENERAL LAWS, CHAPTER 93,
SECTIONS 12 and 69**

**VIOLATIONS OF MASSACHUSETTS GENERAL LAWS, CHAPTER 93A,
SECTIONS 2 AND 11**

(Against All Operational Defendants).....179

THIRD CLAIM FOR RELIEF

AIDING AND ABETTING VIOLATIONS OF MASSACHUSETTS

GENERAL LAWS, CHAPTER 93, SECTIONS 12 and 69, AND

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1 Plaintiff and Putative Class Representative Rita Dos Santos on behalf of herself
2 and all others similarly situated (collectively, “Plaintiffs,” “Putative Class” or “Net
3 Losers”) bring this action against the defendants named herein (“Defendants”). This
4 complaint is based on information and belief, except those paragraphs that relate to
5 Plaintiffs, which are based on personal knowledge. Plaintiffs allege as follows:
6

7 1. TelexFree, Inc., TelexFree, LLC, and TelexFree Financial, Inc.
8 (collectively, “TelexFree”) and its related entities and individuals operated an illegal
9 scheme whereby it sold “memberships,” ostensibly paid its “promoters” (“Members,”
10 “Promoters” or “Participants”) for placing advertisements for a “voice over internet
11 protocol” (“VoIP”) product, and in reality paid them to recruit other investors whose
12 new membership fees kept the scheme afloat (the “TelexFree Program”).
13
14

15 2. Until TelexFree, Inc. changed its compensation plan in March 2014, a
16 month before it filed for bankruptcy, it did not require Promoters to sell its VoIP
17 product to be eligible for payments.
18

19 3. TelexFree’s business and operations constituted an illegal pyramid
20 scheme (the “Pyramid Scheme” or “Scheme”). A pyramid scheme is a form of Ponzi
21 scheme wherein a business enterprise persuades people to invest money into a
22 seemingly legitimate business model and in exchange guarantees profits. The actual
23 sales or services provided, if any, are insufficient to pay the promised returns to
24 investors. The operation of a pyramid scheme relies entirely on additional investment
25 funding by new or existing investors. Once the influx of new investments stops, the
26

1 pyramid scheme collapses because there are no new funds with which to pay previous
2 investors. Pyramid schemes are lucrative for those who occupy top-level or other like
3 positions and for those who service them.

4 4. Participants entered the TelexFree Scheme by purchasing a membership
5 plan or a new VoIP package and opening an account with the company.¹ When a
6 newly-recruited Participant purchased a new membership plan or a new VoIP package,
7 TelexFree issued an invoice to that Participant. As relevant here, the newly-recruited
8 Participant would then satisfy that invoice by making a cash payment not to TelexFree,
9 but directly to the recruiting Participant. Those payments made from one Participant
10 (the recruited) to another (the recruiter) are collectively referred to herein as “Direct
11 Victim Payments.”²

12 5. Participants received nothing of value in return for making the Direct
13 Victim Payments. Although ostensibly Participants received access to a TelexFree user
14 account, because TelexFree was running an illegal pyramid scheme, those accounts
15 were worthless. Moreover, TelexFree, as a criminal enterprise, had no right to the
16 monies paid as Direct Victim Payments.

17 6. Massachusetts General Laws (“M.G.L.”) c. 93, § 69 makes pyramid
18 schemes, as well as many of their traditional features, unlawful. M.G.L. c. 93, § 69(g)
19 expressly declares that a violation of M.G.L. c. 93, § 69 is a per se violation of M.G.L.

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24
25 ¹ Participants could open a single account or could (and did) open hundreds or thousands of
26 user accounts.

² These transactions and amounts of payments are ascertainable.

1 c. 93A, §2(a). For this reason, in addition to others, TelexFree and certain defendants
2 otherwise violated M.G.L. c. 93A, §§ 2 and 11.

3 7. TelexFree raised as much as \$1 billion dollars over the course of eighteen
4 months as follows:

5 2012 Income	\$15,490,349.71
6 2013 Income	\$865,893,524.99
7 2014 Income	\$161,116,265.38*

8 (*Law enforcement authorities shut down TelexFree on April 15,
9 2014.)

10 8. The financial services providers (“Financial Services ” or “Financial
11 Services Defendants”) processed hundreds of thousands of related transactions
12 involving hundreds of millions of dollars, and the substantial assistance they provided
13 was essential to TelexFree.
14

15 9. TelexFree’s founders and principals, executive officers and top level
16 promoters controlled the activities and operations of TelexFree and knowingly,
17 maliciously and willfully conspired to perpetrate, and did perpetrate, the TelexFree
18 Pyramid Scheme with full awareness of its unfair, deceptive, and unlawful nature.
19 Licensed professionals and others were negligent or reckless in providing advice,
20 directly participated in, or otherwise provided essential substantial assistance after
21 knowing the TelexFree business enterprise was unlawful.
22

23 10. The Federal Financial Institutions Examination Council (“FFIEC” or
24 “Council”) regulates the Financial Services Defendants. The Council is a formal
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26

1 interagency body empowered to prescribe uniform principles, standards, and report
2 forms for the federal examination of financial institutions by the Board of Governors of
3 the Federal Reserve System (“FRB”), the Federal Deposit Insurance Corporation
4 (“FDIC”), the National Credit Union Administration (“NCUA”), the Office of the
5 Comptroller of the Currency (“OCC”), and the Consumer Financial Protection Bureau
6 (“CFPB”), and to make recommendations to promote uniformity in the supervision of
7 financial institutions.
8

9 11. The Financial Services Defendants were required by federal law to, and
10 did, maintain robust, sophisticated and thorough due diligence systems at all times.
11

12 12. The Financial Services Defendants are not just required to know their
13 clients, they are required to obtain knowledge of and understand how each client’s
14 business operates, who is running it, and who is associated with it. The Financial
15 Services Defendants did not simply have to gather information; they needed to analyze
16 it and understand their clients’ business models and key personnel, and continue to
17 monitor their customers on an ongoing basis.
18

19 13. TelexFree was purportedly a contract-based business. All TelexFree
20 Promoters, including Plaintiffs and members of the Putative Class, were similarly
21 obligated to enter into TelexFree’s identical form contract (“TelexFree Pre-March 9
22 Contract”). A true and correct copy of the Pre-March 9 TelexFree Contract is attached
23 hereto as **Exhibit 1**.
24

25 14. At all times material herein, TelexFree was a “multi-level distribution
26

1 company” as defined by M.G.L., Chapter 93, Section 69(a).

2 15. M.G.L., Chapter 93, Section 69(d)(2) prohibits any multi-level
3 distribution company from offering or paying any “finder’s fee, bonus, refund, override,
4 commission, cross-commission, dividend or other consideration” to any participant
5 therein “solely for the solicitation or recruitment of other participants.”
6

7 16. The TelexFree Pre-March 9 Contract, on its face, contains numerous
8 instances of promising payment merely for recruitment of new Participants³ (as defined
9 by M.G.L., Chapter 93, Section 69), including, but not limited to, the following:
10

- 11 a. Clause 5.7: “A PROMOTER will achieve TEAM BUILDER status when
12 he is active in an ADCentral FAMILY position (in the marketing
13 network) that has 10 (ten) ADCentral FAMILIES on the incentive plan
14 registered directly by him on his site.”
- 15 b. Clause 5.7.1: “As long as he is fulfilling the qualification in clause 5.9.2⁴
16 [sic], a TEAM BUILDER will earn a payment of 2% (two percent) of the
17 company’s net billing in the following month...the maximum amount for
18 this earning, by contract, which is for one year, is up to US\$ 39,600.00...”
19 (emphasis added).
- 20 c. Clause 5.8: “THE PROMOTER shall receive as an incentive a bonus of
21 US\$ 20.00 (twenty U.S. dollars), for each VOIP ADCentral kit that his
22 direct lower PARTNER acquires and a US\$ 100.00 (one hundred U.S.
23 dollars) bonus for each VOIP FAMILY kit that his direct lower
24 PARTNER acquires.”
- 25 d. Clause 6.1: “A PROMOTER who directly registers 2 (two) new
26 promoters, with one on the left side and the other on the right side of his
marketing network, qualifies for direct and indirect binary earnings, and
for 2% (two percent) of the network from the first to the 6th level,

³ For ease of reading, the terms “Member,” “Promoter” or “Participant,” regardless of capitalization, are at all times herein to be construed as “Participant”, as that term is defined by M.G.L. Chapter 93, Section 69.

⁴ The TelexFree Pre-March 9 Contract does not include a clause numbered 5.9.2.

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- b. “where no amount of judgment or skill exercised by the participant has any appreciable effect” upon such payment,” or
- c. “where the participant is without that degree of control over the operation of such plan as to enable him substantially to affect the amount” of such payment.

19. The TelexFree Pre-March 9 Contract, on its face, contains clear, obvious and direct violations of M.G.L. c. 93, § 69(d)(3)-(4), including:

- a. Clause 5.4: “ADCENTRAL PROMOTERS: After setting up his membership, a PARTNER may acquire an “ADCentral” kit consisting of 10 99TELEXFREE VOIP accounts, for which he must pay the equivalent of US\$ 289.00 (two hundred and eighty-nine U.S. dollars).”
- b. Clause 5.4.1: “with this qualification, the PARTNER will become a TELEXFREE PROMOTER and, accordingly, shall have his own active ad central for 12 (twelve) months, counting from the date of his membership (and not from the date of the purchase of the kit).”
- c. Clause 5.4.2: “He must also post 1 (one) announcement (prepared by TELEXFREE) per day on internet announcement sites (whether free of charge or not), so that at the end of each cycle of 7 (seven) announcements for the week, the PROMOTER shall receive one 99TELEXFREE account.”
- d. Clause 5.5: “ADCENTRAL FAMILY MEMBERSHIP – A PROMOTER wishing to attain the status of an “ADCentral FAMILY Member” must pay the equivalent of US\$ 1,375.00 (one thousand three hundred and seventy-five U.S. dollars).”
- e. Clause 5.5.1: “With this membership, a PROMOTER shall have 5 (five) active announcement centrals for 12 (twelve) months, counting from the date of his activation.”
- f. Clause 5.5.2: “He must, in turn, post 1 (one) announcement (prepared by TELEXFREE) per day at internet announcement sites (whether free of charge or not) on each one of the 5 (five) ADCentral sites. At the end of the 35 (thirty-five) announcements the PROMOTER shall receive 5 (five) 99TELEXFREE accounts as remuneration for these announcements.”

20. The above-cited language makes it clear to a sophisticated reader that

22. Furthermore, VoIP products distributed to Members as remuneration for this mindless spamming activity could be redeemed with TelexFree for cash, resulting in cash remuneration.

24. The TelexFree Pre-March 9 Contract, on its face, contains egregious, obvious violations of M.G.L. c. 93, § 69(b), including:

15

- 1 b. Clause 10.1.4: “If a PARTNER or PROMOTER seeks cancellation of
2 membership after the legal deadline, he is aware that he will not receive
3 any reimbursement of any amount, since his position will continue to
4 entail expenses for its maintenance.”

5 25. In addition to these clear violations of M.G.L. c. 93, § 69(b), the
6 TelexFree Pre-March 9 Contract also sets forth the following draconian terms for
7 cancellation of membership:

8 Clause 10.1.3: “To be disconnected from the TELEXFREE NETWORK
9 Marketing System, a member must request cancellation of his
10 participation on a specific form provided on his personal page, or in the
11 event of absence or inability to use this resource, through a letter written
12 and signed by him, with certified signature recognition, sent to the
13 headquarters of the CONTRACTOR, correctly stating all of the
14 information requested; if these data rigorously match the data reported
15 when putting through the application, which is to be ascertained for
16 reasons of security, the cancellation shall be approved in an irreversible
17 manner.”

18 26. These terms of cancellation are clearly designed to entangle Members in
19 TelexFree’s Scheme and prevent Members from withdrawing.

20 27. Not only does the TelexFree Pre-March 9 Contract explicitly violate
21 M.G.L. Chapter 93, Section 69, but it also lays bare several classic hallmarks of
22 pyramid schemes, including paying participants solely for recruitment of new members,
23 not requiring any meaningful sales or distributive activity by participants, and using
24 coercive measures to prevent participant withdrawal from the scheme.

25 28. The mechanics of the TelexFree Program (e.g. AdCentral, AdCentral
26 Family) were described in the TelexFree Pre-March 9 Contract and on TelexFree’s
website and otherwise accessible to the Financial Services Defendants. TelexFree’s

business model and operations were suspicious, tortious, or illegal to the sophisticated Financial Services Defendants, as demonstrated by the following graphic taken from the public area of TelexFree's website, www.TelexFree.com:



29. Like the TelexFree Pre-March 9 Contract, TelexFree’s own website set forth numerous plain violations of M.G.L. c. 93, § 69. For example, several violations were included in a key promotional video, entitled “Presentation,” which was prominently featured on www.TelexFree.com, and which included, without limitation, the following violations of M.G.L. Chapter 93, Section 69:

- a. promising that Members would “[e]arn US\$20 for the direct registration of each new promoter,” in violation of Section 69(d)(2);

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lucrative relationships with the multilevel marketing industry as a whole.

36. Similarly situated Plaintiffs seek compensation for the ascertainable economic loss they were similarly caused to suffer as a result of Defendants' participation in, or aiding or abetting of, TelexFree's illegal Pyramid Scheme. They also seek equitable relief.

37. An identifiable class of individual Defendants (each a "Direct Victim Payment Recipient" or collectively, the "Defendant Class")⁵ profited from ascertainable payments Plaintiffs -- not TelexFree -- made to those Defendants.⁶

38. Plaintiffs seek compensation from the Defendant Class members solely for the payments made directly by Plaintiff (net loser) victims to Direct Victim Payment Recipients, and which were wrongfully retained by the Direct Victim Payment Recipients, to offset the Plaintiff victims' net losses suffered as a result of the Scheme. As such, the sole cause of action asserted against those Defendants is for unjust enrichment.

⁵ Plaintiffs intend to move pursuant to Federal Rule of Civil Procedure 23(a) and (b)(1)(A) and (B) to certify a class comprised of all persons who (1) were Net Winners and (2) received at least one Direct Victim Payment from Plaintiffs. A "Net Winner" is simply a Participant who received more money from their participation in the Scheme (whether in the form of "earnings," "commissions," "bonuses" or otherwise) than he or she paid to participate in the Scheme. The Federal Rules of Civil Procedure allow for such a defendant class. Rule 23(a) states that "[o]ne or more members of a class may sue *or be sued*" See Fed. R. Civ. P. 23(a) (emphasis added); see also *Henson v. East Lincoln Twp.*, 814 F.2d 410, 412 (7th Cir. 1987) ("It is apparent from the words of Rule 23(a) ('sue or be sued as representative parties') that suits against a defendant class are permitted.").

⁶ To avoid doubt, Plaintiffs seek recompense *solely* for monies *they* paid to the members of the Defendant Class. They do not seek recovery of any monies *TelexFree* paid to that Class.

I. JURISDICTION AND VENUE

39. This Court has subject-matter jurisdiction over the instant matter pursuant to 28 U.S.C. § 1332(d) and the Class Action Fairness Act of 2005 (“CAFA”), 28 U.S.C. §§ 1711, *et seq.*, which vest original jurisdiction in the district courts of the United States for any multi-state class action where the aggregate amount in controversy exceeds \$5,000,000 and where the citizenship of any member of the class of plaintiffs is different from that of any defendant. The \$5,000,000 amount-in-controversy and diverse citizenship requirements of CAFA are satisfied in this case.

40. Venue is proper under 28 U.S.C. § 1391 as to Defendant Sparman because he resides in this district.

II. THE PARTIES

A. PLAINTIFFS

41. Plaintiff Rita D. Dos Santos (“Dos Santos”) is an individual who resides in Massachusetts. Dos Santos, like many other victims of TelexFree’s Pyramid Scheme, tendered funds for a TelexFree Membership and its promised pre-March 9, 2014 return on investment (the “Original Return on Investment”).

42. Ms. Dos Santos invested approximately \$350,000 into the TelexFree Program during the class period. She did not receive any payments from TelexFree.

B. DEFENDANTS

1. TELEXFREE DEFENDANTS

a. Third-Party TelexFree Bankrupt Entities

1 business at 2321 NW 37th Avenue, in Coconut Creek, Florida 33063. TelexFree
2 Financial is a wholly-owned subsidiary of TelexFree, LLC.

3 47. Throughout this complaint, for ease of reference, the named and unnamed
4 TelexFree corporations as well as the Founders, Principals, Executive Office, Top Level
5 Promoters and Associated Individuals; and the Licensed Professionals including
6 Attorneys, Accountants, the Other Professional Services Providers (as defined herein),
7 are alternatively referred to for ease of reading as “Operational Defendants.”
8

9 48. At times relevant to this complaint, the Operational Defendants served as
10 principals, agents, servants, authorized representatives, co-conspirators or employees of
11 TelexFree.
12

13 ***b. Electric and Mobile***

14 49. Defendant TelexElectric, LLLP (“Electric”) is a limited liability limited
15 partnership organized and under the laws of the State of Nevada. Its registered agent is
16 BWFC Processing Center, LLC, 3960 Howard Hughes Parkway, Suite 500, Las Vegas,
17 Nevada 89169.
18

19 50. Defendant Telex Mobile, Holdings, Inc. (“Mobile”) is a corporation
20 organized and existing under the laws of the State of Nevada, and having its registered
21 agent as BWFC Processing Center, LLC, 3960 Howard Hughes Parkway, Suite 500,
22 Las Vegas, Nevada 89169.
23

24 **2. OTHER OPERATIONAL DEFENDANTS**

25 ***a. Founders and Principals, Executive Office, Top Level Promoters and***
26 ***Associated Individuals***

1 51. James M. Merrill (“Merrill”) is an individual with a last known usual
2 place of abode of 1 Coburn Drive in Ashland, County of Middlesex, Commonwealth of
3 Massachusetts 01721. Merrill is a Founder, Principal, and a member of TelexFree’s
4 Executive Office.

5
6 52. Carlos N. Wanzeler (“Wanzeler”) is an individual with a last known usual
7 place of abode of 373 Howard Street, in Northborough, County of Worcester,
8 Commonwealth of Massachusetts 01532. Wanzeler is a Founder, Principal, and a
9 member of TelexFree’s Executive Office.

10
11 53. Carlos Roberto Costa (“Costa”) is an individual with a last known usual
12 place of abode located at Rua Umbizeiro, 37, Bairro de Itapoa, Vila Velha, Espirito
13 Santo, 29101-00 Brazil. Costa is a Founder, Principal and a member of TelexFree’s
14 Executive Office.

15
16 54. Merrill, Wanzeler and Costa are collectively referred to herein as
17 “Founders.”

18 55. Steven M. Labriola is an individual with a last known usual place of
19 abode of 21 Kiwanis Beach Road, in Upton, County of Worcester, Commonwealth of
20 Massachusetts 01568. Labriola is a Principal and a member of TelexFree’s Executive
21 Office.

22
23 56. Joseph H. Craft, also known as Joe H. Craft (“Craft”) is an individual with
24 a last known usual place of abode at 825 E. Main Street in Boonville, Indiana 47601-
25 1885. Craft is a Principal and a member of TelexFree’s Executive Office.
26

1 57. Merrill, Wanzeler, Costa, Labriola and Craft are collectively referred to
2 herein as “Principals” or “Executive Office.”

3 58. Defendant Ann Genet (“Genet”) served as TelexFree, LLC’s Nevada
4 agent, servant or employee, was a resident of Las Vegas, Nevada who served
5 TelexFree’s Executive Office and is an individual associated with Craft and Bridgeway
6 Financial Corporation. Her address is unknown at this time.

7 59. Katia Wanzeler is an individual with a last known usual place of abode of
8 373 Howard Street, in Northborough, County of Worcester, Commonwealth of
9 Massachusetts 01532. Katia Wanzeler served as an agent servant or authorized
10 representative of TelexFree’s Executive Office and is otherwise an individual associated
11 with TelexFree’s Founders, Principals, Executive Office, and Top Promoters.

12 60. Genet and Katia Wanzeler are collectively referred to herein as
13 “Associated Individual” Defendants.

14 61. Sanderley Rodrigues de Vasconcelos (“Rodrigues”) has a last known
15 usual place of abode of 100 Stockton Street, Apt. 49, in Chelsea, County of Suffolk,
16 Commonwealth of Massachusetts 02150. Rodrigues is a TelexFree Top Level Promoter

17 62. Santiago de la Rosa (“De La Rosa”) is an individual with a last known
18 usual place of abode of 189 Beacon Hill Avenue, Unit 2, in Lynn, County of Essex,
19 Commonwealth of Massachusetts 01902. De La Rosa is a TelexFree Top Level
20 Promoter.

21 63. Randy N. Crosby (“Crosby”) has a last known usual place of abode of 30
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Commonwealth of Massachusetts.

b. Licensed Professionals including Attorneys and Other Professional Services Providers

70. Defendant Gerald P. Nehra, Esq. (“Nehra”) is an individual who now resides or formerly resided at 1710 Beach Street, Muskegon, Michigan, 49441 and also maintains a second residence at 2149 Tall Oak Court, Sarasota, Florida 34232. Nehra is an attorney duly licensed to practice law in the State of Michigan.

71. Defendant Gerald P. Nehra, Attorney at Law, PLLC (“Nehra Law Firm”) is a professional limited-liability company engaged in the practice of law and duly organized and existing under the laws of Michigan, with offices located at 1710 Beach Street, Muskegon, Michigan, 49441. Nehra is its sole member, manager, and registered agent.

72. Defendant Richard W. Waak (“Waak”) is an individual who now resides or formerly resided at 11300 East Shore Drive, Delton, Michigan, 49046. Waak is an attorney duly licensed to practice law in the State of Michigan.

73. Defendant Richard W. Waak, Attorney at Law, PLLC (“Waak Law Firm”) is a professional limited-liability company engaged in the practice of law and duly organized and existing under the laws of Michigan, with offices located at 11300 East Shore Drive, Delton, Michigan, 49046. Waak is its sole member, manager, and registered agent.

74. Defendant Law Offices of Nehra and Waak (“Nehra and Waak Law Firm”) is a general partnership formed between Defendants Nehra, Waak, Nehra Law

1 Firm, and Waak Law Firm with primary offices located at 11300 East Shore Drive,
2 Delton, Michigan, 49046, and a secondary office is located at 1710 Beach Street,
3 Muskegon, Michigan.

4 75. Nehra, Waak, Nehra Law Firm, Waak Law Firm, Nehra and Waak Law
5 Firm, are collectively referred to herein as “Attorney Defendants.”
6

7 76. Defendant Opt3 Solutions, Inc. (“Opt3”) is a corporation duly organized
8 and existing under the laws of the State of California, having its principal place of
9 business at 120 Vantis, Suite 300, Alison Viejo, California.
10

11 77. Defendant Jason A. Borromei, also known as Jay Borromei (“Borromei”),
12 is an individual with a last known place of abode located at 23952 Catbird Court,
13 Laguna Niguel, California 92677. At all material times, Borromei served as president
14 and authorized representative of Opt3.

15 78. Borromei and Opt3 are collectively referred to herein as “Other
16 Professional Services Providers.”
17

18 79. By their acts and omissions, the Attorney Defendants and Other
19 Professional Services Providers have transacted business in the Commonwealth of
20 Massachusetts; contracted to supply services and things in the Commonwealth of
21 Massachusetts; caused tortious injury to the putative class in the Commonwealth of
22 Massachusetts; caused tortious injury to the putative class in the Commonwealth of
23 Massachusetts; regularly solicited business and engaged in persistent courses of conduct
24 in the Commonwealth of Massachusetts; made use of the laws, rights, and protections
25 offered by the Commonwealth of Massachusetts; and derived substantial revenue from
26

1 goods used or consumed or services rendered in the Commonwealth of Massachusetts.

2 ***c. The Accountant Defendants***

3 80. Defendant Craft is a certified public accountant who privately provided
4 accounting services and financial advice to TelexFree and others before he served as the
5 chief financial officer of TelexFree, Inc. and TelexFree, LLC.
6

7 81. Defendant Craft Financial Solutions, LLC (“Craft Financial”) is a limited-
8 liability company duly organized and existing under the laws of the State of Indiana
9 with a principal place of business located at 825 E. Main Street, Boonville, Indiana,
10 47601-1885. Craft Financial provided accounting services and financial advice to
11 TelexFree and others. Craft is also the sole member and manager of Craft Financial.
12

13 82. PricewaterhouseCoopers, LLP (“PricewaterhouseCoopers”) is a
14 Registered foreign limited liability partnership, organized and existing under the laws of
15 the State of Delaware, having a principal place of business in New York, New York,
16 and having a place of business at 125 High Street, in Boston, County of Suffolk,
17 Commonwealth of Massachusetts 02110. At times material herein,
18 PricewaterhouseCoopers provided accounting services and other professional services
19 to TelexFree.
20

21
22 83. Craft, Craft Financial and PricewaterhouseCoopers are collectively
23 referred to herein as “Accountant Defendants.”

24 84. By their acts and omissions, the Accountant Defendants have transacted
25 business in the Commonwealth of Massachusetts; contracted to supply services and
26

1 things in the Commonwealth of Massachusetts; caused tortious injury to the putative
2 class in the Commonwealth of Massachusetts; regularly solicited business and engaged
3 in persistent courses of conduct in the Commonwealth of Massachusetts; made use of
4 the laws, rights, and protections offered by the Commonwealth of Massachusetts; and
5 derived substantial revenue from goods used or consumed or services rendered in the
6 Commonwealth of Massachusetts.

8 85. The Attorney Defendants, Accountant Defendants and the foregoing Other
9 Professional Services Providers are collectively referred to herein as “Licensed
10 Professionals.”
11

12 3. FINANCIAL SERVICES PROVIDERS

13 a. *The Bank Defendants*

14 86. TD Bank, N.A. (“TD Bank”) is a national banking institution in the
15 United States chartered and supervised by the federal Office of the Comptroller of the
16 Currency (the “OCC”) with its principal place of business at 15 Broad Street in Boston,
17 County of Suffolk, Commonwealth of Massachusetts 02109.

19 87. Bank of America, N.A. (“Bank of America”) is a national banking
20 institution in the United States chartered and supervised by the OCC with a principal
21 place of business in Charlotte, North Carolina. Bank of America conducts business in
22 the Commonwealth of Massachusetts at, inter alia, 100 Federal Street, in Boston,
23 County of Suffolk, Commonwealth of Massachusetts 02110.

25 88. RSB Citizens, N.A. (“Citizens Bank”) conducts business in the
26

1 Commonwealth of Massachusetts at 725 Canton St., Norwood, County of Norfolk,
2 Commonwealth of Massachusetts 02062 and has a branch at 290 Turnpike Road,
3 Westborough, County of Worcester, Commonwealth of Massachusetts 01581. At all
4 times material herein, Defendant Citizens Bank provided banking services, maintained
5 accounts, and received and executed transfers of funds from or for the benefit of
6 TelexFree.
7

8 89. Wells Fargo Bank, N.A. ("Wells Fargo") is a national banking institution
9 in the United States chartered and is supervised by the federal Office of the Comptroller
10 of the Currency, with an address at P.O. Box 6995, Portland, Oregon 97228 and a
11 branch at 800 North Magnolia Ave., Orlando, Florida. Wells Fargo conducts business
12 in the Commonwealth of Massachusetts at, *inter alia*, 201 Washington Street, in Boston,
13 County of Suffolk, Commonwealth of Massachusetts. At all times material herein,
14 Defendant Wells Fargo provided banking services, maintained accounts, and received
15 and executed transfers of funds from or for the benefit of TelexFree.
16
17

18 90. Fidelity Co-operative Bank, doing business as Fidelity Bank, ("Fidelity
19 Bank") is a Massachusetts Chartered Banking Institution, having its principal offices at
20 675 Main Street, in Fitchburg, County of Worcester, Commonwealth of Massachusetts
21 01420.
22

23 91. John F. Merrill is an individual with a last known usual place of abode of
24 7 Kinnicutt Road, in Worcester, Massachusetts 01602.
25

26 92. At all material times herein, John F. Merrill served as president and chief

operating officer of Fidelity Bank.

93. Synovus Bank (“Synovus”) is a Georgia Chartered Banking Institution, having its principal offices at 1148 Broadway, in Columbus, County of Muscogee, Georgia 31901.

94. TD Bank, Bank of America, Citizens Bank, Fidelity Bank, John F. Merrill, Wells Fargo and Synovus are collectively referred to herein as the “Defendant Banks.”

95. By their acts and omissions, the Defendant Banks have transacted business in the Commonwealth of Massachusetts; contracted to supply services and things in the Commonwealth of Massachusetts; caused tortious injury to the putative class in the Commonwealth of Massachusetts; regularly solicited business and engaged in persistent courses of conduct in the Commonwealth of Massachusetts; made use of the laws, rights, and protections offered by the Commonwealth of Massachusetts; and derived substantial revenue from goods used or consumed or services rendered in the Commonwealth of Massachusetts.

b. Payment Processing Service Companies

96. Global Payroll Gateway, Inc. (“GPG”) is a corporation duly organized and existing under the laws of the State of California, having its principal offices at 18662 MacArthur Boulevard, Suite 200, in Irvine, California 92612.

97. International Payout Systems, Inc. (“IPS”) also doing business as i-Payout, is a corporation duly organized and existing under the laws of the State of

1 Florida, having its principal offices at 2500 East Hallandale Beach Boulevard, Suite
2 800, Hallandale Beach, Florida 33009.

3 98. Propay, Inc. (“ProPay”) is a corporation duly organized and existing under
4 the laws of the State of Utah with its principal offices at 3400 North Ashton Boulevard,
5 Lehi, Utah 84043 and also does business as PROPAY.COM.
6

7 99. Base Commerce, LLC (“Base Commerce”) formerly known as Phoenix
8 Payment, LLC, is a limited liability company duly organized and existing under the
9 laws of the State of Arizona with its principal offices at 7910 S. Kyrene Road, Suite
10 106, Tempe, Arizona 85284, and also does business as Phoenix Payments.
11

12 100. John Hughes (“Hughes”) is an individual with a last known usual place of
13 abode of 6455 E. Rustic Drive, Mesa, Arizona 85215.

14 101. Vantage Payments, LLC (“Vantage Payments”) is a limited liability
15 company duly organized and existing under the laws of the State of Arizona, having its
16 principal offices at 8300 N. Hayden Road #A207, Scottsdale, Arizona 85251.
17

18 102. Dustin Sparman (“Sparman”) is an individual with a last known usual
19 place of abode of 8702 E. Plaza Avenue 85610, Scottsdale, Arizona 85250.
20

21 103. Allied Wallet, Ltd. (“Allied Wallet”) is a limited company having its
22 central office in the United Kingdom, and having its United States office at 900 Sunset
23 Boulevard, Suite 820, West Hollywood, California 90069.

24 104. GPG, IPS, ProPay, Base Commerce, Vantage Payments, Hughes,
25 Sparman and Allied Wallet are collectively referred to herein as the “Payment
26

Processing Service Companies.”

105. By their acts and omissions, the Payment Processing Service Companies have transacted business in the Commonwealth of Massachusetts; contracted to supply services and things in the Commonwealth of Massachusetts; caused tortious injury to the putative class in the Commonwealth of Massachusetts; regularly solicited business and engaged in persistent courses of conduct in the Commonwealth of Massachusetts; made use of the laws, rights, and protections offered by the Commonwealth of Massachusetts; and derived substantial revenue from goods used or consumed or services rendered in the Commonwealth of Massachusetts.

106. Defendants Bank of America, TD Bank, Fidelity Bank, Citizens Bank, Wells Fargo, Synovus, GPG, IPS, ProPay, Base Commerce, Vantage Payments, Allied Wallet, John F. Merrill, Hughes, Sparman and the Doe Banks and Doe Payment Processors are referred to herein collectively as the “Financial Services Providers”.

107. It is believed that additional parties participated and aided and abetted in TelexFree’s Pyramid Scheme but their identities or nature or extent of unlawful participation are as yet unknown. For ease of reference, they can only be referred to herein at this time as Defendants Doe Top Level Promoters, Doe Licensed Professionals, Doe Banks, Doe Payment Processing Services and Paralegal Doe.

4. DEFENDANT CLASS REPRESENTATIVE

108. As described in further detail in the “Defendant Class Allegations” section below, Defendant Shoyfer is the proposed named representative for the Defendant

Class.

III. FACTS AND ALLEGATIONS

A. Chronological Overview

109. The template for TelexFree's Pyramid Scheme was developed and refined in the years immediately prior to the takeoff of its United States enterprise.

110. In 2010, TelexFree Founders and Principals Wanzeler, Merrill and Costa first formed and registered Ympactus Comercial Ltda ("Ympactus") under the laws of Brazil.

111. Ympactus operated out of offices in Marlborough, Massachusetts and Brazil.

112. TelexFree's United States Pyramid Scheme operated out of the same location.⁷

113. Ympactus was registered as a company that would market cosmetics, perfumery and toilet products.

114. Later, in Brazil, Ympactus purported to sell internet telephone services, but in reality sold pyramid scheme "memberships" to investors.

115. TelexFree's United States business model and operations were essentially identical to Ympactus' business model and operations in Brazil.⁸

⁷ There was considerable overlap between Ympactus, which also operated as TelexFree, and TelexFree's United States companies and operations. To assist the reader, TelexFree's Brazilian pyramid scheme will be referred to as "TelexFree Brazil" or "Ympactus." "TelexFree" means the various United States-based TelexFree entities, as well as the Operational Defendants as defined herein.

⁸ As in Brazil, TelexFree's business model has it accept \$299 deposits from Members on the

1 116. Ympactus and TelexFree’s U.S. memberships offered investors (the
2 “Members” or “Promoters”) guaranteed high returns in exchange for promoting the
3 company online and recruiting new investors.

4 117. Ympactus and TelexFree falsely advertised themselves as a “multi-level
5 marketing” company selling local and international telephone service plans that used
6 unique groundbreaking “voice over internet protocol” (“VoIP”) technology.

8 118. The VoIP technology used by Ympactus and TelexFree was not unique or
9 groundbreaking. In fact, it was substandard and offered nothing more than the free
10 Google Voice and Skype.

12 119. In February 2012, Wanzeler and Merrill formed TelexFree, Inc. in the
13 Commonwealth of Massachusetts.

14 120. Wanzeler and Merrill formed TelexFree, Inc. with the intent to use the
15 same unlawful Ympactus business model in the United States.

17 121. After they opened TelexFree in the United States, the Operational
18 Defendants methodically released false or misleading information that was intended to,
19 and did, separate publicly TelexFree and TelexFree Brazil or Ympactus and otherwise
20 shower their Scheme with credibility.⁹ While these calculated information releases
21 were sufficient to mislead members of the Putative Class, they were detectable by the
22 robust and sophisticated Financial Services Providers’ Know Your Customer (as
23

24
25 promise of a \$20 a week rate of interest for 52 weeks. The company also pays Members
26 directly based on how many deposits recruited down line affiliates make via a matrix.

⁹ See, e.g., ¶¶ 126, 127, 129, 133, 134, 142, 147, 151, 155, 164, 528, *infra*; see also
<http://behindmlm.com/companies/telexfree/germy-nehra-gives-legal-blessing-to-telexfree/>.

1 defined herein) investigations and evaluations.

2 122. In March 2012, Founders and Principals Costa, Merrill and Wanzeler
3 repurposed Ympactus to front the TelexFree Brazil's VoIP pyramid scheme.

4 123. In April 2012, Craft was retained to serve as TelexFree's accountant and
5 prepared its financial statements and taxes.¹⁰
6

7 124. As early as July 27, 2012, the multilevel marketing news site
8 BehindMLM.com published a detailed analysis of TelexFree's business operation,
9 concluding that:

10
11 The corporate structure of TelexFree and the obvious business
12 relationship between the company and Disk a Vontade and
13 complete lack of disclosure on either company's website is cause
14 for concern...

15 Personally I believe the ridiculously high membership fee charged
16 by TelexFree (a \$299 fee to publish ads for the company?) and the
17 fact that individual members are able to purchase up to five
18 membership positions strongly indicates a lack of external revenue
19 here.¹¹

20 125. Over the ensuing months, the number of online articles and websites
21 characterizing TelexFree as a Pyramid Scheme increased.

22 126. During or about November 2012, TelexFree increased its focus on United
23 States-based operations including the development of special relationships with United
24 States-based banks, especially those located in the Commonwealth of Massachusetts.

25 127. TelexFree's business plan and operations were an unlawful Pyramid
26

¹⁰ See Omnibus Decl. of William H. Runge, Case 14-1552-abl, Doc. 13, ¶ 31. A true and correct copy of this Declaration is attached hereto as Exhibit 2.

¹¹ See Exhibit 3, Decl. of Gray Echavarria at Attachment 5.

1 Scheme and not a lawful multi-level marketing (“MLM”) enterprise. At all times
2 relevant to this complaint, TelexFree violated the express terms of M.G.L. c. 93, § 69.

3 128. In January 2013, Ympactus/TelexFree Brazil came under legal scrutiny in
4 Brazil by the Brazilian Bureau of Consumer Protection (known as Procon).

5 129. Procon was suspicious of the company’s rapid recruitment of new
6 investors and lack of substantial sales, and Brazilian authorities opened an investigation
7 against Ympactus.

8 130. Prior to and at the time Brazilian authorities shut them down for running a
9 Pyramid Scheme, Ympactus also operated under the name TelexFree.
10

11 131. In a January 11, 2013 press release, the Brazilian Bureau of Consumer
12 Protection indicated that its investigation of TelexFree had “detected evidence of
13 crimes.”
14

15 132. During early 2013, “TelexFree affiliates were urging recruits to make
16 walk-in deposits at a Bank of America branch located at 188 Boston Turnpike,
17 Shrewsbury, Massachusetts 01545.”¹²
18

19 133. In early 2013, TelexFree also preferred to use TD Bank.¹³
20

21 134. In a March 1, 2013 press release, Merrill admitted “[w]e [TelexFree] pay
22 our representatives weekly if they follow our system and advertise our service on the
23 Internet.” This payment condition required no actual sales of the VoIP product.

24
25 ¹²See Exhibit 3, Decl. of Gray Echavarria, Attachment 35 - Facebook Page with Instructions to
26 Deposit at Bank of America, Shrewsbury, Massachusetts; *see also* Exhibit 3, Decl. of Gray
Echavarria, Attachment 22.

¹³ *Id.*

1 135. On March 7, 2013, a TelexFree blog falsely claimed that the TelexFree
2 “program” had “SEC approval from the USA.”

3 136. During spring 2013, Labriola, director of marketing for TelexFree,
4 Boston, announced via a TelexFree-approved email that TelexFree was “pulling out of
5 Bank of America.”
6

7 137. TelexFree’s threatened pull out followed Bank of America’s questioning
8 of TelexFree’s suspicious, tortious or illegal activity.

9 138. During spring 2013, Bank of America had exchanges with TelexFree
10 about terminating their relationship and discontinuing the service of their accounts, but
11 it did not do so until much later.
12

13 139. In an April 2013, TelexFree-approved internet video, Defendant Crosby
14 stated “[t]his company has a joint venture with Best Western.” TelexFree did not have
15 the described business relationship with Best Western.
16

17 140. During spring 2013, the TelexFree website and its president and principal
18 Merrill also falsely promoted the Best Western offer.

19 141. In or about May 2013, Defendant Miller appeared in an internet video
20 deceptively touting TelexFree as an opportunity to earn “not just wealth, but
21 generational wealth,” which was posted on YouTube and widely distributed via social
22 media, and in which he maliciously boasted of his earnings through TelexFree and
23 encouraged others to join the scheme.¹⁴
24
25
26

¹⁴ See Administrative Complaint of instituted by the Secretary of the Commonwealth of

1 142. As part of the June 13, 2013 Court in Acre’s Public Prosecutor’s
2 injunction, TelexFree Brazil faced fines of R\$100,000 a day (\$42,500 USD) if they
3 signed up any more Brazilian affiliate investors or paid out any existing ones.

4 143. On June 19, 2013, the Brazilian Court in Acre issued an injunction putting
5 “a stop to TelexFree Brazil’s business operations, including the registration of new
6 affiliate investors, acceptance of new investments and paying any returns owed on
7 existing affiliate investments.”¹⁵

8
9 144. On or about June 20, 2013, after the Court in Acre suspended TelexFree
10 Brazil’s activities, TelexFree Principals Merrill and Wanzeler and TelexFree Executive
11 Office employee Labriola all maliciously made false, deceptive and misleading
12 statements in a TelexFree-approved video intended to reassure United States Promoters.
13 For example, Merrill stated that “[i]nquiries like this are very common in network
14 marketing We have such unbelievable growth that we’re going to draw attention.”
15
16

17 145. Labriola stated that “[t]hese things happen to network marketing
18 companies over and over again... Let’s not worry about it.”

19 146. Wanzeler added that “[w]e’re still here. We’re going to stay here for a
20 long time.”
21

22 147. During or before June 2013 (and within weeks of having their Brazilian
23 operation shuttered), Wanzeler, Merrill, Labriola and Costa, with the participation and
24

25 Massachusetts, Securities Division, Dkt. No. 2014-0004, page 39, attached as Attachment 36 to
26 Exhibit 3, Decl. of Gray Echavarria.

¹⁵ *Id.*

1 assistance of others including the Defendants named in this complaint, placed an
2 increased focus on and rapidly expanded their fraud in the United States under the name
3 TelexFree.

4 148. During or before June 2013, and after shifting its geographic target market
5 to the United States, several TelexFree Top Level Promoters were recruited by
6 Wanzeler, Costa, Merrill and Labriola and began to target the Brazilian-American and
7 Dominican-American communities in the United States.

8 149. In July 2013, Newport Beach, California became the staging ground for
9 TelexFree's first United States-based "Extravaganza." This was approximately one
10 month after the Brazilian Court in Acre had frozen TelexFree's Brazilian assets and
11 enjoined TelexFree from any further membership or registration related efforts in
12 Brazil,

13 150. The July 2013 TelexFree "Super Weekend" was organized by Zeek
14 Rewards' high-profile pitchman Thomas More.¹⁶

15 151. Thomas More was a key spokesperson and authorized representative for
16 Zeek Rewards. More held out that he had acquired over a million Zeek Rewards VIP
17 points and otherwise greatly profited (from the fraud) while it lasted.

18 152. At the time More organized TelexFree's Newport Beach "Super
19 Weekend" extravaganza, he was a named defendant in a Zeek Rewards Ponzi scheme-
20
21
22
23
24

25
26 ¹⁶ In a widely viewed internet video of the event titled "TelexFree Corporate Speakers at
Newport Beach Extravaganza," Merrill specifically thanked Tom More for putting it together.

related lawsuit.¹⁷

153. During the July 2013 “Super Weekend,” Defendant Miller took the stage and falsely promoted a connection and promotion with Best Western Hotel.

154. During the July 2013 TelexFree “Super Weekend,” Attorney Defendant Nehra gave his “blessing” to TelexFree, representing not only that it was a lawful enterprise and why, but also that he was a duly licensed attorney with extensive specialized skill and experience in MLM.¹⁸

155. During or about August 2013, Attorney Jeffery Babener, of the Law Firm Babener & Associates advised TelexFree Principals, Executive Office, Licensed Professionals and others that TelexFree’s business model, operations and payout scheme were an unlawful MLM and must be changed.

156. During or about August 2013, Attorney Babener advised TelexFree Principals, Executive Office, Licensed Professionals and others that the TelexFree MLM violated M.G.L. c. 93, §69 and, thus, M.G.L. c. 93A.

157. In or about August 2013, Brazilian Judge Braz Aristóteles dos Reis found that, in the public eye, TelexFree (Brazil) and Ympactus are one and the same company.

158. On August 19, 2013, the TelexFree FaceBook page falsely posted the following: “The President of Google involved with Telexfree!! Google’s President will be speaking at our next Telexfree event in Brazil....11 year contract with Best Western

¹⁷ See Exhibit 4, Decl. Carol L. Harris, Exhibit 14.

¹⁸ *Id.*

160. In late 2013, Costa withdrew his ownership in Ympactus.

162. On or before December 2013, Craft was hired to serve and did thereafter serve as TelexFree, LLC's chief financial officer.

164. In January and February 2014, the SOC issued subpoenas.

43

167. During late February 2014 through early March 2014, TelexFree Principals, Executive Office, Licensed Professionals and Top Level Promoters developed during teleconferences strategies to siphon off funds and maximize the exploitation of the rank and file TelexFree Promoters.

169. On March 9, 2014, TelexFree unilaterally changed its compensation plan, for the first time requiring existing Promoters to actually sell its VoIP product to qualify for the payments that TelexFree had previously promised to pay them. Before making the change, TelexFree informed its highest grossing Top Level Promoters of the impending change in compensation and held a strategy meeting during which they discussed unfair, deceptive and unlawful ways to further fleece the rank and file TelexFree Members and ways to continue to profit from the unlawful business.

44

1 171. On March 9, 2014, Steven Labriola and others traveled to Haiti and made
2 public that they arrived via private jet, and once on the ground, proclaimed “we got in
3 the Prime Minister of Haiti’s motorcade.”

4 172. On April 1, 2014, dozens of Promoters descended upon TelexFree’s
5 Marlborough Office to protest the March 9 change and to attempt to reclaim their
6 money. They left empty-handed.

8 173. On April 14, 2014, TelexFree, Inc. along with two affiliated companies,
9 TelexFree, LLC and TelexFree Financial, Inc. (together, the “Bankrupt Companies”),
10 filed for Chapter 11 bankruptcy protection in Nevada claiming that TelexFree revenues
11 were insufficient to meet its obligations.

13 174. On or about April 15, 2014, the United States Department of Homeland
14 Security, the Federal Bureau of Investigation (the “FBI”) and others raided the offices
15 of TelexFree, shutting down its operation, seizing records and other evidentiary items.

17 175. On May 9, 2014, the United States Department of Homeland Security
18 filed criminal proceedings against two of TelexFree’s Founders, Wanzeler and Merrill,
19 for conspiracy to commit wire fraud.

20 176. Thereafter, the United States Department of Justice (the “DOJ”) brought
21 charges of wire fraud and conspiracy to commit wire fraud against TelexFree’s owners
22 Wanzeler and Merrill, and the same were indicted by grand jury on July 23, 2014.

24 177. TelexFree’s other Principals and Operational Defendants are currently
25 under state and federal investigation, and some are the subjects of lawsuits by the
26

1 Securities and Exchange Commission (“SEC”) and the SOC for operating a Pyramid
2 Scheme as detailed herein.

3 178. The DOJ announced at the March 3, 2015 status hearing in the above-
4 captioned MDL 2566 that undisclosed Financial Service Providers are also the subjects
5 of its ongoing investigations.
6

7 **B. TelexFree’s History, Formation and its Brazilian Links**

8 179. In or about 2007, Wanzeler, Merrill, Costa and other Defendants began
9 operating or assisting in the operation of purported telecommunications businesses in
10 the United States and Brazil, under the names “Brazilian Help” and “Disk A Vontade
11 Telefonica,” respectively, charging \$49.90 monthly for VoIP service.
12

13 180. Disk A Vontade Telefonica, Ltd., also known as Diskavontade, also known
14 as Disk (“Disk A Vontade”), is a Brazilian limited liability company, now or formerly
15 having its principal offices as Rua Jose Luiz Gabeira, NRO 170, APTO 103 Barro
16 Vermelho.
17

18 181. Defendant Wanzeler is the chief executive officer of Disk A Vontade.

19 182. Defendant Merrill is vice president and a signatory of Disk A Vontade.

20 183. Disk A Vontade’s domain (“discavontade.com”) is registered to
21 Defendant Wanzeler.
22

23 184. Brazilian Help, Inc. (“Brazilian Help”) is a domestic profit corporation,
24 organized and existing under the laws of the Commonwealth of Massachusetts, now or
25 formerly having a principal place of business at 225 Cedar Hill Street, Suite 118, in
26

186. Defendant Wanzeler is the president, secretary, treasurer, and registered agent of Brazilian Help.

188. Costa, a longtime friend of Wanzeler, was employed by Disk A Vontade and was Wanzeler's top sales agent in Brazil.

189. Ympactus is a Brazilian limited liability company, which served as TelexFree's Brazilian branch.

191. The records of the SOC demonstrate no meaningful distinction between U.S. TelexFree operations and Brazilian operations.

192. As described by TelexFree management, the ownership interests in TelexFree, Inc. (Massachusetts-based), TelexFree LLC (Nevada-based) and Ympactus (Brazilian-based) overlap.

47

1 194. Paragraph 2.1.2 of the standard TelexFree Pre-March 9 Contract with its
2 Members states “TELEXFREE INC, from its headquarters in, Marlboro [sic],
3 Massachusetts (U.S.), on the basis of an operating contract between the latter and the
4 CONTRACTOR (YMPACTUS), has as its primary activity VOIP telephony, using its
5 equipment installed at its headquarters in Massachusetts, where it makes the necessary
6 connections for these calls; it also provides virtual media, through the website
7 www.telexfree.com to associates and to the Promoters that YMPACTUS/TELEXFREE
8 coordinates and controls, including the respective publicity channels.”¹⁹
9

10
11 195. This contract was made available to each Defendant at or prior to the time
12 they became involved with TelexFree.

13 196. Each of the Financial Services Defendants was obligated to, and did
14 review the TelexFree contract during its Know Your Customer investigation, analysis
15 and monitoring.
16

17 197. The TelexFree entities used the same executives, management,
18 employees, back office support, physical address and offices, merely providing identical
19 information in multiple languages and under a different name in part after Ympactus
20 was shut down and had its assets seized.
21

22 198. At times relevant to this complaint, TelexFree used essentially identical
23 fraudulent income generation methods as Ympactus.

24 199. At times relevant to this complaint, TelexFree used essentially identical
25

26 ¹⁹ See TelexFree Pre-March 9 Contract, attached herewith as Exhibit 1.

1 promotional materials and marketing techniques as Ympactus.

2 200. In January 2013, Ympactus came under legal scrutiny in Brazil by the
3 Brazilian Bureau of Consumer Protection (known as Procon). Suspicious of the
4 company's rapid recruitment of new investors and lack of substantial sales, Brazilian
5 authorities opened an investigation against Ympactus.
6

7 201. In late 2013, Costa withdrew his ownership in Ympactus for what Merrill
8 characterized as "legal reasons."²⁰

9 202. Both Merrill and Wanzeler provided testimony to the SEC stating that
10 they transferred at least \$3 million to Costa long after Brazilian authorities shut down
11 Ympactus operations.²¹ This was accomplished only with the necessary assistance of
12 the Financial Services Defendants.
13

14 203. The TelexFree entities use the same website and back office support as
15 Ympactus, providing identical information in multiple languages.
16

17 204. Since at least February 15, 2012, there has been a high degree of
18 operational interdependence among TelexFree entities and Ympactus, and, to
19 sophisticated banks and payment processors, the operations of these entities were
20 related.
21

22 205. The TelexFree entities and Ympactus shared common management and
23 ownership.
24

25 ²⁰ See Administrative Complaint of instituted by the SOC, Dkt. No. 2014-0004, page 7, attached
26 as Attachment 36 to Exhibit 3, Decl. of Gray Echavarria.

²¹ *Id.*

1 206. For example, both Merrill and Wanzeler, self-proclaimed Founders of
2 TelexFree, hold 50% ownership interest in the United States entities and 20% and 40%
3 interests respectively in the Brazilian entity.

4 207. At times relevant to this complaint, Costa, head of Brazilian operations
5 and longtime friend of Wanzeler, was an owner of TelexFree, LLC.
6

7 208. More particularly, and at least since February 15, 2012, Defendants
8 Merrill, Wanzeler, Labriola, Craft and Costa have together owned, managed and/or
9 operated the TelexFree entities and Ympactus with no distinction among these entities
10 other than Ympactus' Brazilian operations being shut down by Brazilian authorities.
11

12 209. The TelexFree entities and Ympactus have also shared common financial,
13 strategic, legal and human resources.

14 210. TelexFree entities and Ympactus were both wrongfully, fraudulently,
15 unfairly or deceptively organized from the start to unlawfully convert, divert, launder or
16 shelter funds rightfully belonging to Plaintiffs and the putative class.
17

18 **D. The Bankrupt TelexFree Companies**

19 211. Between mid-November 2013 and April 17, 2014, TelexFree, Inc. and
20 TelexFree, LLC transferred approximately \$30 million from their operating accounts to
21 accounts owned and controlled by TelexFree, its affiliated companies or the individual
22 Defendants.
23

24 212. Defendant Ann Genet served as TelexFree's advisor and person on the
25 ground in Nevada.
26

1 213. The investment funds of the putative class inflated TelexFree accounts by
2 hundreds of millions of additional dollars.

3 214. The funds of the putative class remain unaccounted for to date.

4 **E. TelexFree, Inc.**

5 215. Common Cents Communications, Inc. was formed by Merrill, Wanzeler
6 and Labriola in December 2002.

7 216. Common Cents Communications, Inc. was a predecessor enterprise to
8 TelexFree, Inc.

9 217. In 2012, Costa suggested to Wanzeler that they begin soliciting customers
10 in the United States through online advertisements.

11 218. Acting on Costa's proposal, Wanzeler and Merrill changed the name of
12 Common Cents Communications, Inc. to TelexFree, Inc. on February 15, 2012.

13 219. Wanzeler and Costa also caused the website, "www.telexfree.com" to be
14 created.

15 220. Disk A Vontade was the registered owner of the telexfree.com domain
16 name.

17 221. By February 15, 2012 and until approximately April 15, 2014, TelexFree,
18 Inc. maintained a principal office at TelexFree's Marlborough Office.

19 222. Co-Defendants Merrill and Wanzeler are officers and directors of
20 TelexFree, Inc., a domestic profit corporation.

21 223. Beginning on March 15, 2005, Merrill served as registered agent of
22
23
24
25
26

1 Common Cents Communications, Inc., and continued as registered agent thereof after
2 the change of name to TelexFree, Inc.

3 224. Since February 15, 2012, Merrill has maintained a registered address for
4 service of process at TelexFree's Marlborough Office.

5 225. Merrill, Wanzeler, Labriola, Craft and Costa conducted the business of
6 TelexFree, Inc. in TelexFree's Marlborough Office.

7
8 **F. TelexFree, LLC**

9 226. In July 2012, Wanzeler, Merrill and Costa together formed TelexFree,
10 LLC.

11 227. Telex Free, LLC was organized under the laws of the State of Nevada on
12 July 19, 2012.

13 228. TelexFree, LLC was wrongfully, fraudulently, unfairly or deceptively
14 organized from the start to unlawfully convert, divert, launder or shelter funds rightfully
15 belonging to Plaintiffs and the putative class.
16

17 229. There is no distinction between the business operations of TelexFree, LLC
18 and TelexFree, Inc.
19

20 230. At all material times, TelexFree LLC was identified as a limited liability
21 company as registered with the Corporations Division of the Secretary to the
22 Commonwealth of Massachusetts (Identification Number 001105166). TelexFree, LLC
23 registered with the Secretary of State for the Commonwealth of Massachusetts on April
24 18, 2013.
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1 240. On April 14, 2014, Defendants TelexFree, Inc., TelexFree, LLC and
2 TelexFree Financial abruptly sought bankruptcy protection in Nevada under the United
3 States Bankruptcy Code, Chapter 11, admitting that they could not meet their
4 obligations from VoIP revenues and seeking authority to reject all their current
5 obligations to Promoters.
6

7 **H. Relationship of the Bankrupt TelexFree Companies**

8 241. Since at least February 15, 2012, there has been a high degree of
9 operational interdependence among TelexFree, LLC, TelexFree, Inc., and TelexFree
10 Financial, and the operations of these entities are indistinguishable.
11

12 242. TelexFree, LLC, TelexFree, Inc. and TelexFree Financial shared common
13 management and ownership.

14 243. More particularly, and at least since February 15, 2012, Defendants
15 Merrill, Wanzeler, Labriola, Craft and Costa have together owned, managed and/or
16 operated TelexFree, LLC, TelexFree, Inc., and TelexFree Financial with no distinction
17 among these entities.
18

19 244. At least between February 15, 2012 and approximately April 15, 2014,
20 funds were freely transferred between and among TelexFree, LLC, TelexFree, Inc., and
21 TelexFree Financial with no distinction among these entities.
22

23 245. TelexFree, LLC, TelexFree, Inc., and TelexFree Financial have also
24 shared common financial, strategic, legal, and human resources.

25 246. TelexFree, LLC, TelexFree, Inc., and TelexFree Financial are alter ego
26

entities that combine to form a single enterprise.

I. Defendants Electric and Mobile

247. Mobile is a Nevada corporation formed on November 26, 2013.

248. According to its filings with the State of Nevada Secretary of State Office, Mobile identifies its officers and directors as follows:

- Defendant Merrill is president, secretary and director, having an address at the Nevada Post Office Box;
- Defendant Wanzeler is treasurer and director, having an address at the Nevada Post Office Box;
- Defendant Ann Genet served as their advisor and person on the ground; and
- Defendant Craft provided essential services and integral advice, without which Mobile would not have been able to operate.

249. TelexFree, Inc. and TelexFree, LLC made a \$500,870 “loan” to Mobile during the class period, as indicated by financial statements prepared by Craft. The loan was a sham.

250. Wanzeler and Merrill formed Electric in December 2013 as a Nevada limited liability partnership.

251. Defendant Ann Genet served as Mobile's, Electric's and all TelexFree entities' advisor and person on the ground. Defendant Genet provided essential services and integral advice, which Electric and the other TelexFree Defendants used to further and operate the Pyramid Scheme.

252. Defendant Craft provided essential services and integral advice, without which Electric would not have been able to operate.

253. According to its filings with the State of Nevada Secretary of State Office, Co-Defendants Merrill and Wanzeler are Electric's general partners.

254. Merrill and Wanzeler further list their addresses as the Nevada Post Office Box.

255. Electric also lists its address as the Nevada Post Office Box.

256. TelexFree, Inc. and TelexFree, LLC made a \$2,022,329 "loan" to Electric during the class period, as indicated by financial statements prepared by Craft.²² The loan was a sham.

257. The loan was a sham carried out by Craft to wrongfully, fraudulently, unfairly or deceptively convert, divert, launder or shelter funds invested by Plaintiffs and the putative class.

258. Electric and Mobile possess funds rightfully belonging to the putative class.

J. TelexFree's Founders and Principals, Executive Officers and Top Level Promoters

259. At all material times Merrill was:

- President, secretary and director of Defendant Mobile and a general partner of Defendant Electric;
- Founder, president, secretary, and director of third-party TelexFree, Inc.;
- Founder and manager of third-party TelexFree, LLC, and was listed with the Massachusetts Secretary of State Corporations Division as an authorized person to execute, acknowledge, deliver,

²² See TelexFree, LLC Balance Sheet as of December 31, 2013, a true and correct copy of which is attached hereto as Exhibit 5.

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- served as the chief financial officer of third parties TelexFree, Inc. and TelexFree, LLC;
- prepared and approved the financial statements for third parties TelexFree, Inc. and TelexFree, LLC; and
- was a member of TelexFree's Executive Office.

267. Katia Wanzeler was at all times relevant to this complaint Wanzeler's partner and co-conspirator in TelexFree's unlawful enterprise.

268. Katia Wanzeler actively assisted her husband, Carlos Wanzeler, in fraudulently stealing and laundering funds that were derived from the TelexFree Pyramid Scheme, and in converting said funds to their private use.

269. At all times relevant to this complaint, Rodrigues was a TelexFree Top Level Promoter.

270. At all times relevant to this complaint, De La Rosa was one of TelexFree's Top Level Promoters. De La Rosa appears in internet videos promoting the TelexFree Program and is one of its most successful Promoters, having recruited numerous other Promoters within the Dominican community in Massachusetts and elsewhere.

271. At all times relevant to this complaint, Crosby was a TelexFree Top Level Promoter. Crosby appears in internet videos promoting the TelexFree Program and is one of its most successful Promoters, having recruited numerous other Promoters, primarily through a website known as "everybodygetspaidweekly.biz," in Massachusetts and elsewhere.

272. At all times relevant to this complaint, Defendant Miller was a TelexFree

1 Top Level Promoter. Miller appeared in internet videos promoting the TelexFree
2 program, giving numerous “tutorials,” and was one of its most successful at doing so,
3 having recruited numerous other Promoters, primarily through his personal YouTube
4 page at “https://www.youtube.com/user/TelexFreeTrainer” in Massachusetts and
5 elsewhere.
6

7 273. At all times relevant to this complaint, Defendant Miller was a career
8 MLM promoter, doing business primarily through his YouTube page at
9 “https://www.youtube.com/user/TelexFreeTrainer” and “www.join-getpaid-
10 period.com,” using many of the same graphics and techniques he used as a TelexFree
11 Promoter.
12

13 274. At all times relevant to this complaint, Sloan was a TelexFree Top Level
14 Promoter. Sloan appears in internet videos promoting the TelexFree Program, and is
15 one of its most successful Promoters, having recruited numerous Promoters. Sloan
16 promoted TelexFree through a website known as “telexfreepower.com.”
17

18 275. At all times relevant to this complaint, Shoyfer was one of TelexFree’s
19 Top Level Promoters, managing a large network of TelexFree Members in New York
20 City. Shoyfer recruited many Promoters through public meetings that he arranged and
21 held in New York City. Shoyfer’s TelexFree network had Members in other states as
22 well, including Massachusetts.
23

24 276. TelexFree changed its compensation plan on or about March 9, 2014,
25 much to the fury of affiliates, noted below. Shoyfer, however, continued to promote it
26

unremittingly, sending group text messages to his network with such as the following:

Hey..my team Telexfree! ! And here we go again..Come to check out and learn about new compensation plan TF 2.0.. and how to grow it even faster and MUCH more aggressively and efficiently than the one we had before....Here is this week's schedule. . Monday 03/24 at Salon Delacqua (2027 86 str) at 8.00 pm (in English) ..Wednesday 03/26 at SOHO launch(2213 65th street) at 7.45 pm (in Russian) and Thursday 03/27 at 7.30 pm at 63-112 Woodhaven Blvd in a real estate office. In my case, since I have started from absolute zero during this passed week Mon 03/17- Sun 03/23/14 I booked 11,500 from new one and 21,600 still coming from old plan..A total of 31,100 in 7 short days... Go Telex!!!

277. After the institution of the new TelexFree compensation plan in March 2014, Shoyfer took part in a closed meeting with TelexFree's directors and owners in Marlborough, Massachusetts, at which Shoyfer was instructed not to discuss the new TelexFree compensation plan with others and non-insiders, as the new compensation plan was detrimental to Promoters and was adopted to forestall filing bankruptcy."

278. Shoyfer worked in concert with TelexFree management to dupe people into enrolling right up until the time of TelexFree's bankruptcy filing.

279. Filings in the TelexFree bankruptcy case suggest that Shoyfer received nearly \$88,000 from TelexFree in two separate payments just prior to the April 13 bankruptcy filing. The first, for \$9,902.37, occurred on March 21, and the second, for \$78,037.33, occurred on March 28.

280. Opt3 and Borromei have a history of providing technical services within the multilevel marketing industry and hold themselves out as having related specialized knowledge. For example, Borromei previously served as chief information officer of

1 Joystar, Inc., later renamed Travelstar, a multilevel marketing company that collapsed in
2 approximately late 2008, and subsequently entered involuntary chapter 7 bankruptcy.

3 281. Opt3 and Borromei intentionally, knowingly, unfairly and deceptively set
4 up TelexFree's United States-based servers in Brazil with the intent of directly
5 furthering, aiding or abetting their unlawful and fraudulent operation, including
6 facilitating the placement of evidence of the Pyramid Scheme beyond the jurisdiction of
7 the United States' courts.
8

9 282. Opt3 and Borromei otherwise intentionally, knowingly, unfairly and
10 deceptively set up TelexFree's United States-based servers and electronic data systems
11 with the intent of directly furthering, aiding or abetting their unlawful and fraudulent
12 operation.
13

14 283. Opt3 presently holds itself out as providing substantial technical services
15 to multilevel marketing companies Healthient, Inc. and Travelstar, Inc. Borromei
16 serves as chief information officer of Healthient, Inc.
17

18 284. At times relevant to this complaint, Opt3 and Borromei:

- 19
- 20 • directly made unfair and deceptive misrepresentations to the putative class;
 - 21 • transacted business in the Commonwealth;
 - 22 • contracted to supply services or things in this Commonwealth;
 - 23 • advanced TelexFree's unlawful enterprise;
 - 24 • caused tortious injury by an act or omission in this Commonwealth;
 - 25 • advanced TelexFree's unlawful enterprise;
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1 services to TelexFree. At all material times herein, Sparman:

- 2 • personally handled TelexFree's account with Vantage Payments;
- 3 • performed integral services and provided essential advice and
- 4 assistance that was used to further TelexFree's unlawful business;
- 5 • personally ensured TelexFree was given access to payment-
- 6 processing and banking services, as well as the national banking
- 7 system, and those services were used to further TelexFree's
- 8 unlawful business; and
- 9 • solicited services and negotiated with payment processors on
- 10 TelexFree's behalf.

11 288. Despite having knowledge that TelexFree was an enterprise carrying out
12 unlawful, unfair, or deceptive acts or practices, James Merrill, Carlos Wanzeler, Steven
13 Labriola, Carlos Costa, Joseph Craft, Ann Genet, Opt 3 Solutions Inc., Jason Borromei,
14 Katia Wanzeler, Sanderley Rodrigues de Vasconcelos, Santiago de la Rosa, Randy
15 Crosby, Faith Sloan, Daniil Shoyfer, Scott Miller, John Merrill, John Hughes and
16 Dustin Sparman all personally performed integral services and provided essential advice
17 and assistance that was used to further TelexFree's unlawful business and fully and
18 knowingly furthered TelexFree's unlawful Pyramid Scheme.

19 **K. TelexFree's Unlawful, Unfair and Deceptive Pyramid Scheme**

20 289. A pyramid scheme is a fraudulent business operation whereby an
21 individual or organization guarantees and sometimes pays returns to its investors from
22 new money paid into the operation by new victims, rather than from profit earned by the
23 operator.
24

25 290. Typically, operators of pyramid schemes entice new victims by promising
26

1 guaranteed returns that are short-term returns, abnormally high or unusually consistent.

2 291. Pyramid schemes inevitably fail when new investors are not recruited
3 quickly enough to pay the promised returns to the earlier investors. Typically, this is
4 when the investment is revealed to be an illegal scam.

5 292. Financial services providers, including banks and payment processing
6 companies, are required to be on alert for pyramid-type Ponzi schemes because they are
7 one of the most common schemes presently being used by international thieves, and
8 recently, by organized crime.

9 293. Pyramid schemes follow a pattern that is well known to the sophisticated
10 personnel and systems that support financial services providers, including the Defendant
11 Financial Services Providers.

12 294. As referenced herein, during the putative class period, the TelexFree
13 Pyramid Scheme made use of pyramid-scheme techniques recognizable or known to the
14 Financial Services Provider Defendants. They include but are not limited to the
15 following:

16 295. **The Hook:** In a pyramid scheme, potential investors are promised that an
17 investment opportunity will achieve an above normal rate of return on investment that is
18 often specified, or very easy to figure out. The promised interest rate or return on
19 investment in successful pyramid schemes will be an amount high enough to be
20 worthwhile to the investor but not so high as to be unbelievable. This is called an
21 “above normal rate of return on investment.” In violation of M.G.L. c. 93, § 69,
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297. **The Scheme is Showered with Credibility:** The victims of pyramid schemes are always given a believable explanation of how their investment will earn the “above normal rate of return on investment.” The explanation must be good enough to convince people to invest and reinvest their money and importantly, to recruit others. Many times the founders or those running the company operating the pyramid scheme are described as being highly successful, skilled, trained or educated. For example here, TelexFree falsely represented on its web site that the Founder and Principal Merrill was a college graduate with specialty degrees in a field related to the product they touted as driving the profit. TelexFree also deceptively touted its Principals long-term experience

and involvement in telecommunications. Most often, perpetrators of pyramid schemes will hire lawyers, certified public accountants (“CPAs”), or other credible professionals to bless the scam as a legal and sound business opportunity. The lawyers, CPAs and other professionals vouch for the scam in exchange for payoffs. They will also often have other seemingly credible persons serve as shills by touting the investment as an incredibly great opportunity that worked for them. Shills include so-called rock stars and so-called regular people all of whom have “gotten rich quick” through the pyramid scheme.

299. TelexFree, like other major pyramid schemes before it, also held extravagant conferences at hotels that were beyond the means of its victims and hyped

301. **Communicated Successes:** Pyramid scheme principals and others at the top levels will uniformly and heavily promote success stories and build in a system that

communicates motivating success stories. The historical success of the investment opportunity is another ploy intended to deceptively lend credibility to the pyramid scheme. Historically, the most damaging pyramid schemes put victims in a position where they believed convincing others close to them to invest money into the scam was doing them a great favor. TelexFree showered its investors and potential investors with stories and visuals evidencing big payoffs. TelexFree positioned its owners and Top Level Promoters as “Rock Stars” and they promoted the above normal rate of return on investment, often with great deal of flourish. Large-scale pyramid schemes also typically sponsor conferences and events at hotels or exotic locations, as did TelexFree. Large-scale pyramid schemes also commonly promote success stories involving tales of great income, early retirement or other dreams come true. TelexFree played each of those angles heavily. TelexFree spokespersons often sported expensive attire, and promoted the fact they owned luxury cars and boats, lived in enormous homes, and made their dreams come true.

303. According to the Securities Exchange Commission (the “SEC”) and the

305. Since 2009, the Department has authorized 94 new Assistant U.S. Attorney positions, both criminal prosecutors and civil litigators, to combat financial fraud in districts all across the country.²⁶

307. Enforcement steps are having an impact. Between fiscal year 2008 and

²⁵ *Id.*

²⁷ See Ben Protess, *Post-Madoff, A Greater Awareness of Ponzi Schemes*, DealBook (Nov. 14, 2011), <http://dealbook.nytimes.com/2011/11/14/post-madoff-a-greater-awareness-of-ponzi-schemes/>, r=0.

1 fiscal year 2011, the numbers of defendants prosecuted by the U.S. Attorneys' Offices
2 for securities fraud and other financial fraud offenses increased dramatically each year.
3 More prosecutions of defendants also mean more restitution orders for victims and more
4 forfeiture of ill-gotten gains.²⁸

5
6 308. With respect to the TelexFree Scheme, the Federal Trade Commission
7 stated that TelexFree utilized a pyramid scheme structure offering straight recruitment
8 commissions and binary recruitment commissions. These commissions directly
9 compensate existing affiliates upon the recruitment of new affiliates into the scheme.

10
11 309. At times relevant to this complaint, the Defendant Founders, Principals,
12 Executive Office, Top Level Promoters and Associated Individual Defendants knew
13 that TelexFree was a Pyramid Scheme and yet actively assisted and profited thereby.

14
15 310. At times relevant to this complaint, the Defendant Attorneys, Defendant
16 Accountants, other Professional Service Providers, and Persons Associated with them
17 knew that TelexFree was a Pyramid Scheme and yet unfairly or deceptively actively
18 assisted, aided and abetted and profited thereby.

19
20 311. At times relevant to this complaint, the Defendant Financial Services
21 Providers knew that TelexFree was a Pyramid Scheme and yet unfairly and deceptively
22 actively assisted, aided and abetted and profited thereby and were unjustly enriched.

23 312. TelexFree presented itself to the putative class as a marketer of
24

25 ²⁸ Benjamin B. Wagner, *Crimes on Main Street Are as Devastating as Those on Wall Street*,
26 United States Department of Justice (Dec. 8, 2104), <http://www.justice.gov/usao/priority-areas/financial-fraud/investment-fraud>.

314. TelexFree, with the integral assistance of numerous banks, payment processors, professionals and other third parties, operated an unlawful Pyramid Scheme of nationwide and international scope.

316. Using run-of-the-mill and essentially borrowed technology, TelexFree rebranded Disc A Vontade's VoIP program, offering it for a flat monthly fee of \$49.90.

318. Because it featured an inferior product that offered no improvement over what others Google Voice, Skype, or others made available elsewhere for free, Wanzeler, Merrill and Costa's Disk A Vontade's phone service had been unprofitable. Departing from the unsuccessful Disk A Vontade business model, TelexFree coupled the VoIP program with a purportedly lucrative and fraudulent scheme. The VoIP program served purely as a façade.

72

1 millions of dollars.

2 320. TelexFree was willfully and knowingly, wrongfully and maliciously,
3 unfairly and deceptively organized and maintained. From the start it was intended to,
4 and did, unlawfully convert, divert, launder and shelter funds invested by Plaintiffs and
5 the putative class.
6

7 321. TelexFree could not have successfully carried out its unlawful enterprise,
8 nor launder or shelter its ill-gotten funds, without the integral assistance of the other
9 Defendants, including the cooperating Defendant financial institutions, payment
10 processing service companies and Operational Defendants.
11

12 322. TelexFree purported to sell internet telephone services but, in actuality,
13 generated its income almost exclusively through its recruitment of “Members” (also
14 referred to interchangeably herein as “Promoters”).
15

16 323. TelexFree promised its Promoters a guaranteed return on investment in
17 excess of 200% annually, purportedly in exchange for promoting TelexFree’s business.

18 324. TelexFree created memberships, known as “AdCentral” packages, which
19 entitled Promoters to be paid for cutting-and-pasting spam advertisements on the
20 Internet, creating the illusion that they were performing valuable services in exchange
21 for compensation.
22

23 325. TelexFree promised its Promoters a guaranteed financial return in
24 exchange for their participation in a passive income scheme.

25 326. Promoters were financially motivated to recruit and “build” their own
26

1 network of new Members because they were promised additional compensation when
2 they did. TelexFree did not monitor the futile make-work activity of cutting-and-
3 pasting of spam advertisements by its Promoters.

4 327. At all times relevant to this complaint, TelexFree and each of its
5 Executives and Top Level Promoters, knew that the purported requirement made upon
6 TelexFree Members to place ads was a sham, yet an integral part of the unfair and
7 deceptive acts and practices necessary to carry out and further their unlawful business
8 enterprise.
9

10 328. At times relevant to this complaint, TelexFree and each of its Licensed
11 Professionals, and Financial Services Providers also knew that the purported
12 requirement made upon TelexFree Members to place ads was economically worthless,
13 yet an integral part of TelexFree's business enterprise.
14

15 329. Though TelexFree was purportedly a separate and distinct legal entity
16 from Ympactus, Wanzeler, Labriola, Merrill and Costa intermingled the resources and
17 assets of the two businesses including the labor and representation of employees and
18 executives, telephones, addresses, office furniture and space, bank and other financial
19 accounts, finances, computer network systems, and postage.
20

21 330. Wanzeler, Labriola, Merrill and Costa used the TelexFree entity as a
22 convenient vehicle to re-create in the United States the same massive Pyramid Scheme
23 that they had earlier conducted in Brazil, even to the extent, for example, that both
24 companies also provided the same information on their websites.
25
26

332. Wanzeler, Merrill, Labriola and Costa, and those working with them, specifically targeted unwitting purchasers (the Members/Promoters) for memberships that promised annualized returns of over 200% in exchange for placing duplicative advertisements on social media. The bait for TelexFree's scheme was the right to promote and profit from its VoIP product - an illusory menial task willfully designed to convince purchasers of the legitimacy of the business model.

333. TelexFree similarly used its membership fees ploy to further grow its unlawful and fraudulent enterprise as well as to unjustly and unfairly line the pockets of the Defendants with profits earned through the victimization of the putative class representatives and the other members of the putative class they seek to represent.

334. Notwithstanding the earlier shutdown of TelexFree's essentially identical operation, Ympactus, and many other indicators of unlawful business operations, each of the Defendants chose to earn handsome fees for providing services to TelexFree's suspicious and unlawful enterprise.

335. Over time, TelexFree's revenue from sales of its VoIP service plans only accounted for only approximately \$1.3 million (or approximately 0.1%) of the nearly \$1.1 billion needed to honor its promises to Promoters. This was because TelexFree

337. The Financial Services Providers who performed the Know Your Customer investigations and analysis were able to recognize with the help of their robust or sophisticated systems or personnel that TelexFree's actual business was the unlawful recruitment of new Promoters.

339. New Promoters generated no income by placing advertisements on the Internet. New Promoters did, however, generate income for TelexFree through the recruitment of more new Promoters who paid its membership fees. TelexFree's operations were unsustainable without a continuous influx of new capital coming from the recruitment of additional participants.

341. The first option was known as the “AdCentral” program. Participation in AdCentral cost \$289 plus a \$50 membership fee for a one-year contract.

363. As represented in the TelexFree website and promotional materials mailed out and handed to participants at TelexFree's "Extravaganzas" by Defendant Principals, Executive Office and Top Level Promoters, a Promoter was allowed to invest in more than one advertisement kit and purchase the VoIP Program to earn bonuses.

364. A feature of TelexFree's bonus structure and recruitment commissions is the fact that TelexFree participants could self-qualify for sales and commissions.

366. Therefore, without selling any VoIP programs, the Promoter could receive, or expect to receive, a return far over the 200-250% guaranteed return.³⁸

368. According to an investigation conducted by the SEC, between August 2012 and March 2014, TelexFree received slightly more than \$1.3 million from the sale of approximately 26,300 VoIP programs, while receiving more than \$302 million in investments by Promoters, less than one-half of one percent of total revenue during this period from sales of its purported product.

370. TelexFree did not produce anywhere near \$1.1 billion dollars in VoIP revenue.

372. Net revenue received by TelexFree from VoIP program sales was

1 inhibited by substantial commission payments.

2 373. In other words, only a trivial number, if any, of non-Promoters purchased
3 the VoIP product. In his statement to the Massachusetts SOC, TelexFree Founder
4 Wanzeler could not identify the number of individuals who purchased only a VoIP
5 program without also becoming a participant, and provided wildly varied estimates
6 when challenged to identify the number of VoIP programs sold to non-participants.
7

8 374. Over the same period, TelexFree received 783,771 package purchases of
9 either \$289 or \$1,375 totaling \$880,189,455.32.
10

11 375. Under this compensation plan, if each of the 783,771 Promoters invested
12 in only one AdCentral package at \$289 and only posted one advertisement per day,
13 TelexFree would have owed Promoters \$799,446,420.
14

15 376. Under this compensation plan, if each of the 783,771 Promoters invested
16 in the AdCentral Family package at \$1,375 and only posted five advertisements per day,
17 TelexFree would have owed \$3,997,232,100 to Promoters.
18

19 377. According to data provided by TelexFree, the \$1,375 AdCentral Family
20 memberships accounted for 88% of the transactions by Massachusetts-based
21 participants.
22

23 378. Even assuming that only 50% of all participant memberships were at the
24 AdCentral Family level, TelexFree would still have owed \$2,398,897,200, a number
25 that far exceeded TelexFree's reported total revenues over the same period.
26

379. This figure of almost \$2.4 billion omits further bonuses, recruitment

1 commissions and revenue sharing; including these additional payments would create an
2 even greater disparity between the VoIP program revenue and the guaranteed money
3 paid out of the passive income scheme to Promoters.

4 380. At no time during the class period did TelexFree generate sufficient funds
5 from sales of their phone service to make the payments they had contracted to pay to
6 existing Promoters. Those funds came from the registration fees of subsequent
7 TelexFree Promoters.

9 **L. Gallery of Rogues Assembled**

10 ***1. The Seasoned Scam Artists***

11 381. TelexFree, Wanzeler, Merrill, Costa, Labriola and others enlisted the
12 involvement of persons and entities that operated or otherwise had highly publicized
13 involvement in business models that were later found to be fraudulent and unlawful
14 Ponzi Schemes.

15 382. For example, prior to his involvement with TelexFree, Rodrigues was
16 charged by the SEC with operating a fraudulent pyramid scheme under the name of
17 Universo FoneClub Corporation, another Massachusetts corporation formed by
18 Rodrigues, in which he acted as officer and director.

19 383. Rodrigues settled these charges in 2007. As a condition of his settlement,
20 Rodrigues was permanently enjoined from violating Section 10(b) of the Exchange Act
21 and Rule 10b-5, and Sections 5(a), 5(c) and 17(a) of the Securities Act.

22 384. As a condition of his settlement, Rodrigues was further ordered disgorged
23 of approximately \$1.8 million of related ill-gotten gains.
24
25
26

385. Rodrigues formed and organized WWW Global Business, Inc. (“WWW Global Business”) on or about February 7, 2013, to market and sell TelexFree Memberships. WWW Global Business was and is a “shell” corporation holding no, or virtually no, assets and having no employees beyond its principal, Defendant Rodrigues, who served as its sole director, officer, and agent for service. WWW Global Business was organized for the sole purpose of marketing and selling TelexFree Memberships, *i.e.* AdCentral packages, and did not engage in the sale of TelexFree’s purported VoIP product.

387. Rodrigues attended meetings at TelexFree's Marlborough Office headquarters. While at TelexFree's headquarters, on phone conferences and while located elsewhere, he unfairly and deceptively conspired with other Defendants to carry on TelexFree's unlawful enterprises. Despite having knowledge that TelexFree was an enterprise carrying out unlawful, unfair, or deceptive acts or practices, Rodrigues personally performed integral services and provided substantial and essential advice and assistance that were used to further TelexFree's unlawful business.

390. Another example is Brandon Bradshaw, who had formerly served as vice president and sales director of AddWallet, a now-defunct pyramid scheme, through March 29, 2013. AddWallet was a successor to Zeek Rewards, an infamous Ponzi scheme. Zeek Rewards ran from January 2011 into August 2012 when the SEC shut it down. The Zeek Rewards Ponzi scheme bilked investors out of a purported \$850 million dollars. Prior to being shut down, Zeek Rewards was alleged to have paid out \$350 million dollars to early investors.

392. In March 2013, AddWallet held a conference call intended to assure investors. During the call, AddWallet representatives assured investors that it was an

- [4:52] “After the fall of the major player Zeek (Rewards), we. . . saw a lot of things there.”
- [13:34] “It’s unfortunate what happened, a lot of good people got hurt. I thought Zeek was doing a fantastic job.”
- [5:26] “We put a base operating system down. Yes, it’s very much like Zeek when you go into the retail profit pool earnings, you see something that you’ve seen before.”

395. Bradshaw spoke during a September 6, 2013 TelexFree conference call hosted by Labriola, during which Bradshaw promoted sales of TelexFree memberships and instructed and otherwise provided advice to Promoters and potential Promoters on behalf of TelexFree that furthered its unlawful enterprise.

397. In 2014, Bradshaw became a co-founder of another pyramid scheme,

1 Genesis Global Network, which was characterized in online promotional materials as
2 “operat[ing] just like Zeek and Add Wallet. The early members in Zeek earned over \$1
3 Million and this one is better and completely offshore.”³⁹

4 398. Another example is Defendant Miller, another big player in the infamous
5 \$850 million Zeek Rewards Ponzi scheme, which had a component similar to
6 TelexFree’s AdCentral. Like TelexFree Members, Zeek members were told they got
7 paid for posting ads about the company online. Zeek Rewards told its “Affiliates” that
8 in order to “earn” their points, they were required to place a short, free digital ad each
9 day on one of the many free classified websites available on the Internet. According to
10 Zeek receiver Kenneth D. Bell, “[i]n reality the ads were just an attempt to manufacture
11 a cover for what was nothing more than the investment of money by Affiliates with the
12 expectation of receiving daily ‘profit’ distributions.” Bell targeted Miller in his
13 prosecution of Zeek’s massive Ponzi scheme. Miller spoke on behalf of TelexFree at
14 TelexFree events and was one of its key pitchmen.

15 399. According to a video playing on YouTube, Miller was one of the featured
16 TelexFree speakers at the Newport Beach event. Members of his group claim in videos
17 that, if one sends \$15,125 to TelexFree to purchase a “contract,” one will emerge with
18 guaranteed earnings of at least \$1,100 a week for a year. The math of the claim is
19 basically this: \$1,100 a week for 52 weeks equals \$57,200. Subtract the original outlay
20 of \$15,125, and emerge with \$42,075 on the plus side.

21
22
23
24
25
26 ³⁹ See <https://www.facebook.com/mlmsuccessgroup/posts/772337832778294>; see also Exhibit 3, Decl. of Gray Echavarria, Attachment 25.

2. The Professional Legitimizers' Roles

402. TelexFree’s operations had many signs of unlawful, unfair and deceptive wrongdoing that were highly suspicious and in fact constituted Red Flags recognized by the Federal Financial Institutions Examinations Counsel (“FFIEC”).

404. After authorities shut down TelexFree’s Brazilian unlawful predecessor, Ympactus, the Licensed Professionals and Financial Services Providers knew that TelexFree was nothing other than a new entity created by the same principals to engage

⁴¹ *Id.*

406. The promotional materials posted online by TelexFree and its Executives specifically referred to income received by Promoters for placing ads as part of the AdCentral Packages as “passive income”⁴² in violation of Massachusetts black letter law.

408. The great bulk of the content centered on the payment for posting of ads, such as “Work over the Internet Posting ads daily,” and the membership commission structure.

410. All of this served as “Red Flags” to the sophisticated Financial Services

89

1 Defendants and Licensed Professionals Defendants who had sophisticated Know Your
2 Client protocols and systems as well as expertise in MLM.

3 411. Nehra and Waak Law Firm, Nehra Law Firm, Waak Law Firm, Nehra and
4 Waak were also persons who the Financial Services Providers knew had prior
5 involvement in pyramid or unlawful MLM schemes.
6

7 412. Defendants Nehra, Waak, Nehra Law Firm, Waak Law Firm, and Nehra
8 and Waak Law Firm each provided legal services to TelexFree. There was no clear
9 distinction between Nehra, Waak, Nehra Law Firm, Waak Law Firm, and Nehra and
10 Waak Law Firm with regard to the legal services that they provided to TelexFree.
11

12 413. The Attorney Defendants each are self-proclaimed MLM and direct
13 marketing specialist attorneys.⁴³

14 414. The Attorney Defendants each boast on their respective websites that they
15 have vast knowledge and experience representing MLM and direct-sales clients.⁴⁴
16

17 415. The Attorney Defendants each boast on their respective websites that they
18 have specialized knowledge and experience and can discern between legitimate and
19 lawful MLM and direct-sales ventures and illegitimate and unlawful pyramid or Ponzi
20 scheme ventures.⁴⁵
21

22 416. Nehra represented or advised ventures that had been shuttered by state or
23 federal authorities as fraudulent pyramid or Ponzi schemes, including Zeek Rewards
24

25 ⁴³ See Exhibit 4, Decl. of Carol L. Harris, ¶¶ 6-49, Exhibits 1-14.

26 ⁴⁴ See *id.*

⁴⁵ See *id.*

1 and AdSurfDaily, both before and concurrent with Nehra's provision of services to
2 TelexFree.

3 417. During the investigation of the AdSurfDaily scheme, Attorney Nehra filed
4 an affidavit in court representing that AdSurfDaily was "not a Ponzi Scheme."
5

6 418. AdSurfDaily's operations were shut down as a Ponzi scheme in 2010.

7 419. Zeek Rewards' operations were shut down as an unlawful pyramid and
8 Ponzi scheme in August 2012.

9 420. Nehra's extensive experience with MLM and direct-sales ventures,
10 particularly his involvement with the unlawful AdSurfDaily and Zeek Rewards
11 ventures, armed him with the knowledge of what constitutes violations of United States
12 securities law.
13

14 421. The Attorney Defendants were used in an attempt to hide TelexFree's
15 Pyramid Scheme activity with obfuscating phraseology.
16

17 422. Similar to Nehra, Waak claims to have over thirty years advising MLM
18 and direct-selling enterprises. Waak claims to have managed the legal defense of
19 multiple class action lawsuits involving claims for "pyramiding, securities fraud, false
20 advertising and civil RICO."
21

22 423. As counsel for TelexFree, the Attorney Defendants had actual personal
23 knowledge of TelexFree's product and business model.

24 424. Nehra, negligently or recklessly gave his professional opinion as a duly
25 licensed attorney who specialized in MLM for decades. He informed the putative class
26

1 in July 2013 that he had “vetted” and “bless[ed]” TelexFree’s business model and
2 operation.⁴⁶

3 425. The Attorney Defendants negligently or recklessly drew upon their prior
4 experience to substantially aid, abet, and play an integral role in TelexFree’s unlawful,
5 unfair, and deceptive acts and practices during the times relevant to this complaint.
6

7 426. Despite their actual knowledge, rather than decline or cease rendering
8 services to TelexFree, the Attorney Defendants failed to adequately provide even
9 minimally acceptable legal counsel.
10

11 427. In spring 2013, TelexFree was forced to focus on new markets, including
12 the United States and Canada, because its Brazilian operations had been shut down and
13 all of its Brazilian assets frozen. TelexFree used the presence, representations and
14 statements of the Attorney Defendants to perpetuate and advance the Pyramid Scheme
15 in those new markets.
16

17 428. Nehra’s representations and statements that TelexFree’s operations in the
18 United States were legitimate and lawful were part of its total “post Brazilian shut down
19 package.”
20

21 429. Nehra was aware of how his representations and statements were being
22 used by TelexFree, yet willingly spoke on behalf of TelexFree at an event dubbed a
23 “Super Weekend” in Newport Beach, California on July 26 and 27, 2013. His focus at
24 the “Super Weekend” event was to reassure Promoters that TelexFree’s United States
25

26 ⁴⁶ See Exhibit 4, Decl. of Carol L. Harris, ¶ 19, Exhibit 14.

1 operations were legitimate, lawful and worthy of investment.

2 430. Although at the time of the “Super Weekend,” TelexFree’s Brazilian bank
3 accounts had been frozen and all of TelexFree’s Brazilian recruiting and payments had
4 been suspended by court order in its largest affiliate market, Nehra advised attendees
5 that the shutdown in Brazil would not affect TelexFree’s operations in the United States.
6

7 431. Nehra spoke at length during that “Super Weekend” and reassured the
8 attendees of the legality and legitimacy of TelexFree’s operations in the United States,
9 stating “It is legally designed . . . you are on very solid legal ground,” and that
10 TelexFree’s operations had been “vetted by the Nehra and Waak law firm.”
11

12 432. Nehra’s statements and opinions provided legal representations. Nehra’s
13 statements and opinions constituted legal advice. Nehra knew that TelexFree’s conduct
14 constituted a breach of duty to its Promoters.
15

16 433. In addition, at all relevant times, the Attorney Defendants consented to be
17 and acted as agents of Telex Free and had authority to represent and bind TelexFree.
18

19 434. As agents of TelexFree, the Attorney Defendants owed a duty to the
20 putative class not to negligently or recklessly make statements or misrepresentations, or
21 offer incorrect opinions that would support the TelexFree business model or smooth the
22 way for the additional influx of membership driven funding.

23 435. The Attorney Defendants drew direct financial benefit from assisting
24 TelexFree to perpetuate and further the Pyramid Scheme to the detriment and loss of the
25 putative class.
26

1 436. Plaintiffs and all other members of the putative class are “Investors” under
2 Massachusetts state securities law.

3 437. However, upon the advice of the Nehra and Waak attorneys, TelexFree
4 referred to the members of the putative class as “Associates,” “Members,” and
5 “Promoters.”
6

7 438. The TelexFree Pre-March 9 Contract at Section 2.6.5 (m) mandates that
8 Promoters are not to use the term “investment” regarding the registration costs.

9 439. Specifically, the TelexFree Pre-March 9 Contract at Section 2.6.5 (m)
10 provides that the Promoter must not “use terms that distort the real meaning of products
11 or the mechanism and functioning of multilevel marketing, including, without
12 limitation, expressions that convey the idea of instant wealth for nothing in exchange, as
13 well as speaking of registration costs as a ‘financial investment.’ Similarly, it is
14 expressly prohibited to use the term ‘INVESTMENT’ at meetings and in promotional
15 materials in general, orally or in writing.”
16
17

18 440. TelexFree, the Operational Defendants and the Licensed Professional
19 Defendants, including the Accountant and Attorney Defendants, provided the bad
20 advice that distorted, furthered and perpetuated the unlawful, unfair and deceptive
21 Pyramid Scheme.
22

23 441. Promotional materials also falsely represented that TelexFree was a “clean
24 & scam free business.” (Emphasis in original).

25 **M. TelexFree’s Fraudulent and Deceptive Use of Best Western Hotel**
26

investment.

N. Investigation of, and Injunctions against, TelexFree's Brazilian Operations in Brazil

448. The following activities were taking place as TelexFree was carrying out approximately \$865,893,524.99 in transactions with the Defendant Financial Services Providers.

449. In or about January 2013, the Brazilian Bureau of Consumer Protection (known as Procon) began to investigate TelexFree.

450. In its January 11, 2013 press release, Procon indicated that it had "detected evidence of crimes":

The investigation initiated by civil prosecution of Consumer Protection (no. 01/2013) shows several controversial issues and possible crimes that put consumers at risk in time to accept that kind of deal.

Among the possibilities, there is a breach in the Federal Law No. 1.521/51, art. 2, according to which it is a crime:

Obtaining or attempting to obtain illicit gains at the expense of the people or of undetermined number of people through speculation or processes fraudulent ('snowball', 'chains', 'pichardismo' and any other equivalent) including Ponzi pyramid.

There is also the possible violation of the Code of Consumer Protection (CDC), with false advertising, failure of product information and company, abuse of weakness or ignorance of consumers and conditions unreasonable disadvantage, among others.⁴⁷

451. Procon subsequently initiated an official complaint and notified the "State

⁴⁷ See Exhibit 3, Decl. of Gray Echavarria, Attachment 6.

453. On February 15, 2013, the MLM news site BehindMLM.com reported that TelexFree was under criminal investigation in Brazil for having operated an illegal Ponzi scheme.⁴⁹

454. On February 17, 2013, A (MLM) Skeptic, an MLM blog, reported that Brazil's Bureau of Consumer Protection had investigated TelexFree upon suspicion of operating a Ponzi scheme, and had subsequently forwarded the case to the State Prosecutor's office for filing of formal charges.⁵⁰

The TelexFree business of selling packages of internet telephony (VoIP, its acronym in English), is not sustainable and suggests a Ponzi scheme, which is a crime against the popular economy.

That is the conclusion of the Secretariat for Economic Monitoring of the Ministry of Finance (Seae / MF) in a statement on Thursday (14).⁵¹

456. As the matter progressed through the Brazilian court system, the Ministry of Finance was ordered not to issue further statements about the matter.

⁴⁸ See, Exhibit 3, Decl. of Gray Echavarria, Attachment 38.

⁴⁹ See Exhibit 3, Decl. of Gray Echavarria, Attachment 6.

⁵⁰ See, Exhibit 3, Decl. of Gray Echavarria, Attachment 27.

51 *Id.*

1 457. TelexFree and the Defendant Founders seized upon that fact and
2 circulated through its affiliates the following misleading misrepresentation of the order:

3 It's official! The investigation on TelexFree has been absolved of
4 what Behind MLM has researched and posted.⁵²

5 458. On June 19, 2013, the Brazilian Court in Acre issued an injunction putting
6 "a stop to TelexFree's business operations, including the registration of new affiliate
7 investors, acceptance of new investments and paying any returns owed on existing
8 affiliate investments."⁵³

9
10 459. In addition, following a court order in Brazil by Judge Borges for
11 TelexFree to turn over "data relating to the registration and operation of the accounts of
12 each of the affiliates, including twelve months of retroactive data," TelexFree claimed it
13 had no access to registrations and transfer accounts of the company's Promoters.

14
15 460. This claim directly contradicts the internet video in which Costa is
16 surrounded by stacks of books he falsely claims holds the requested affiliate data.⁵⁴

17 461. At no point did TelexFree sell VoIP products legally in Brazil.

18
19 462. On January 26, 2015, the Brazilian government filed a criminal complaint
20 seeking fines and jail time against Defendant Founders Wanzeler and Costa for their
21 failure to register their offering of VoIP products with the Brazilian National
22 Telecommunications Agency.

23
24 ⁵² See, Exhibit 3, Decl. of Gray Echavarria, Attachment 7.

25 ⁵³ *Id.*

26 ⁵⁴ See Exhibit 3, Decl. of Gray Echavarria, Attachment 24; "*TelexFree claim no affiliate data, fined again*," Behind MLM (Jan. 1, 2014) (explaining Judge Borges' request and TelexFree's contentious response).

O. TelexFree's Continued United States' Operations

463. After the Brazilian government's seizure of Ympactus in June 2013, TelexFree continued to operate its Pyramid Scheme in the United States.

464. In late summer or fall of 2013, TelexFree retained a consulting group, The Sheffield Group, which also markets itself as having extensive MLM expertise and experience, to review its business plan. At this time, the advice provided by Sheffield Group and whether it was followed is unknown.

465. Jeffrey Babener of Babener & Associates advised TelexFree that its business plan was unlawful and needed to be redesigned in 2013. Babener markets himself as having specialized MLM expertise and experience.

466. Despite being advised of the illegality of the TelexFree program by Babener and Babener & Associates, TelexFree and its Defendant Founders continued operations without modification until March 2014.

467. Each Defendant knew TelexFree was an unlawful Pyramid Scheme, but continued to participate in or aid, abet and further such illegal activities. Each Defendant knew that TelexFree was shut down in Brazil, but continued to participate, substantially aid and abet and act to further its unlawful operations and activities in the United States.

P. Collapse of TelexFree's United States Operations

468. On or about February 5, 2014, the SOC, in connection with an investigation of TelexFree's operations, served TelexFree with subpoenas.

469. At least six banks, not named here as Defendants, rejected TelexFree's

1 business.

2 470. However over several years of operations, TelexFree did employ financial
3 accounts, including domestic and international bank accounts and various online
4 payment processors to carry out and facilitate its fraudulent and deceptive scheme in the
5 Commonwealth of Massachusetts including a nearly continuous banking relationship
6 with Bank of America and TD Bank.
7

8 471. At least three banks, not named here as Defendants, terminated their
9 relationship with TelexFree as its illegal and tortious operations became apparent.
10

11 472. Emails between TelexFree management and financial institutions painted
12 a bleak picture of TelexFree's continuing financial operations.

13 473. In an August 28, 2013 email to Defendants Merrill, Craft and
14 Wanzeler, Defendant Hughes, President of Base Commerce, a payment processing
15 company serving TelexFree, clearly stated "[n]o US Bank or Processor . . . will accept
16 your [TelexFree] business given that you are on month five of the Visa Chargeback
17 monitoring program. You are one of only three merchants in the USA on month five so
18 you are a real hot-potato as they say."⁵⁵
19

20
21 474. Financial institutions were an essential part of the TelexFree Pyramid
22 Scheme and provided substantial assistance or encouragement, without which payments
23 from Promoters could not be obtained or funneled through various shell companies and
24 personal accounts. Without the substantial services of the Financial Service
25

26 ⁵⁵ *Id.*

1 Defendants, TelexFree would not have been able to grow, be maintained or flourish as it
2 did.

3 **Q. TelexFree's Belated Efforts to Legitimize Its Scheme**

4 475. On March 9, 2014, TelexFree abruptly changed its compensation plan,
5 requiring Promoters to sell its VoIP product to qualify for the payments that TelexFree
6 had previously promised to pay them. A central component of the new change affected
7 the ease of participant withdrawals. TelexFree Participants could no longer withdraw
8 money, even money already "earned," without making a specified number of retail sales
9 and recruiting several new investors.
10

11 476. These changes were put in place in an attempt to forestall the impending
12 collapse of the scheme.
13

14 477. Following these changes, numerous TelexFree Participants frantically
15 contacted the Office of the Secretary of the Commonwealth, correctly suspecting the
16 harbinger of TelexFree's collapse. The changes also generated a storm of protests from
17 Promoters who could not recover their money.
18

19 478. As it became more difficult to withdraw money from TelexFree,
20 TelexFree switched its compensation plan from one that paid participants in United
21 States currency to one that operated on TelexFree "credits," which were essentially
22 worthless.
23

24 479. The switch from payment in United States currency to payment in
25 "credits" was made without any announcement or forewarning to TelexFree's Members,
26

1 and was designed merely to forestall the impending collapse of the Scheme.

2 480. Furthermore, the value of the “credits” issued by TelexFree was not fixed
3 in relation to any currency, thus giving TelexFree and its Executives the power to alter
4 the value of the “credits” to suit their own interests and avoid compensating TelexFree’s
5 Members.
6

7 481. On April 1, 2014, dozens of Promoters descended upon TelexFree’s
8 Marlborough Office to protest the changes and to attempt to regain access to their
9 money. Local media covering the chaos interviewed one Promoter who admitted that
10 the VoIP service is “almost impossible to sell.”⁵⁶
11

12 482. On April 14, 2014, TelexFree, Inc., TelexFree, LLC and TelexFree
13 Financial abruptly sought bankruptcy protection in Nevada under Chapter 11, admitting
14 that they could not meet their obligations from VoIP revenues and seeking authority to
15 reject all its current obligations to Promoters.
16

17 483. In furtherance of the enterprise, TelexFree mailed fraudulent and
18 inaccurate 1099 (Miscellaneous Income) forms to Promoters in or about mid-April
19 2014, an attempt to create the illusion that TelexFree had made payments to Promoters
20 when no such payments were made.
21

22 484. The 1099 forms were provided long after the mandated January 31, 2014
23 deadline, and some after the April 15, 2014 filing deadline.
24

25 ⁵⁶ See Exhibit 3, Decl. of Gray Echavarria, Attachment 33; see also Scott O’Connell, “Upset
26 customers look for answers at TelexFREE offices,” Wicked Local-Dennis (April 1, 2014
(updated April 17, 2014)),
<http://dennis.wickedlocal.com/article/20140401/NEWS/140409503?sect=More&map=0>.

1 485. TelexFree falsely represented that Promoters had received income that
2 they in fact had not received.

3 486. TelexFree's former officers or employees stated to the TelexFree
4 bankruptcy transition team that under the TelexFree Pre-March 9 Contract, TelexFree
5 owed its Promoters over \$5 billion dollars.
6

7 **R. Events Since TelexFree's Bankruptcy Filing**

8 487. On April 15, 2014, the SOC filed an Administrative Complaint against
9 TelexFree, Inc. and TelexFree, LLC, alleging violations of the Massachusetts Uniform
10 Securities Act, MASS. GEN. LAWS, c. 110A.
11

12 488. The SOC sought injunctions and orders requiring TelexFree, Inc. and
13 TelexFree, LLC to cease and desist from further conduct violating Massachusetts
14 securities laws and regulations, to provide an accounting of all proceeds received
15 because of TelexFree's fraud, to provide restitution to Promoters for losses attributable
16 to the fraud operations, and to disgorge all profits.
17

18 489. Also on April 15, 2014, the SEC filed a civil Complaint and Jury Demand
19 against TelexFree, Inc. and TelexFree, LLC as well as Defendants Merrill, Wanzeler,
20 Labriola, Craft, Rodrigues, De La Rosa, Crosby, and Sloan, alleging violations of the
21 Securities Act of 1933, the Securities Exchange Act of 1934, and SEC Regulations.
22 The SEC requested and was granted a preliminary injunction and an order freezing the
23 assets of TelexFree. The SEC is also seeking disgorgement of profits and additional
24 civil penalties.
25
26

1 490. Additionally on April 15, 2014, the FBI and the DHS conducted a raid of
2 TelexFree's Marlborough Office.

3 491. During this raid by the FBI and DHS, federal agents apprehended
4 Defendant Craft as he attempted to leave the building with a laptop and approximately
5 \$38 million in cashier's checks in a bag. He also tried to leave with TelexFree
6 computer equipment containing incriminating data.

7 492. When questioned, Craft stated to the federal agents he was merely a
8 "consultant," and claimed that the checks and computer were "personal."
9

10 493. Defendant Katia Wanzeler was apprehended as she attempted to board a
11 flight to Brazil, on which she had a one-way ticket, cash and seventy pounds of luggage.
12

13 494. On or about May 1, 2014, the Montana Securities Commissioner filed a
14 cease and desist order against TelexFree.

15 495. The following day, the United States Bankruptcy Court for the District of
16 Nevada, on motion by the SEC, transferred the matter to the federal district court in
17 Massachusetts, Central Division.
18

19 496. During hearings conducted on May 2, 2014, William H. Runge, III,
20 former Chief Restructuring Officer of TelexFree, estimated that as of TelexFree's
21 bankruptcy filing TelexFree had assets of \$31 million in its bank accounts, \$28 million
22 in brokerage accounts, and nearly \$30 million held by payment processing companies.
23

24 497. The location of hundreds of millions of dollars received by TelexFree
25 from Promoters remains unknown.
26

S. TelexFree's Principals, Founders and Executive Office Controlled TelexFree, Knowingly Perpetrated the Unlawful, Unfair, and Deceptive Pyramid Scheme and Made False Representations about TelexFree

498. Defendants Merrill, Wanzeler, Labriola, Craft and Costa were responsible for the control and operation of TelexFree.

499. These Defendants, TelexFree's Founders and Principals, Executive Office and Top Level Promoters knowingly and willfully conspired to perpetrate, and did perpetrate, the TelexFree Pyramid Scheme with full awareness of its unfair, deceptive, and unlawful nature.

500. Defendant Merrill served as the president, secretary, and director of TelexFree, Inc.; a manager of TelexFree, LLC; president, secretary and director of TelexFree Financial; general partner of Defendant Electric, and president, secretary and director of Defendant Mobile, and in those capacities, exercised significant control over TelexFree's business operations.

501. Merrill exercised significant control over the TelexFree Pyramid Scheme. Merrill has appeared in videos posted to the internet – including, among numerous others, a November 3, 2012 YouTube video entitled “TelexFree James Merrill Brasil,”⁵⁷ a June 20, 2013 YouTube video entitled “James Merrill Speaks About TelexFREE BR Investigation,”⁵⁸ and the highly promoted “TelexFree 1st Extravaganza” video made available on www.TelexFree.com in which he can be seen promoting TelexFree as a revenue opportunity for Promoters.

⁵⁷ Available at <https://www.youtube.com/watch?v=8hYuvWNIL2M>.

⁵⁸ Available at <https://www.youtube.com/watch?v=zO4xe-0tE-4>.

1 502. Merrill also otherwise made numerous false representations in furtherance
2 of the Pyramid Scheme.

3 503. In a March 21, 2014 press release, Merrill misrepresented that TelexFree
4 had been “in the VoIP business for more than a decade.”

5 504. Through to at least March 28, 2014, the TelexFree website included a
6 biography of Merrill, which falsely stated that Merrill was a 1985 graduate of Westfield
7 State University in economics, and that he is “well versed in one of the new
8 technologies of the era (VoIP).”

9 505. According to testimony obtained by the SOC, Merrill attended Westfield
10 State University for a mere two years, without either receiving a degree or declaring a
11 major.

12 506. In further direct contravention to the representations made on the
13 TelexFree websites, Merrill also testified to the SOC on March 25, 2014 that he had
14 only a basic understanding of VoIP technology.

15 507. Defendant Merrill received \$3,136,200 on December 26 and 27, 2013
16 from one of the named Financial Service Provider Defendants.

17 508. Defendant Wanzeler served as treasurer and a director of TelexFree, Inc.;
18 a manager of TelexFree, LLC; vice president, treasurer, and a director of TelexFree
19 Financial; general partner of Defendant Electric and treasurer and director of Defendant
20 Mobile, and, according to corporate filings on record with SOC, as the chief executive
21 officer of TelexFree, Inc.

1 509. In those capacities, Wanzeler exercised significant control over
2 TelexFree's business operations.

3 510. Wanzeler exercised significant control over the TelexFree Pyramid
4 Scheme and participated in marketing TelexFree to potential investors.

5 511. Wanzeler appeared in TelexFree videos posted to the Internet in which he
6 willfully, maliciously, unfairly, deceptively:

- 7
- 8 • promoted TelexFree as a revenue opportunity for Promoters;
 - 9 • detailed the, unlawful and fraudulent TelexFree Program; and
 - 10 • made false representations regarding returns.
- 11

12 512. Wanzeler received \$4,317,800 on December 26 and 27, 2013, and wired
13 \$3.5 million to the Oversea-Chinese Banking Corporation in Singapore on January 2,
14 2014.

15 513. Defendant Labriola served as the international marketing director for
16 TelexFree, Inc.

17

18 514. Labriola was one of the original directors and founders of Common Cents
19 Communications, Inc.

20 515. At all material times, Labriola exercised significant control over
21 TelexFree's business operations and the operations of its interrelated companies.

22

23 516. Labriola also appeared in several videos posted on the Internet promoting
24 TelexFree as a revenue opportunity for Promoters, detailing the fraudulent TelexFree
25 program and making false representations regarding returns.

26

1 517. Labriola has acted as TelexFree’s spokesman to Promoters during post-
2 bankruptcy petition conference calls.

3 518. As a director of TelexFree, Inc., Labriola exercised significant control
4 over the TelexFree Pyramid Scheme.

5 519. As international marketing director for TelexFree, Inc., Labriola
6 maliciously and knowingly perpetrated the TelexFree fraud through the dissemination
7 of false and misleading advertising and marketing communications.
8

9 520. Defendant Craft is a CPA and served as the chief financial officer
10 (“CFO”) of Telex Free, Inc. and TelexFree, LLC.
11

12 521. In his capacity as CFO of TelexFree, Craft was responsible for preparing
13 or approving TelexFree’s financial statements, overseeing TelexFree’s accounting
14 methods and records, and otherwise exercising significant supervision and control over
15 TelexFree.
16

17 522. According to the SEC, two companies controlled by Craft received more
18 than \$2 million from TelexFree between November 19, 2013 and March 14, 2014.

19 523. On April 23, 2013, in response to a request for a profit-and-loss statement
20 issued by the SOC, TelexFree produced a document purporting to be TelexFree’s 2012
21 profit-and-loss statement.⁵⁹
22

23 524. TelexFree did not make use of usual and accepted MLM accounting
24 practices. For example, they did not separate out income generated by sales of VoIP
25

26 ⁵⁹ See Administrative Complaint of instituted by the SOC, Dkt. No. 2014-0004, page 39,
attached as Attachment 36 to Exhibit 3, Decl. of Gray Echavarria.

1 from income generated by other means.

2 525. On February 5, 2014, the SOC requested a second profit-and-loss
3 statement from TelexFree for 2012, which TelexFree produced on February 26, 2014.⁶⁰

4 526. A comparison of these two profit-and-loss statements – each purporting to
5 be TelexFree’s profit-and-loss statement for 2012 – reveals massive discrepancies (and
6 “conflicting statements”).
7

8 527. The first statement provided by TelexFree lists total income for 2012 at
9 \$1,864,939.70, while the second lists total income for 2012 at \$2,834,835.70.⁶¹
10

11 528. As further examples, agent commission is listed at \$520,582.95 in the
12 first, versus \$2,105,925.61 in the second; total expenses are listed as \$784,899.22 in the
13 first, versus \$2,333,893.09 in the second; net operating income is listed as
14 \$1,080,040.48 in the first, versus \$478,251.56 in the second; and net income is listed as
15 \$1,066,313.39 in the first, versus \$477,652.23 in the second.⁶²
16

17 529. The existence of duplicative accounting records containing egregious
18 discrepancies indicates TelexFree’s falsification of accounting records and negligent
19 failure to adhere to Generally Accepted Accounting Principles (“GAAP”).
20

21 530. As CFO for TelexFree, Inc. and TelexFree, LLC, and a certified public
22 accountant, Defendant Craft negligently or recklessly perpetuated the TelexFree
23 unlawful enterprise by:
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25 ⁶⁰ *Id.*

26 ⁶¹ *Id.*

⁶² *Id.*

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1 displaying an insurance notification representing that it was proof of coverage for
2 Promoters' payments; however, in actuality, the document was a notification denying
3 coverage.⁶³

4 **T. TelexFree's Top Level Promoters Played an Integral, Essential and Primary**
5 **Role and also Aided and Abetted the Pyramid Scheme**

6 537. TelexFree conducted its Pyramid Scheme through the use and with the
7 participation of several high profile Promoters referred to herein as "Top Level
8 Promoters," including Defendants Rodrigues, De La Rosa, Crosby, Miller, Sloan,
9 Shoyfer and others.

10
11 538. TelexFree's Top Level Promoters played a primary role in the Pyramid
12 Scheme and were integral and essential co-conspirators who at all times knew that they
13 were involved in unlawful activities designed to wrongfully take the funds invested by
14 the class. In fact, that is why the Founders, Principals, and Executive Office recruited
15 many of them for involvement in TelexFree.

16
17 539. The presence of the Top Level Promoters as well as their suspicious,
18 tortious or unlawful activities were Red Flags for the Financial Services Defendants as
19 identified by the FFIEC.

20
21 540. Each Top Level Promoter deceptively, fraudulently and misleadingly
22 promoted and furthered the Pyramid Scheme with knowledge of its illegality.

23 **U. TelexFree's Attorneys Played an Integral Role in and Aided and Abetted the**
24 **Unlawful, Unfair, and Deceptive Pyramid Scheme**

25 541. TelexFree's Attorney Defendants were a critical component of the

26 ⁶³ See <http://www.youtube.com/watch?v=q2A2IsAPd0I>.

1 TelexFree Pyramid Scheme as their representation of TelexFree went beyond the
2 ordinary attorney-client relationship of delivering legal advice.

3 542. At times relevant to this complaint, the Attorney Defendants had actual
4 knowledge that the TelexFree business model was a fraudulent Pyramid Scheme.

5
6 543. The Attorney Defendants were obligated to advise their clients on how to
7 comply with the law, yet TelexFree's Attorney Defendants negligently, recklessly,
8 willfully, knowingly, unfairly and deceptively advised their clients how to avoid
9 detection, maintain the appearance of legality, and maintain and build the Pyramid
10 Scheme. They knowingly extended their roles to become supporters of the Pyramid
11 Scheme by lending legitimacy to its operation.

12
13 544. Throughout TelexFree's profitable Pyramid Scheme, the Attorney
14 Defendants acted as legal counsel to TelexFree, and used their positions of authority,
15 education and respect of the profession of law within the targeted immigrant and other
16 communities as an integral part of the Pyramid Scheme "and its post Brazilian shut
17 down package."

18
19 545. Beyond his licensure, Attorney Nehra's extensive experience in MLM,
20 and particularly his involvement with the Ponzi schemes involving AdSurfDaily and
21 Zeek Rewards, armed him with the knowledge of what constitutes violations of United
22 States securities law, which he used in an attempt to hide TelexFree's Pyramid Scheme
23 activity with obfuscating phraseology.

24
25 546. Similar to Attorney Nehra, Attorney Waak also claimed to have over
26

1 thirty years of experience in counseling MLM and direct-selling enterprises.⁶⁴

2 547. On the website of the Law Offices of Nehra and Waak, the Defendant
3 Attorneys boasted that “[n]o Company that retained this firm BEFORE LAUNCH has
4 been shut down by a regulator.”⁶⁵ (emphasis in original).

5 548. On their website, Attorney Nehra and Attorney Waak claim to specialize
6 in counseling “domestic and foreign companies operating MLM (multi-level marketing)
7 businesses in the United States.”⁶⁶

8 549. The Law Offices of Nehra and Waak provided legal counsel to TelexFree,
9 and Attorney Waak was principal attorney of the law firm and was charged with
10 oversight of the firm’s daily activities.

11 550. Attorneys Nehra and Waak also maintained the Defendant professional
12 limited liability companies Gerald P. Nehra, Attorney at Law, PLLC and Richard W.
13 Waak, Attorney at Law, PLLC, which also provided legal and counseling services to
14 TelexFree.

15 551. Among the Attorney Defendants, and throughout TelexFree’s Scheme,
16 there was no clear distinction among the services provided to TelexFree by the Law
17 Offices of Nehra and Waak, the individual Attorney Defendants, and their respective
18 professional limited liability companies.

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24 ⁶⁴ See Exhibit 4, Decl. of Carol L. Harris, Exhibit 2. <http://www.mlmatty.com/meet-mlm-attorneys/>.

25 ⁶⁵ *Id.*

26 ⁶⁶ *Id.*

1 552. As general partners of the Law Offices of Nehra and Waak, Attorney
2 Nehra and Attorney Waak are jointly and severally liable for torts and obligations of the
3 firm.

4 553. Seeking to profit from TelexFree's exploitation of the members of the
5 putative class, Defendant Nehra drew upon his prior experience to aid, abet and play a
6 substantial and integral part in TelexFree's unlawful, unfair and deceptive acts and
7 practices during times relevant to this complaint.
8

9 554. The Attorney Defendants attended meetings at TelexFree's headquarters
10 in Massachusetts to discuss TelexFree's product, business model, and operations,
11 participated in teleconferences with Defendant Founders, Principals, Executive Office,
12 and Top Level Promoters to discuss TelexFree's product, business model, and
13 operations and had access to and input into TelexFree's documents, including the
14 contracts entered into between TelexFree and the putative class.
15
16

17 555. Attorney Nehra negligently, recklessly, willfully, knowingly, unfairly or
18 deceptively counseled TelexFree on actions that would serve to evade United States
19 securities laws that were intended to offer, in part, to provide the members of the
20 putative class with protection from pyramid schemes, and advised TelexFree Promoters
21 (excluding Top Level Promoters) to unknowingly participate in the evasion of federal
22 and state securities laws, to enrich himself financially and serve his own selfish
23 interests.
24

25 556. Attorney Nehra otherwise negligently, recklessly, willfully, knowingly,
26

1 unfairly or deceptively counseled and advised TelexFree Promoters (except the Top
2 Level Promoters) to unknowingly participate in the evasion of federal and state
3 securities laws.

4 557. Defendant Nehra accomplished this through his reputation as a licensed
5 attorney, his purported experience as an MLM expert and his purported research of
6 TelexFree's business model, which allowed him to hold out TelexFree as a legal
7 business.
8

9 558. Defendant Nehra did this in a variety of ways, including his instruction to
10 Investors to avoid using the terms "investment" regarding AdCentral Packages (*see*
11 TelexFree Pre-March 9 Contract, Paragraph 2.6.5(m)), which was an attempt to conceal,
12 and encouraged others to conceal, TelexFree's sale of securities in an attempt to strip
13 Promoters of the rights afforded them by federal and state securities laws.
14

15 559. In company videos, Attorney Nehra failed, refused and neglected to
16 advise prospective TelexFree Promoters, the putative class members, that their
17 participation in TelexFree presented a risk, including the risk of participating in an
18 unlawful scheme, or that his advice was, in fact, against their own interests.
19

20 560. Attorney Nehra perpetuated and enhanced the Scheme by not advising the
21 putative class member TelexFree Investors that his web-published purported
22 professional advice was intended to serve the interests of TelexFree and himself.
23

24 561. Attorney Nehra's actions exceeded the scope of zealous representation of
25 TelexFree. Although he was licensed to practice law and purported to offer legal
26

1 opinions, active and integral participation in a Pyramid Scheme does not fall within the
2 parameters of the profession in which he was licensed to practice.

3 562. Nehra negligently told Promoters and prospective members that
4 TelexFree's actions were within the purview of federal and state law. As described
5 above, the Defendant Founders, Principals, Executive Office and Top Level Promoters
6 knowingly used Attorney Nehra's false legal opinions and misrepresentations as a
7 marketing tool to unfairly and deceptively further the illegal Pyramid Scheme.
8

9 563. Attorney Nehra's opinions, and the opinions of other Attorney
10 Defendants, were packaged and promoted as part of TelexFree's total "post Brazilian
11 shut down package" to the members of the putative class.
12

13 564. On an internet video posted on August 2, 2013, Attorney Nehra provided
14 false and deceptive assurances to Promoters and potential Promoters, stating that "[t]he
15 special ingredient is that you have a real product."
16

17 565. Attorney Nehra assured Promoters on internet postings, in writing, and in
18 person at marketing promotions that, in his professional opinion, the TelexFree business
19 model was legitimate despite having actual knowledge that TelexFree MLM Network
20 "Partnerships"⁶⁷ involving TelexFree's AdCentral marketing packages were unlawful,
21 as he had actual knowledge of the ruling of the Brazilian Court, knowledge of and
22 access to TelexFree's United States operations and its composition, and knowledge of
23 United States law.
24
25

26 ⁶⁷ See Exhibit 1 - Standard TelexFree Contract at ¶2.2.1.

1 566. More particularly, when he advised potential participants of the soundness
2 of the venture, Attorney Nehra knew that a Brazilian court had determined that
3 TelexFree's activity was fraudulent, and that its Brazilian attorneys essentially admitted
4 it was a pyramid scheme.

5 567. Defendant Nehra's own comments suggest that when providing legal
6 opinions at the request of TelexFree and Defendant Founders, he knew that TelexFree
7 intended to use his advice and likeness prominently as a marketing tool on both their
8 localized Brazilian (Portuguese) and Spanish (Spanish) website portals, in an effort to
9 make TelexFree's business appear legitimate thereby continuing and perpetuating the
10 ongoing fraud.
11

12 568. Defendant Nehra knew TelexFree used his legal opinions as a marketing
13 tool to promote its suspicious, tortious or unlawful Pyramid Scheme on Brazilian
14 (Portuguese) and Spanish/Dominican (Spanish) website portals.
15

16 569. Attorney Nehra aided, abetted, counseled, induced, and/or procured
17 TelexFree's violations of law regarding the proper segregation and maintenance of
18 customer funds, and acted in concert and combination with TelexFree in such
19 violations.
20

21 570. Defendant Nehra gave substantial assistance to TelexFree and Defendant
22 Founders in accomplishing a tortious and illegal result, and Nehra's own conduct,
23 separately considered, constitutes a breach of duty to Promoters since he:
24
25
26

- negligently misrepresented the legality and sustainability of TelexFree's operations to the detriment of Promoters, and received fees from TelexFree;
- negligently obscured and obfuscated the illegal nature of TelexFree's Scheme by the manipulative use of language, including, e.g., advising TelexFree that using the term "investment" must be avoided;
- breached his duty of professional care to Promoters by failing to exercise proper due diligence in investigating the legality of TelexFree's operations;
- breached his duty of care by encouraging and advising individuals to become and remain Promoters to their detriment, despite his knowledge of the illegality of TelexFree's operations; and
- engaged in a civil conspiracy to defraud TelexFree's Promoters with a Pyramid Scheme, and took a leading role in the Scheme.⁶⁸

571. Attorney Waak, as general partner and principal attorney of the Law Offices of Nehra and Waak, and the other Attorney Defendants knew of, oversaw, and participated in Attorney Nehra's tortious and illegal conduct regarding the TelexFree Pyramid Scheme.

572. With their specialized knowledge of the laws governing MLM and direct-sales ventures and their personal knowledge of TelexFree's product, business model, and operations which were identical to its Brazilian product, business model, and operations, the following publicly available information caused or should have caused the Attorney Defendants to recognize that TelexFree was an unlawful pyramid or Ponzi

⁶⁸ As stated by Justice William O. Douglas, "just as a fine natural football player needs coaching in the wiles of the sport, so, too, it takes a corporation lawyers with a heart for the game to organize a great stock swindle or income tax dodge and drill the financiers in all the precise details of their play." William O. Douglas, "*Directors Who Do Not Direct*," 47 Harv. L. Rev. 1305, 1329 (1934).

573. Despite having knowledge that TelexFree was an enterprise carrying out unlawful, unfair, or deceptive acts or practices, Nehra and Defendant Nehra Law Firm performed integral services and provided essential advice and substantial assistance that was used to further TelexFree's unlawful business.

1 574. The Attorney Defendants used their knowledge and experience with MLM
2 and direct-sales ventures, the laws applicable to those types of ventures, and their
3 personal knowledge of TelexFree's product, business model, and operations to assist
4 TelexFree in perpetrating the Pyramid Scheme. More specifically the Attorney
5 Defendants:
6

- 7 • belatedly advised TelexFree that its compensation plan required
8 amendment;
- 9 • advised TelexFree on how to avoid detection from state and federal
10 agencies;
- 11 • advised TelexFree on how to maintain the appearance of legality,
12 including to avoid using the term "investment" regarding the
13 AdCentral Packages (TelexFree Pre-March 9 Contract, Paragraph
14 2.6.5(m)), which was an attempt to conceal, and encourage others
15 to conceal, TelexFree's sale of securities in an attempt to strip
16 Promoters of the rights afforded them by federal and state
17 securities laws;
- 18 • advised TelexFree on how to maintain and advance TelexFree;
- 19 • advised TelexFree on how to avoid United States securities laws
20 intended to offer, in part, protection from pyramid and Ponzi
21 schemes;
- 22 • advised TelexFree Promoters (excluding Top Level Promoters) to
23 unknowingly participate in the evasion of federal and state
24 securities laws;
- 25 • advised TelexFree on laws concerning the proper segregation and
26 maintenance of consumer funds;
- failed to inform the putative class that the Attorney Defendants'
web-published professional "advice" was intended to serve the
interests of TelexFree and the Attorney Defendants;
- failed to inform the putative class that participation in TelexFree
presented a risk, including the risk of participating in an unlawful

scheme, or that their advice was against the putative class's interests;

- advised Promoters and represented to the putative class that TelexFree was a lawful, legitimate, and sustainable venture under state and federal laws, which TelexFree then used as a potent marketing tool to recruit new members;
- provided legal representations and statements to Defendant Founders, Principals, Executive Office, and Top Level Promoters that Attorney Defendants knew would be used by TelexFree in its efforts to recruit and retain members;
- allowed their names, experience, and likenesses to be used by TelexFree in propaganda aimed at retaining and obtaining members to the Pyramid Scheme like online postings, in-person meetings, company "super weekends" and "extravaganzas," brochures, and videos;
- gave speeches to the putative class at TelexFree's recruiting and retention "extravaganzas," "super weekends," and other events proclaiming with an air of authority that TelexFree's product and model was legitimate and lawful;
- informed the putative class that the Brazilian government's shutdown of TelexFree's activities in Brazil would not affect TelexFree's operations in the United States;
- refused to address questions asked by the putative class regarding implications of the injunction granted against TelexFree's operations in Brazil;
- informed the putative class that TelexFree "is legally designed . . . you are on very solid legal ground," and that TelexFree's operation had been "vetted" and "bless[ed]" by the Attorney Defendants;
- encouraged the putative class to become or remain Promoters; and
- provided assurances to Promoters and the putative class on website postings and other writings, and in person that TelexFree was legitimate and lawful, including assurances that "[t]he special ingredient is that you have a real product."

575. The acts and omissions of the Attorney Defendants were integral for

1 TelexFree to perpetuate and further the Pyramid Scheme and constitute substantial
2 assistance in that Scheme by the Attorney Defendants.

3 576. The Attorney Defendants committed their respective acts and omissions
4 with the knowledge and purpose of assisting and benefiting TelexFree and themselves
5 and to the detriment and loss of the putative class.
6

7 577. The Attorney Defendants knew their representations and statements would
8 be and were used by TelexFree as a marketing tool to further advance its business
9 model and illegal activities.
10

11 578. The Attorney Defendants knowingly allowed TelexFree to utilize their
12 statements and representations regarding the legality of TelexFree as propaganda to
13 retain and maintain members in the Pyramid Scheme.

14 579. The Attorney Defendants negligently, recklessly, willfully, knowingly,
15 unfairly or deceptively failed to exercise proper diligence in investigating the legality,
16 legitimacy, and sustainability of TelexFree's product, business model, and operations or
17 otherwise offered bad advice.
18

19 **V. TelexFree's Accountants and Professional Services Providers Played an**
20 **Integral Role in and Aided and Abetted the Unlawful, Unfair, and Deceptive**
21 **Pyramid Scheme**

22 580. Defendants Craft and Craft Financial participated in and perpetuated
23 TelexFree's unlawful business operation.

24 581. In his dual capacity as CFO and CPA for TelexFree, Craft and Craft
25 Financial were responsible for preparing or approving TelexFree's financial statements
26 and overseeing TelexFree's accounting methods and records, and otherwise exercised

583. As the CFO and CPA for TelexFree, Inc. and TelexFree, LLC, Craft and Craft Financial negligently assisted in perpetuating TelexFree's fraudulent Pyramid Scheme by:

584. Defendants Craft and Craft Financial knew when providing their financial assistance that their roles would give substantial assistance or encouragement to the Pyramid Scheme.

123

1 accounting and consulting services to TelexFree during the Pyramid Scheme.

2 586. More particularly, TelexFree retained PwC in January 2014, several
3 months after TelexFree had been shuttered by government authorities in Brazil, to
4 provide tax and financial consultation, including assistance with the development of
5 international tax structures.
6

7 587. PwC negligently advised TelexFree to prepare and issue unfair, deceptive,
8 inaccurate, suspicious, and unlawful 1099 (Miscellaneous Income) forms.

9 588. In an effort to maintain the illusion that it had made payments to its
10 members and on the negligent advice of PwC, TelexFree mailed fraudulent and
11 inaccurate 1099 (Miscellaneous Income) forms to its members as described above.
12

13 589. Craft Financial and Craft also negligently assisted in preparing and
14 sending the inaccurate 1099 forms to TelexFree's members.
15

16 590. Those inaccurate 1099 forms were filed with the Internal Revenue Service
17 and State Revenue Offices and will impose an undue burden and hardship on Promoters
18 who may now be liable to pay taxes on income they never received.

19 591. The CPA Defendants also negligently prepared financial documents for
20 affiliated TelexFree entities and prepared tax returns for the affiliated TelexFree entities.
21

22 592. PwC also negligently assisted TelexFree in responding to the
23 Massachusetts SOC Securities Division's information requests.

24 593. PwC negligently provided TelexFree with its services despite having
25 access to TelexFree's internal financial documents that demonstrated that TelexFree
26

1 received virtually no income from the sale of its VoIP product and was, in fact, an
2 illegal Pyramid Scheme.

3 594. Craft Financial, Craft, and PwC negligently performed services and
4 provided assistance and advice that was integral and essential to TelexFree and used to
5 further TelexFree's unlawful business.
6

7 595. Craft Financial, Craft and PwC negligently provided TelexFree with these
8 professional services despite having access to TelexFree's internal financial documents,
9 which demonstrated that TelexFree received virtually no income from the sale of its
10 VoIP product and was, in fact, an illegal Pyramid Scheme.
11

12 596. Craft Financial, Craft and PwC knew when providing their professional
13 services to TelexFree that their role would give substantial assistance or encouragement
14 to TelexFree to continue its unlawful business model and would further the illegal
15 Scheme.
16

17 597. Craft Financial, Craft and PwC knew their representations and statements
18 were false and misleading and that they would be and were used by TelexFree as a
19 marketing tool to further advance its business model and illegal activities.
20

21 598. At all times relevant to this complaint, Craft Financial, Craft and PwC
22 acted subject to pervasive control of TelexFree and were subject to TelexFree's will.
23 Despite having actual knowledge that TelexFree's Brazilian operations had been found
24 fraudulent and enjoined by Brazilian courts, Craft Financial, Craft and PwC, at the
25 direction of and with information provided by TelexFree, negligently crafted financial
26

1 statements and negligently made representations designed to misrepresent and hide the
2 true nature of TelexFree's product, business model, and operations in the United States
3 and the effect of the Brazilian courts' findings and orders.

4 599. At all times relevant to this complaint, Craft Financial, Craft, and PwC
5 consented to be agents of TelexFree. Craft Financial, Craft and PwC knowingly
6 allowed TelexFree to utilize their deceptive and misleading financial statements and
7 representations regarding TelexFree as propaganda to retain and maintain members in
8 the Pyramid Scheme.
9

10 600. As agents of TelexFree, Craft Financial, Craft and PwC owed a duty to
11 the putative class not to make deceptive statements or misrepresentations in order to
12 induce the putative class to buy into TelexFree's Pyramid Scheme.
13

14 601. Craft Financial, Craft and PwC committed their respective acts and
15 omissions with the knowledge of assisting TelexFree to perpetuate and advance the
16 Pyramid Scheme to the benefit of TelexFree and Craft Financial, Craft and PwC, but to
17 the detriment and loss of the putative class.
18

19 602. At all material times, Defendant Borromei served as the direct contact and
20 liaison between Defendant Opt3 and TelexFree.
21

22 603. At all material times, Borromei had actual knowledge that TelexFree was
23 an unlawful Pyramid Scheme.

24 604. In addition to providing technical support and assistance with payment
25 processing, Opt3 and Borromei managed and oversaw the technological aspects of
26

1 TelexFree's fraudulent and illegal activities.

2 605. In or around 2012, Opt3 and Borromei were contracted by TelexFree to
3 provide internet technology ("IT") services, to establish TelexFree's electronic database
4 in Brazil, to maintain and service TelexFree's computers and electronic database, to
5 provide assistance with processing payments and financial transactions, and to provide
6 other technical support.
7

8 606. Opt3 and Borromei set up and maintained TelexFree's electronic
9 database. Together with TelexFree, Opt3 and Borromei conspired to set up TelexFree's
10 servers in Brazil with the goal of evading U.S. regulators and hindering investigation of
11 TelexFree in the event that TelexFree's Scheme should collapse or be shut down.
12

13 607. On August 13, 2013, Defendant Borromei co-hosted an open webinar with
14 Defendant Labriola, which promoted TelexFree's payment system, which had been
15 established by Opt3 and which utilized Defendant GPG's electronic payment gateway,
16 to TelexFree Investors and potential investors and encouraged them to make further
17 investments using this system.
18

19 608. On August 16, 2013, Borromei hosted an additional open webinar, in
20 which he further promoted the payment system, including Defendant GPG's electronic
21 payment gateway, and encouraged further investments in TelexFree using this system.
22

23 609. By email dated September 27, 2013, Borromei petitioned GPG to allow
24 TelexFree's continued use of its electronic gateway for transmitting Member credit card
25 data.
26

1 610. By email dated September 27, 2013, in response to Borromei’s email
2 earlier that same day, Jayme Amirie, President of GPG, indicated to Borromei that,
3 although TelexFree represented a “reputational risk” for GPG, GPG would continue to
4 allow TelexFree to use GPG’s electronic gateway to transfer electronic data to
5 Defendant Allied Wallet for processing Members’ credit card payments.
6

7 611. Borromei also worked with Defendants Sparman and Vantage Payments
8 to establish TelexFree’s payment processing through Allied Wallet.
9

10 612. Opt3 and Borromei continued to provide services to TelexFree until the
11 time of TelexFree’s bankruptcy petition.

12 613. Opt3 is listed as a trade creditor in TelexFree’s initial bankruptcy filings.

13 614. Borromei was also copied on numerous emails between and among
14 TelexFree, Defendant Base Commerce’s John Hughes, and GPG’s Jayme Amirie,
15 discussing the transition of TelexFree’s payment processing to Allied Wallet and
16 transfers of funds.
17

18 615. Through their close relationship with co-Defendants Merrill, Wanzeler
19 and Craft, and through their providing TelexFree with technological oversight and
20 support, Borromei and Opt3 had actual knowledge of TelexFree’s illegal and fraudulent
21 activities yet continued to provide substantial assistance in the furtherance thereof.
22

23 **W. The Financial Services Providers Were Required to Comply With Various**
24 **Statutory and Regulatory Investigation and Monitoring Obligations**

25 616. Each of the Financial Services Provider Defendants is a “financial
26 institution” under the terms of the Bank Secrecy Act, 31 U.S.C. § 5312.

1 617. Each of the Financial Services Provider Defendants is required to
2 implement in their business operations proven solutions to assure compliance with key
3 anti-bribery and corruption regulations, including the Bank Secrecy Act (“BSA”),
4 Foreign Corrupt Practices Act (“FCPA”), and critical anti-money laundering (“AML”)
5 mandates such as Know Your Customer (“KYC”) and the Customer Information
6 Program (“CIP”).
7

8 618. Each of the Financial Services Provider Defendants is required by key
9 anti-bribery and corruption regulations to possess AML expertise.
10

11 619. At least six financial institutions not named in this action turned
12 TelexFree away before opening an account.

13 620. At least six financial institutions not named in this action turned
14 TelexFree away because of suspicious activity and other numerous “Red Flags” alerting
15 them of fraud during the same time period that the Defendant Banks transacted millions
16 of dollars in business with TelexFree.
17

18 621. Other banks not named in this action discharged TelexFree within weeks
19 of opening a financial service relationship with them.
20

21 622. Each Financial Services Provider profited from its relationship with
22 TelexFree and the other Defendants.

23 623. Given TelexFree’s unlawful business operation and the “Know Your
24 Customer” and AML regulations, each Financial Services Provider was obligated to
25 refuse to open any accounts or process any transactions for the benefit of TelexFree.
26

624. Each of the Defendant Financial Services Providers was required to maintain robust, sophisticated and effective due diligence systems for purposes of BSA and AML compliance.

625. During times relevant to the complaint, each of the Defendant Financial Services Providers did maintain robust, sophisticated and effective due diligence systems for purposes of BSA and AML compliance.

626. When a Financial Services Provider finds out that a client is laundering money or running an unlawful enterprise it should:

- terminate the banking relationship;
- shut down the accounts; and
- file a Suspicious Action Report (“SAR”).

627. Each of the Financial Services Provider Defendants are required to take precautions against violations of the BSA and AML laws by clearly understanding the risk in their customer base and conducting comprehensive enhanced due diligence that prioritizes those risks.

628. At all times relevant to this complaint, each of the Financial Services Provider Defendants was subject to federal regulatory law obligations that required them to:

- obtain and possess knowledge of and understand⁶⁹ their clients’ business operations;

⁶⁹ In other words, the Financial Services Defendants did not simply have to gather information; they needed to analyze it and understand their clients' business models and key personnel.

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- collection and analysis of basic identity information (referred to in U.S. regulations and practice as “Customer Identification Program” or CIP);
- name matching against lists of known parties;
- determination of the customer’s risk in terms of propensity to commit money laundering, terrorist finance, or identity theft;
- creation of an expectation of a customer’s transactional behavior;
- monitoring of a customer’s transactions against its expected behavior and recorded profile; and
- monitoring of a customer’s transactions against that of the customer’s peers.

633. At all times relevant to this complaint, the Defendant Financial Services Providers were also mandated without limitation by the BSA, the Money Laundering Control Act of 1986 (the “Money Laundering Control Act”), the Patriot Act, and the Know-Your-Customer Regulations *to continue* to actively monitor TelexFree’s business activities, customer base, *and product offerings* once it became a customer.

635. Processed transactions in excess of \$25,000 in the aggregate on behalf of

637. As a result of their obligation to file SARs with the Financial Crimes Enforcement Network of the U.S. Department of the Treasury and other appropriate federal law enforcement agencies, as required by the BSA and accompanying Federal Regulations, 31 U.S.C. § 5312 et seq. and 12 CFR § 21.11 (the “Obligation”), each of the Financial Services Providers Defendants was obligated to determine the nature of TelexFree’s normal business activities at the beginning of their relationship with TelexFree.

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1 639. Each of the Defendant Financial Services Providers performed the above
2 SAR-related investigations at times relevant to this complaint.

3 640. During times relevant to this complaint, TelexFree's Financial Services
4 Providers knowingly participated in and aided and abetted TelexFree's Pyramid Scheme
5 by, *inter alia*, enabling the TelexFree Pyramid Scheme to operate, expand and continue
6 by providing necessary financial services to TelexFree, the Operational Defendants, and
7 each other, despite actual knowledge that they were engaged in suspicious, tortious or
8 illegal activity.
9

10 641. Each of the Defendant Financial Services Providers understood, at a
11 minimum, TelexFree's business models and key personnel prior to opening accounts.
12

13 642. Each of the Defendant Financial Services Providers performed the above
14 investigations and understood, at a minimum, TelexFree's business models and key
15 personnel at all times after they opened them and while they were servicing TelexFree's
16 accounts.
17

18 643. At times relevant to this complaint, each of the Financial Services
19 Providers Defendants willfully and knowingly acted unfairly, deceptively and in bad
20 faith by failing to timely or properly act on their knowledge of TelexFree's suspicious,
21 tortious or illegal business operation, and to otherwise fulfill their obligations under the
22 BSA, 31 U.S.C. § 5311 et seq.; the Patriot Act, § 326, 31 U.S.C. § 5318; and 31 C.F.R.
23 § 1020 *et seq.*, or, in the alternative, by failing to disclose or report the nature of
24 TelexFree's business operations.
25
26

1 644. At all times material herein, the Financial Services Providers maintained
2 departments responsible for ensuring compliance with the investigation, reporting, and
3 procedural requirements contained in, *inter alia*, the Know-Your-Customer Regulations,
4 31 U.S.C. § 5312 *et seq.*, 31 U.S.C. § 5311 *et seq.*, the Patriot Act, § 326, and 12 CFR §
5 21.11 (hereinafter, “Regulatory Account Monitoring Department”).
6

7 645. Each of the Financial Services Providers maintained a Regulatory
8 Account Monitoring Department.

9 646. Each of the Financial Services Providers performed the initial
10 investigations required by the foregoing laws.
11

12 647. Each of the Financial Services Providers performed the continual
13 monitoring required by the foregoing laws.

14 648. At all times relevant to this complaint, in the course of complying with
15 their regulatory duties and obligations, the Financial Services Providers and their
16 employees and officers obtained actual knowledge that TelexFree, its Defendant
17 Executive Officers and Top Level Promoters were engaged in suspicious, tortious or
18 illegal activity.
19

20 649. In addition to what has already been set forth, actual knowledge of
21 TelexFree’s unlawful operation was based in part on the:
22

- 23 • large magnitude and long duration of the Scheme;
- 24 • nature and volume of the deposits;
- 25 • open association with others known to have been closely tied to
- 26 past high profile Ponzi and pyramid schemes;

- extensive negative news reports; and
- the fact that the related accounts and transactions bore the classic hallmarks of a Pyramid Scheme.

650. Each of the Financial Service Provider Defendants possess and made use of highly sophisticated software programs that provided them with background information and financial details about prospective customers that are not available to the general public.

651. Under the federal AML laws, the Defendant Financial Service Providers must investigate the top managers, directors, and principal owners of their clients.

652. The Defendant Financial Service Providers also were aware of many Red Flags of suspicious, tortious, and criminal misconduct by TelexFree.

653. At least eleven major news and watchdog websites covering the MLM industry, Ponzi schemes, and online scams analyzed TelexFree in 2012, 2013 and 2014, including, but not limited to:

- BehindMLM.com, an internet watchdog and journalism site dedicated to the MLM industry;
- PatrickPretty.com, an internet watchdog and journalism site covering Ponzi schemes and internet crime;
- Skeptic.blogspot.com, an internet watchdog and blog covering the MLM industry and online scams;
- ASDUpdates.com, an online journal covering internet scams;
- BusinessForHome.org, an internet news site analyzing direct-selling and MLM opportunities;
- CitizenCorps.com, an internet news site analyzing work-from-home and online income opportunities;

- EthanVanderbuilt.com, an internet watchdog and news site covering online scams;
- MLMHelpDesk.com, a blog and news site dedicated to the MLM industry;
- PonziTracker.com, an internet watchdog and news site covering and analyzing Ponzi schemes;
- Scam.com, a community-operated message board analyzing and discussing internet scams; and
- ScamXPoser.com, an internet watchdog site analyzing online income opportunities.

654. In addition to the above-listed websites dedicated to the MLM industry, the following websites specifically dedicated to Ponzi schemes and other online scams conducted analysis and exposés on TelexFree in 2012, 2013, and 2014, including, but not limited to:

- During the entirety of 2013 until approximately November 6, 2013, the front page of www.TelexFree.com included a certificate stating that, according to data analyst Alexa Internet, Inc., “we are among the most visited sites in Brazil.” (Importantly, no similar certification with respect to any other country was included); and
- From approximately June 2012 through approximately May 25, 2013, the tab header for www.TelexFree.com announced, “Make money by posting ads.”

656. Moreover, setting aside the highly advanced BSA and AML due diligence programs utilized by the Financial Services Provider Defendants, even the most basic internet investigation of TelexFree’s clients or its business model or principals would have revealed to these sophisticated corporate entities with experience in identifying illegal and suspicious operations that TelexFree was running an unlawful Pyramid Scheme in the United States that was essentially identical to its shuttered and enjoined Brazilian operation and was otherwise suspicious, tortious or illegal.

657. At a minimum, the following high-profile English-language Google search results generated simply by entering the search term “telexfree” required the Defendant Financial Services Providers to carry out closer-than-standard inquiry and monitoring:⁷¹

- January 1, 2013. The first page of Google search results includes a video posted by promoter Kelly Isom Tolar to dailymotion.com that clearly sets forth the payment structure of company, as well as the Best Western investment opportunity (http://www.dailymotion.com/video/xwbhex_telexfree-has-launched-in-usa-english-presentation_news). The visible video description by Kelly Isom Tolar states the following:

⁷¹ See also search engine trends for TelexFree (provided by MLMRankings.com): <http://www.mlmlrankings.com/telexfree/trend.htm>.

<http://telexfreeusateam.com> “TelexFree has taken over Brazil since January 2012. Now the USA has the green light to open their doors as of November 2012. In just 11 months, Brazil has created 8 millionaires with 380,000+ reps company wide. Here comes the USA and our opportunity with TelexFREE. I look forward to a lucrative business partnership with you.”

- January 24, 2013. A prominent Google result is a Blogspot webpage discussing the income scheme – including references to “6 Generations of Passive Income” – that unambiguously describes a pyramid scheme, and also discusses the hotel opportunity (<http://mmoljbp.blogspot.com/p/telexfree.html>) .
- March 1, 2013. A first-page Google result is a video entitled “TelexFree Marketing Plan,” with transcript, posted to slideshare.net (<http://www.slideshare.net/growrichteam/telexfree-marketing-plan-english>) that sets forth the structure of TelexFree, clearly describing a pyramid scheme.
- April 27, 2013. A posting by promoter “Suzanna” on getresponse.com, an online marketing community site, discloses that TelexFree is a “company that originated in Brazil and has even been examined and sued by the Brazilian SEC.” She also describes TelexFree as a passive income opportunity. (<http://www.getresponse.com/archive/interestedpeople/Interested-People-TelexFree-Earn-20-a-week-for-a-year-no-recruiting-at-all-10992068.html>).

658. There were also many other videos posted to YouTube and other sites that constituted Red Flags to the Financial Services Provider Defendants.

659. The already sophisticated eye of the Financial Service Providers in AML monitoring is buttressed by the requirements imposed on them by federal banking regulators under the auspices of the FFEIC.

660. FFIEC’s Bank Secrecy Act and Anti-Money Laundering Examination Manual (the “FFIEC Examination Manual”) requires Financial Services Providers operating in the United States to establish mandatory Anti-Money Laundering Programs

668. The Financial Services Provider's account opening procedures must mandate that the Provider conduct a risk assessment of prospective customers and classify them as low-risk, medium-risk or higher-risk.

670. The FFIEC Examination Manual states “the bank may determine that a customer poses a higher risk because of the customer’s business activity, ownership structure, anticipated or actual volume and types of transactions, including those transactions involving higher-risk jurisdictions.” If so, the bank should consider obtaining, both at account opening and throughout the relationship, the following information on the customer:

- 142

Trading Commission, in May 2010. The guidance consolidates existing regulatory expectations for obtaining beneficial ownership information for certain accounts and customer relationships;

- occupation or type of business (of customer or other individuals with ownership or control over the account);
- financial statements;
- banking references;
- domicile (where the business is organized);
- proximity of the customer's residence, place of employment, or place of business to the bank;
- description of the customer's primary trade area and whether international transactions are expected to be routine;
- description of the business operations, the anticipated volume of currency and total sales, and a list of major customers and suppliers; and
- explanations for changes in account activity.

671. AML experts consider MLM companies such as TelexFree to be higher-risk customers for BSA and AML purposes, partly because they pose the risk of Ponzi schemes and violations of the Securities Act of 1933.

672. AML experts also regard MLMs as higher-risk because those companies have high volumes of sales, high customer dissatisfaction rates, and guaranteed money-back policies.

673. In 2013, the Financial Crimes Enforcement Network ("FinCen") instituted a BSA proceeding against TD Bank, which assessed a \$37.5 million civil money penalty against that bank for failing to detect and report another Ponzi scheme and was predicated on the theory that Financial Services Providers should treat MLMs as higher-

675. To comply with the requirements in FFIEC Examination Manual, the Defendant Financial Services Providers must also inquire into and consider:

676. The Defendant Financial Services Providers must ascertain and form a reasonable belief as to the true identity of a customer, including any higher-risk customers.

678. In addition, for customers that are business entities, the Defendant Financial Services Providers must obtain documents showing the legal existence of the entity (such as certified articles of incorporation, an unexpired government-issued business license, a partnership agreement, or a trust instrument).

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1 679. The Defendant Financial Services Providers may require added
2 identifying information for higher-risk customers.

3 680. Specifically, where, based on their risk assessment of a new account
4 opened by a customer that is not an individual, the Defendant Financial Services
5 Providers should obtain information about individuals with authority or control over
6 such accounts including signatories, to verify the customer's identity.
7

8 681. This verification method applies when the Defendant Financial Services
9 Providers cannot verify the customer's true identity using documentary or non-
10 documentary methods.
11

12 682. For example, a Financial Services Provider may need to obtain
13 information about and verify the identity of a sole proprietor or the principals in a
14 partnership when the bank cannot otherwise satisfactorily identify the sole
15 proprietorship or the partnership.
16

17 683. The Defendant Financial Services Providers must also verify the
18 customer's identity within a reasonable period of time after opening the account.
19

20 684. The Defendant Financial Services Providers must report any suspicious
21 activity by completing a Suspicious Activity Elevation Form and submitting it to the
22 appropriate federal regulator.

23 685. The FFIEC Examination Manual also requires Financial Services
24 Providers to conduct "Customer Due Diligence" or "CDD."
25

26 686. The FFIEC Examination Manual states, "the bank should obtain

1 information at account opening sufficient to develop an understanding of normal and
2 expected activity for the customer's occupation or business operations."

3 687. According to FFIEC, "much of the CDD information can be confirmed
4 through an information-reporting agency, banking references (for larger accounts),
5 correspondence and telephone conversations with the customer, and visits to the
6 customer's place of business. Additional steps may include obtaining third-party
7 references or researching public information (e.g., on the Internet or commercial
8 databases)."

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10
11 688. In addition to ascertaining the customer's identity, the Defendant
12 Financial Services Providers must be entirely satisfied with their understanding of the
13 customer's beneficial ownership, management structures, and usual transaction flows.

14 689. In that regard, the Defendant Financial Services Providers must verify the
15 personal identity of the customer's major shareholders and top managers (especially
16 authorized signatories).

17
18 690. During CDD, the Defendant Financial Services Providers should also pay
19 attention to any Red Flags.

20
21 691. FFIEC has identified a long list of BSA and AML Red Flags, including,
22 but not limited to:

- 23
- 24 • "A customer makes frequent or large transactions and has no
record of past or present employment experience."
 - 25 • "Many funds transfers are sent in large, round dollar, hundred
26 dollar, or thousand dollar amounts."

- “Funds transfer activity occurs . . . when the activity is inconsistent with the customer’s business or history.”
- “Many small, incoming transfers of funds are received.”
- “Funds transfer activity is unexplained, repetitive, or shows unusual patterns.”
- “Payments or receipts with no apparent links to legitimate contracts, goods, or services are received.”
- “A large volume of cashier’s checks, money orders, or funds transfers is deposited into, or purchased through, an account when the nature of the account holder’s business would not appear to justify such activity.”
- “Unusual transfers of funds occur among related accounts or among accounts that involve the same or related principals.”
- “Goods or services purchased by the business do not match the customer’s stated line of business.”
- “Payments to or from the company have no stated purpose, do not reference goods or services, or identify only a contract or invoice number.”
- “Customer receives large and frequent deposits from online payments systems yet has no apparent online or auction business.”
- “A large number of incoming or outgoing funds transfers take place through a business account, and there appears to be no logical business or other economic purpose for the transfers, particularly when this activity involves higher-risk locations.”

692. Subsequent to an account opening, the Defendant Financial Services Providers must monitor the account and the customer.

693. Specifically, to comply with FFIEC’s Examination Manual, it is not enough to only conduct CDD at account opening.

694. In addition, according to FFIEC, “banks should monitor their lower-risk

696. Furthermore, the FFIEC clearly mandates that higher-risk customers must undergo enhanced due diligence (“EDD”) and that higher-risk customers should be reviewed more frequently and intensively than lower-risk customers and particularly if new Red Flags appear.

698. When a bank finds out that a client is laundering money or running an unlawful enterprise it should terminate the banking relationship, shut down the accounts and file a SAR.

699. After authorities began to shut down TelexFree, Wanzeler, Merrill and

Costa's unlawful Pyramid Scheme in Brazil in June of 2013, they simply switched their geographic target market to the United States.

700. During the putative class period, the Financial Services Defendants maintained robust, sophisticated, and effective due diligence systems that detected TelexFree's Red Flags because the components of TelexFree's switch from its Brazil-targeted Pyramid Scheme to its United States-targeted Pyramid Scheme would have been included within their search parameters, including, but not limited to, the following:

- use of the identical business name;
- use of the identical business model;
- use of the same product;
- specifically naming their unlawful business operation in Brazil – Ympactus – in their standard contract as owning the product and as a party to the contract;
- use of the same people to serve as officers, executives and management;
- use of the same address, office space and office equipment;
- use of the same back office support;
- changing its public name to TelexFree;
- indiscriminately transferring money from account to account including business to personal;
- obtaining cashiers checks for millions of dollars from business accounts after changing its compensation and business plan; and
- obtaining cashiers checks for millions of dollars from business accounts after filing for bankruptcy.

701. The following graphics taken from the public areas of both the English



and Spanish
TelexFree
websites, as
well as
numerous
Promoters’
websites and

video “tutorials,” made no secret of the pyramid structure of the business:



Attention: For The First Time In HISTORY...

**Every *SINGLE* Person
Who Joins **Gets Paid**
Weekly. PERIOD**

This Means YOU!

- ✓ CAN'T SPONSOR? CAN'T SELL? NO WORRIES...
- ✓ YOU STILL GET PAID!
- ✓ YOU ARE PAID WEEKLY BY CONTRACT!



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1 704. In carrying out their FFIEC due diligence, the Financial Service Provider
2 Defendants were required under the circumstances to investigate and uncover false facts
3 such as the false past experience and education of a corporate principal.

4 705. As a result of their compliance with the foregoing laws, each of the
5 Financial Services Providers was actually aware of the facts and evidence of suspicious,
6 tortious, or illegal activity, or Red Flags as follows, as well as those offered elsewhere
7 in the complaint:
8

- 9 • the TelexFree Program violated the express terms of M.G.L. c. 93,
10 § 69 governing multi-level distribution companies (i.e., MLMs),
11 and thereby M.G.L. c. 93A prohibiting unfair or deceptive acts or
12 practices;
- 13 • the TelexFree business operations in Brazil were shuttered by
14 Brazilian authorities and TelexFree and its Principals and
15 Executive Office were enjoined from doing further business;
- 16 • the TelexFree program was the subject of extensive MLM coverage
17 warning that it was an unlawful, tortious and suspicious Pyramid
18 Scheme;
- 19 • the TelexFree business model expressly sold memberships that
20 enabled Promoters to be paid without the sales of any actual
21 product;
- 22 • less than 0.5% of TelexFree's total revenue was derived from sales
23 of its VoIP product, with the remainder deriving from membership
24 fees;
- 25 • Promoters were expressly paid for merely placing spam
26 advertisements on the internet or recruiting additional promoters
 and product sales were expressly unrelated to a *guaranteed* return
 on investment ("ROI");
- the guaranteed ROI promised to Promoters was exceedingly high
 with no apparent risk;

- the memberships were not registered with any governmental agency but were nevertheless marketed and sold to members of the general public via public solicitation over the Internet and otherwise;
- the vast majority of Investors were of Brazilian/Dominican-American ethnicity as evidenced by their sur-names;
- videos by Defendant Founders and Inside Promoters;
- the advertisements posted by Promoters were merely spam ads;
- various Defendant Founders, Principals, and Top Level Promoters were associated with other unlawful and previously exposed Pyramid Schemes;
- an extremely large number of account transactions occurred and that number increased rapidly over time;
- many funds transfers and deposits were received in the exact same dollar amounts and with no apparent links to legitimate contracts, goods, or services. This latter factor and the high volume of small incoming transactions are considered by the FFIEC as a red flag in its examination handbook;
- credit card payments involving TelexFree were subject to an exceptionally high rate of credit card fraud and chargebacks;
- as a MLM company, TelexFree was regarded as a high-risk customer by banks and payment processing companies;
- funds were commingled between TelexFree entities;
- TelexFree failed to keep financial records in accordance with GAAP standards;
- huge wire transfers of funds were made to personal accounts of certain Defendant Founders and shell corporations;
- wire transfers of large sums to foreign entities occurred;
- TelexFree was widely regarded as a fraudulent scheme by the online MLM community;

- TelexFree maintained a Brazilian affiliate, also operating under the name TelexFree, which was under investigation by the Brazilian government as of February 2013 under suspicion of operating an illegal Ponzi scheme;
- in a March 1, 2013 press release available online, Defendant Merrill, president of TelexFree, admitted that “the real ‘secret sauce’ of our [TelexFree’s] success is our compensation plan... We [TelexFree] pay our representatives weekly if they follow our system and advertise our service on the Internet,” while making no mention of any product or service;
- in June 2013, TelexFree’s Brazilian affiliate had publicly falsely claimed that MAPFRE, an international insurance company, served as insurer to TelexFree, prompting MAPFRE to release a public statement online denying any relationship with TelexFree and threatening legal action against TelexFree for making this false statement; and
- in June 2013, TelexFree’s Brazilian affiliate Ympactus, also operating under the name TelexFree, was shut down and enjoined from doing further business by the Brazilian government for operating an illegal Ponzi scheme. This event was promptly reported online in English language news sources as was follow up news.

706. Pursuant to FFEIC guidelines, the payments being deposited into the accounts maintained at the Bank Defendants or processed by the Defendant Payment Processing Service Companies originated in the majority of instances from individuals bearing foreign surnames, raising actionable concerns regarding potential violations of the Patriot Act and other federal banking laws and regulations regarding issues of potential money laundering, terrorism, drug trafficking, and Ponzi schemes.

707. The overwhelming number of Red Flags referenced throughout this complaint was sufficient to have compelled a reasonable Financial Services Provider to make further inquiries and/or decline to provide financial services (as some banks did).

1 TelexFree Scheme and without them, TelexFree would not have been able to get off the
2 ground, develop, maintain or grow its Pyramid Scheme.

3 713. The Financial Services Providers were also an integral cog in the siphoning
4 off of funds by the Operational Defendants.

5 714. Without the active assistance and cooperation of the Financial Services
6 Providers, the Operational Defendants would not have been able to wrongfully convert
7 the class members' funds to their own personal possession and use.

8 715. Notwithstanding knowledge of suspicious, tortious or illegal activity, the
9 Bank Defendants accepted, processed and maintained deposit accounts on behalf of
10 TelexFree, accepted payment of AdCentral package membership fees from the
11 Promoters on behalf of TelexFree and made transfers of the payments derived from the
12 Scheme.

13 716. Notwithstanding knowledge of suspicious, tortious or illegal activity, the
14 Payment Processing Services Company Defendants processed payments between
15 TelexFree, the Operational Defendants, and its Promoters.

16 717. Notwithstanding knowledge of suspicious, tortious or illegal activity the
17 Payment Processing Services Company Defendants provided the electronic gateway
18 used to send and receive such payments, and provided the electronic interface services
19 used by both TelexFree and its Promoters and were thereby enriched.

20 **Y. The Bank Defendants**

21 718. During the time they did business with TelexFree, the Defendant Banks
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1 services to TelexFree.

2 727. More particularly, the Defendant Banks earned fees from their
3 participation in the TelexFree Scheme on several levels:

- 4 • interest on amounts held on behalf of TelexFree at or above the
5 Federal Funds Rate, currently set at .25%;
- 6 • processing fees for each transaction, typically in an amount of 1-
7 4% of the amount transferred per transaction, or, in some cases,
8 \$40 per transaction;
- 9 • annual ACH processing charges;
- 10 • return deposit item fees;
- 11 • chargeback fees; and
- 12 • miscellaneous fees and servicing charges.

13 728. In general, the Defendant Banks possessed a federal regulatory duty to
14 look for certain types of facts or lack thereof, including the identity and purpose of the
15 individuals opening and making payments into their accounts.

16 729. Even a perfunctory investigation of TelexFree in accordance with their
17 regulatory duties would have revealed the existence of the tortious Pyramid Scheme.

18 730. Each of the Defendant Banks became aware of the Red Flags surrounding
19 TelexFree and its conduct pursuant to their regulatory duties.

20 731. Each of the Defendant Banks also became aware of strong evidence of
21 suspicious, tortious or illegal activity including the outright fraud on the part of
22 TelexFree, its Founders and Principals pled with excruciating particularity herein.

23 732. The overwhelming number of Red Flags and other indicia of fraud
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1 established the existence of TelexFree's tortious conduct and the Pyramid Scheme and
2 the Defendant Banks thereby gained actual knowledge of its tortious conduct.

3 733. In the alternative, if any Defendant Banks failed to perform any of the
4 required investigations and account monitoring, it turned a blind eye to the tortious
5 conduct it actually knew underlied TelexFree's activities despite its general awareness
6 of the unlawful nature of the Scheme.

8 734. At times material herein, despite having knowledge that TelexFree was an
9 enterprise carrying out suspicious, tortious, or unlawful, unfair or deceptive acts or
10 practices, the Defendant Banks performed integral services and provided essential
11 assistance that was used to further TelexFree's unlawful business.

13 735. At times material herein, despite having knowledge that TelexFree was an
14 enterprise carrying suspicious, tortious, or unlawful, unfair or deceptive acts or
15 practices, the Defendant Banks ensured TelexFree was given access to banking services
16 and those banking services were used to further TelexFree's unlawful business.

18 736. Despite actual knowledge of the fraudulent nature of TelexFree's business
19 operations, the Defendant Banks continued to provide TelexFree with banking services
20 and substantially assisted its tortious conduct.

22 737. As an integral part of the Pyramid Scheme, the Defendant Banks received
23 funds from Promoters, which funds were then held for the benefit of or transferred from
24 or to TelexFree, its affiliated entities, and its Defendant Founders and Principals,
25
26

Executive Office, Top Level Promoters and Licensed Professionals.⁷⁵

738. Obtaining, maintaining and transferring Promoters' funds was the essence of the TelexFree Pyramid Scheme and without the services of the Defendant Banks, the TelexFree United States Pyramid Scheme could not have been opened, been maintained, thrived and been exploited through to the end where Principals and other Defendants were issued cashiers checks and either successfully absconded with significant funds or were caught while in the act of doing so.

739. Despite their actual knowledge, the Defendant Banks agreed and undertook to provide banking services that were essential to the operation of the Pyramid Scheme.

740. The services provided by each Defendant Bank included, *inter alia*, the following:

- processing and opening of depository accounts;
- receiving payments made by Promoters to TelexFree to become Members of the TelexFree Program;
- maintaining depository accounts containing funds paid by Promoters to TelexFree for AdCentral Package membership fees;
- making payments to certain Promoters as part of TelexFree's purported return on investment;
- transferring funds paid by Promoters to TelexFree among TelexFree entities, Defendant Founders' personal accounts, foreign companies and shell companies; and

⁷⁵ See, e.g., check deposited by TelexFree into its account with Fidelity Bank, to wit, account number 211370707, attached as Exhibit 7.

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1 747. Despite Bank of America’s knowledge of the illegal nature of TelexFree’s
2 business activities, including the fact it obviously violated M.G.L. c. 93, § 69, Bank of
3 America agreed to accept TelexFree as a customer and began to perform banking
4 services for TelexFree, which it continued to perform until at least December 31, 2013.

5
6 748. In addition to opening and maintaining accounts for TelexFree, Bank of
7 America was specifically named in TelexFree’s “signup procedures” document which
8 was available online as an entity holding TelexFree accounts into which transfers of
9 membership funds could be made by Members.⁷⁶

10
11 749. As described above, during 2013, TelexFree affiliates were urging recruits
12 to make walk-in deposits at a Bank of America branch in Massachusetts and the
13 instructions given strongly resembled instructions given to recruits in 2008 by another
14 infamous Ponzi scheme, AdSurfDaily.

15
16 750. More specifically, Members were directed to transfer their membership
17 fees to a “corporate” account at Bank of America under the name “TelexFREE LLC,”
18 were provided with the applicable account and routing numbers, and were provided
19 with the Bank of America branch address, “188 Bosyon [sic] Tpke Shrewsbury Ma
20 01545.”⁷⁷

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23 ⁷⁶ See “Signup procedures for TelexFREE,” attached to Exhibit 3, Decl. of Gray Echavarria,
24 Attachment 37, <http://PatrickPretty.com>, “TelexFree Affiliates Gave AdSurfDaily-Like
25 Coaching Tips, Instructed Prospects to Make Deposits at Bank of America[...]TelexFree Also
26 May Have TD Bank Account,” <http://patrickpretty.com/2013/07/08/telexfree-affiliates-gave-adsurfdaily-like-coaching-tips-instructed-prospects-to-make-deposits-at-bank-of-america-and-to-copy-slips-to-team-leaders-gmail-address-for-expedited-service-t/> (July 8, 2013) (including screen shot of TelexFree bank transfer instructions).

⁷⁷ See *id*; see also TelexFree Recruitment Presentation, available at

1 751. Bank of America knowingly permitted TelexFree to identify it in
2 promotional materials as the holder of its accounts and thereby lent an aura of
3 legitimacy and credibility to TelexFree's business operations through TelexFree's
4 connection with a large and well-established financial institution.

5
6 752. In addition to maintaining and servicing depository accounts, Bank of
7 America also provided credit to TelexFree, via at least two credit cards, which are
8 identified in TelexFree's 2013 balance sheet as "Bank of America Braz Help 0033" and
9 "Bank of America Telexfree 2658."

10
11 753. Pursuant to its obligations to perform ongoing customer monitoring of
12 TelexFree, Bank of America's Regulatory Account Monitoring Office, employees and
13 officers discovered the Red Flags and evidence of the suspicious, tortious or unlawful
14 activities described herein and deliberately ignored them.

15
16 754. In addition, the fact that virtually all deposits into Bank of America's
17 account xxxxxxxx7408 were made for the purchase of an AdCentral package, and not
18 TelexFree's purported VoIP product, was known to Bank of America's Regulatory
19 Account Monitoring Office, employees and officers and was an additional indication
20 that TelexFree was operating an illegal Pyramid Scheme.

21
22 755. Specifically, between June 2012 and May 2013, Bank of America account
23 xxxxxxxx7408, held in the name of TelexFree, Inc., received 1,133 deposits, totaling
24 \$12,203,496.48.

758. Notably, TelexFree's marketing materials that were available online made clear to what these sums corresponded.

760. As a result of Bank of America's required initial investigation and ongoing monitoring of TelexFree, Bank of America possessed actual knowledge that TelexFree was engaged in an illegal Pyramid Scheme.

⁷⁸ See Exhibit 3, Decl. of Gray Echavarria, Attachment 22, <http://patrickpretty.com/2013/07/08/telexfree-affiliates-gave-adsurfdaily-like-coaching-tips-instructed-prospects-to-make-deposits-at-bank-of-america-and-to-copy-slips-to-team-leaders-gmail-address-for-expedited-service-t/> (“Steve Labriola, Director of Marketing for Telex FREE, Boston, announced via email earlier today that they are ‘pulling out of Bank of America.’ These appear to be dated April 24, 2013. The claims appear on sites slugged

1 announced, in a mass email to TelexFree Members that TelexFree would be “pulling
2 out” of Bank of America.⁷⁹

3 762. Despite the foregoing representation that Bank of America would cease
4 doing business with TelexFree, Bank of America continued to perform banking services
5 for TelexFree and its Defendant Founders for at least another eight months, until about
6 December 2013.
7

8 763. As an example of services continued, on August 30, 2013, Defendant
9 Labriola announced during a public conference call with TelexFree Members that
10 payments due-and-owing from Bank of America to members as of July 30, 2013
11 required manual sorting, since “Bank of America didn’t give them a sorted list” as to
12 which of the payments had already been made by Bank of America.⁸⁰
13

14 764. As another example, a document dated November 11, 2013, establishes
15 that Defendant Merrill, on behalf of TelexFree, directed Allied Wallet, a Defendant
16 payment processor, to transfer funds via international wire transfer to a TelexFree
17 account with Bank of America.⁸¹
18

19
20

telexfreeunitedkingdon.weebly.com and mytelexfree4u.blogspot.com and
21 telexfreeunitedstates.com. So, this leads to questions about whether TelexFree had the ‘Zeek
22 problem’ — i.e., whether the banks pulled the plug on TelexFree. The sites also make this
claim: ‘ . . . For now, and those on the East Coast, please use TD Bank for your walk-in
deposits.’”).

23 ⁷⁹ See <http://telexfreeunitedkingdon.weebly.com/telexfree-updates.html> (recruitment website of
24 TelexFree ‘Team Builder’ Leonardo de Souza] and <http://mytelexfree4u.blogspot.com/>
(website of TelexFree Promoter).

25 ⁸⁰ See http://teamstelexfree.blogspot.com/p/blog-page_7.html (recruitment website of
TelexFree Promoter)

26 ⁸¹ See, Allied Wallet Bank Information Form for Bank of America, attached herewith as
Exhibit 8.

1 765. Furthermore, Bank of America continued to provide credit, via at least
2 two credit cards, at least through December 31, 2013, as indicated on TelexFree's 2013
3 balance sheet.

4 766. Bank of America continued to provide credit to TelexFree despite its
5 knowledge of the suspicious, tortious or illegal nature of TelexFree's conduct, also
6 lending an aura of legitimacy and credibility to TelexFree's business operations through
7 TelexFree's connection with a large and well-established financial institution.

8
9 767. Although Bank of America possessed knowledge of the tortious nature of
10 TelexFree's business activities from the time of its initial investigation and during its
11 monitoring of TelexFree, it continued to provide TelexFree with credit and depository
12 services integral to the TelexFree Scheme.

13
14 768. Through its actions, Bank of America substantially assisted in the
15 perpetration of, and otherwise became an integral part of, TelexFree's fraudulent
16 Scheme.

17
18 769. At a minimum, Bank of America's initial investigation and ongoing
19 monitoring of TelexFree, made it aware that TelexFree was engaged in suspicious,
20 tortious or unlawful conduct, but it willfully turned a blind eye to the results of its
21 investigation and monitoring because it refused to suspend service or terminate its
22 banking relationship with them or Operational Defendants and it continued to provide
23 TelexFree with credit and depository services integral to the TelexFree Scheme until at
24 least December 2013.
25
26

1 770. Through its actions, Bank of America knew TelexFree's conduct
2 constituted a breach of duty and violated M.G.L. c. 93, § 69 and M.G.L. c. 93A, and it
3 gave substantial assistance and encouragement to the perpetuation of, and otherwise
4 became an integral part of, TelexFree's unlawful Scheme.

5 **2. Defendant TD Bank**

6 771. Defendant TD Bank, N.A., has over 1,300 domestic locations in 16 states
7 and one foreign branch without a physical location. TD Bank is a large national bank
8 with approximately \$212 billion in assets and approximately 25,000 employees. TD
9 Bank is a member of TD Bank Group and a subsidiary of The Toronto-Dominion Bank
10 of Toronto, Canada. The Toronto-Dominion Bank trades on the NYSE Euronext under
11 the ticker symbol "TD."
12

13 772. TD Bank has previously settled accusations that it provided active
14 assistance to large Ponzi schemes in violation of the BSA and other laws, including
15 Scott Rothstein's \$1.2 billion Florida-based Ponzi scheme, for which it was civilly
16 prosecuted and fined.
17

18 773. The Office of the Comptroller of the Currency ("OCC") is TD Bank's
19 federal functional regulator. In September 2013, the OCC determined that TD Bank
20 violated the BSA from April 2008 through September 2009, by failing to file SARs in a
21 timely manner, in violation of 31 C.F.R. § 1020.320 and 31 U.S.C. § 5318(g). TD Bank
22 agreed to a \$37.5 million civil money penalty assessed by the OCC.⁸²
23
24
25

26 ⁸² See Exhibit 9 – September 20, 2013 OCCurrency Consent Decree.

1 774. The September 22, 2013 consent decree followed several years of active
2 investigation and negotiations. At all times in 2012, 2013, and 2014 that TD Bank was
3 servicing TelexFree, it was under investigation by the OCC because it “willfully
4 violated the Bank Secrecy Act’s reporting requirements by failing to detect and
5 adequately report suspicious activities in a timely manner in violation of 31 U.S.C. §
6 5318(g) and 31 C.F.R. § 1020.320.”⁸³

8 775. TD Bank violated BSA suspicious activity reporting requirements by
9 failing to detect and report suspicious activity and by filing late SARs in relation to the
10 so-called Rothstein Ponzi scheme. TD Bank failed to properly identify, monitor, and
11 report suspicious activity in Rothstein’s accounts. A lack of adequate training for both
12 the business and BSA/AML staff also contributed to TD Banks’ failure to recognize this
13 suspicious activity.
14

15 776. In May 2010, Coquina Investments filed a lawsuit alleging that TD Bank
16 aided and abetted the Rothstein Ponzi scheme, made fraudulent misrepresentations and
17 engaged in a pattern of racketeering in violation of RICO.
18

19 777. In January 2012, a jury returned a verdict against TD on both aiding and
20 abetting and fraudulent misrepresentation, awarding \$32,000,000 in compensatory
21 damages and \$35,000,000 in punitive damages.
22

23 778. Evidence showed that TD Bank, through its then-regional vice president,
24 Frank Spinosa, and other employees, aided and abetted the scheme and made fraudulent
25

26 ⁸³ *Id.* at 2.

misrepresentations.

779. Evidence established TD Bank N.A. had in place standard protocols to detect suspicious and/or illegal banking activities. The evidence also established that to facilitate the Ponzi Scheme TD Bank N.A. ignored alerts generated by its standard protocols for years. These protocols included its AML system that would alert it to suspicious activity and a related “Standard Investigative Protocol,” which provided guidance concerning reportable or non-reportable suspicious activity and provided procedures that TD Bank employees were to follow without exception.

780. TD Bank N.A. ignored 17 months of alerts on the AML system. The amount of money moving through the accounts and the speed with which it moved was also a focus of the OCC. TD Bank N.A. also ignored numerous concerns raised by multiple TD Bank, N.A. executives relative to the selling of settlements, the limited banking relationship with various parties seeking to open accounts with significant balance changes, and the large value of wires being received.

781. TD Bank N.A.’s awareness of the Ponzi scheme and the Red Flags associated with Ponzi schemes generally was highlighted not only through the *Coquina* verdict and the evidence supporting it.

782. TD Bank’s awareness of the Ponzi scheme and the Red Flags associated with Ponzi schemes generally was also highlighted through TD Bank’s actions through counsel and its witnesses because during the course of the litigation TD Bank willfully withheld evidence of Red Flags showing illegal activity.

1 783. During discovery, Coquina requested documents evidencing potential
2 illegal activity, including documents related to the standard protocols. In response, TD
3 Bank willfully provided only limited documents despite the requirements imposed upon
4 it by the Federal Rules of Civil Procedure.

5
6 784. The Coquina plaintiffs filed five motions for sanctions, three before or
7 during trial and two after trial, alleging serious discovery violations willfully carried out
8 by TD Bank and/or its counsel.

9 785. These motions unveiled the following among other things:

- 10
- 11 • Just before the close of discovery and subsequent to the deposition
12 of the 30(b)(6) corporate representative, Vincent Auletta (vice
13 president of global due diligence), wherein he testified that there
14 were no Rothstein alerts before September 2009 and no more than
15 5 alerts after, the bank produced 150 pages of AML alerts from
16 September 2009 –November 2009.
 - 17 • On the eve of trial, TD Bank, N.A. produced 17 months' worth of
18 AML alerts generated by the Searchspace system for Rothstein
19 accounts which had not been previously disclosed and which were
20 separate and distinct from normal fraud alerts, in addition to
21 numerous communications indicating that TD Bank executives
22 were aware of the investment schemes.
 - 23 • After the trial had concluded, during the course of different
24 litigation against TD Bank, Coquina learned that TD Bank did in
25 fact have a document called "Standard Investigative Protocol,"
26 which it had repeatedly denied having during discovery and trial
and that a document they had received, the CDD (Customer Due
Diligence) form generated by the Cash Management Department of
TD Bank, was not produced in color, which resulted in the absence
of important and relevant information including the presence of a
red banner at the top proclaiming that the account was "HIGH
RISK."

786. The district court sanctioned TD Bank for willful misconduct in failing to

1 provide the color copy of the CDD and other relevant documents.

2 787. At all times relevant to the complaint, Defendant TD Bank maintained
3 multiple accounts on behalf of TelexFree, another Ponzi scheme.

4 788. TD Bank first opened accounts in TelexFree's name in September 2012.⁸⁴

5
6 789. TD Bank performed its KYC investigation of TelexFree prior to agreeing
7 to accept TelexFree as a customer and otherwise complied with all banking regulations
8 when opening TelexFree's accounts.

9 790. TD Bank continually performed its KYC investigations of TelexFree and
10 otherwise complied with all banking regulations at all times it continued to service
11 TelexFree during the 2012-2014 class period.

12
13 791. Yet, despite the obvious illegal nature of TelexFree's business activities,
14 TD Bank agreed to accept TelexFree as a customer and began to perform banking
15 services for it.

16
17 792. Despite the obvious illegal nature of TelexFree's business activities, TD
18 Bank did not suspend servicing or terminate its relationship with TelexFree or any of
19 the Operational Defendants until at least January 2014.

20
21 793. TelexFree continued to maintain three depository accounts with TD Bank
22 as of December 31, 2013.⁸⁵

23 794. In addition to opening and maintaining accounts for TelexFree, TD Bank
24

25
26 ⁸⁴ See DHS Criminal Complaint dated May 9, 2014 against Wanzeler and Merrill at ¶ 62(b).

⁸⁵ See TelexFree's December 31, 2013 Balance Sheet, attached hereto as Exhibit 5.

1 was specifically named in TelexFree’s “signup procedures” document which was
2 available online as an entity holding TelexFree accounts into which transfers of
3 membership funds could be made by Members.⁸⁶

4 795. Specifically, TelexFree Promoters were directed to transfer their
5 membership fees to a “corporate” account at TD Bank under the name “TelexFREE
6 LLC,” and were provided with the applicable account and routing numbers.⁸⁷

8 796. TD Bank knowingly permitted TelexFree to identify it as the holder of its
9 accounts and thereby lent an aura of legitimacy and credibility to TelexFree’s business
10 operations through TelexFree’s connection with a large and well-established financial
11 institution.

13 797. On or about September 6, 2013, TelexFree leadership instructed its
14 members via a public conference call that the fastest way to send money to TelexFree
15 was by direct deposit to TelexFree’s accounts with TD Bank.⁸⁸

17 798. The person speaking on behalf of TelexFree during this conference call
18 was Bradshaw, the above-described high profile pyramid scheme regular formerly
19 active with the now-defunct pyramid schemes Zeek Rewards and AddWallet.

21 799. The fact that well over ninety percent (90%) of deposits into TD Bank’s
22 accounts held in the name of TelexFree, LLC were made for the purchase of an

23 ⁸⁶ See “*Signup procedures for TelexFREE*,” Exhibit 3, Decl. of Gray Echavarria, Attachment
24 37; see also n. 71.

25 ⁸⁷ *Id.*

26 ⁸⁸ See Exhibit 3, Decl. of Gray Echavarria, Attachment 34, BehindMLM.com, “*TelexFree US
business plagued with ‘rampant fraud’*”, Sept. 7, 2013,
<http://behindmlm.com/companies/telexfree/telexfree-us-business-plagued-with-rampant-fraud/>.

1 AdCentral package, and not TelexFree's purported VoIP product, was known to TD
2 Bank's Regulatory Compliance Office, employees and officers and was an additional
3 indication that TelexFree was operating an illegal Pyramid Scheme.

4 800. Specifically, between October 9, 2013, and January 17, 2014, TD Bank
5 account xxxxxx8409 held in the name of TelexFree, LLC received 478 incoming wire
6 transfers ranging from \$309 to \$142,500, totaling \$2,638,712.

8 801. Of these deposits into account xxxxxx8409, 2,474 were in the amount of
9 \$1,425 – the AdCentral Family package purchase price – totaling \$3,525,450.

10 802. During this same period, there was only one deposit into account
11 xxxxxx8409 in the amount of \$49.90 – the VoIP purchase price.

13 803. Notably, TelexFree's marketing materials that were available online made
14 clear to what these sums corresponded.

15 804. Between September 2012 and July 2013, there were 1,550 deposits by
16 cash, check, money order or wire transfer into TD Bank account xxxxxx2808, held in
17 the name of TelexFree, LLC, in the exact amount of \$1,425, the AdCentral Family
18 package purchase price.

19 805. During this same period, there was only one deposit into account
20 xxxxxx2808 in the amount of \$49.90 – the VOIP purchase price.

21 806. Between June 2013 and October 2013, there were 1,800 deposits into TD
22 Bank account TD Bank account xxxxxxx334, held in the name of TelexFree, LLC, in
23 the exact amount of \$1,425, the AdCentral Family package purchase price.
24
25
26

1 807. During this same period, there was only one deposit into account
2 xxxxxxxx334 in the amount of \$49.90 – the VOIP purchase price.

3 808. While examining TelexFree during the initial account opening process and
4 later while conducting ongoing customer monitoring of TelexFree, TD Bank
5 investigated TelexFree’s management, business activities, customer base, and product
6 offerings.
7

8 809. While examining TelexFree during the initial account opening process and
9 later during its ongoing customer monitoring of TelexFree, TD Bank’s Regulatory
10 Account Compliance Office, other employees or officers discovered the Red Flags and
11 other evidence described throughout this complaint, indicating that TelexFree was
12 engaging in suspicious, tortious or unlawful conduct.
13

14 810. At a minimum, TD Bank’s initial investigation and ongoing monitoring of
15 TelexFree, made it aware that TelexFree was engaged in suspicious, tortious or
16 unlawful conduct, but it willfully turned a blind eye to the results of its investigation and
17 monitoring because it refused to suspend service or terminate its banking relationship
18 with them or Operational Defendants and it continued to provide TelexFree with credit
19 and depository services integral to the TelexFree Scheme until at least January 2014.
20
21

22 811. Through its actions, TD Bank knew TelexFree’s conduct constituted a
23 breach of duty and violated M.G.L. c. 93, § 69 and M.G.L. c. 93A and gave substantial
24 assistance and encouragement to the perpetuation of, and otherwise became an integral
25 part of, TelexFree’s unlawful Scheme.
26

1 **3. Fidelity Bank**

2 812. Fidelity Bank opened three accounts for TelexFree, two on August 8,
3 2013 with initial deposits of \$7,123,784.58 and one on September 12, 2013 with
4 deposits of \$2,951,337.12.

5 813. Fidelity Bank helped TelexFree to conduct its business more easily by
6 using remote deposit capture.

7 814. Fidelity Bank continued to accept deposits from TelexFree until at least
8 December 26, 2013.

9 815. Notably, the president and chief operating officer of Fidelity Bank,
10 Defendant John Merrill, is the brother of Defendant James Merrill, one of the Founders
11 of the TelexFree Pyramid Scheme.

12 816. John Merrill's knowledge is imputed to Fidelity Bank because at all times
13 material he was its president and chief operating officer.

14 817. This familial relationship facilitated the relationship between TelexFree
15 and Fidelity Bank and made Fidelity Bank privy to information regarding TelexFree and
16 its suspicious, tortious or unlawful conduct.

17 818. At all material times, through his personal relationship with his brother,
18 Defendant John F. Merrill was fully aware of the fact that TelexFree's business
19 operation was nothing more than a Pyramid Scheme, and that TelexFree's other banking
20 relationships were souring.

21 819. Despite this knowledge, Defendant John F. Merrill used his position and
22
23
24
25
26

1 influence with Fidelity Bank to procure the described banking services from Fidelity
2 Bank for TelexFree and others including the Defendant Founders.

3 820. Despite Fidelity Bank's actual knowledge of the suspicious, tortious or
4 unlawful nature of TelexFree's business activities, Fidelity Bank agreed to accept
5 TelexFree as a customer and acted as a creditor and depository bank for TelexFree until
6 at least December 31, 2013.

7
8 821. Fidelity Bank's Regulatory Account Compliance Office did in fact
9 perform an investigation of TelexFree prior to agreeing to accept TelexFree as a
10 customer in or about August 2013.

11
12 822. Although Fidelity Bank possessed knowledge of the suspicious, tortious
13 or unlawful nature of TelexFree's business activities from the time of its initial
14 investigation of TelexFree, it continued to provide TelexFree with credit and depository
15 services.

16
17 823. Either through Fidelity Bank's attempts to comply with all banking
18 regulations when opening and maintained its accounts, including the Know-Your-
19 Customer Regulations, or because of the familial relationship between its President and
20 one of TelexFree's masterminds, Fidelity was aware of the Pyramid Scheme
21 characteristics and of TelexFree's unlawful business operation and stopped servicing,
22 terminated its relationship and filed SAR reports but it did not.

23
24 824. An investigation was initiated by the SOC against Fidelity Bank on April
25 30, 2014, concerning Fidelity's banking relationship with TelexFree.
26

1 825. That investigation resulted in the entry into a Consent Decree, dated
2 September 22, 2014, whereby Fidelity Bank agreed to establish an escrow fund of \$3.5
3 million for victims of the Scheme.⁸⁹

4 826. The SOC alleged, *inter alia*, that Fidelity Bank's account opening process
5 in 2013 was inadequate and insufficient to handle the voluminous TelexFree deposit
6 accounts.⁹⁰

7 827. These failures to comply even minimally with mandatory banking
8 regulations allowed the bank's president John F. Merrill to obtain the account services
9 for his brother James Merrill, the other TelexFree Founders and TelexFree itself.
10

11 828. The Consent Decree establishes that Fidelity Bank wrongfully permitted
12 TelexFree to deposit funds received from victims of its illegal Pyramid Scheme in
13 Fidelity Bank's accounts between August 8 and December 26, 2013.⁹¹
14

15 829. On or about November 23, 2013, pursuant to Fidelity Bank's obligations
16 to perform ongoing customer monitoring of TelexFree, Fidelity Bank's compliance and
17 BSA officer discovered Red Flags, other evidence of suspicious, tortious or unlawful
18 conduct.
19

20 830. That officer also discovered further indicators of fraud in the TelexFree
21 business model, and he notified president Merrill and an outside compliance consultant
22 utilized by Fidelity Bank.
23

24

25 ⁸⁹ *Id.*

26 ⁹⁰ *Id.*

⁹¹ SOC Consent Order E 2014-0073 is herewith attached and marked as Exhibit 10.

1 831. The outside consultant advised Fidelity Bank of his conclusions that
2 TelexFree was a high-risk customer based upon its account balance and extensive wire
3 transfers and that TelexFree's accounts would "require the appropriate monitoring level
4 for a high risk customer."

5
6 832. Less than two weeks after this initial investigation, Fidelity Bank made a
7 determination it should close TelexFree's accounts.

8 833. Fidelity Bank notified TelexFree of its determination to close its accounts
9 on December 3, 2013.

10
11 834. Despite that determination, Fidelity Bank continued to receive the
12 victims' funds obtained by TelexFree until December 27, 2013 and to perform other
13 banking services until December 31, 2013.

14 835. Fidelity Bank did not terminate its relationship with TelexFree, refuse to
15 accept victims' funds, or stop servicing accounts and report suspicious activity, after its
16 internal review revealed the suspicious, tortious or unlawful conduct.

17
18 836. As a result of the direct influence and unfair, deceptive and unlawful
19 involvement of Fidelity Bank president and chief operating officer, Defendant John F.
20 Merrill, Fidelity Bank opened personal accounts for TelexFree Founders and Principals,
21 including Defendant James Merrill (president Merrill's brother) and Wanzeler after
22 Fidelity's internal review revealed the tortious conduct.

23
24 837. After its November 27, 2013 receipt of the outside consultant's report,
25 Fidelity Bank unfairly, deceptively and unlawfully transferred over \$10 million dollars
26

1 out of TelexFree's and Defendant Founders' accounts and into the personal accounts of
2 Defendants James Merrill and Wanzeler.

3 838. This wrongful transfer included a \$3.5 million transfer by Wanzeler to a
4 Singapore account on December 30, 2013.

5 839. The SOC concluded that the use of Fidelity Bank's corporate and personal
6 accounts caused harm to the victims of the TelexFree fraud.

7 840. At a minimum, as a result of Fidelity Bank's initial investigation and
8 ongoing monitoring, the relationship between the Merrill brothers, and its investigation
9 and ongoing monitoring of TelexFree, Fidelity Bank was aware that TelexFree was
10 engaged in tortious conduct, but it deliberately and willfully turned a blind eye to its
11 knowledge and the results of its investigation and monitoring and continued to act as its
12 banking institution, causing the members of the putative class to suffer ascertainable
13 economic harm.
14
15
16

17 841. Although Defendant Fidelity Bank and Defendant John F. Merrill
18 possessed actual knowledge of the suspicious, tortious or illegal nature of TelexFree's
19 business activities at all times it received or held TelexFree funds, they willfully acted
20 in concert with them to until at least December 31, 2013 to:
21

- 22 • further the unlawful Pyramid Scheme;
- 23 • unfairly, deceptively and unlawfully siphon class member funds;
- 24 • unfairly, deceptively and unlawfully convert class member funds;
- 25 • continue to provide TelexFree and James Merrill and Carlos
26 Wanzeler services integral to the TelexFree Scheme; and

- continue to provide TelexFree and James Merrill and Carlos Wanzeler with substantial assistance and encouragement essential to their unlawful plan.

842. Through its actions, Fidelity Bank and John Merrill provided substantial assistance and encouragement and otherwise became an integral part of TelexFree's fraudulent Scheme. Fidelity Bank and John Merrill also assisted TelexFree and its Principals to further achieve their unfair, deceptive and unlawful Scheme that was at a minimum violative of M.G.L. c. 93, § 69.

4. Synovus

843. At all material times, Defendant Synovus served as the "sponsor" bank of Defendants Base Commerce and GPG, and provided depository account and funds transfer services in connection with Base Commerce's and GPG's payment processing services.

844. At all material times, Defendants Synovus, Base Commerce, and GPG shared a close business relationship, which included serving common clients, including TelexFree, and sharing information regarding said clients.

845. At all material times, Base Commerce served as an agent of Synovus with respect to Synovus' relationship with TelexFree, which began in April 2013.

846. Synovus performed an investigation of TelexFree prior to agreeing to accept TelexFree as a customer and its initial investigation and ongoing monitoring of TelexFree revealed indicia of suspicious, tortious and unlawful activities.

847. Given Synovus' knowledge of the illegal nature of TelexFree's business

1 operations, Synovus was obligated to refuse to open any accounts, process any
2 transactions, or serve as a conduit for payments for the benefit of TelexFree.

3 848. Synovus agreed to accept TelexFree as a customer and began to act as a
4 conduit for TelexFree in April 2013, which services it continued to perform until at least
5 January 16, 2014.
6

7 849. In August 2013, due to concerns regarding public accusations that
8 TelexFree was running a Pyramid Scheme, and the possibility of an investigation by the
9 Federal Trade Commission or other federal agencies, Defendant Synovus indicated that
10 it would no longer hold funds on TelexFree's behalf.
11

12 850. More particularly, Synovus instructed Base Commerce and GPG to cease
13 performing payment-processing services for TelexFree by August 31, 2013.
14

15 851. Nevertheless, Synovus continued to act as the sponsor bank for GPG and
16 Base Commerce thereafter and continued to process payments and make transfers for
17 the benefit of TelexFree.

18 852. For example, Synovus acted as the sponsor bank for Base Commerce's \$5
19 million transfer on or about September 26, 2013 authorized by Base Commerce's
20 Hughes for the benefit of TelexFree.
21

22 853. Synovus continued to act as GPG's sponsor bank for its electronic
23 payments transmitting credit card processing data to Defendant Allied Wallet until at
24 least January 16, 2014, for the benefit of TelexFree.
25

26 854. At a minimum, Synovus' initial investigation and ongoing monitoring of

1 TelexFree made it aware that TelexFree was engaged in suspicious, tortious or unlawful
2 conduct and was at a minimum violative of M.G.L. c. 93, § 69, but it continued to
3 provide TelexFree with payment processing services, integral to the TelexFree Scheme
4 until at least January 16, 2014.

5
6 855. Through its actions, Synovus provided substantial assistance and
7 encouragement to TelexFree. Synovus also assisted TelexFree and its Principals to
8 further achieve their unfair, deceptive and unlawful Scheme that was at a minimum
9 violative of M.G.L. c. 93, § 69.

10 **Z. Defendant Payment Processing Service Companies**

11
12 856. Defendants GPG, IPS, Propay, Base Commerce, Vantage Payments,
13 Allied Wallet, and the Doe Payment Processors possessed actual knowledge of the
14 suspicious, tortious and unlawful nature of TelexFree's business operations, yet
15 substantially assisted and encouraged them by providing essential payment processing
16 services as early as October 2012.⁹²

17
18 857. Despite actual knowledge of the suspicious, tortious, or unlawful nature of
19 TelexFree's business operations, the Payment Processing Service Company Defendants
20 continued to encourage and provide TelexFree with payment processing services and
21 substantially assisted and encouraged its suspicious, tortious or unlawful conduct.

22
23 858. As an integral part of the Pyramid Scheme, the Payment Processing
24 Service Company Defendants processed payments between TelexFree and its Members,

25
26 ⁹² See also Omnibus Decl. of William H. Runge, Case No. 14-125234-ABL, Doc. 13, ¶61,
attached herewith as Exhibit 2.

1 provided the electronic gateway used to send and receive such payments, and provided
2 the electronic interface services used by both TelexFree and its Members.

3 859. As set forth below, certain Payment Processing Companies went far
4 beyond this role and became active direct participants in TelexFree's unlawful business
5 enterprise by providing specialized advice and assisting them to skirt the law.
6

7 860. The services of the Payment Processing Service Company Defendants,
8 including the capturing, maintenance and transferring of Promoters' funds, was essential
9 and without their integral assistance TelexFree's Pyramid Scheme could not have
10 operated.
11

12 861. Each Payment Processing Service Company Defendant possessed a
13 regulatory duty to look for certain types of facts or lack thereof, including the identity
14 and purpose of the individuals opening and making payments into their accounts.
15

16 862. In 2012, TelexFree underwent a "several day" period during which they
17 double-billed customers, resulting in a temporary spike in the rate of customer
18 chargebacks, according to an interoffice email of Defendant Base Commerce, dated
19 May 22, 2013.⁹³
20

21 863. As a result of this period of especially heavy chargebacks, TelexFree was
22 added to MasterCard's MATCH database in 2012, indicating that TelexFree was no
23 longer to receive any credit card processing services due to exceptionally high risk.
24

25 864. In addition to the alert from Mastercard's MATCH database in 2012, each
26

⁹³ See email from John Hughes, dated May 22, 2013, attached herewith as Exhibit 11.

866. Each Payment Processing Service Company Defendant performed all of the investigations and monitoring required of it by the federal government yet it:

867. The services provided by each Payment Processing Service Company Defendant included, *inter alia*, the following:

- 184

- making payments to certain Promoters as part of TelexFree's purported return on investment; and
- transferring funds paid by Promoters to TelexFree between TelexFree entities, Defendant Founders' personal accounts, foreign companies and shell companies.

1. Propay

868. Defendant ProPay processed electronic transfers of funds on behalf of TelexFree.

869. ProPay agreed to accept TelexFree as a customer and began processing transactions for the benefit of TelexFree in or about October 2012.

870. ProPay continued to process transactions for the benefit of TelexFree until at least January 16, 2014.

871. According to TelexFree's December 2012 Balance Sheet, as of December 31, 2012, ProPay held a total of \$546,947.23 in two accounts for the benefit of TelexFree.

872. Furthermore, as of December 31, 2012, ProPay held an additional amount of \$279,209.46, which is listed as "on hold" by TelexFree's 2012 Balance Sheet.

873. Between October 2012 and December 2012, ProPay processed a total of \$1,506,856.60 in incoming transfers of membership fees for the benefit of TelexFree.

874. According to TelexFree's July 2013 Balance Sheet, as of July 31, 2013, Propay held a total of \$3,743,049.03 in funds for the benefit of TelexFree.

875. Furthermore, as of July 31, 2013, ProPay held an additional amount of \$4,698,867.83, which is listed as "on hold" by TelexFree's July 2013 Balance Sheet.

1 876. According to TelexFree's December 2013 Balance Sheet, as of December
2 31, 2013, ProPay continued to hold funds in the amount of \$98,463.24 for the benefit of
3 TelexFree.

4 877. In addition to this amount, as of December 31, 2013, ProPay continued to
5 hold funds in the amount \$4,468,411.11 in a "reserve" account for the benefit of
6 TelexFree.

7 878. In the course of providing services to TelexFree, ProPay directly
8 communicated with fellow Defendant Payment Processing Service Companies Base
9 Commerce and GPG regarding the inherent risks and concerns with TelexFree.
10

11 879. More particularly, in an email to Defendant Hughes, president of Base
12 Commerce, a Payment Processing Company serving TelexFree, ProPay characterized
13 TelexFree as an extremely high-risk client and indicated that no United States bank or
14 processor would be willing to take on TelexFree as a client given this risk. This email
15 was referenced in a subsequent email from Hughes to Defendants Merrill, Wanzeler,
16 and Craft, as well as Defendant GPG, dated August 28, 2013.
17

18 880. Hughes, as President of Base Commerce, stated in that August 28, 2013
19 email to Defendants Merrill, Craft, and Wanzeler, "[n]o US Bank or Processor . . . will
20 accept your [TelexFree] business given that you are on month five of the Visa
21 Chargeback monitoring program. You are one of only three merchants in the USA on
22 month five so you are a real hot-potato as they say."⁹⁴
23
24
25

26 ⁹⁴ See email from Hughes to Merrill, dated August 28, 2013, attached hereto as Exhibit 12.

1 881. Despite ProPay's knowledge of TelexFree's legal issues and the risk
2 surrounding TelexFree, and despite ProPay's own warnings to Base Commerce
3 regarding these issues, ProPay continued to provide payment processing services to
4 TelexFree into January 2014.

5 882. ProPay continued to provide payment-processing services to TelexFree
6 until at least January 16, 2014 and during that time ProPay conducted its continued
7 monitoring obligations under the law.
8

9 883. Pursuant to its obligations to perform ongoing customer monitoring of
10 TelexFree, ProPay's Regulatory Monitoring Office, employees and officers discovered
11 the Red Flags and evidence of suspicious, tortious or unlawful conduct described above.
12

13 884. At a minimum, ProPay's initial investigation and ongoing monitoring of
14 TelexFree made it aware that TelexFree was engaged in suspicious, tortious or unlawful
15 conduct that was at a minimum violative of M.G.L. c. 93, § 69, but it continued to
16 provide TelexFree with payment processing services, integral to the TelexFree Scheme
17 until at least January 16, 2014.
18

19 885. Through its actions, ProPay provided substantial assistance and
20 encouragement to TelexFree. ProPay also assisted TelexFree and its Principals to
21 further achieve their unfair, deceptive and unlawful Scheme that was violative of
22 M.G.L. c. 93, § 69.
23

24 **2. GPG**

25 886. Defendant GPG is a Payment Processing Service Provider that specializes
26

1 in making outgoing payroll and commission payments for clients as well as processing
2 credit card transactions for incoming payment.

3 887. On April 17, 2013, GPG and TelexFree entered into a Corporate Client
4 Payroll & Commission Processing and Payment Services Agreement, and it continued
5 to render TelexFree substantial assistance that was necessary for TelexFree's operation
6 to continue until at least January 16, 2014.

8 888. In the course of providing services to TelexFree, on August 13, 2013,
9 Defendant Borromei co-hosted an open webinar with Defendant Labriola, which
10 promoted GPG's payment system to TelexFree Investors and potential investors and
11 encouraged them to make further investments in TelexFree using GPG's system.

13 889. On August 16, 2013, Borromei hosted an additional open webinar, in
14 which he further promoted the payment system that GPG was providing to TelexFree,
15 and encouraged further investments in TelexFree using GPG's payment system.

17 890. On August 28, 2013, GPG received an email from Defendant Hughes,
18 president of Base Commerce, that included prior statements by ProPay characterizing
19 TelexFree as an extremely high-risk client and indicating that no United States bank or
20 processor would be willing to take on TelexFree as a client given this risk.

22 891. Despite previous correspondence indicating that it would cease doing
23 business with TelexFree by August 31, 2013, and the explicit instructions from its
24 "sponsor bank," Defendant Synovus, to cease performing any services for TelexFree by
25 August 31, 2013, GPG continued to provide services to TelexFree well after this date.
26

1 892. These services included permitting TelexFree to utilize GPG's electronic
2 payment conduit, or "GPG Gateway," to transmit credit card processing data to Allied
3 Wallet until at least January 16, 2014.

4 893. More particularly, in an email from GPG to Defendants Merrill, Wanzeler,
5 and Labriola, as well as Base Commerce, dated September 3, 2013, GPG's Jayme
6 Amirie indicated that, against the specific instructions of its sponsor bank, which had
7 instructed it to cease all services for TelexFree, GPG "sneaked" payouts from the bank
8 on TelexFree's behalf.⁹⁵

9
10 894. In his email of September 27, 2013 to Defendant Borromei and copied to
11 Merrill, GPG's Jayme Amirie acknowledged that "TelexFree can continue to use the
12 GPG gateway to transmit electronic data to Allied Wallet."⁹⁶

13
14 895. Pursuant to its obligations to perform initial and ongoing customer
15 monitoring of TelexFree, GPG's Regulatory Monitoring Office, employees and officers
16 discovered the Red Flags and evidence indicating that TelexFree was engaging in
17 suspicious, tortious or unlawful conduct.

18
19 896. As a result of GPG's required initial investigation and ongoing monitoring
20 of TelexFree, ProPay possessed actual knowledge that TelexFree was engaged in an
21 illegal Pyramid Scheme, yet they willfully chose to offer substantial assistance and
22 encouragement and directly became involved as described herein.

23
24 _____
25 ⁹⁵ See email from Jayme Amirie to James Merrill dated September 3, 2013, attached hereto and
26 marked as Exhibit 13.

⁹⁶ See email from Jayme Amirie to Jay Borromei dated September 27, 2013, attached hereto
and marked as Exhibit 14.

1 897. Although Defendant GPG and Borromei possessed knowledge of the
2 suspicious, tortious or illegal nature of TelexFree's business activities, at all times it
3 received or held TelexFree funds, it willfully acted in concert with them to:

- 4 • further the unlawful Pyramid Scheme;
- 5 • unfairly, deceptively and unlawfully siphon class member funds;
- 6 • unfairly, deceptively and unlawfully convert class member funds;
- 7 • continue to provide services integral to the TelexFree Scheme; and
- 8 • continue to provide TelexFree with substantial assistance and
9 encouragement essential to their unlawful plan.

10 898. Through its actions, GPG provided substantial assistance and
11 encouragement to TelexFree and otherwise became an integral part of TelexFree's
12 fraudulent Scheme. GPG also assisted TelexFree and its Principals to further achieve
13 their unfair, deceptive and unlawful Scheme that was at a minimum violative of M.G.L.
14 c. 93, § 69.

15 899. At a minimum, GPG's initial investigation and ongoing monitoring of
16 TelexFree, made it generally aware that TelexFree was engaged in tortious conduct, but
17 it deliberately and willfully turned a blind eye to the results of its investigation and
18 monitoring.

19 900. Although GPG possessed knowledge of the tortious nature of TelexFree's
20 business activities from the time of its initial investigation of TelexFree and during its
21 monitoring of TelexFree, it continued to promote and to provide TelexFree with
22 payment processing services integral to the TelexFree Scheme until at least January 16,
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2014.

3. Base Commerce

901. At all times material times, Defendants GPG, Base Commerce and Synovus shared a close business relationship, acting as payment processing partners and sharing information regarding customers, including TelexFree.

902. In April 2013, Defendants Merrill and Wanzeler, on behalf of TelexFree, submitted an application for payment processing services to Base Commerce, which also does business as Phoenix Payments, GPG's credit card processing partner.

903. Despite Base Commerce's knowledge of the suspicious, tortious or unlawful nature of TelexFree's business activities, Base Commerce agreed to accept TelexFree as a customer and began to perform payment processing services for TelexFree, which services it continued to perform until at least December 31, 2013.

904. Although TelexFree's application to Base Commerce for payment processing services requested the Social Security number and date of birth of Wanzeler and Merrill as co-owners of TelexFree, Wanzeler refused to provide his Social Security number and date of birth, which was a Red Flag that prompted Base Commerce to perform additional credit checks, or "pull credit," on both Merrill and Wanzeler.

905. Base Commerce's additional credit check involved running a "FraudDefender" search on TelexFree, which resulted in a score of 30/50 for TelexFree, indicating moderate risk, and score of 20/50 for Wanzeler, indicating moderately high risk.

1 906. The results of this “FraudDefender” search were an additional “red flag”
2 to Base Commerce and indicate its actual knowledge of TelexFree’s tortious conduct.

3 907. In an interoffice letter dated May 22, 2013, Defendant Hughes, president
4 of Base Commerce, noted that TelexFree was formerly known as Common Cents
5 Communications, stating:
6

7 [t]hat program paid people residual commissions for placing ads
8 online and the network marketing commentators accused them of
9 being a Ponzi scheme as the commission advertised appeared
 unrealistically high and therefore fictitious.

10 908. At that time, TelexFree was widely and prominently marketed and
11 advertised as a similar passive income scheme in which Members would be paid
12 commissions for placement of online advertisements.

13 909. In the same interoffice letter dated May 22, 2013, Hughes indicated that
14 TelexFree’s “current primary market” was Brazil, and that TelexFree would receive a
15 \$19 million annual receivable from Ympactus Comercial, Ltda, “a Brazilian Company
16 to whom they license their IOP System.”
17

18 910. Despite Base Commerce’s actual knowledge of TelexFree’s negative
19 press, its Brazilian investigation and the accusations of operating a Pyramid Scheme, it
20 ultimately accepted TelexFree’s application.
21

22 911. Beginning in June 2013, Base Commerce provided TelexFree with
23 payment processing services via an account held by Base Commerce’s “sponsor bank,”
24 Defendant Synovus, from which Base Commerce deducted its monthly processing,
25 chargeback, and other service fees.
26

1 912. The assistance that Base Commerce provided to TelexFree was
2 substantial. For example, Base Commerce's total deductions from the TelexFree
3 account for the months of June 2013 through January 2014, were as follows:

4 June 2013	\$340,106.76
5 July 2013	\$565,582.16
6 August 2013	\$1,164,038.56
7 September 2013	\$113,672.76
8 October 2013	\$99,326.90
9 November 2013	\$61,438.21
10 December 2013	\$108,181.78
11 January 2014	\$98,903.07

12 913. Base Commerce received instruction from its sponsor bank Defendant
13 Synovus to cease performing payment-processing services for TelexFree by August 31,
14 2013.
15

16 914. Only due to this pressure from Synovus, Hughes forwarded a letter to
17 Merrill on August 20, 2013, advising him that Base Commerce would terminate its
18 services with TelexFree "as of 5:00 PM Pacific Standard Time on August 31, 2013."⁹⁷
19

20 915. In a subsequent email from Hughes to Defendants Merrill, Wanzeler, and
21 Craft, as well as GPG, dated August 28, 2013, Hughes stated, regarding TelexFree
22

23 [we] have an MLM with a huge amount of negative news and
24 serious accusations. Hence, banks and processors are running

25
26 ⁹⁷ See Letter from John Hughes to James Merrill, dated August 20, 2013, attached herewith as Exhibit 15.

1 away based on what the FTC, Treasury Dept., FDIC and Justice
2 Dept. has done to them lately to include suing them,[sic] fining
3 them and freezing their settlement funds.⁹⁸

4 916. Hughes characterized TelexFree as an extremely high-risk client and
5 indicated that no United States bank or processor would be willing to take on TelexFree
6 as a client given this risk.⁹⁹

7 917. In the same email, in which Hughes also characterized TelexFree as “a
8 real hot-potato as they say,” Hughes indicated that Base Commerce had worked, and
9 was continuing to work, to find a replacement processor for TelexFree “such that
10 [TelexFree’s] business was not interrupted” and that he had arranged, via Defendant
11 Vantage Payments, for Defendant Allied Wallet, a United Kingdom-based payment
12 processor, to take over payment processing services for TelexFree.

13 918. Hughes also indicated that Base Commerce was actively applying to off-
14 shore banks on TelexFree’s behalf, noting “no US Bank or Processor, as evidenced by
15 the email from PROPAY [sic], will accept your business. . . .”¹⁰⁰

16 919. Hughes also offered Merrill business planning advice, which included
17 advising that TelexFree charge members for its \$1,425 AdCentral membership packages
18 by ACH instead of credit card.

19 920. In another email from Defendant Merrill to Hughes, also dated August 28,
20 2013, Merrill indicated that he believed that Base Commerce’s activity in soliciting off-
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25 ⁹⁸ See Exhibit 12, email from John Hughes to James Merrill, dated August 28, 2013.

26 ⁹⁹ See *id.*

¹⁰⁰ See Exhibit 12 email from John Hughes to James Merrill, dated August 28, 2013.

1 shore banking services on TelexFree's behalf was connected with TelexFree's desire to
2 separate its international, U.S.-based, and Brazil-based business among different banks
3 and processors.

4 921. In approximately August 2013, Defendant Sparman, managing partner of
5 Vantage Payments, was contacted by Hughes regarding TelexFree.
6

7 922. More particularly, Hughes asked Vantage Payments to act as a broker on
8 TelexFree's behalf, and to contact banks and processors with whom it had a business
9 relationship to secure payment-processing services for TelexFree, which services
10 Vantage Payments agreed to perform.
11

12 923. In an email from Hughes to Defendants Merrill and Wanzeler, dated
13 September 27, 2013, Hughes indicated that, against the instructions of Synovus, he had
14 authorized approximately \$5 million in transfers on September 26, 2013, stating:

15 "The bank is clearly not happy with me but we are still trying to do
16 the best job we can for you. Their concerns are that if, god forbid,
17 TelexFree came under a publicized FTC investigation, there could
18 be an indeterminate wave of chargeback's. . . ." ¹⁰¹

19 924. In September 2013, Base Commerce successfully applied to IPS, on
20 TelexFree's behalf, for TelexFree to receive its ACH processing services through IPS.
21 This went well beyond its role as a Financial Services Provider. By working in concert
22 with them to skirt the law, Base Commerce and Hughes became active participants in
23 TelexFree's unlawful operation.
24

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26 ¹⁰¹ See email from Hughes to Merrill, dated September 27, 2013, attached herewith as Exhibit 16.

1 925. Thereafter, TelexFree’s ACH processing was conducted by IPS, also
2 doing business as e-Wallet.

3 926. On or about October 10, 2013, Hughes reiterated to Merrill his concern
4 over the possibility of a FTC investigation.

5 927. In an email from Defendant Merrill to Hughes, dated January 16, 2014,
6 Merrill indicated that TelexFree, which was continuing to do business with GPG, was
7 having “a great deal of issues with GPG,” specifically, regarding TelexFree’s reserve
8 balance and cash flow in and out of GPG.

9 928. Hughes, on behalf of Base Commerce, responded that Base Commerce
10 was “happy to help” regarding TelexFree’s issue with GPG.

11 929. Despite the numerous Red Flags and evidence of suspicious, tortious or
12 unlawful activity that Base Commerce was aware of, and despite being instructed by its
13 sponsor bank to cease providing services by August 31, 2013, Base Commerce
14 continued to provide services to TelexFree.

15 930. These services included: processing transactions for TelexFree until at
16 least January 2014, connecting TelexFree with off-shore processors, applying for
17 accounts at off-shore banks on TelexFree’s behalf and providing advice and guidance
18 regarding TelexFree’s business operations. By working so in concert with them to skirt
19 the law, Base Commerce and Hughes became active participants in TelexFree’s
20 unlawful operation.

21 931. As a result of Base Commerce’s required initial investigation and ongoing
22 23 24 25 26

1 monitoring of TelexFree, Base Commerce and Hughes possessed actual knowledge that
2 TelexFree was engaged in an illegal Pyramid Scheme.

3 932. At a minimum, Base Commerce's initial investigation and ongoing
4 monitoring of TelexFree, made it generally aware that TelexFree was engaged in
5 tortious conduct, but it deliberately and willfully turned a blind eye to the results of its
6 investigation and monitoring.

8 933. Although Base Commerce and Hughes possessed knowledge of the
9 tortious nature of TelexFree's business activities from the time of its initial investigation
10 of TelexFree and during its monitoring of TelexFree, it continued to promote and to
11 provide TelexFree with payment processing services integral to the TelexFree Scheme.

13 934. Although Defendant Base Commerce and Hughes possessed knowledge
14 of the suspicious, tortious or illegal nature of TelexFree's business activities at all times
15 it received or held TelexFree funds, they willfully acted in concert with them to:
16

- 17 • further the unlawful Pyramid Scheme;
- 18 • unfairly, deceptively and unlawfully convert class member funds;
- 19 • continue to provide services integral to the TelexFree Pyramid
20 Scheme; and
- 21 • continue to provide TelexFree with substantial assistance and
22 encouragement essential to their unlawful business enterprise.

23 935. Through its actions, Base Commerce and Hughes provided substantial
24 assistance and encouragement to TelexFree and otherwise became an integral part
25 of TelexFree's Pyramid Scheme. Base Commerce and Hughes also assisted
26 TelexFree and its Principals to further achieve their unfair, deceptive and

1 unlawful Scheme that was at a minimum violative of M.G.L. c. 93, § 69.

2 **4. Vantage Payments**

3 936. Defendant Vantage Payments, which characterizes itself as an
4 “Independent Sales Agent,” served as a broker between TelexFree and other banks and
5 processors for purposes of securing payment-processing services.
6

7 937. Despite Vantage Payments’ knowledge of the suspicious, tortious or
8 unlawful nature of TelexFree’s business activities and operation, Vantage Payments
9 agreed to accept TelexFree as a customer in August 2013 and began to solicit payment
10 processing services on behalf of TelexFree, which services it continued to perform up to
11 the time that TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc. declared
12 bankruptcy in April 2014.
13

14 938. In approximately August 2013, Defendant Sparman, managing partner of
15 Vantage Payments, was contacted by Defendant Hughes of Base Commerce regarding
16 TelexFree, asking it to act as a broker on TelexFree’s behalf and to contact banks and
17 processors with whom it had a business relationship to secure payment processing
18 services for TelexFree, which services Vantage Payments agreed to perform.
19

20 939. Thereafter, Vantage Payments contacted Defendant Allied Wallet, and
21 applied on TelexFree’s behalf for Allied Wallet to provide payment-processing services
22 to TelexFree.
23

24 940. Vantage Payments also contacted an additional payment processor based
25 in the United Kingdom, who, at that time, refused to provide services to TelexFree due
26

1 to known accusations of fraud regarding TelexFree's operations.

2 941. Vantage Payments was able to secure Allied Wallet's agreement to
3 provide payment processing services to TelexFree, pursuant to which agreement Allied
4 Wallet would provide a "processing account" and process both incoming and outgoing
5 payments for the benefit of TelexFree, among other services.¹⁰²
6

7 942. In connection with TelexFree's agreement with Allied Wallet, Defendant
8 Merrill instructed Allied Wallet to transfer funds from TelexFree's processing account
9 with Allied Wallet to accounts with Fidelity Bank.
10

11 943. Vantage Payments, on behalf of TelexFree, also registered an entity in the
12 United Kingdom, known as "TelexFree, LTD," to serve as TelexFree's EU-based
13 operation.
14

15 944. In fact, as Vantage Payments was aware, "TelexFree, LTD" was a shell
16 company with no physical presence beyond a mere address.

17 945. On or about October 10, 2013, Allied Wallet informed TelexFree that, due
18 to an increase in both payment volume and chargebacks, it would be increasing the
19 rolling reserve on TelexFree's processing account to 20%.
20

21 946. Thereafter, Vantage Payments negotiated extensively with Allied Wallet
22 on TelexFree's behalf, to have this rolling reserve reduced.

23 947. These negotiations entailed, *inter alia*, Sparman meeting personally with
24 the CEO of Allied Wallet in Los Angeles, California on TelexFree's behalf.
25

26 ¹⁰² See Allied Wallet Card Payment Processing Agreement, dated August 26, 2013, attached
herewith and marked as Exhibit 17.

1 948. Ultimately, after extensive lobbying by Vantage Payments on TelexFree's
2 behalf, Allied Wallet agreed to reduce its rolling reserve on the TelexFree processing
3 account to 10%, and also agreed to increase the maximum processing volume on the
4 account

5 949. On or about November 13, 2013, Sparman, on behalf of Vantage
6 Payments, and acting on behalf of TelexFree, once again contacted another United
7 Kingdom-based payment processor in hopes of securing TelexFree additional payment
8 processing volume.¹⁰³

9 950. This effort was ultimately unsuccessful, as this additional United
10 Kingdom-based payment processor declined to perform services for TelexFree in light
11 of the accusations of fraud and illegality surrounding TelexFree.

12 951. The foregoing activities were beyond the scope of Vantage Payments' role
13 as a Financial Services Provider. By working so in concert with the indicted parties to
14 skirt the law, Vantage Payments and Sparman were active participants in TelexFree's
15 unlawful operation.

16 952. By agreement with TelexFree, Vantage Payments also provided TelexFree
17 with access to its Customer Dispute Resolution Network ("CDRN") Portal to Verifi by
18 Visa's CDRN, the purpose of which was to provide TelexFree with the capability to
19 address issues relating to customer payment disputes.¹⁰⁴

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25 ¹⁰³ See email from Dustin Sparman to James Merrill, dated November 13, 2013, attached hereto
and marked as Exhibit 18.

26 ¹⁰⁴ See Vantage Payments CDRN Portal Agreement, attached hereto and marked as Exhibit 19.

1 953. TelexFree executed a CDRN Portal Agreement with Vantage Payments
2 on December 5, 2013.

3 954. This authorized TelexFree to make use of Vantage Payments' online
4 CDRN portal for processing of ACH and credit card transactions.

5 955. In return for these services, Vantage Payments charged TelexFree a flat
6 rate of \$40 per transaction.

7 956. In connection with this Agreement, Merrill authorized Vantage Payments
8 to transmit all incoming payments to the account of TelexFree, Inc. at Fidelity Bank.

9 957. Vantage Payments continued to provide TelexFree with these portal
10 access services until at least March 13, 2014.

11 958. In an email from Defendant Merrill to Sparman, dated January 15, 2014,
12 Merrill stated, regarding dividing TelexFree's payment processing between Vantage
13 Payments and IPS, "[T]here will be plenty of business to go around. You deserve your
14 share for getting us started... Whomever treats us best will get most of the business."¹⁰⁵

15 959. Despite having direct knowledge of the shutdown of TelexFree in Brazil
16 and Rwanda, the United Kingdom scam warning against TelexFree, well-publicized
17 accusations of fraud and illegality on the part of TelexFree, and an enormous number of
18 Red Flags and indicia of the suspicious, tortious or unlawful nature of TelexFree's
19 business operations, Vantage Payments continued to provide processing and processing-
20 related services to TelexFree up to the time that TelexFree, LLC, TelexFree, Inc., and
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26 ¹⁰⁵ See email from James Merrill to Dustin Sparman, dated January 15, 2014, attached hereto and marked as Exhibit 20.

1 TelexFree Financial, Inc. declared bankruptcy in April 2014.

2 960. Although Defendant Vantage Payments possessed knowledge of the
3 suspicious, tortious or illegal nature of TelexFree's business activities at all times it
4 received or held TelexFree funds, they willfully acted in concert with them to:

- 5 • further the unlawful Pyramid Scheme;
- 6 • unfairly, deceptively and unlawfully convert class member funds;
- 7 • continue to provide services integral to the TelexFree Pyramid
- 8 Scheme; and
- 9 • continue to provide TelexFree with substantial assistance and
- 10 encouragement essential to their unlawful business enterprise.

11 961. Through its actions, Vantage Payments provided substantial assistance
12 and encouragement to TelexFree and otherwise became an integral part of TelexFree's
13 Pyramid Scheme. Vantage Payments also assisted TelexFree and its Principals to
14 further achieve their unfair, deceptive and unlawful Scheme that was at a minimum
15 violative of M.G.L. c. 93, § 69.

16 962. At a minimum, Vantage Payments' initial investigation and ongoing
17 monitoring of TelexFree, made it generally aware that TelexFree was engaged in
18 suspicious, tortious or unlawful conduct, but it deliberately and willfully turned a blind
19 eye to the results of its investigation and monitoring.

20 963. Although Vantage Payments possessed knowledge of the tortious nature
21 of TelexFree's business activities from the time of its initial investigation of TelexFree
22 and during its monitoring of TelexFree, it continued to promote and to provide
23 TelexFree with payment processing services integral to the TelexFree Scheme until at
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1 to an increase in both payment volume and chargebacks, it would be increasing the
2 rolling reserve on TelexFree's processing account to 20%.

3 970. Thereafter, Vantage Payments negotiated extensively with Allied Wallet
4 on TelexFree's behalf, to have this rolling reserve reduced.

5 971. These negotiations entailed, *inter alia*, Sparman meeting personally with
6 the CEO of Allied Wallet in Los Angeles, California on TelexFree's behalf.

7 972. Ultimately, after extensive lobbying by Vantage Payments on TelexFree's
8 behalf, Allied Wallet agreed to reduce its rolling reserve on the TelexFree processing
9 account to 10%, and also agreed to increase the maximum processing volume on the
10 account to 10%, and also agreed to increase the maximum processing volume on the
11 account.

12 973. Allied Wallet also made transfers from TelexFree's corporate accounts to
13 private accounts held in the names of Defendant Founders, despite knowledge of the
14 suspicious, tortious or unlawful nature of TelexFree's business enterprise and
15 operations.
16

17 974. Despite having direct knowledge of the shutdown of TelexFree in Brazil
18 and Rwanda, the United Kingdom scam warning against TelexFree, well-publicized
19 accusations of fraud and illegality on the part of TelexFree, and an enormous number of
20 Red Flags and indicia indicating the suspicious, tortious or unlawful nature of
21 TelexFree's operations, Allied Wallet continued to provide processing and processing-
22 related services to TelexFree up to the time that TelexFree, LLC, TelexFree, Inc., and
23 TelexFree Financial, Inc. declared bankruptcy in April 2014.
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1 975. Although Defendant Allied Wallet possessed knowledge of the
2 suspicious, tortious or illegal nature of TelexFree's business activities at all times it
3 received or held TelexFree funds, it willfully acted in concert with TelexFree to:

- 4 • further the unlawful Pyramid Scheme;
- 5 • unfairly, deceptively and unlawfully convert class member funds;
- 6 • continue to provide services integral to the TelexFree Pyramid
- 7 Scheme; and
- 8 • continue to provide TelexFree with substantial assistance and
- 9 encouragement essential to their unlawful business enterprise.

10 976. Through its actions, Allied Wallet provided substantial assistance and
11 encouragement and otherwise became an integral part of TelexFree's Pyramid Scheme.
12 Allied Wallet also assisted TelexFree and its Principals to further achieve their unfair,
13 deceptive and unlawful Scheme that was at a minimum violative of M.G.L. c. 93, § 69.

14 977. At a minimum, Allied Wallet's initial investigation and ongoing
15 monitoring of TelexFree, made it generally aware that TelexFree was engaged in
16 suspicious, tortious or unlawful conduct, but it deliberately and willfully turned a blind
17 eye to the results of its investigation and monitoring.

18 978. Although Allied Wallet possessed knowledge of the tortious nature of
19 TelexFree's business activities from the time of its initial investigation of TelexFree and
20 during its monitoring of TelexFree, it continued to promote and to provide TelexFree
21 with payment processing services integral to the TelexFree Scheme until at least April
22 2014.

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26 **6. IPS**

1 979. In September 2013, Defendant Base Commerce successfully applied to
2 IPS, on TelexFree's behalf, for TelexFree to receive its ACH processing services
3 through IPS.

4 980. Thereafter, TelexFree's ACH processing was conducted by IPS, also
5 doing business as e-Wallet.
6

7 981. In approximately December 2013, TelexFree entered into a further
8 agreement with IPS for additional payment processing services, under the name and
9 address of "TelexFree, LTD," the shell company established by Vantage Payments.¹⁰⁷
10

11 982. Thereafter, beginning in approximately January 2014, IPS provided
12 TelexFree with a service titled "e-Wallet," which was used by TelexFree for additional
13 processing of funds transferred by Promoters to TelexFree.

14 983. IPS performed an investigation of TelexFree prior to agreeing to accept
15 TelexFree as a customer and its initial investigation and ongoing monitoring of
16 TelexFree revealed indicia of fraud and illegality, or Red Flags, and other evidence of
17 fraud cited above.
18

19 984. Given IPS's knowledge of the illegal nature of TelexFree's business
20 operations, IPS was obligated to refuse to open any accounts or process any transactions
21 for the benefit of TelexFree.
22

23 985. Despite IPS's knowledge of the illegal nature of TelexFree's business
24 activities, IPS agreed to accept TelexFree as a customer and began to perform payment
25

26 ¹⁰⁷ See email from Sparman to Merrill, dated December 27, 2013, attached herewith as Exhibit 21.

1 processing services for TelexFree in September 2013.

2 986. IPS has a history of representing Ponzi schemes. Prior clients include the
3 well-publicized Ponzi schemes Spinding, Wealth4AllTeam, Primus Hub, (an attempted
4 reboot of Wealth4AllTeam following Wealth4AllTeam's collapse), Funky Shark (a
5 planned Ponzi scheme that shut down prior to launch after receiving legal advice and a
6 \$40,000 fine), Team Vinh International, MyAdvertisingPays (a 120% return-on-
7 investment advertising-based Ponzi scheme, similar to TelexFree), Diamond Banners,
8 Argent Network (which was advertised as advertised as "a mixture of Zeek Rewards
9 and TelexFree"), and 1BuckAdShare.
10
11

12 987. Despite the overwhelming evidence of TelexFree's fraudulent activities,
13 in an October 2013 public statement to the news website *BehindMLM.com*, IPS
14 audaciously stated that they had "done a complete due diligence on TelexFree" and
15 "confirmed the product as compliant with all US laws." This activity was beyond the
16 scope of its role as a Financial Services Provider. By publicly endorsing their business
17 model, IPS became an active participant in TelexFree's unlawful operation.
18

19 988. On or about February 12, 2014, IPS announced that they were partnering
20 with MLM attorney Kevin Thompson of Thompson Burton, PLLC, to "provide up-to-
21 date compliance guidance to their new and existing clients in the Direct Selling and
22 Multi-Level Marketing industry."
23

24 989. TelexFree was a recipient of such "compliance guidance" services.

25 990. According to a TelexFree balance sheet, dated December 31, 2013, posted
26

992. Thereafter, in place of the previous e-Wallet online interface, IPS posted a message online stating that TelexFree's payment processing services had been disabled, and suggested that this could be due to TelexFree having "violated Anti-Money Laundering policies."

994. Although Defendant IPS possessed knowledge of the suspicious, tortious or illegal nature of TelexFree's business activities at all times it received or held TelexFree funds, it willfully acted in concert with TelexFree to:

208

- further the unlawful Pyramid Scheme;
- unfairly, deceptively and unlawfully convert class member funds;
- continue to provide services integral to the TelexFree Pyramid Scheme; and
- continue to provide TelexFree with substantial assistance and encouragement essential to their unlawful business enterprise.

995. Through its actions, IPS provided substantial assistance and encouragement and otherwise became an integral part of TelexFree's Pyramid Scheme. IPS also assisted TelexFree and its Principals to further achieve their unfair, deceptive and unlawful Scheme that was at a minimum violative of M.G.L. c. 93, § 69.

996. At a minimum, IPS's initial investigation and ongoing monitoring of TelexFree, made it generally aware that TelexFree was engaged in suspicious, tortious or unlawful conduct, but it deliberately and willfully turned a blind eye to the results of its investigation and monitoring.

997. Although IPS possessed knowledge of the suspicious, tortious or unlawful nature of TelexFree's business activities from the time of its initial investigation of TelexFree and during its monitoring of TelexFree, it continued to promote and to provide TelexFree with payment processing services integral to the TelexFree Scheme until April 17, 2014.

998. Each of the Financial Services Providers failed to timely or adequately respond to information relating to TelexFree, or persons or entities it was related to, and as a direct and proximate result caused each member of the putative class to similarly suffer ascertainable economic harm.

1 999. Various persons or entities that are not named as Defendants herein have
2 participated as co-conspirators or aiders and abettors in the violations and other claims
3 alleged herein and have performed acts and made statements in furtherance thereof.
4 These persons or entities have directly participated because they have facilitated,
5 adhered to, and/or communicated with others regarding the Pyramid Scheme or offered
6 substantial assistance or encouragement. Plaintiffs reserve the right to name some or all
7 of these persons as Defendants at a later date.
8

9 1000. Plaintiffs and the putative class representatives seek to obtain damages,
10 restitution and injunctive relief for the Class, as defined, below, from Defendants.
11

12 **IV. CLASS ACTION ALLEGATIONS**

13 1001. Under Rule 23 of the Federal Rules of Civil Procedure, Plaintiffs sue on
14 their own behalf, and on behalf of all other persons similarly situated (the “Plaintiff
15 Class”). The Plaintiff Class that Plaintiffs seek to represent is:
16

17 All persons residing in the United States who purchased TelexFree
18 AdCentral or AdCentral Family packages and suffered a Net Loss¹⁰⁹
19 during the period from January 1, 2012 to April 16, 2014 (the “Class
20 Period”).

21 1002. Excluded from the Plaintiff Class are Defendants and their officers,
22 directors, and employees; any entity in which any Defendant has a controlling interest;
23 the co-conspirators, the so-called Top Level Promoters, legal representatives, attorneys,
24 heirs, and assigns of Defendants.

25
26 ¹⁰⁹ A Plaintiff Class member suffered a “Net Loss” if he or she invested more funds than he or she withdrew.

1 1003. The Plaintiff Class meets the requirements of Federal Rules of Civil
2 Procedure 23(a) because the members of the Plaintiff Class are so numerous that the
3 joinder of all members is impractical. While the exact number of Plaintiff Class
4 members is unknown to Plaintiffs, it is estimated to be in the hundreds of thousands.
5

6 1004. The Plaintiff Class meets the requirements of Federal Rules of Civil
7 Procedure 23(a) because there is a well-defined community of interest among the
8 members of the Plaintiff Class, common questions of law and fact predominate,
9 Plaintiffs' claims are typical of the members of the Plaintiff Class, and Plaintiffs can
10 fairly and adequately represent the interests of the Class.
11

12 1005. This action satisfies the requirements of Federal Rule of Civil Procedure
13 23(b)(3) because it involves questions of law and fact common to the members of the
14 Plaintiff Class that predominate or questions affecting only individual members,
15 including, but not limited to:
16

- 17 • whether TelexFree operated an unlawful Pyramid Scheme;
- 18 • whether the class of Direct Victim Payment Recipients was
19 unjustly enriched;
- 20 • whether the funds paid by the Plaintiff Class directly to the
21 Defendant Class must be repaid, without regard to the individual
22 circumstances of participation in the Scheme, because it constituted
unjust enrichment;
- 23 • whether TelexFree ran an unlawful Pyramid Scheme or a legitimate
24 business;
- 25 • whether TelexFree ran a lawful MLM program or an unlawful
26 pyramid Scheme;

- whether each Defendant knew that TelexFree was an illegal Pyramid Scheme, yet continued to aid, abet and further such illegal activities or are otherwise liable for the economic loss suffered by the Putative Class;
- whether the aid that each Defendant provided was a substantial in the context of aiding and abetting;
- was TelexFree a “multi-level distribution company” as defined by Massachusetts General Laws Chapter 93, Section 69(a);
- did the standard TelexFree Pre-March 9 Contract contain promises to pay merely for the recruitment of new members in violation of Massachusetts General Laws Chapter 93, Section 69(a);
- did the standard TelexFree Pre-March 9 Contract contain offers to pay a “finder’s fee, bonus, refund, override, commission, cross-commission, dividend or other consideration” to Participants in the TelexFree Program in violation of Massachusetts General Laws Chapter 93, Section 69(a);
- did the TelexFree Program offer its Members payment without requiring them to engage in any “bona fide and essential supervisory, distributive, selling or soliciting” nor exercise any “judgment,” “skill,” or “control over the operation in violation of Massachusetts General Laws Chapter 93, Section 69(a);
- did each of the Financial Services Defendants have actual knowledge of TelexFree’s suspicious, tortious or unlawful activities;
- when did each of the Financial Services Defendants have actual knowledge of TelexFree’s suspicious, tortious or unlawful activities;
- whether TelexFree’s Financial Services Providers, including the aforesaid banking institutions and payment processing services providers aided and abetted TelexFree’s Pyramid Scheme;
- whether TelexFree violated M.G.L. c. 93A;
- whether Massachusetts’ Blue Sky Laws will apply to the claims of the Putative Class;

- whether TelexFree violated M.G.L. c. 110A, § 410 - Massachusetts' Blue Sky Laws;
- whether certain Defendants used and employed manipulative and deceptive devices and contrivances in violation of M.G.L. c. 110A, § 410; used means and instrumentalities, directly and indirectly, for the purchase and sale of unregistered securities; and used and employed manipulative and deceptive devices and contrivances in violation of the Massachusetts Uniform Securities Act, M.G.L. c. 110A, § 410(b) and M.G.L. c. 93A;
- whether TelexFree mailed fraudulent and inaccurate 1099 (Miscellaneous Income) forms to investors;
- whether the 1099 (Miscellaneous Income) forms should be declared void as a matter of law;
- whether Defendants' conduct violated any of the articulated Massachusetts state common laws; and
- whether Plaintiff and the Class are entitled to damages, civil penalties, punitive damages, and/or injunctive relief.

1006. Plaintiffs' claims are typical of those of other Plaintiff Class members because Plaintiffs were defrauded by Defendants' common Scheme.

1007. Plaintiffs will fairly and accurately represent the interests of the Plaintiff Class.

1008. The prosecution of separate actions by individual members of the Plaintiff Class would create a risk of inconsistent or varying adjudications regarding individual members of the Plaintiff Class, which would establish incompatible standards of conduct for Defendants and would lead to repetitive adjudication of common questions of law and fact.

1009. Class treatment is superior to any other method for adjudicating the

1 controversy. Plaintiffs know of no difficulty likely to be encountered in the
2 management of this litigation that would preclude its maintenance as a class action
3 under Rule 23(b)(3).

4 1010. Damages for any individual class member likely cannot justify the cost of
5 individual litigation, so that absent class treatment, the Defendants' violations of law
6 inflicting substantial damages in the aggregate would go un-remedied without
7 certification of the Plaintiff Class.
8

9 1011. Defendants have acted or refused to act on grounds that apply to the
10 Plaintiff Class, as alleged above, and certification is proper under Rule 23(b)(2).
11

12 **V. DEFENDANT CLASS ALLEGATIONS**

13 1012. Plaintiffs also bring a portion of this action as a defendant class action
14 pursuant to Federal Rules of Civil Procedure 23(a) and (b)(1)(A) and (B) against a class
15 consisting of all persons or entities who (1) were Net Winners and (2) received at least
16 one Direct Victim Payment from Plaintiffs or those similarly situated.
17

18 1013. The members of the putative Defendant Class are so numerous that
19 joinder of all members is impracticable. Upon information and belief, there are in
20 excess of 20,000 members of the putative Defendant Class. Any potential
21 dissimilarities among the members of the proposed Defendant Class do not impair the
22 ability to reach a common resolution to the core issues of law and fact in this case.
23

24 1014. The named Defendant Shoyfer, who qualifies as a Net Winner Defendant
25 and who was among the largest Net Winners of the TelexFree Scheme and is already a
26

1 party to this action, should be appointed, without cost to the class as representative of
2 the class of Direct Victim Payment Recipients (the “Defendant Class Representative”).

3 1015. The putative Defendant Class Representative Shoyfer and each similarly
4 situated member of the Defendant Class participated in the same events and courses of
5 conduct that has given rise to the Defendant Class. Specifically, they each participated
6 in the TelexFree Pyramid Scheme, they were Net Winners, and they received at least one
7 Direct Victim Payment from members of the Plaintiff Class.
8

9 1016. The putative Defendant Class Representative Shoyfer shares the same
10 defenses against liability for repayment of the ill-gotten proceeds taken from the
11 Plaintiff Class, and the common legal and factual questions do not depend on the
12 personal circumstances of any particular member of the putative Defendant Class .
13

14 1017. The putative Defendant Class Representative is among the largest Net
15 Winners. Defendant Shoyfer reported earning \$300,000 per week and acquired lavish
16 properties in Florida and New York. Shoyfer has a sufficient stake in the outcome to
17 bear the burdens of the litigation. He has retained counsel to mount his defense. The
18 Defendant Class Representative will be an adequate and appropriate representative of
19 the Defendant Class in the course of and by virtue of his own defense to the same
20 claims. Because he has substantially more (or certainly at least as much) incentive to
21 vigorously defend against Plaintiffs’ claims for return of his unjustly-received monies as
22 any unnamed member of the Defendant Class, this defendant will fairly and adequately
23 protect and represent the interests of the unnamed members of the Defendant Class
24
25
26

1 because his interests are not antagonistic to, but rather aligned with, the interests of the
2 unnamed class members. The putative Defendant Class Representative shares common
3 objectives and the same factual and legal positions and has the same interest in
4 defending against liability as does each member of the putative Defendant Class.

5
6 1018. There are questions of law and fact that are common to the Defendant
7 Class. These questions include, but are not limited to the common questions identified
8 in Section IV., *supra*, as well as the question of the legal liability of Direct Victim
9 Payment Recipients for their net winnings under unjust enrichment theories. Resolution
10 of the identical primary legal and factual issues will prove dispositive for each member
11 of the putative Defendant Class. The efficiency of one action in which all parties can
12 argue their case and assert their rights will benefit the Plaintiff Class and all members of
13 the Defendant Class and so satisfy the intent of Rules 23(b)(1)(A) and (b)(1)(B). Larger
14 Direct Victim Payment Recipients may chose to opt out and defend themselves, and
15 smaller Direct Victim Payment Recipients will realize the benefit of cost sharing.

16
17
18 1019. The claims against and anticipated defenses of the Defendant Class
19 Representative are typical of the claims against and anticipated defenses of the unnamed
20 members of the Defendant Class. Like the Defendant Class Representative, each of the
21 Direct Victim Payment Recipients voluntarily participated in the TelexFree Scheme as
22 affiliates and received more money in connection with the TelexFree Program than they
23 paid in to TelexFree during the course of their participation. In addition, each Direct
24 Victim Payment Recipient received their funds in the course of and in connection with
25
26

1 a common Scheme. The claims for return of Direct Victim Payments that constitute
2 “net winnings” against all the Direct Victim Payment Recipients are the same and
3 should be calculated the same way for all class members. The nature of the defenses
4 that may be asserted by the Defendant Class Representative also would be the same, as
5 liability for the wrongful funds received from the TelexFree Scheme does not depend on
6 the personal circumstances of particular affiliates (other than in the mathematical
7 calculation of the amount of their liability, which will be resolved independently of the
8 determination of liability).

10
11 1020. The prosecution of separate actions against individual members of the
12 Direct Victim Payment Defendant Class would create a risk of inconsistent or varying
13 adjudications regarding individual members of the Direct Victim Payment Defendant
14 Class, which would establish incompatible standards of conduct for Defendants and
15 would lead to repetitive adjudication of common questions of law and fact.

17 1021. Further, as a practical matter, the cost and difficulty of defending against
18 separate suits following the adjudication of the common questions of fact and law
19 related to TelexFree and the liability of the members of the proposed Defendant Class
20 for Direct Victim Payments that constitute “net winnings” would be dispositive of or
21 substantially impair the interests of the unnamed members of the putative Defendant
22 Class.
23
24
25
26

VI. CLAIMS FOR RELIEF

FIRST CLAIM FOR RELIEF

**VIOLATIONS OF MASSACHUSETTS GENERAL LAWS,
CHAPTER 93, SECTIONS 12 and 69
(Against All Operational Defendants)**

1022. Plaintiffs incorporate by reference all allegations in all previous paragraphs, as though fully set forth here.

1023. The Operational Defendants were engaged in acts in violation of Massachusetts General Laws Chapter 93, Section 69.

1024. Massachusetts General Laws Chapter 93, Section 12 provides for a private right of action for violations of Chapter 93, Section 69.

1025. In consequence of said Defendants' violative conduct, Plaintiffs and the Putative Class have suffered great financial losses, and have also incurred considerable expenses and loss of income, and have otherwise been greatly damaged.

1026. In consequence of said Defendants' violative conduct or other unfair and deceptive acts and practices, Plaintiffs and the Putative Class have been similarly caused to suffer ascertainable economic loss, have incurred expense and have otherwise been similarly damaged. Because the Operational Defendants' violations of Massachusetts General Laws Chapter 93, Section 69 were engaged in with malicious intent to injure the members of the Putative Class, the Class is entitled to (up to) three times the amount of actual damages sustained, together with the costs of suit, including reasonable attorneys' fees.

SECOND CLAIM FOR RELIEF
VIOLATIONS OF MASSACHUSETTS GENERAL LAWS,
CHAPTER 93A, SECTIONS 2 AND 11
(Against All Operational Defendants)

1027. Plaintiffs incorporate by reference all allegations in all previous paragraphs, as though fully set forth here.

1028. All Operational Defendants were engaged in “trade” and “commerce” as defined by Massachusetts General Laws Chapter 93A, Section 1.

1029. Plaintiffs and the Putative Class were engaged in “trade” and “commerce” as defined by Massachusetts General Laws Chapter 93A, Section 1.

1030. The transactions, actions or inaction of the Operational Defendants constitute unfair and deceptive acts and practices as defined by, and in violation of, Massachusetts General Laws, Chapter 93A, Sections 2 and 11.

1031. In addition, said Defendants engaged in acts in violation of Massachusetts General Laws Chapter 93, Section 69. Pursuant to Chapter 93, Section 69(g) any violation of the provisions of M.G.L. c. 93, section 69 shall constitute an unlawful method, act or practice within the meaning of clause (a) of section two of chapter ninety-three A.

1032. As a result, the foregoing transactions, actions and inactions of said Defendants thereby constitute per se an unlawful method, act or practice within the meaning of Massachusetts General Laws, Chapter 93A, Section 2(a) by operation of Massachusetts General Laws, Chapter 93, Section 69(g).

1033. The foregoing transactions, actions and inactions of said Defendants

1 thereby constitute per se unfair and deceptive acts and practices as defined by, and in
2 violation of, Massachusetts General Laws Chapter 93A, §§ 2 and 11.

3 1034. In consequence of said Defendants' violative acts, and unfair methods of
4 competition or unfair or deceptive acts or practices, Plaintiffs and the Putative Class
5 have been similarly caused to suffer ascertainable economic loss, have incurred expense
6 and have otherwise been similarly damaged. The Operational Defendants' violations of
7 Massachusetts General Laws Chapter 93A, Section 69 were willful or knowing, and the
8 Class is otherwise entitled to (up to) three times the amount of actual damages
9 sustained, together with the costs of suit, including reasonable attorneys' fees.
10
11

12 **THIRD CLAIM FOR RELIEF**

13 AIDING AND ABETTING VIOLATIONS OF MASSACHUSETTS GENERAL
14 LAWS, CHAPTER 93, SECTIONS 12 and 69, AND MASSACHUSETTS GENERAL
15 LAWS, CHAPTER 93A, SECTIONS 2(a) or 11

(Against TelexFree And All Defendants Except The Defendant Class)

16 1035. Plaintiffs incorporate by reference all allegations in all previous
17 paragraphs, as though fully set forth here.

18 1036. As described above, to comply with federal anti-money laundering and
19 other banking laws, the Financial Services Provider Defendants, including Bank of
20 America, TD Bank, Fidelity Bank, Wells Fargo, Citizens Bank, Synovus, GPG, IPS,
21 ProPay, Base Commerce, Vantage Payments, Allied Wallet and individual defendants
22 John F. Merrill, John Hughes and Dustin Sparman, must understand their customers'
23 business model and must know their clients.
24
25

26 1037. Under the attendant facts, any application of the mandated Know-Your-

1 Customer Regulations by each of the Financial Services Providers obviously included
2 evaluating whether TelexFree's business model and operations violated Massachusetts
3 General Laws Chapter 93, Section 69.

4 1038. Violations of Massachusetts General Laws c. 93, § 69 are per se violations
5 of Massachusetts General Laws Chapter 93A, Section 2(a).
6

7 1039. Under the attendant facts, that TelexFree violated Massachusetts General
8 Laws Chapter 93, Section 69 during 2013 and 2014 was obvious or at a minimum
9 apparent, to the sophisticated eye, as focused by the FFIEC, of the Financial Services
10 Providers.
11

12 1040. As described herein, TelexFree and the Operational Defendants, except
13 for Katia Wanzeler, otherwise violated MGL c. 93A.

14 1041. Massachusetts General Laws Chapter 93, Sections 12 and 69 and
15 Massachusetts General Laws Chapter 93A created a duty carried by TelexFree and each
16 of the Operational Defendants that inured to the benefit of the putative class.
17

18 1042. The Operational Defendants and the Financial Services Providers knew
19 that TelexFree's conduct was suspicious, tortious, unlawful, and constituted a breach of
20 duty owed to each member of the putative class.
21

22 1043. The Operational Defendants and the Financial Services Providers knew
23 that TelexFree Program violated Massachusetts General Laws Chapter 93, Sections 12
24 and 69 and that TelexFree's conduct was unfair, deceptive, suspicious, tortious, and
25 unlawful constituted a breach of duty owed to each member of the putative Class.
26

1 1044. During the TelexFree Pyramid Scheme, the Financial Services Providers
2 provided essential financial services to TelexFree, the Operational Defendants, and each
3 other, which substantially assisted and enabled them to carry on their unlawful, unfair,
4 and deceptive Pyramid Scheme notwithstanding the presence of suspicious, tortious or
5 illegal activity on TelexFree's part.
6

7 1045. As described herein, the assistance and encouragement given to TelexFree
8 by the Financial Services Providers to conduct its business operations was essential
9 because TelexFree's business operations were entirely dependent on them.
10

11 1046. For example, without the indispensable services provided by the Financial
12 Services Providers, TelexFree would not have been able to accept, process or
13 misappropriate the funds invested by the putative class.
14

15 1047. Without the indispensable services provided by the Financial Services
16 Providers, TelexFree would not have been able to otherwise open shop in the United
17 States , develop and maintain its unlawful business operations.
18

19 1048. As described herein, the assistance and encouragement given to TelexFree
20 by the Financial Services Providers to conduct its business operations was substantial.
21 According to an investigation by the SOC, in 2012 and 2013 TelexFree identified
22 4,845,576 VoIP Program transactions totaling \$238,395,353.80. Over the same period,
23 TelexFree received 783,771 package purchases of either \$289 or \$1,375 totaling
24 \$880,189,455.32.
25

26 1049. Each Defendant, while knowing that the other's conduct provided

1 essential and substantial encouragement to TelexFree, the Operational Defendants, and
2 each other, substantially assisted and enabled them to carry on their unlawful, unfair,
3 and deceptive Pyramid Scheme notwithstanding the presence of suspicious, tortious or
4 illegal activity on TelexFree's part.

5
6 1050. Each Defendant provided substantial assistance and/or encouragement to
7 the other Defendants in committing the violations of M.G.L. c. 93, § 69 and M.G.L.
8 c. 93A alleged herein, and did so with unlawful intent and knowledge that such parties
9 were perpetuating a fraudulent and illegal Pyramid Scheme, and yet continued to
10 substantially assist or encourage said Scheme.

11
12 1051. Each Defendants rendered this substantial assistance despite their
13 knowledge that TelexFree's operations constituted an unlawful, unfair, deceptive and
14 unsustainable Pyramid Scheme and violated M.G.L. c. 93 § 69 and M.G.L. c. 93A.

15
16 1052. Such substantial assistance was rendered by Defendants despite their
17 knowledge of the illegal nature of TelexFree's operations, is detailed within this
18 complaint and includes, but is not limited to:

- 19
20 a. managing and controlling TelexFree and its affiliated entities;
21 b. providing accounting services to TelexFree;
22 c. providing legal services to TelexFree;
23 d. publicly certifying that TelexFree's business model and
24 operations were legal, proper, and economically viable and
25 sustainable;
26

- e. providing banking, investment and asset management services for TelexFree and its management;
- f. promoting TelexFree AdCentral packages;
- g. continuing to provide financial services following the Brazilian Court's injunction to stop TelexFree's business in Brazil;
- h. processing payments to, from, and on behalf of TelexFree and its affiliated entities;
- i. processing payments for transfers of funds which deepened TelexFree's insolvency;
- j. making transfers from TelexFree's corporate accounts to private accounts held in the names of Defendant Founders, despite knowledge of the fraudulent nature of TelexFree's business enterprise;
- k. investing ill-gotten funds for the benefit of TelexFree's Founders, despite knowledge of the suspicious, tortious or illegal nature of TelexFree's business enterprise;
- l. providing TelexFree's Founders with cashier's checks in amounts totaling millions of dollars and purchased using funds in TelexFree's corporate accounts;
- m. providing credit to TelexFree;
- n. participating in a cover-up by knowingly failing and/or refusing

1 to report the results of such financial services provider's own
2 investigation of TelexFree to the proper authorities, despite the
3 suspicious, tortious or illegal activity revealed by such
4 investigation;

- 5 o. soliciting financial services for the benefit of TelexFree;
- 6 p. negotiating with financial services providers on TelexFree's
- 7 behalf;
- 8 q. incorporating foreign "shell corporations" on TelexFree's behalf
- 9 in order to expand TelexFree's suspicious, tortious or illegal
- 10 business internationally;
- 11 r. providing financial advice to TelexFree designed to keep the
- 12 violations of M.G.L. c. 93 § 69 and M.G.L. c. 93A and the
- 13 unlawful MLM Pyramid Scheme alive and avoid detection by
- 14 regulators;
- 15 s. "sneaking" payments out of bank accounts to TelexFree in order
- 16 to avoid detection;
- 17 t. appearing in online videos with TelexFree Founders promoting
- 18 TelexFree to the public;
- 19 u. publicly falsely stating that TelexFree's business operations had
- 20 been assessed by the financial services provider and determined
- 21 to be legal; or
- 22
- 23
- 24
- 25
- 26

1 v. otherwise becoming an integral part of TelexFree's Pyramid
2 Scheme by, inter alia, enabling the TelexFree Pyramid Scheme to
3 expand and continue by providing necessary financial services to
4 TelexFree, despite actual knowledge of violations of M.G.L. c. 93
5 § 69 and M.G.L. c. 93A by TelexFree and other suspicious,
6
7 tortious or illegal activities.

8 1053. By each Defendant's actions participating in the Pyramid Scheme as
9 described herein, as alleged above, each Defendant aided and abetted the commission of
10 the causes of action alleged herein.
11

12 1054. As a direct and proximate result of TelexFree's illegal Pyramid Scheme
13 and all the activities performed in connection therewith, to which said Defendants
14 provided substantial assistance, Plaintiffs and the Putative Class sustained ascertainable
15 damages and losses and demand they be made whole.
16

17 **FOURTH CLAIM FOR RELIEF**
18 **UNJUST ENRICHMENT**
19 **(Against All Defendants)**

20 1055. Plaintiffs incorporate by reference all allegations in all previous
21 paragraphs, as though fully set forth here.

22 1056. Plaintiffs and the Putative Class conferred a benefit upon the Defendants
23 by furnishing funds to Defendants, who accepted them without protest or defect and
24 retained and benefitted from them.

25 1057. Defendants had an appreciation or knowledge of the benefit.
26

1 1058. Defendants knew of such funds received by them.

2 1059. Defendants have unlawfully and in bad faith denied Plaintiffs and the
3 putative Class access to such funds, and have instead knowingly retained the benefit of
4 such funds for themselves.

5 1060. Acceptance or retention by Defendants of the benefit under the
6 circumstances set forth herein would otherwise be inequitable without payment for its
7 value.
8

9 1061. As a direct and proximate result of Defendants' actions, as hereinabove
10 set forth, Defendants are, and continue to be, unjustly enriched and Plaintiffs demand
11 they and the Putative Class be made whole.
12

13 **FIFTH CLAIM FOR RELIEF**
14 **CIVIL CONSPIRACY**

15 (Against TelexFree, All Operational Defendants, John Merrill, John Hughes, Dustin
16 Sparman, Fidelity Bank, Base Commerce, GPG, and IPS)

17 1062. Plaintiffs incorporate by reference all allegations in all previous
18 paragraphs, as though fully set forth here.

19 1063. TelexFree, the Operational Defendants, Katia Wanzeler, John Merrill,
20 John Hughes, Dustin Sparman, Fidelity Bank, Base Commerce, GPG and IPS have
21 combined by common design to enter into a civil conspiracy.

22 1064. Said Defendants conspired with each other to operate and maintain in
23 operation a Pyramid Scheme in violation of Massachusetts General Laws Chapter 93,
24 Section 69 and Chapter 93A.
25

26 1065. Said Defendants, by agreement or common design, engaged directly in the

1 operation of, or otherwise worked in concert to further the activities of, the unlawful
2 Pyramid Scheme.

3 1066. As detailed above, each of said Defendants engaged in a tortious act in
4 furtherance of the agreement or common design to engage in the lawful Pyramid
5 Scheme.
6

7 1067. Said Defendants conspired with each other, making use of confidential
8 information, and used this confidential information to misappropriate the funds of the
9 Putative Class through the operation and maintenance of unlawful Pyramid Scheme.
10

11 1068. Said Defendants, for an unlawful purpose and using unlawful means, with
12 the intent of so combining, unlawfully defrauded Plaintiffs and the Putative Class out of
13 funds.
14

15 1069. Said Defendants' conduct constitutes a conspiracy to operate an unlawful
16 enterprise, rendering all Defendants jointly and severally liable for the breaches of each
17 other's obligations.

18 1070. As a direct and proximate cause of said Defendants' conspiracy, the
19 Putative Class has and will continue to suffer substantial direct and consequential
20 damages and Plaintiffs demand they and the Putative Class be made whole.
21

22 **SIXTH CLAIM FOR RELIEF**
23 **PROFESSIONAL NEGLIGENCE**
24 **(Against All Licensed Professional Defendants)**

25 1071. Plaintiffs incorporate by reference all allegations in all previous
26 paragraphs, as though fully set forth here.

1 1072. Craft, Craft Financial, Ann Genet, Nehra, Nehra Law Firm, Waak, Waak
2 Law Firm, Nehra and Waak Law Firm, Opt3 Solutions, Inc., PricewaterhouseCoopers,
3 Jason A. Borromei and each of the Licensed Professional Defendants owed a duty to
4 Plaintiffs and the Putative Class to act with reasonable care to avoid negligently
5 misstating, misrepresenting or being misleading about the true nature of TelexFree's
6 operation and its financial information or its returns, and to comply with all laws. Each
7 and everyone failed and similarly caused the Putative Class to suffer ascertainable
8 economic loss.
9

10
11 1073. By negligently misstating and omitting relevant information, including the
12 source of and sufficiency of funds for payments to Promoters, said Defendants breached
13 the duty of care they owed to Plaintiffs and the Putative Class.

14 1074. Each of the Licensed Service Provider Defendants owed Plaintiffs and the
15 Putative Class a duty to act with reasonable care and to exercise the ordinary skill and
16 ability commonly exercised by such professionals.
17

18 1075. Plaintiffs and the Putative Class relied upon said Defendants' expertise
19 and/or performance of their duties or was similarly affected and similarly caused to
20 incur ascertainable economic loss.
21

22 1076. Plaintiffs and the Putative Class reposed faith, confidence and trust in said
23 Defendants' representations and advice.

24 1077. As a direct and proximate result of said Defendants' negligence and
25 carelessness, Plaintiffs and the Putative Class have been caused to suffer and sustain
26

1 damages and losses and demand they be made whole.

2 **SEVENTH CLAIM FOR RELIEF**
3 **NEGLIGENT MISREPRESENTATION**

4 (Against All Operational Defendants Except Katia Wanzeler)

5 1078. Plaintiffs incorporate by reference all allegations in all previous
6 paragraphs, as though fully set forth here.

7 1079. The Operational Defendants, except Katia Wanzeler, directly, and through
8 their agents, servants, employees and/or representatives, negligently made false
9 misrepresentations of material fact and omissions to Plaintiffs and the Putative Class in
10 the course of their businesses for the purpose of obtaining and/or wrongfully
11 appropriating and converting money from Plaintiffs and the Putative Class.
12

13 1080. The said Operational Defendants made negligent misrepresentations and
14 omissions although said Defendants knew, or should have known, that such
15 representations were false.
16

17 1081. Said representations, statements and omissions were material and were
18 relied upon by Plaintiffs and the Putative Class, inducing them to furnish money to
19 Defendants.
20

21 1082. Further, the Licensed Service Provider Defendants failed to exercise
22 proper due diligence in the discharge of their investigatory duties as certified public
23 accountants and attorneys of TelexFree, and knew or should have known Plaintiffs and
24 the Putative Class would have relied upon their expertise and misrepresentations.
25

26 1083. Plaintiffs and the Putative Class reposed faith, confidence and trust in said

1 Operational Defendants' representations and advice.

2 1084. In consequence of the reliance on the negligent misrepresentations of said
3 Defendants, Plaintiffs and the Putative Class have suffered great financial losses, have
4 also incurred considerable expenses and loss of income, and have otherwise been
5 greatly damaged and demand they be made whole.
6

7 **EIGHTH CLAIM FOR RELIEF**
8 **VIOLATIONS OF MASSACHUSETTS GENERAL LAWS,**
9 **CHAPTER 110a, SECTION 410(b)**
10 **(Against All Operational Defendants Except PricewaterhouseCoopers)**

11 1085. Plaintiffs incorporate by reference all allegations in all previous
12 paragraphs, as though fully set forth here.

13 1086. For the purposes of this cause of action alone, Defendant
14 PricewaterhouseCoopers is not included within the definition of Licensed Professionals.

15 1087. At the time of the wrongs alleged, the Defendant Founders, Top Level
16 Promoters and Licensed Professionals were each a controlling person, partner, officer,
17 director, person occupying a similar status, agent or employee materially aiding in the
18 sale of securities, of TelexFree within the meaning of Section 410(b) of the
19 Massachusetts Uniform Securities Act, Massachusetts General Laws Chapter 110A.
20

21 1088. By their respective positions of authority, the Defendant Founders and
22 Principals, Executive Office and Licensed Professional had the power and authority, to
23 influence and control, and influenced and controlled, the decision-making and activities
24 of TelexFree and the affiliated TelexFree entities and caused them to engage in the
25 wrongful conduct described and in violations of Section 410(a) of the Massachusetts
26

1 Uniform Securities Act, M.G.L. c. 110A.

2 1089. The Defendant Founders and Principals, Executive Office and Licensed
3 Professional actively participated in the leadership and decision-making process of the
4 selling entity causing the dissemination of false and misleading statements and
5 omissions of material facts.
6

7 1090. By their positions as controlling persons, partners and officers and
8 directors of TelexFree, and because of the aforementioned conduct, said Defendants are
9 liable under Section 410(b) of the Massachusetts Uniform Securities Act, Massachusetts
10 General Laws Chapter 110A..
11

12 1091. In addition, the Defendant Top Level Promoters and Licensed
13 Professionals were agents who materially aided in the sales of the fraudulent securities
14 in violation of Sections 410 (b) of the Massachusetts Uniform Securities Act,
15 Massachusetts General Laws Chapter 110A.
16

17 1092. Said Defendants made significant contributions toward making the sales
18 to Plaintiffs and the Putative Class possible through their actions detailed above.
19

20 1093. Said Defendants prepared and provided information on, and endorsed and
21 actively promoted the opportunity regarding the securities on websites and at TelexFree
22 events and extravaganzas. Each of the said Defendants provided print materials,
23 electronic materials, and made oral representations to the Putative Class
24

25 1094. The stated Defendants are liable under 410(b) as a primary violation by
26 TelexFree was under 410(a) because Defendants materially aided in the sale of

1 unregistered securities, and knew, or by reasonable diligence should have known, of the
2 primary violation.

3 1095. Said Defendants are jointly and severally liable for the primary violations
4 under Section 410(a)(2) detailed above.

5 1096. Plaintiffs and the Putative Class seek the award of actual damages on
6 behalf of the Class.

7 1097. The Putative Class has and will continue to suffer irreparable harm as a
8 result of the Defendants' conduct that cannot adequately be redressed at law.

9 1098. Unless this Court grants injunctive relief, the Putative Class will be
10 irreparably harmed in a manner not fully compensable by money damages.

11
12
13 **NINTH CLAIM FOR RELIEF**

14 **FRAUD**

15 (Against Operational Defendants)

16 1099. Plaintiffs incorporate by reference all allegations in all previous
17 paragraphs, as though fully set forth here.

18 1100. The Operational Defendants directly, and through their agents, servants,
19 employees and/or representatives, did intentionally or recklessly make false
20 representations and omissions of material fact to Plaintiffs and the Putative Class with
21 these misrepresentations being made to obtain and/or wrongfully appropriate and
22 convert money from Plaintiffs and the Putative Class.

23 1101. Said Defendants' fraudulent or reckless misrepresentations and omissions
24 are detailed above and include, but are not limited to:
25
26

- a. providing false and misleading information on the nature of TelexFree's business operation;
- b. misrepresenting the financial statements;
- c. providing false and misleading information on the value of the AdCentral package;
- d. providing false and misleading information on the method and source from which income was derived;
- e. providing false and misleading information on the legality of TelexFree's business model;
- f. providing false and misleading information on the sustainability of the returns to Promoter;
- g. providing false and misleading information regarding the investigation in Brazil and subsequent closure of TelexFree's Brazilian operations;
- h. knowingly participating in false and deceptive information televised over the internet and other media;
- i. failing to comply with federal and state laws;
- j. employing legal and accountant counsel to mask their illegal and fraudulent activities to further and perpetuate such illegal fraudulent activities; and
- k. setting up TelexFree's computer servers in a foreign

country with the intent to avoid prosecution, legal service on the benefits of United States legal process and otherwise with knowledge that TelexFree was an unlawful Pyramid Scheme.

1102. Said Defendants knew of the fraudulent or reckless deceptive misrepresentations and omissions of material facts set forth.

1103. Said Defendants made these intentional or reckless misrepresentations although Defendants knew that such representations were false for the purpose of inducing Plaintiffs and the Putative Class to purchase initially and to continue to purchase memberships and to recruit new members.

1104. Such misrepresentations and omissions were done knowingly or recklessly for the additional purpose and effect of concealing the true information about the TelexFree Program, including its financial condition and operations.

1105. Said Defendants received information reflecting the facts regarding TelexFree's business practices and exercised control over the materially misleading misstatements.

1106. Because of their control over and/or association with the TelexFree Program, said Defendants were active and culpable participants in the fraudulent Scheme.

1107. Said Defendants knew and recklessly disregarded the false and misleading nature of the information they caused to be disseminated to Promoters and potential

Promoters.

1108. The ongoing fraudulent Pyramid Scheme could not have been perpetrated over a substantial period without the knowledge and complicity of said Defendants.

1109. These misrepresentations and statements were material and were relied upon by Plaintiffs as true, inducing them to furnish money to said Defendants and recruit new members.

1110. In consequence of the reliance on the negligent, intentional or reckless misrepresentations, Plaintiffs and the Putative Class have paid artificially inflated prices for worthless membership interests, suffered great financial losses, and have also incurred considerable expenses and loss of income, and have otherwise been greatly damaged during the Class Period and demand to be made whole.

TENTH CLAIM FOR RELIEF
TORTIOUS AIDING AND ABETTING
(Against All Defendants Except The **Defendant Class)**

1111. Plaintiffs incorporate by reference all allegations in all previous paragraphs, as though fully set forth here.

1112. Each Defendant provided substantial assistance or encouragement to the other Defendants in committing the primary causes of action alleged herein, and did so with unlawful intent and knowledge that such parties were perpetuating an illegal Pyramid Scheme yet continuing to substantially assist or encourage.

1113. Defendants rendered this substantial assistance despite their knowledge that TelexFree's operations constituted an unlawful, unfair, deceptive and unsustainable

Pyramid Scheme and financial fraud.

1114. Such substantial assistance rendered by Defendants despite their knowledge of, or with reasonable diligence they should have known of, the illegal nature of TelexFree's operations, is detailed above and includes, but is not limited to:

- a. managing and controlling TelexFree and its affiliated entities;
- b. providing accounting services to TelexFree;
- c. providing legal services to TelexFree;
- d. publicly certifying that TelexFree's business model and operations were legal, proper, and economically viable and sustainable;
- e. providing banking, investment and asset management services for TelexFree and its management;
- f. promoting TelexFree AdCentral packages;
- g. continuing to provide financial services following the Brazilian Court's injunction to stop TelexFree's business in Brazil;
- h. processing payments to, from, and on behalf of TelexFree and its affiliated entities;
- i. processing payments for transfers of funds which deepened TelexFree's insolvency; and
- j. setting up TelexFree's computer servers in a foreign country with the intent to avoid prosecution, legal service on the benefits of United States legal process and otherwise with knowledge that

TelexFree was an unlawful Pyramid Scheme.

1115. By each Defendant's actions participating in the Pyramid Scheme, as alleged above, each said Defendant aided and abetted the commission of the causes of action alleged herein.

1116. As a direct and proximate result of TelexFree's illegal Pyramid Scheme and all the activities performed in connection therewith, to which Defendants provided substantial assistance, Plaintiffs and the Putative Class sustained damages and losses and demand to be made whole.

VII. PRAYER FOR RELIEF

WHEREFORE, Plaintiffs, on behalf of themselves and the Class, pray for judgment against Defendants as follows:

1. The Court determine that this action be maintained as a class action under Rule 23(a) and 23(b)(3) of the Federal Rules of Civil Procedure, appoint Plaintiffs as Class Representatives and their counsel of record as Class Counsel, and direct that notice of this action, as provided by Rule 23(c)(2) of the Federal Rules of Civil Procedure, be given to the Class;

2. The Court determine that this action be maintained as a defendant class action under Rule 23(a), 23(b)(1)(A) and (B) and 23(b)(3) of the Federal Rules of Civil Procedure, appoint Defendant Shoyfer as Defendant Class Representative and his counsel of record as Defendant Class Counsel, and direct that notice of this action, as

1 provided by Rule 23(c)(2) of the Federal Rules of Civil Procedure, be given to the
2 Defendant Class;

3 3. The unlawful conduct alleged herein be adjudged and decreed an unlawful
4 Pyramid Scheme in violation of Massachusetts General Laws Chapter 93, § 69 and
5 Chapter 93A, §§ 2 and 11;
6

7 4. Plaintiffs and the members of the Class recover damages, as provided by law, to
8 the maximum extent allowed under the law, including, without limitations, multiple
9 damages, against Defendants;
10

11 5. Plaintiffs and the members of the Class recover their costs of suit, including
12 reasonable attorneys' fees, as provided by law;

13 6. Defendants, their affiliates, successors, transferees, assignees and other officers,
14 directors, partners, agents and employees thereof, and all other persons acting or
15 claiming to act on their behalf or in concert with them, be permanently enjoined and
16 restrained from in any manner continuing, maintaining, or renewing the conduct alleged
17 herein, or from entering into, adopting, or following any practice, plan, program, or
18 device having a similar purpose or effect;
19

20 7. Plaintiffs and the members of the Class be awarded pre- and post-judgment
21 interest as provided by law, and that such interest be awarded at the highest legal rate
22 from and after the date of service of this complaint;
23

24 8. Plaintiffs and the members of the Class be granted such other and further relief
25 as the case may require and the Court may deem just and proper.
26

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Dated this 22nd day of September 2015

/s/ Steven J. German
Steven J. German, Esq.
(AZ Bar No. 014789)
ADELMAN GERMAN, PLC
8245 N. 85th Way
Scottsdale, AZ 85258
Telephone: 480-607-9166
Email: steve@adelmangerman.com

R. Christopher Gilreath, Esq.
(TN Bar No. 18667)
Gilreath & Associates, PLLC
200 Jefferson Avenue, Suite 711
Memphis, TN 38103
Telephone: 901-527-0511
Email: chrisgil@sidgilreath.com

Robert J. Bonsignore, Esq.
(NH Bar No. 21241)
BONSIGNORE TRIAL LAWYERS, PLLC
2513 Morocco Avenue
North Las Vegas, NV 89031
Telephone: 781-856-7650
Email: rbonsignore@classactions.us

Ronald A. Dardeno, Esq.
(BBO No. 548278)
Alexander D. Wall, Esq.
(BBO No. 688881)
Law Offices of Frank N. Dardeno
424 Broadway
Somerville, MA 02145
Telephone: 617-666-2600
Email: rdardeno@dardeno.com

1 Telephone: 978-922-4025
2 Email: scott@goldberganddulles.com

3 Jan R. Schlichtmann, Esq.
4 (MA Bar No. 445900)
5 Jan R. Schlichtmann, Attorney at Law, PC
6 P.O. Box 233
7 Prides Crossing, MA 01965
8 Telephone: 978-927-1037
9 Email: jan@schlichtmannlaw.com

10 Randall Renick, Esq.
11 Hadsell Stormer Richardson & Renick, LLP
12 128 N. Fair Oaks Avenue, Suite 204
13 Pasadena, CA 91103
14 Telephone: 626-381-9261
15 Email: rrr@hadsellstormer.com

16 Adriana Contartese, Esq.
17 (FL Bar No. 89634)
18 Law Offices of Adriana Contartese
19 OCN Document Prep Suite 926
20 19W Flagler Street
21 Miami, FL 33130
22 Telephone: 617-268-3557
23 Email: adriana911@juno.com

24 Ihuoma Igboanugo, Esq.
25 (NC Bar No. 46618)
26 The Crescent Law Practice
183 Wind Chime Court, Suite 100
Raleigh, NC 27615
Telephone: 919-341-9707
Email: ihuoma2007@yahoo.com

Mark A. Tate, Esq.
(GA Bar No. 698820)
Tate Law Group, LLC
2 East Bryan Street, Suite 600
P.O. Box 9060
Savannah, GA 31412
Telephone: 912-234-3030

1 Email: marktate@tatelawgroup.com

2 Stephen M. Smith, Esq.
3 (NY Bar No. 277784)
4 (VA Bar No. 14362)
5 (NY Bar No. 277784)
6 (DC Bar No. 230995)
7 Brain Injury Law Center
8 2100 Kecoughtan Road
9 Hampton, VA 23661
10 Telephone: 877-840-3431
11 Email: ssmith@braininjurylawcenter.com

12 Lisa Sleboda, Esq.
13 (PA No. 71580)
14 Ernesto Ganaden, Esq.
15 Bonsignore Trial Lawyers, PLLC
16 193 Plummer Hill Road
17 Belmont, NH 03220
18 Telephone: 781-856-7650
19 Email: lsleboda@class-actions.us
20 Email: sganadan@class-actions.us

21 Kevin Barry, Esq.
22 (BBO #690595)
23 Bonsignore Trial Lawyers, PLLC
24 23 Forest Street
25 Medford, MA 02155
26 Telephone: 781-350-0000
Email: kbarry@class-actions.us

Sheri Sadler

The JS 44 civil cover sheet and the information contained herein neither replace nor supplement the filing and service of pleadings or other papers as required by law, except as provided by local rules of court. This form, approved by the Judicial Conference of the United States in September 1974, is required for the use of the Clerk of Court for the purpose of initiating the civil docket sheet. (SEE INSTRUCTIONS ON THE REVERSE OF THE FORM.)

I. (a) PLAINTIFFS

RITA DOS SANTOS, PUTATIVE CLASS REPRESENTATIVES
AND THOSE SIMILARLY SITUATED

(b) County of Residence of First Listed Plaintiff _____
(EXCEPT IN U.S. PLAINTIFF CASES)

(c) Attorney's (Firm Name, Address, and Telephone Number)

STEVEN J. GERMAN, ADELMAN GERMAN, PLC
8245 N. 85TH WAY, SCOTTSDALE, AZ 85258 (480) 607-9166

DEFENDANTS

TELEXELECTRIC, LLLP; TELEX MOBILE, HOLDINGS, INC.;
JAMES M. MERRILL; CARLOS N. WANZELER; (cont'd on attached

County of Residence of First Listed Defendant MARICOPA
(IN U.S. PLAINTIFF CASES ONLY)

NOTE: IN LAND CONDEMNATION CASES, USE THE LOCATION OF THE
LAND INVOLVED.

Attorneys (If Known)

II. BASIS OF JURISDICTION (Place an "X" in One Box Only)

- ☐ 1 U.S. Government Plaintiff ☐ 3 Federal Question (U.S. Government Not a Party)
- ☐ 2 U.S. Government Defendant ☒ 4 Diversity (Indicate Citizenship of Parties in Item III)

III. CITIZENSHIP OF PRINCIPAL PARTIES (Place an "X" in One Box for Plaintiff and One Box for Defendant)

- | | PTF | DEF | | PTF | DEF |
|---|---------------------------------------|---------------------------------------|---|----------------------------|----------------------------|
| Citizen of This State | <input type="checkbox"/> 1 | <input checked="" type="checkbox"/> 1 | Incorporated or Principal Place of Business in This State | <input type="checkbox"/> 4 | <input type="checkbox"/> 4 |
| Citizen of Another State | <input checked="" type="checkbox"/> 2 | <input type="checkbox"/> 2 | Incorporated and Principal Place of Business in Another State | <input type="checkbox"/> 5 | <input type="checkbox"/> 5 |
| Citizen or Subject of a Foreign Country | <input type="checkbox"/> 3 | <input type="checkbox"/> 3 | Foreign Nation | <input type="checkbox"/> 6 | <input type="checkbox"/> 6 |

IV. NATURE OF SUIT (Place an "X" in One Box Only)

CONTRACT	TORTS	FORFEITURE/PENALTY	BANKRUPTCY	OTHER STATUTES
<input type="checkbox"/> 110 Insurance <input type="checkbox"/> 120 Marine <input type="checkbox"/> 130 Miller Act <input type="checkbox"/> 140 Negotiable Instrument <input type="checkbox"/> 150 Recovery of Overpayment & Enforcement of Judgment <input type="checkbox"/> 151 Medicare Act <input type="checkbox"/> 152 Recovery of Defaulted Student Loans (Excl. Veterans) <input type="checkbox"/> 153 Recovery of Overpayment of Veteran's Benefits <input type="checkbox"/> 160 Stockholders' Suits <input checked="" type="checkbox"/> 190 Other Contract <input type="checkbox"/> 195 Contract Product Liability <input type="checkbox"/> 196 Franchise	PERSONAL INJURY <input type="checkbox"/> 310 Airplane <input type="checkbox"/> 315 Airplane Product Liability <input type="checkbox"/> 320 Assault, Libel & Slander <input type="checkbox"/> 330 Federal Employers' Liability <input type="checkbox"/> 340 Marine <input type="checkbox"/> 345 Marine Product Liability <input type="checkbox"/> 350 Motor Vehicle <input type="checkbox"/> 355 Motor Vehicle Product Liability <input type="checkbox"/> 360 Other Personal Injury PERSONAL INJURY <input type="checkbox"/> 362 Personal Injury - Med. Malpractice <input type="checkbox"/> 365 Personal Injury - Product Liability <input type="checkbox"/> 368 Asbestos Personal Injury Product Liability PERSONAL PROPERTY <input type="checkbox"/> 370 Other Fraud <input type="checkbox"/> 371 Truth in Lending <input type="checkbox"/> 380 Other Personal Property Damage <input type="checkbox"/> 385 Property Damage Product Liability	<input type="checkbox"/> 610 Agriculture <input type="checkbox"/> 620 Other Food & Drug <input type="checkbox"/> 625 Drug Related Seizure of Property 21 USC 881 <input type="checkbox"/> 630 Liquor Laws <input type="checkbox"/> 640 R.R. & Truck <input type="checkbox"/> 650 Airline Regs. <input type="checkbox"/> 660 Occupational Safety/Health <input type="checkbox"/> 690 Other <input type="checkbox"/> 710 Fair Labor Standards Act <input type="checkbox"/> 720 Labor/Mgmt. Relations <input type="checkbox"/> 730 Labor/Mgmt. Reporting & Disclosure Act <input type="checkbox"/> 740 Railway Labor Act <input type="checkbox"/> 790 Other Labor Litigation <input type="checkbox"/> 791 Empl. Ret. Inc. Security Act <input type="checkbox"/> 462 Naturalization Application <input type="checkbox"/> 463 Habeas Corpus - Alien Detainee <input type="checkbox"/> 465 Other Immigration Actions	<input type="checkbox"/> 422 Appeal 28 USC 158 <input type="checkbox"/> 423 Withdrawal 28 USC 157 PROPERTY RIGHTS <input type="checkbox"/> 820 Copyrights <input type="checkbox"/> 830 Patent <input type="checkbox"/> 840 Trademark SOCIAL SECURITY <input type="checkbox"/> 861 HIA (1395ff) <input type="checkbox"/> 862 Black Lung (923) <input type="checkbox"/> 863 DIWC/DIWW (405(g)) <input type="checkbox"/> 864 SSID Title XVI <input type="checkbox"/> 865 RSI (405(g)) FEDERAL TAX SUITS <input type="checkbox"/> 870 Taxes (U.S. Plaintiff or Defendant) <input type="checkbox"/> 871 IRS—Third Party 26 USC 7609	<input type="checkbox"/> 400 State Reapportionment <input type="checkbox"/> 410 Antitrust <input type="checkbox"/> 430 Banks and Banking <input type="checkbox"/> 450 Commerce <input type="checkbox"/> 460 Deportation <input type="checkbox"/> 470 Racketeer Influenced and Corrupt Organizations <input type="checkbox"/> 480 Consumer Credit <input type="checkbox"/> 490 Cable/Sat TV <input type="checkbox"/> 810 Selective Service <input type="checkbox"/> 850 Securities/Commodities/Exchange <input type="checkbox"/> 875 Customer Challenge 12 USC 3410 <input type="checkbox"/> 890 Other Statutory Actions <input type="checkbox"/> 891 Agricultural Acts <input type="checkbox"/> 892 Economic Stabilization Act <input type="checkbox"/> 893 Environmental Matters <input type="checkbox"/> 894 Energy Allocation Act <input type="checkbox"/> 895 Freedom of Information Act <input type="checkbox"/> 900 Appeal of Fee Determination Under Equal Access to Justice <input type="checkbox"/> 950 Constitutionality of State Statutes

V. ORIGIN

(Place an "X" in One Box Only)

- ☒ 1 Original Proceeding ☐ 2 Removed from State Court ☐ 3 Remanded from Appellate Court ☐ 4 Reinstated or Reopened ☐ 5 Transferred from another district (specify) ☐ 6 Multidistrict Litigation ☐ 7 Appeal to District Judge from Magistrate Judgment

VI. CAUSE OF ACTION

Cite the U.S. Civil Statute under which you are filing (Do not cite jurisdictional statutes unless diversity):

Class Action Fairness Act of 2005, 28 U.S.C. Sections 1332(d), 1453, and 1711-1715

Brief description of cause:

TelexFree was an unlawful Pyramid scheme and the Plaintiffs seeks to recoup their lost funds

VII. REQUESTED IN COMPLAINT:

☒ CHECK IF THIS IS A CLASS ACTION UNDER F.R.C.P. 23 DEMAND \$ 500,000,000.00

CHECK YES only if demanded in complaint:

JURY DEMAND: ☒ Yes ☐ No

VIII. RELATED CASE(S) IF ANY

(See instructions):

JUDGE

DOCKET NUMBER

DATE

SIGNATURE OF ATTORNEY OF RECORD

09/22/2015

Steven J. German

FOR OFFICE USE ONLY

RECEIPT # _____ AMOUNT _____ APPLYING IFP _____ JUDGE _____ MAG. JUDGE _____

CARLOS N. WANZELER; STEVEN M. LABRIOLA; JOSEPH H. CRAFT, a/k/a JOE H. CRAFT; CRAFT FINANCIAL SOLUTIONS, LLC; ANN GENET; CARLOS COSTA; KATIA WANZELER; SANDERLEY RODRIGUES DE VASCONCELOS; SANTIAGO DE LA ROSA; RANDY N. CROSBY; FAITH R. SLOAN; DANIIL SHOYFER; SCOTT MILLER; GERALD P. NEHRA, individually and doing business as LAW OFFICES OF NEHRA AND WAAK; GERALD P. NEHRA ATTORNEY AT LAW, PLLC; RICHARD W. WAAK, individually and doing business as LAW OFFICES OF NERHA AND WAAK; RICHARD W. WAAK, ATTORNEY AT LAW, PLLC; OPT3 SOLUTIONS, INC.; JASON A. BORROMEI; PRICEWATERHOUSECOOPERS, LLP; BANK OF AMERICA, NA; TD BANK, NA; RSB CITIZENS, N.A.; FIDELITY CO-OPERATIVE BANK, doing business as FIDELITY BANK; JOHN F. MERRILL; WELLS FARGO BANK, N.A.; SYNOVUS BANK; GLOBAL PAYROLL GATEWAY INC.; INTERNATIONAL PAYOUT SYSTEMS, INC.; PROPAY, INC., doing business as PROPAY.COM; BASE COMMERCE, LLC, doing business as PHOENIX PAYMENTS; JOHN HUGHES; VANTAGE PAYMENTS, LLC; DUSTIN SPARMAN; ALLIED WALLET, LTD; COMMERCE, LLC, doing business as PHOENIX PAYMENTS; JOHN HUGHES; VANTAGE PAYMENTS, LLC; DUSTIN SPARMAN; ALLIED WALLET, LTD; DOE TOP LEVEL PROMOTERS; DOE LICENSED PROFESSIONALS; DOE BANKS; DOE PAYMENT PROCESSING SERVICES, PARALEGAL DOE, and a Defendant Class of Direct Victim Payment Recipients

EXHIBIT I

UNITED STATES JUDICIAL PANEL
on
MULTIDISTRICT LITIGATION

IN RE: TELEXFREE SECURITIES LITIGATION

MDL No. 2566

(SEE ATTACHED SCHEDULE)

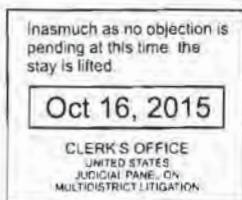
CONDITIONAL TRANSFER ORDER (CTO -2)

On October 21, 2014, the Panel transferred 2 civil action(s) to the United States District Court for the District of Massachusetts for coordinated or consolidated pretrial proceedings pursuant to 28 U.S.C. § 1407. *See* 54 F.Supp.3d 1353 (J.P.M.L. 2014). Since that time, 1 additional action(s) have been transferred to the District of Massachusetts. With the consent of that court, all such actions have been assigned to the Honorable Timothy S Hillman.

It appears that the action(s) on this conditional transfer order involve questions of fact that are common to the actions previously transferred to the District of Massachusetts and assigned to Judge Hillman.

Pursuant to Rule 7.1 of the Rules of Procedure of the United States Judicial Panel on Multidistrict Litigation, the action(s) on the attached schedule are transferred under 28 U.S.C. § 1407 to the District of Massachusetts for the reasons stated in the order of October 21, 2014, and, with the consent of that court, assigned to the Honorable Timothy S Hillman.

This order does not become effective until it is filed in the Office of the Clerk of the United States District Court for the District of Massachusetts. The transmittal of this order to said Clerk shall be stayed 7 days from the entry thereof. If any party files a notice of opposition with the Clerk of the Panel within this 7-day period, the stay will be continued until further order of the Panel.



FOR THE PANEL:



Jeffery N. Lüthi
Clerk of the Panel

IN RE: TELEXFREE SECURITIES LITIGATION

MDL No. 2566

SCHEDULE CTO-2 - TAG-ALONG ACTIONS

<u>DIST</u>	<u>DIV.</u>	<u>C.A.NO.</u>	<u>CASE CAPTION</u>
ARIZONA			
AZ	2	15-01906	Dos Santos v. Telexelectric LLLP et al

I hereby certify on 10/20/15 that the
foregoing document is true and correct copy of the
☐ electronic docket in the captioned case
☒ electronically filed original filed on 10/16/15
☐ original filed in my office on _____

Robert M. Farrell
Clerk, U.S. District Court
District of Massachusetts

By: [Signature]
Deputy Clerk

EXHIBIT J

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

MARIA MURDOCH, ANGELA BATISTA
JIMENEZ, ELISANGELA OLIVEIRA, and
DIOGO DERAUGO, PLAINTIFFS, Putative
Class Representatives, and Those Similarly
Situating,

Plaintiffs,

v.

TELEXELECTRIC, LLLP, TELEX MOBILE
HOLDINGS, INC., DOUGLAS M. MACHADO,
ALEXANDRO O. ROCHA, DAVID REIS,
LEONARDO FRANCISCO, LINDA S.
HACKETT, DAVID HACKETT, DL1 INC.,
BENJAMIN ARGUETA, JACQUELINE DA
COSTA ZIEFF, JOSE CARLOS MACIEL,
BRUNO GRAZIANI, RENATO RIBEIRO,
ERASMO BARROSO, LAIR FERNANDES,
LAYZA DUARTE, LYVIA M. WANZELER,
RODRIGO MONTEMOR, RONI YASMINE,
RUDNEI DA SILVA, VAGNER DANTAS
SILVA, WAGNER WEIHRAUCH, JULIO
SILVA, JOSE NETO, JULIO C. PAZ, EUZEBIO
SUDRE NETO, HUGO ALVARADO, ANA R.
RAMOS, RUDDY ABREAU, MARCO
ALMEIDA, LAUREANO ARELLANO, AARON
ATAIDE, ROSANE CRUZ, OMAR QUINONEZ,
CARLO DEJESUS, BILKISH SUNESARA,
ANDRES BOLIVAR ESTEVEZ, JOSE LOPEZ,
ANA ROSA LOPEZ, FRANTZ BALAN,
MARCELO DASILVA, BENERANDO
CONTRERAS, GLADYS ALVARDO, STEVEN
M. LABRIOLA, CARLOS COSTA,
SANDERLEY RODRIGUES DE
VASCONCELOS, SANTIAGO DE LA ROSA;
RANDY N. CROSBY

Defendants.

**CLASS ACTION
COMPLAINT**

AND

DEMAND FOR TRIAL BY JURY

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Plaintiffs and Putative Class Representatives Elisangela Oliveira, Maria Murdoch, Diogo Dearaugo, on behalf of themselves and all others similarly situated, (“Plaintiffs”), bring this action against the defendants named herein (“Defendants”). This complaint is based on information and belief, except those paragraphs that relate to Plaintiffs, which are based on personal knowledge. To preserve the resources of this Court and the parties, Plaintiffs¹ assert the following abbreviated allegations as follows:

1. TelexFree, Inc., TelexFree, LLC, and TelexFree Financial, Inc. (collectively, “TelexFree” or the “Debtors”) and its related entities and individuals operated an illegal and fraudulent scheme whereby it sold “memberships,” ostensibly paid its “promoters” for placing duplicative and meaningless advertisements for a “voice over internet protocol” (“VoIP”) product, and in reality paid them to recruit other investors whose new membership fees kept the scheme afloat (the “TelexFree Program”).

2. Until TelexFree, Inc. changed its compensation plan in March 2014, a month before it filed for bankruptcy, it did not require promoters to sell its VoIP product to be eligible for payments.

3. Only 11.7% of the face value of invoices for membership plans or VoIP packages was paid in cash to the Debtors, and the remainder was satisfied by the use of victims’ credits. *See* Affidavit of Stephen B. Darr in Support of Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief at ¶ 35, *In re TelexFree, LLC*, No. 14-40987 (Bankr. D. Mass. Oct. 7, 2015), ECF No. 623-1 (“While invoices associated with the sale of membership plans or VoIP packages had a face value of \$3,073,471,326, only \$359,792,242, or approximately twelve percent (11.7%) of

¹ Plaintiffs suggest the Court consider a separate litigation track be created for their claims against the Top-Level Promoters.

that amount, was paid in cash to the Debtors. The balance of these invoices, totaling \$2,713,679,084, was satisfied by the use of Participants' credits.”).

4. TelexFree’s business and operations constituted an illegal pyramid scheme (the “TelexFree Pyramid Scheme”); in fact, the United States Bankruptcy Court for the District of Massachusetts (Hoffman, J.) has made a finding of fact applicable to all proceedings that TelexFree's operations constituted a Ponzi Scheme (Chapter 11 Case No. 14-40987-MSH; EFC No. 668). A pyramid scheme is a form of a Ponzi scheme wherein a business enterprise persuades people to invest money into a seemingly legitimate business model and in exchange guarantees unrealistic and, ultimately, illusory profits. The actual sales or services provided, if any, are insufficient to pay the promised returns to investors. The operation of a pyramid scheme relies entirely on additional investment funding by newly recruited or existing investors. Once the influx of new cash from new investors becomes insufficient to satisfy the ever-growing number of participants/previous investors, or as in the case of TelexFree stops short following law enforcement raids, the pyramid scheme collapses because there are no new funds with which to pay previous investors.

5. TelexFree’s founders and principals, executive office and top-level promoters controlled the activities and operations of TelexFree and knowingly, maliciously, and willfully conspired to perpetrate, and did perpetrate, the TelexFree Pyramid Scheme with full awareness of its unfair, deceptive, and unlawful nature.

6. A class action is pending in this district based upon the TelexFree Pyramid Scheme against, *inter alia*, TelexFree’s founders and principals, executive office and top-level promoters, certain licensed professionals and certain financial services providers for the knowing role they each played in substantially assisting the Scheme.

7. Through the present action, Plaintiffs seek compensation for the ascertainable economic loss they were caused to suffer as a result of the participation of the below-described Defendants in the illegal Pyramid Scheme.

8. These individual Defendants (each a “Direct Victim Payment Recipient” or “Top-Level Promoter”) profited from ascertainable payments Plaintiffs -- not TelexFree -- made to those Defendants.²

9. Plaintiffs seek compensation from the Defendant Top-Level Promoters solely for the payments made directly by Net Loser victims to them because the retention of such funds would be wrongful and unjust enrichment. Only the return of those funds will offset the net loss the Putative class suffered as a result of the unlawful Pyramid Scheme.

10. Each Defendant benefitted from the Scheme, possessed full knowledge of that benefit and accepted and retained such benefit, unjustly, at the expense of the named Plaintiffs and/or putative class members. The Defendants’ retention of the monies paid by the victim/class members is patently unjust under the attendant circumstances. As such, the sole cause of action asserted against the Defendants here is for unjust enrichment.

I. JURISDICTION AND VENUE

11. This Court has subject-matter jurisdiction over the instant matter pursuant to 28 U.S.C. § 1332(d) and the Class Action Fairness Act of 2005 (“CAFA”), 28 U.S.C. §§ 1711, *et seq.*, which vest original jurisdiction in the district courts of the United States for any multi-state class action where the aggregate amount in controversy exceeds \$5,000,000 and where the citizenship of any member of the class of plaintiffs is different from that of any defendant.

² To avoid doubt, Plaintiffs seek recompense *solely* for monies *they* paid to the Defendants. They do not seek recovery of any monies *TelexFree* paid to those Defendants.

The amount in controversy is over \$5,000,000 and as evidenced below, the diverse citizenship requirement of CAFA are also satisfied.

12. Venue is proper under 28 U.S.C. § 1391 because a substantial part of the events giving rise to Plaintiffs' claims occurred in this District, a substantial portion of the affected interstate trade and commerce described herein was carried out in this District, and one or more of the Defendants reside, are licensed to do business in, are doing business in, had agents in, or are found or transact business in this District.

13. This Court has *in personam* jurisdiction over the Defendants because each, either directly or through the valueless ownership of the fraudulent TelexFree packages, *inter alia*: (a) transacted business and participated in the carrying out and perpetration of a fraud by engaging in substantial activities in Massachusetts; (b) solicited victims in Massachusetts; (c) attended meetings in Massachusetts; (d) regularly spoke with the founders of TelexFree and members of the home office in Massachusetts in furtherance of their obtaining funds from victims; (e) directly or indirectly sold or marketed in Massachusetts; (f) otherwise committed a tort within the Commonwealth of Massachusetts including making use of the resources offered by the Founders or others in Massachusetts; (g) committed a breach of contract within Massachusetts; (h) had substantial aggregate contacts with Massachusetts; (i) were engaged in an illegal pyramid scheme conspiracy that was directed at, and had a direct, substantial, reasonably foreseeable and intended effect of causing injury to, the business or property of persons and entities residing in, located in, or doing business throughout Massachusetts and through that activity were substantially involved in the Commonwealth of Massachusetts' stream of commerce; and (j) to the extent that participants of an unlawful enterprise purposefully take advantage of the laws of Commonwealth of Massachusetts – each

did.

14. Each Defendant Top-Level Promoter communicated regularly with TelexFree's founders, principals, executive officers, home office employees³, including James Merrill, Carlos Wanzeler, Steven Labriola, Carlos Costa, and other Defendants and others identified as Does in Massachusetts during all material relevant times beginning on February 15, 2012 through approximately April 2014 in furtherance of their taking of funds from the putative class of victims. Each Defendant together with financial service providers, licensed professionals and others conducted business and carried out acts that were substantial and essential to the operation of the TelexFree Pyramid Scheme in Massachusetts, and they have purposefully availed themselves of the laws of the Commonwealth of Massachusetts. Moreover each Defendant was party to acts and transactions giving rise to this action that occurred in this District.

15. By reason of the unlawful activities hereinafter alleged, Defendants substantially affected commerce throughout Massachusetts and the United States, causing injury to the Plaintiffs and members of the putative class. Defendants, directly and through their agents, engaged in activities affecting Massachusetts and other states, to operate and profit from an unlawful Pyramid Scheme.

16. Defendants' conspiracy and unlawful conduct described herein adversely affected persons in Massachusetts and throughout the United States who purchased TelexFree packages, including Plaintiffs and the members of the class.

³ The foregoing terms are meant to comport with their common usage. A further description may be found through a review of the individuals and entities named in the Second Consolidated Amended Complaint in MDL 2566.

II. THE PARTIES

A. PLAINTIFFS

17. Plaintiff Maria Murdoch (“Murdoch”) is an individual who resides in Wakefield, Massachusetts. Murdoch, like many other victims of TelexFree’s Pyramid Scheme, paid funds to one or more of the Defendants with the hope of earning a profit and instead, suffered a Net Loss because TelexFree was an unlawful Pyramid scheme and not a lawful business venture. “Net Loss” is defined throughout as the class member having invested more funds into the Pyramid Scheme than he or she withdrew.

18. Plaintiff Angela Batista Jimanenez (“Jamanenez”) is an individual who resides in Las Vegas, Nevada. Jamanenez, like many other victims of TelexFree’s Pyramid Scheme, paid funds to one or more of the Defendants with the hope of earning a profit and instead, suffered a Net Loss because TelexFree was an unlawful Pyramid scheme and not a lawful business venture. “Net Loss” is defined throughout as the class member having invested more funds into the Pyramid Scheme than he or she withdrew.

19. Plaintiff Elisangela Oliveira (“Oliveira”) is an individual who resides in Medford, Massachusetts. Oliveira, like many other victims of TelexFree’s Pyramid Scheme, paid funds to one or more of the Defendants with the hope of earning a profit and instead, suffered a Net Loss because TelexFree was an unlawful Pyramid scheme and not a lawful business venture.

20. Plaintiff Diogo Dearaugo (“Dearaugo”) is an individual who resides in Saugus, Massachusetts. Dearaugo, like many other victims of TelexFree’s Pyramid Scheme, paid funds to one or more of the Defendants with the hope of earning a profit and instead, suffered a Net Loss because TelexFree was an unlawful Pyramid scheme and not a lawful business venture.

B. DEFENDANTS

a. Electric and Mobile

21. TelexElectric, LLLP (“Electric”) is a limited liability limited partnership organized and under the laws of the State of Nevada. Its registered agent is BWFC Processing Center, LLC, 3960 Howard Hughes Parkway, Suite 500, Las Vegas, Nevada 89169.

22. Telex Mobile Holdings, Inc. (“Mobile”) is a corporation organized and existing under the laws of the State of Nevada, and having its registered agent as BWFC Processing Center, LLC, 3960 Howard Hughes Parkway, Suite 500, Las Vegas, Nevada 89169.

b. Top Level Promoters and Associated Individuals

23. Leonardo Francisco (“Francisco”) is an individual with a last known usual place of abode of 30D Mount Avenue, Marlborough, Middlesex County, Massachusetts 01752. At all relevant times herein, Francisco served as a promoter for TelexFree, and received payment of funds directly from victims. Francisco was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

24. Francisco is the nephew of TelexFree founder and Vice President Carlos N. Wanzeler, and also served as a “straw” investor for Carlos N. Wanzeler, purchasing AdCentral packages in his own name but on Wanzeler’s behalf, and transferring his profits to Wanzeler.

25. Lyvia M. Wanzeler is an individual with a last known usual place of abode of 41A Mount Avenue, Worcester, Worcester County, Massachusetts 01606. At all relevant times herein, Lyvia M. Wanzeler served as a promoter for TelexFree, and received payment of funds directly from victims. Wanzeler was a net winner in that she received funds from

victims that exceeded what she invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because her identity was then unknown.

26. Lyvia M. Wanzeler is also the daughter of TelexFree founder and Vice President Carlos N. Wanzeler, and is believed to have served as a “straw” investor for Carlos N. Wanzeler, purchasing AdCentral packages in her own name but on Carlos N. Wanzeler’s behalf, and transferring her profits to Carlos N. Wanzeler.

27. Wagner Weihrauch (“Weihrauch”) is an individual with a last known usual place of abode of Everett, Middlesex County, Massachusetts 01819. At all relevant times herein, Weihrauch served as a promoter for TelexFree, and received payment of funds directly from victims. Weihrauch was a net winner in that he received funds from victims that exceeded what invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

28. Linda S. Hackett is an individual with a last known usual place of abode of 97 Bellevue Avenue, Melrose, Middlesex County, Massachusetts 02176. At all relevant times herein, Linda S. Hackett served as a Promoter for TelexFree, and received payment of funds directly from victims. Hackett was a net winner in that she received funds from victims that exceeded what she invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because her identity was then unknown.

29. David Hackett is an individual with a last known usual place of abode of 97 Bellevue Avenue, Melrose, Middlesex County, Massachusetts 02176. At all relevant times

33. At all times material herein, DL1 was effectively an alter ego of Defendants Linda S. Hackett and David Hackett, and furthermore, had no legitimate business purpose, failed to maintain corporate formalities, had no independent board of directors and otherwise served as a “facade” for the sole benefit of said Defendants.

35. Jacqueline Da Costa Zieff (“Zieff”) is an individual with a last known usual place of abode of 50 Woodlawn Drive, Newton, Middlesex County, Massachusetts 02467. At all relevant times herein, Zieff served as a promoter for TelexFree, and received payment of funds directly from victims. Zieff was a net winner in that she received funds from victims that exceeded what she invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because her identity was then unknown.

37. Bruno Graziani (“Graziani”) is an individual with a last known usual place of abode of 80 Lilac Circle, Marlborough, Middlesex County, Massachusetts 01752. At all

38. Renato Ribeiro (“Ribeiro”) is an individual with a last known usual place of abode of 14 Washington Street, Medford, Middlesex County, Massachusetts 02155. At all relevant times herein, Ribeiro served as a promoter for TelexFree, and received payment of funds directly from victims. Ribeiro was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

39. Erasmio Barroso (“Barroso”) is an individual with a last known usual place of abode of 78 Neil Street, Unit 1, Marlborough, Middlesex County, Massachusetts 01752. At all relevant times herein, Barroso served as a promoter for TelexFree, and received payment of funds directly from victims. Barroso was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

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43. Roni Yasmine (“Yasmine”) is an individual with a last known usual place of abode 181 Massachusetts Avenue, Boston, Suffolk County, Massachusetts 02115. At all relevant times herein, Yasmine served as a promoter for TelexFree, and received payment of funds directly from victims. Yasmine was a net winner in that he received funds from victims that exceeded what was invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This

44. Rudnei Da Silva is an individual with a last known usual place of abode of 65 Johnson St., Leominster, Worcester County, Massachusetts 01453. At all relevant times herein, Rudnei Da Silva served as a promoter for TelexFree, and received payment of funds directly from victims. Rudnei DaSilva was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

46. David Reis (“Reis”) is an individual with a last known usual place of abode in Somerville, Middlesex County, Massachusetts 02144. At all relevant times herein, Reis served as a promoter for TelexFree, and received payment of funds directly from victims. Reis was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

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50. Euzebio Sudre Neto (“Sudre Neto”) is an individual with a last known usual place of abode of 334 Chestnut Farm Way, Raynham, Bristol County, Massachusetts 02767. At all relevant times herein, Sudre Neto served as a promoter for TelexFree, and received payment of

funds directly from victims. Sudre Neto was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

51. Hugo Alvarado (“Alvarado”) is an individual with a last known usual place of abode of 18 Catherine Street, #1, Worcester, Worcester County, Massachusetts 01605. At all relevant times herein, Alvarado served as a promoter for TelexFree, and received payment of funds directly from victims. Alvarado was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

52. Ana R. Ramos (“Ramos”) is an individual with a last known usual place of abode of 63 Fremont Ave., Apt. 2, Chelsea, Suffolk County, Massachusetts 02150. At all relevant times herein, Ramos served as a promoter for TelexFree, and received payment of funds directly from victims. Ramos was a net winner in that she received funds from victims that exceeded what she invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because her identity was then unknown.

53. Ruddy Abreau (“Abreau”) is an individual with a last known usual place of abode of 9 Longwood Drive, Methuen, Essex County, Massachusetts 01844. At all relevant times herein, Abreau served as a promoter for TelexFree, and received payment of funds directly from victims. Abreau was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational

62. Jose Lopez (“Lopez”) is an individual with a last known usual place of abode of 164 Exchange Street, 2nd Floor, Lawrence, Essex County, Massachusetts 01841. At all relevant times herein, Lopez served as a promoter for TelexFree, and received payment of funds directly from victims. Lopez was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

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66. Gladys Alvarado (“Alvarado”) is an individual with a last known usual place of abode of 177 Lincoln St., #2, Worcester, Massachusetts 01605. At all relevant times herein, Alvarado served as a promoter for TelexFree, and received payment of funds directly from victims. Alvarado was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously

71. Carlos Costa, ("Costa") is an individual now or formerly of 44A McClintock Avenue, Unit A, in Worcester, Worcester County, Massachusetts 01604. Costa was listed as Manager of TelexFree, LLC with the Massachusetts Secretary of State Corporations Division.

72. Sanderley Rodrigues De Vasconcelos, ("Rodrigues"), is an individual now or formerly of, 100 Stockton Street, Apt. 49, in Chelsea, Suffolk County, Massachusetts 02150. At no time has Rodrigues been registered with the Commonwealth of Massachusetts as a broker or dealer of securities. Rodrigues had been charged by the United States Securities and Exchange Commission with operating a fraudulent Pyramid Scheme under the name of Universo FoneClub Corporation, another Massachusetts corporation formed by Rodrigues, in which he acted as Officer and Director. Rodrigues, settled these charges in 2007 and as condition of this settlement 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 Act. He was further disgorged of about \$1.8 Million in ill-gotten gains.

73. Rodrigues is the sole Officer, Director, and Registered Agent of WWW GLOBAL BUSINESS, INC. (sometimes referred to as “WWW Global Business”), is a corporation duly organized and existing under the laws of the Commonwealth of Massachusetts, having a principal place of business at 189 Squire Road, Suite 40, in Revere, Suffolk County, Massachusetts. WWW Global Business was organized by Rodrigues on or about February 7, 2013, to market and sell TelexFree Investments.

74. Santiago De La Rosa ("De La Rosa"), is an individual now or formerly of 189 Beacon Hill Avenue, Unit 2, in Lynn, Essex County, Massachusetts 01902. De La Rosa appears in internet videos promoting TelexFree and is one of TelexFree's most successful promoters, having recruited numerous other Promoters/Investors for TelexFree within the Dominican

75. Randy N. Crosby ("Crosby"), is an individual now or formerly of 30 Club Court, in Alpharetta, Georgia 30005. Crosby appears in internet videos promoting TelexFree and is one of TelexFree's most successful promoters, having recruited numerous other Promoters/Investors for TelexFree – especially through a website known as “everybodygetspaidweekly.biz”.

77. Each of the Defendants listed herein within Paragraphs 23 - 75 are herein collectively referred to as “Top-Level Promoters”. It is believed that additional Top-Level Promoters participated in TelexFree’s Pyramid Scheme but their identities are as yet unknown.

78. TelexFree, Inc., TelexFree, LLC and TelexFree Financial, Inc. are not currently Defendants due to their Chapter 11 bankruptcy protections, but they are third-party participants in the unlawful activities described in this Complaint.

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80. TelexFree, LLC is a limited liability company duly organized and existing under the laws of Nevada, having a purported place of business at 4705 S. Durango Drive, #100-J51 (a post office box), Las Vegas, Nevada 89147 (the “Nevada Post Office Box”).⁵ TelexFree, LLC also maintained offices in the Commonwealth of Massachusetts at the TelexFree Marlborough Office between 2012 and late April 2014. At all material times, TelexFree LLC was identified as a limited liability company as registered with the Corporations Division of the Secretary to the Commonwealth of Massachusetts (Identification Number 001105166). TelexFree, LLC registered with the Secretary of State for the Commonwealth of Massachusetts on April 18, 2013.

A. TelexFree’s History

82. Each Defendant was a Top-Level Promoter was encouraged to and did recruit and “build” a network of new investor victims. They worked in conjunction with Pyramid scheme Founders and administrative personal including Merrill Wanzeler and Costa; Steven Labriola; and others whose role has not yet been determined.

⁴ See Office of the Secretary of the Commonwealth of Mass., Corporations Div., Corporate Summary for TelexFree, Inc., attached hereto as Exhibit 1.

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84. A pyramid scheme is a fraudulent business operation whereby an individual or organization pays returns to its investors from new money paid into the operation by new victims, rather than from profit earned by the operator. Inevitably, every pyramid scheme fails.

86. During the putative class period, the Top-Level Promoter Defendants made use of each of the identical stereotypical Pyramid scheme components and marketing program listed hereafter.

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what so ever to the identically set income promised. The marketing program of the over arching Pyramid scheme that each Defendant Top-Level Promoter relied on and participated in generated the funds that unjustly enriched each Top-Level Promoter including the “Hook”.

88. **The Scheme is Showered with Credibility:** The victims of pyramid schemes are always given a believable explanation of how their investment will earn the “above normal rate of return on investment.” The explanation must be good enough to convince people to invest and reinvest their money and importantly, to recruit others. The “Credibility Showers” were included in the marketing plan each Defendant participated in or used, and it was an identical and essential component of the same overarching unlawful Pyramid scheme. Here the Defendant Top-Level Promoters made use of the same marketing as put forward by the persons who founded or operated the Pyramid scheme. This included the false representation⁶ that the Founder and Principal Merrill was a college graduate with specialty degrees in a field related to the product they touted as driving the profit. TelexFree also falsely represented that its Principals had been involved in telecommunications for many years. Moreover, the identical marketing program used by each Defendant Top-Level Promoter involved the identical lawyers, certified public accountants (“CPAs”),⁷ and other credible professionals⁸ who had blessed the instant Pyramid scheme as a legal and sound business opportunity. The identical marketing plan that the Top-Level Promoters made use of also involved the same “credible persons” touting the

⁶ Among other places this appeared on an identical or commonly used web site.

⁷ TelexFree first had Nehra, an attorney who also heavily promoted himself as having specialized MLM experience, guarantee that its business enterprise was legitimate. It later promoted the fact that Nehra had teamed up with another heavily promoted MLM attorney, Defendant Waak. TelexFree was also publicly tied to Bank of America and TD Bank.

⁸ Well-known MLM “professionals” with great experience or success were used to state on TelexFree’s behalf that the pyramid scheme was legal and a good investment. TelexFree made such use of Rodrigues, De La Rosa, Crosby, Sloan, Shoyfer, Smith and others.

89. **Initial Investors Paid Off:** In most pyramid schemes, some initial investors will receive the promised return. The “Bait Payoffs” were included in the marketing plan each Defendant participated in or used and were, an identical and essential component of the same overarching unlawful Pyramid scheme. This trick is used to convince victims that the investment is not risky and that a return will be received. The scammers use smaller payouts to bring in bigger ones. Payouts are also used to prompt victims to bring in the investment cash of their family, friends, co-workers and others. It is also used to turn the \$100 dollar investor into a \$1,000 or \$10,000 investor. Participants also become more comfortable after learning of pay outs to the point they eventually recommend others close to them such as family, friends, and business associates to invest. The marketing program the Defendant Top-Level Promoters used and participated in here was identical. The marketing program of the overarching Pyramid scheme that each Defendant Top-Level Promoter relied on and participated in generated the funds that unjustly enriched each Top-Level Promoter including the “Bait Payouts”.

91. In February 2012, founders and principals Carlos Wanzeler and James Merrill formed TelexFree, Inc. in the Commonwealth of Massachusetts.

93. TelexFree falsely advertised itself as a “multi-level marketing” company selling

local and international telephone service plans that used unique groundbreaking “voice over internet protocol” (“VoIP”) technology.

94. The VoIP technology used by TelexFree was not unique or groundbreaking. In fact, it was substandard and offered nothing more than the free Google Voice and Skype.

95. TelexFree’s business plan and operations were an unlawful Pyramid Scheme and not a lawful multi-level marketing (“MLM”) enterprise. At all times relevant to this complaint, TelexFree violated the express terms of Massachusetts General Laws (“M.G.L.”) c. 93, § 69.

96. United States authorities began to investigate TelexFree, and in January and February 2014, the Secretary of the Commonwealth of Massachusetts, Securities Division (the “SOC”) issued subpoenas.

97. On April 14, 2014, TelexFree, Inc. along with two affiliated companies, TelexFree, LLC and TelexFree Financial, Inc. (together, the “Bankrupt Companies”), filed for Chapter 11 bankruptcy protection in Nevada claiming that TelexFree’s revenues were insufficient to meet its obligations.

98. On or about April 15, 2014, the United States Department of Homeland Security (the “DHS”), the Federal Bureau of Investigation (the “FBI”) and others raided the offices of TelexFree, shutting down its operation, seizing records and other evidentiary items.

99. On May 9, 2014, the DHS filed criminal proceedings against two of TelexFree’s founders, Wanzeler and Merrill, for conspiracy to commit wire fraud.

100. Thereafter, the United States Department of Justice (the “DOJ”) brought charges of wire fraud and conspiracy to commit wire fraud against TelexFree’s owners Wanzeler and Merrill, and the same were indicted by grand jury on July 23, 2014.

101. TelexFree’s other principals and operational defendants are currently under state

and federal investigation, and some are the subjects of lawsuits by the Securities and Exchange Commission (the “SEC”) and the Massachusetts SOC for operating the Pyramid Scheme.

B. Defendants Electric and Mobile

102. Mobile is a Nevada corporation formed on November 26, 2013.

103. TelexFree, Inc. and TelexFree, LLC made a \$500,870 “loan” to Mobile during the class period, as indicated by its financial statements. The loan was a sham.

104. TelexFree, Inc. and TelexFree, LLC made a \$2,022,329 “loan” to Electric during the class period, as indicated by financial statements.

105. The loan was a sham designed to wrongfully, fraudulently, unfairly or deceptively convert, divert, launder or shelter funds invested by Plaintiffs and the putative class.

106. Electric and Mobile possess funds rightfully belonging to the putative class.

C. TelexFree Was An Unlawful, Unfair and Deceptive Pyramid Scheme

107. TelexFree purported to sell VoIP products, but it was not a viable business operation. Defendant Labriola was fully aware of this and the other unlawful aspects of TelexFree at all times, yet knowingly chose to unfairly and deceptively spearhead many aspects of the unlawful Pyramid scheme for sole motive of making money.

108. TelexFree's revenues from sales of its VoIP products were inconsequential compared to its overall operations.

109. The vast majority of TelexFree’s revenue came from the purchase of membership plans by Participants.

110. Participants who purchased memberships could open user accounts and accumulate “credits” in these accounts. The “credits” represented money purportedly owed by TelexFree to the Participant, and could be theoretically redeemed for cash, transferred to another user account, or redeemed in satisfaction of an invoice for another user account.

cross-commission, dividend or other consideration” to any participant therein “solely for the solicitation or recruitment of other participants.”

120. The standard TelexFree contract (“TelexFree Contract”), on its face, contains numerous instances of promising payment to Promoters merely for recruitment of new Participants⁹ as defined by M.G.L., Chapter 93, Section 69, including but not limited to Clauses 5.7, 5.7.1, 5.8, 6.1, 6.1.1, 6.1.2, and 8.1.

121. The above provisions of the standard TelexFree Contract are clear and direct violations of M.G.L. c. 93, § 69(d), as they promise payments, including cash payments, “bonuses,” “gratuities,” “royalties,” and dividends, merely for the recruitment of new TelexFree Members/Participants (i.e. through the sale of AdCentral membership accounts).

122. Furthermore, M.G.L., Chapter 93, Section 69(d)(3)-(4) also prohibits any multi-level distribution company from offering or paying any “finder’s fee, bonus, refund, override, commission, cross-commission, dividend or other consideration” to any participant therein:

- a. “[U]nless such participant performs a bona fide and essential supervisory, distributive, selling or soliciting function in the sale or delivery of such product or services,” or,
- b. “[W]here no amount of judgment or skill exercised by the participant has any appreciable effect” upon such payment,” or
- c. “[W]here the participant is without that degree of control over the operation of such plan as to enable him substantially to affect the amount” of such payment.

123. The TelexFree Contract, on its face, contains clear, obvious and direct violations of M.G.L. c. 93, § 69(d)(3)-(4), including, but not limited to, Clauses 5.4, 5.4.1, 5.4.2, 5.5, 5.5.1 and 5.5.2.

⁹ For ease of reading, the terms “Member”, “Promoter” or “Participant”, regardless of capitalization, are at all times herein to be construed as “Participant” defined by Massachusetts General Laws Chapter 93, Section 69.

125. Rather, Members were only required to engage in the mindless activity of cutting-and-pasting spam advertisements, which were “prepared by TELEXFREE,” onto “internet announcement sites,” and would receive “remuneration for these announcements.”

127. Not only does the TelexFree Contract explicitly violate M.G.L. Chapter 93, Section 69 – it also lays bare several classic hallmarks of pyramid schemes, including paying participants solely for recruitment of new members, not requiring any meaningful sales or distributive activity by participants, and using coercive measures to prevent participant withdrawal from the scheme.

129. The TelexFree Contract, on its face, contains egregious, obvious violations of M.G.L. c. 93, § 69(b), including, but not limited to, Clauses 10.1.2, 10.1.3 and 10.1.4.

131. TelexFree's founders, Labriola, and Top-Level Promoters engaged in acts of civil conspiracy. The founders controlled the conduct of and colluded with the Top-Level Promoters through meetings, written materials, regular conference calls, and other means.

138. TelexFree provided the Top-Level Promoters with many of the marketing materials that the Promoters, in turn, used to recruit Members.

139. These fraudulent marketing materials – including those found on TelexFree’s website, online videos, cut-and-paste advertisements, social media postings, and statements of TelexFree’s attorneys – were re-posted, re-stated, and re-iterated by the Top-Level Promoters in order to build their network of recruits.

E. Events Since TelexFree’s Bankruptcy Filing

140. On April 15, 2014, the SOC filed an Administrative Complaint against TelexFree, Inc. and TelexFree, LLC, alleging violations of the Massachusetts Uniform Securities Act, M.G.L., c. 110A.

141. The SOC sought injunctions and orders requiring TelexFree, Inc. and TelexFree, LLC to cease and desist from further conduct violating Massachusetts securities laws and regulations, to provide an accounting of all proceeds received because of TelexFree’s fraud, to provide restitution to Promoters for losses attributable to the fraud operations, and to disgorge all profits.

142. Also on April 15, 2014, the SEC filed a civil Complaint and Jury Demand against TelexFree, Inc. and TelexFree, LLC as well as Merrill, Wanzeler, Stephen Labriola, and certain top-level promoters, alleging violations of the Securities Act of 1933, the Securities Exchange Act of 1934, and SEC Regulations. The SEC requested and was granted a preliminary injunction and an order freezing the assets of TelexFree. The SEC is also seeking disgorgement of profits and additional civil penalties.

143. Additionally on April 15, 2014, the FBI and the DHS conducted a raid of TelexFree’s Marlborough Office.

144. On or about May 1, 2014, the Montana Securities Commissioner filed a cease and

151. Plaintiffs meet the requirements of Federal Rule of Civil Procedure 23(a) because there is a well-defined community of interest among the members of the Class, common questions of law and fact predominate, Plaintiffs' claims are typical of the members of the Class, and Plaintiffs can fairly and adequately represent the interests of the Class.

- whether TelexFree operated a lawful MLM program or an unlawful Pyramid Scheme or a legitimate business
- whether the Top-Level Promoters who received direct victim payment were unjustly enriched;
- whether the funds paid by the Plaintiff Class directly to the Defendants must be repaid, without regard to the individual circumstances of participation in the Scheme, because it constituted an unjust enrichment;
- whether the Form 1099's issued by the Defendants are valid or should be voided by this Court;
- whether TelexFree was a "multi-level distribution company" as defined by Massachusetts General Laws Chapter 93, Section 69(a);
- whether the standard TelexFree Contract contained promises to pay merely for the recruitment of new members in violation of Massachusetts General Laws Chapter 93, Section 69(a);
- whether the standard TelexFree Contract contained offers to pay a "finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration" to Participants in the TelexFree program in violation of Massachusetts General Laws Chapter 93, Section 69(a);
- whether the TelexFree program offered its Members payment without requiring them to engage in any "bona fide and essential supervisory, distributive, selling or soliciting," nor exercise any "judgment," "skill," or "control over the operation" in violation of Massachusetts General Laws

Chapter 93, Section 69(a); and

- whether Plaintiffs and the Class are entitled to damages, civil penalties, punitive damages, and/or injunctive relief;
- what information the Top-Level promoters were given that was not made available to the members of the Putative Class at the same time.

153. Plaintiffs' claims are typical of those of other Class members because Plaintiffs were defrauded by TelexFree's common Scheme.

154. Plaintiffs will fairly and accurately represent the interests of the Class.

155. The prosecution of separate actions by individual members of the Class would create a risk of inconsistent or varying adjudications regarding individual members of the Class, which would establish incompatible standards of conduct for Defendants and would lead to repetitive adjudication of common questions of law and fact.

156. Class treatment is superior to any other method for adjudicating the controversy. Plaintiffs know of no difficulty likely to be encountered in the management of this litigation that would preclude its maintenance as a class action under Rule 23(b)(3).

157. Damages for any individual class member likely cannot justify the cost of individual litigation, so that absent class treatment, the Defendants' violations of law inflicting substantial damages in the aggregate would go un-remedied without certification of the Class.

158. Defendants have acted or refused to act on grounds that apply to the Class, as alleged above, and certification is proper under Rule 23(b)(2).

V. CLAIM FOR RELIEF

FIRST CLAIM FOR RELIEF **UNJUST ENRICHMENT**

159. Plaintiffs incorporate by reference all allegations in all previous paragraphs, as though fully set forth here.

161. The overarching Pyramid marketing program that each Defendant Top-Level Promoter relied on and participated in generated the funds that unjustly enriched each Defendant

163. The success of the TelexFree Pyramid Scheme, and the unjust receipt of Direct Victim Payments by the Defendants, was dependent upon the common participation and wrongful acts of the Top-Level Promoters.

165. In performing their common roles as Top-Level Promoters, Defendants utilized TelexFree's fraudulent marketing materials and implemented the uniform features of its program.

166. When obtaining an additional victim, and pocketing a Direct Victim Payment, each Defendant relied upon, utilized and implemented the common Scheme's standard modes of operation.

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169. Each Defendant, as a Top-Level Promoter, performed a common, integral role in the commission, expansion and perpetuation of the TelexFree Pyramid Scheme.

171. Defendants had an appreciation or knowledge of that they received a benefit when they took payment.

173. Defendants have unlawfully and in bad faith denied Plaintiffs and the putative Class access to such funds, and have instead knowingly retained the benefit of such funds for themselves.

175. Allowing IRS Form 1099's issued by the Defendants to have a lawful effect under the circumstances set forth herein would otherwise be inequitable.

176. As a direct and proximate result of Defendants' actions, as hereinabove set forth, Defendants are, and continue to be, unjustly enriched and Plaintiffs demand they and the

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Evans J. Carter, Esq.
(MA Bar No. 076560)
Evans J. Carter, P.C.
860 Worcester Road, 2nd Floor
P.O. Box 812
Framingham, MA 01701
Telephone: 508-875-1669
Email: ejcatty1@verizon.net

D. Michael Noonan, Esq.
(NH Bar No. 8214)
(MA Bar No. 558247)
Christine M. Craig, Esq.
(MA Bar No. 631211)
Shaheen and Gordon
140 Washington Street
P.O. Box 977
Dover, NH 03821
Telephone: 603-871-4144
Email: mnoonan@shaheengordon.com
Email: ccraig@shaheengordon.com

R. Alexander Saveri, Esq.
(CA Bar No. 173102)
Cadio Zirpoli, Esq.
(CA Bar No. 179108)
Carl N. Hammarskjold, Esq.
(CA Bar No. 280961)
Saveri & Saveri, Inc.
706 Sansome Street
San Francisco, CA 94111
Telephone: 415-217-6810
Email: rick@saveri.com
Email: cadio@saveri.com
Email: carl@saveri.com

Ronald P. Passatempo, Esq.
(MA Bar No. 632508)
Ronald P. Passatempo Law Offices
200 Broadway
Lynnfield, MA 01940
Telephone: 781-596-3100
Email: passatempolaw@comcast.net

William Coulthard, Esq.
(NV Bar No. 3927)
Michael Gayan, Esq.
(NV Bar No. 11135)
Kemp, Jones & Coulthard, LLP
Wells Fargo Tower
3800 Howard Hughes Parkway, 17th Floor
Las Vegas, NV 89169
Telephone: 702-385-6000
Email: w.coulthard@kempjones.com

D. Scott Dulea, Esq.
(MA Bar No. 670416)
Goldberg & Dullea
5 Briscoe Street
Beverly, MA 01915
Telephone: 978-922-4025
Email: scott@goldberganddulses.com

Jan R. Schlichtmann, Esq.
(MA Bar No. 445900)
Jan R. Schlichtmann, Attorney at Law, PC
P.O. Box 233
Prides Crossing, MA 01965
Telephone: 978-927-1037
Email: jan@schlichtmannlaw.com

Randall Renick, Esq.
Hadsell Stormer Richardson & Renick, LLP
128 N. Fair Oaks Avenue, Suite 204
Pasadena, CA 91103
Telephone: 626-381-9261
Email: rrr@hadsellstormer.com

Adriana Contartese, Esq.
(FL Bar No. 89634)
Law Offices of Adriana Contartese
OCN Document Prep Suite 926
19W Flagler Street
Miami, FL 33130
Telephone: 617-268-3557
Email: adriana911@juno.com

Stephen M. Smith, Esq.
(NY Bar No. 277784)
(VA Bar No. 14362)
(NY Bar No. 277784)
(DC Bar No. 230995)
Brain Injury Law Center
2100 Kecoughtan Road
Hampton, VA 23661
Telephone: 877-840-3431
Email: ssmith@braininjurylawcenter.com

The JS 44 civil cover sheet and the information contained herein neither replace nor supplement the filing and service of pleadings or other papers as required by law, except as provided by local rules of court. This form, approved by the Judicial Conference of the United States in September 1974, is required for the use of the Clerk of Court for the purpose of initiating the civil docket sheet. (SEE INSTRUCTIONS ON NEXT PAGE OF THIS FORM.)

I. (a) PLAINTIFFS

Maria Murdoch, Angela Batista Jamanenez, Elisangela Oliveira and Diogo Dearaugo

(b) County of Residence of First Listed Plaintiff Middlesex County
(EXCEPT IN U.S. PLAINTIFF CASES)

(c) Attorneys (Firm Name, Address, and Telephone Number)

Robert J. Bonsignore / Bonsignore Trial Lawyers, PLLC
3771 Meadowcrest Drive, Las Vegas, NV 89121
781-856-7650**DEFENDANTS**

TelexElectric, LLLP, et al

County of Residence of First Listed Defendant Clark County
(IN U.S. PLAINTIFF CASES ONLY)

NOTE: IN LAND CONDEMNATION CASES, USE THE LOCATION OF THE TRACT OF LAND INVOLVED.

Attorneys (If Known)

II. BASIS OF JURISDICTION (Place an "X" in One Box Only)

- ☐ 1 U.S. Government Plaintiff
- ☐ 2 U.S. Government Defendant
- ☐ 3 Federal Question
(U.S. Government Not a Party)
- ☒ 4 Diversity
(Indicate Citizenship of Parties in Item III)

III. CITIZENSHIP OF PRINCIPAL PARTIES (Place an "X" in One Box for Plaintiff and One Box for Defendant)

- | | PTF | DEF | | PTF | DEF |
|---|---------------------------------------|---------------------------------------|---|----------------------------|----------------------------|
| Citizen of This State | <input checked="" type="checkbox"/> 1 | <input type="checkbox"/> 1 | Incorporated or Principal Place of Business In This State | <input type="checkbox"/> 4 | <input type="checkbox"/> 4 |
| Citizen of Another State | <input type="checkbox"/> 2 | <input checked="" type="checkbox"/> 2 | Incorporated and Principal Place of Business In Another State | <input type="checkbox"/> 5 | <input type="checkbox"/> 5 |
| Citizen or Subject of a Foreign Country | <input type="checkbox"/> 3 | <input type="checkbox"/> 3 | Foreign Nation | <input type="checkbox"/> 6 | <input type="checkbox"/> 6 |

IV. NATURE OF SUIT (Place an "X" in One Box Only)

CONTRACT	TORTS		FORFEITURE/PENALTY	BANKRUPTCY	OTHER STATUTES
<input type="checkbox"/> 110 Insurance <input type="checkbox"/> 120 Marine <input type="checkbox"/> 130 Miller Act <input type="checkbox"/> 140 Negotiable Instrument <input type="checkbox"/> 150 Recovery of Overpayment & Enforcement of Judgment <input type="checkbox"/> 151 Medicare Act <input type="checkbox"/> 152 Recovery of Defaulted Student Loans (Excludes Veterans) <input type="checkbox"/> 153 Recovery of Overpayment of Veteran's Benefits <input type="checkbox"/> 160 Stockholders' Suits <input checked="" type="checkbox"/> 190 Other Contract <input type="checkbox"/> 195 Contract Product Liability <input type="checkbox"/> 196 Franchise	PERSONAL INJURY <input type="checkbox"/> 310 Airplane <input type="checkbox"/> 315 Airplane Product Liability <input type="checkbox"/> 320 Assault, Libel & Slander <input type="checkbox"/> 330 Federal Employers' Liability <input type="checkbox"/> 340 Marine <input type="checkbox"/> 345 Marine Product Liability <input type="checkbox"/> 350 Motor Vehicle <input type="checkbox"/> 355 Motor Vehicle Product Liability <input type="checkbox"/> 360 Other Personal Injury <input type="checkbox"/> 362 Personal Injury - Medical Malpractice	PERSONAL INJURY <input type="checkbox"/> 365 Personal Injury - Product Liability <input type="checkbox"/> 367 Health Care/Pharmaceutical Personal Injury Product Liability <input type="checkbox"/> 368 Asbestos Personal Injury Product Liability PERSONAL PROPERTY <input type="checkbox"/> 370 Other Fraud <input type="checkbox"/> 371 Truth in Lending <input type="checkbox"/> 380 Other Personal Property Damage <input type="checkbox"/> 385 Property Damage Product Liability	<input type="checkbox"/> 625 Drug Related Seizure of Property 21 USC 881 <input type="checkbox"/> 690 Other	<input type="checkbox"/> 422 Appeal 28 USC 158 <input type="checkbox"/> 423 Withdrawal 28 USC 157 PROPERTY RIGHTS <input type="checkbox"/> 820 Copyrights <input type="checkbox"/> 830 Patent <input type="checkbox"/> 840 Trademark SOCIAL SECURITY <input type="checkbox"/> 861 HIA (1395ff) <input type="checkbox"/> 862 Black Lung (923) <input type="checkbox"/> 863 DIWC/DIWW (405(g)) <input type="checkbox"/> 864 SSID Title XVI <input type="checkbox"/> 865 RSI (405(g))	<input type="checkbox"/> 375 False Claims Act <input type="checkbox"/> 400 State Reapportionment <input type="checkbox"/> 410 Antitrust <input type="checkbox"/> 430 Banks and Banking <input type="checkbox"/> 450 Commerce <input type="checkbox"/> 460 Deportation <input type="checkbox"/> 470 Racketeer Influenced and Corrupt Organizations <input type="checkbox"/> 480 Consumer Credit <input type="checkbox"/> 490 Cable/Sat TV <input type="checkbox"/> 850 Securities/Commodities/Exchange <input type="checkbox"/> 890 Other Statutory Actions <input type="checkbox"/> 891 Agricultural Acts <input type="checkbox"/> 893 Environmental Matters <input type="checkbox"/> 895 Freedom of Information Act <input type="checkbox"/> 896 Arbitration <input type="checkbox"/> 899 Administrative Procedure Act/Review or Appeal of Agency Decision <input type="checkbox"/> 950 Constitutionality of State Statutes
REAL PROPERTY	CIVIL RIGHTS	PRISONER PETITIONS	LABOR	FEDERAL TAX SUITS	
<input type="checkbox"/> 210 Land Condemnation <input type="checkbox"/> 220 Foreclosure <input type="checkbox"/> 230 Rent Lease & Ejectment <input type="checkbox"/> 240 Torts to Land <input type="checkbox"/> 245 Tort Product Liability <input type="checkbox"/> 290 All Other Real Property	<input type="checkbox"/> 440 Other Civil Rights <input type="checkbox"/> 441 Voting <input type="checkbox"/> 442 Employment <input type="checkbox"/> 443 Housing/Accommodations <input type="checkbox"/> 445 Amer. w/Disabilities - Employment <input type="checkbox"/> 446 Amer. w/Disabilities - Other <input type="checkbox"/> 448 Education	Habeas Corpus: <input type="checkbox"/> 463 Alien Detainee <input type="checkbox"/> 510 Motions to Vacate Sentence <input type="checkbox"/> 530 General <input type="checkbox"/> 535 Death Penalty Other: <input type="checkbox"/> 540 Mandamus & Other <input type="checkbox"/> 550 Civil Rights <input type="checkbox"/> 555 Prison Condition <input type="checkbox"/> 560 Civil Detainee - Conditions of Confinement	<input type="checkbox"/> 710 Fair Labor Standards Act <input type="checkbox"/> 720 Labor/Management Relations <input type="checkbox"/> 740 Railway Labor Act <input type="checkbox"/> 751 Family and Medical Leave Act <input type="checkbox"/> 790 Other Labor Litigation <input type="checkbox"/> 791 Employee Retirement Income Security Act IMMIGRATION <input type="checkbox"/> 462 Naturalization Application <input type="checkbox"/> 465 Other Immigration Actions	<input type="checkbox"/> 870 Taxes (U.S. Plaintiff or Defendant) <input type="checkbox"/> 871 IRS—Third Party 26 USC 7609	

V. ORIGIN (Place an "X" in One Box Only)

- ☒ 1 Original Proceeding
- ☐ 2 Removed from State Court
- ☐ 3 Remanded from Appellate Court
- ☐ 4 Reinstated or Reopened
- ☐ 5 Transferred from Another District (specify)
- ☐ 6 Multidistrict Litigation

VI. CAUSE OF ACTION

Cite the U.S. Civil Statute under which you are filing (Do not cite jurisdictional statutes unless diversity):

28:1332 Diversity: Securities Fraud

Brief description of cause:
illegal pyramid scheme**VII. REQUESTED IN COMPLAINT:**☒ CHECK IF THIS IS A CLASS ACTION UNDER RULE 23, F.R.Cv.P.

DEMAND \$

CHECK YES only if demanded in complaint:

JURY DEMAND: ☒ Yes ☐ No**VIII. RELATED CASE(S) IF ANY**

(See instructions):

JUDGE Timothy S. HillmanDOCKET NUMBER 14-md-02566

DATE

02/24/2016

SIGNATURE OF ATTORNEY OF RECORD

Robert J. Bonsignore

FOR OFFICE USE ONLY

RECEIPT #

AMOUNT

APPLYING IFP

JUDGE

MAG. JUDGE

INSTRUCTIONS FOR ATTORNEYS COMPLETING CIVIL COVER SHEET FORM JS 44

Authority For Civil Cover Sheet

The JS 44 civil cover sheet and the information contained herein neither replaces nor supplements the filings and service of pleading or other papers as required by law, except as provided by local rules of court. This form, approved by the Judicial Conference of the United States in September 1974, is required for the use of the Clerk of Court for the purpose of initiating the civil docket sheet. Consequently, a civil cover sheet is submitted to the Clerk of Court for each civil complaint filed. The attorney filing a case should complete the form as follows:

- I.(a) Plaintiffs-Defendants.** Enter names (last, first, middle initial) of plaintiff and defendant. If the plaintiff or defendant is a government agency, use only the full name or standard abbreviations. If the plaintiff or defendant is an official within a government agency, identify first the agency and then the official, giving both name and title.
 - (b) County of Residence.** For each civil case filed, except U.S. plaintiff cases, enter the name of the county where the first listed plaintiff resides at the time of filing. In U.S. plaintiff cases, enter the name of the county in which the first listed defendant resides at the time of filing. (NOTE: In land condemnation cases, the county of residence of the "defendant" is the location of the tract of land involved.)
 - (c) Attorneys.** Enter the firm name, address, telephone number, and attorney of record. If there are several attorneys, list them on an attachment, noting in this section "(see attachment)".
- II. Jurisdiction.** The basis of jurisdiction is set forth under Rule 8(a), F.R.Cv.P., which requires that jurisdictions be shown in pleadings. Place an "X" in one of the boxes. If there is more than one basis of jurisdiction, precedence is given in the order shown below.
- United States plaintiff. (1) Jurisdiction based on 28 U.S.C. 1345 and 1348. Suits by agencies and officers of the United States are included here.
- United States defendant. (2) When the plaintiff is suing the United States, its officers or agencies, place an "X" in this box.
- Federal question. (3) This refers to suits under 28 U.S.C. 1331, where jurisdiction arises under the Constitution of the United States, an amendment to the Constitution, an act of Congress or a treaty of the United States. In cases where the U.S. is a party, the U.S. plaintiff or defendant code takes precedence, and box 1 or 2 should be marked.
- Diversity of citizenship. (4) This refers to suits under 28 U.S.C. 1332, where parties are citizens of different states. When Box 4 is checked, the citizenship of the different parties must be checked. (See Section III below; **NOTE: federal question actions take precedence over diversity cases.**)
- III. Residence (citizenship) of Principal Parties.** This section of the JS 44 is to be completed if diversity of citizenship was indicated above. Mark this section for each principal party.
- IV. Nature of Suit.** Place an "X" in the appropriate box. If the nature of suit cannot be determined, be sure the cause of action, in Section VI below, is sufficient to enable the deputy clerk or the statistical clerk(s) in the Administrative Office to determine the nature of suit. If the cause fits more than one nature of suit, select the most definitive.
- V. Origin.** Place an "X" in one of the six boxes.
- Original Proceedings. (1) Cases which originate in the United States district courts.
- Removed from State Court. (2) Proceedings initiated in state courts may be removed to the district courts under Title 28 U.S.C., Section 1441. When the petition for removal is granted, check this box.
- Remanded from Appellate Court. (3) Check this box for cases remanded to the district court for further action. Use the date of remand as the filing date.
- Reinstated or Reopened. (4) Check this box for cases reinstated or reopened in the district court. Use the reopening date as the filing date.
- Transferred from Another District. (5) For cases transferred under Title 28 U.S.C. Section 1404(a). Do not use this for within district transfers or multidistrict litigation transfers.
- Multidistrict Litigation. (6) Check this box when a multidistrict case is transferred into the district under authority of Title 28 U.S.C. Section 1407. When this box is checked, do not check (5) above.
- VI. Cause of Action.** Report the civil statute directly related to the cause of action and give a brief description of the cause. **Do not cite jurisdictional statutes unless diversity.** Example: U.S. Civil Statute: 47 USC 553 Brief Description: Unauthorized reception of cable service
- VII. Requested in Complaint.** Class Action. Place an "X" in this box if you are filing a class action under Rule 23, F.R.Cv.P.
- Demand. In this space enter the actual dollar amount being demanded or indicate other demand, such as a preliminary injunction.
- Jury Demand. Check the appropriate box to indicate whether or not a jury is being demanded.
- VIII. Related Cases.** This section of the JS 44 is used to reference related pending cases, if any. If there are related pending cases, insert the docket numbers and the corresponding judge names for such cases.

Date and Attorney Signature. Date and sign the civil cover sheet.

1. Title of case (name of first party on each side only) Maria Murdoch et al v. Telexelectric, LLLP et al
2. Category in which the case belongs based upon the numbered nature of suit code listed on the civil cover sheet. (See local rule 40.1(a)(1)).
- ☐ I. 410, 441, 470, 535, 830*, 891, 893, 895, R.23, REGARDLESS OF NATURE OF SUIT.
- ☒ II. 110, 130, 140, 160, 190, 196, 230, 240, 290, 320, 362, 370, 371, 380, 430, 440, 442, 443, 445, 446, 448, 710, 720, 740, 790, 820*, 840*, 850, 870, 871.
- ☐ III. 120, 150, 151, 152, 153, 195, 210, 220, 245, 310, 315, 330, 340, 345, 350, 355, 360, 365, 367, 368, 375, 385, 400, 422, 423, 450, 460, 462, 463, 465, 480, 490, 510, 530, 540, 550, 555, 625, 690, 751, 791, 861-865, 890, 896, 899, 950.
- *Also complete AO 120 or AO 121. for patent, trademark or copyright cases.
3. Title and number, if any, of related cases. (See local rule 40.1(g)). If more than one prior related case has been filed in this district please indicate the title and number of the first filed case in this court.
- In Re: TelexFree Securities Litigation 4:14-md-02566-TSH
4. Has a prior action between the same parties and based on the same claim ever been filed in this court?
- YES ☐ NO ☒
5. Does the complaint in this case question the constitutionality of an act of congress affecting the public interest? (See 28 USC §2403)
- YES ☐ NO ☒
- If so, is the U.S.A. or an officer, agent or employee of the U.S. a party?
- YES ☐ NO ☒
6. Is this case required to be heard and determined by a district court of three judges pursuant to title 28 USC §2284?
- YES ☐ NO ☒
7. Do all of the parties in this action, excluding governmental agencies of the United States and the Commonwealth of Massachusetts ("governmental agencies"), residing in Massachusetts reside in the same division? - (See Local Rule 40.1(d)).
- YES ☐ NO ☒
- A. If yes, in which division do all of the non-governmental parties reside?
- Eastern Division ☐ Central Division ☐ Western Division ☐
- B. If no, in which division do the majority of the plaintiffs or the only parties, excluding governmental agencies, residing in Massachusetts reside?
- Eastern Division ☒ Central Division ☐ Western Division ☐
8. If filing a Notice of Removal - are there any motions pending in the state court requiring the attention of this Court? (If yes, submit a separate sheet identifying the motions)
- YES ☐ NO ☐

(PLEASE TYPE OR PRINT)

ATTORNEY'S NAME Robert J. Bonsignore

ADDRESS 3771 Meadowcrest Drive, Las Vegas, NV 89121

TELEPHONE NO. 781-856-7650

EXHIBIT K

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

ELISANGELA OLIVEIRA, PLAINTIFF, Putative
Class Representative, and Those Similarly Situated,

Plaintiff,

v.

DOUGLAS M. MACHADO, ALEXANDRO O.
ROCHA, DAVID REIS, LEONARDO
FRANCISCO, LINDA S. HACKETT, DAVID
HACKETT, DL1 INC., BENJAMIN ARGUETA,
JACQUELINE DA COSTA ZIEFF, JOSE
CARLOS MACIEL, BRUNO GRAZIANI,
RENATO RIBEIRO, ERASMO BARROSO, LAIR
FERNANDES, LAYZA DUARTE, LYVIA M.
WANZELER, RODRIGO MONTEMOR, RONI
YASMINE, RUDNEI DA SILVA, VAGNER
DANTAS SILVA, WAGNER WEIHRAUCH,
JULIO SILVA, JOSE NETO, JULIO C. PAZ,
EUZEBIO SUDRE NETO, HUGO ALVARADO,
ANA R. RAMOS, RUDDY ABREAU, MARCO
ALMEIDA, LAUREANO ARELLANO, AARON
ATAIDE, ROSANE CRUZ, OMAR QUINONEZ,
CARLO DEJESUS, BILKISH SUNESARA,
ANDRES BOLIVAR ESTEVEZ, JOSE LOPEZ,
ANA ROSA LOPEZ, FRANTZ BALAN,
MARCELO DASILVA, BENERANDO
CONTRERAS, GLADYS ALVARDO, STEVEN
M. LABRIOLA, CARLOS COSTA, SANDERLEY
RODRIGUES DE VASCONCELOS, SANTIAGO
DE LA ROSA; RANDY N. CROSBY

Defendants.

CIVIL ACTION NO. 16-40018

**AMENDED CLASS ACTION
COMPLAINT**

AND

DEMAND FOR TRIAL BY JURY

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VII. DEMAND FOR JURY TRIAL	40

Plaintiff and Putative Class Representative Elisangela Oliveira, on behalf of herself and all others similarly situated, (“Plaintiff”), brings this action against the defendants named herein (“Defendants”). This complaint is based on information and belief, except those paragraphs that relate to Plaintiff, which are based on personal knowledge. To preserve the resources of this Court and the parties, Plaintiff¹ asserts the following abbreviated allegations as follows:

1. TelexFree, Inc., TelexFree, LLC, and TelexFree Financial, Inc. (collectively, “TelexFree” or the “Debtors”) and its related entities and individuals operated an illegal and fraudulent scheme whereby it sold “memberships,” ostensibly paid its “promoters” for placing duplicative and meaningless advertisements for a “voice over internet protocol” (“VoIP”) product, and in reality paid them to recruit other investors whose new membership fees kept the scheme afloat (the “TelexFree Program”).

2. Until TelexFree, Inc. changed its compensation plan in March 2014, a month before it filed for bankruptcy, it did not require promoters to sell its VoIP product to be eligible for payments.

3. Only 11.7% of the face value of invoices for membership plans or VoIP packages was paid in cash to the Debtors, and the remainder was satisfied by the use of victims’ credits. *See* Affidavit of Stephen B. Darr in Support of Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief at ¶ 35, *In re TelexFree, LLC*, No. 14-40987 (Bankr. D. Mass. Oct. 7, 2015), ECF No. 623-1 (“While invoices associated with the sale of membership plans or VoIP packages had a face value of \$3,073,471,326, only \$359,792,242, or approximately twelve percent (11.7%) of

¹ Plaintiff suggests the Court consider a separate litigation track be created for their claims against the Top-Level Promoters.

that amount, was paid in cash to the Debtors. The balance of these invoices, totaling \$2,713,679,084, was satisfied by the use of Participants' credits.”).

4. TelexFree’s business and operations constituted an illegal pyramid scheme (the “TelexFree Pyramid Scheme”); in fact, the United States Bankruptcy Court for the District of Massachusetts (Hoffman, J.) has made a finding of fact applicable to all proceedings that TelexFree’s operations constituted a Ponzi Scheme (Chapter 11 Case No. 14-40987-MSH; EFC No. 668). A pyramid scheme is a form of a Ponzi scheme wherein a business enterprise persuades people to invest money into a seemingly legitimate business model and in exchange guarantees unrealistic and, ultimately, illusory profits. The actual sales or services provided, if any, are insufficient to pay the promised returns to investors. The operation of a pyramid scheme relies entirely on additional investment funding by newly recruited or existing investors. Once the influx of new cash from new investors becomes insufficient to satisfy the ever-growing number of participants/previous investors, or as in the case of TelexFree stops short following law enforcement raids, the pyramid scheme collapses because there are no new funds with which to pay previous investors.

5. TelexFree’s founders and principals, executive office and top-level promoters controlled the activities and operations of TelexFree and knowingly, maliciously, and willfully conspired to perpetrate, and did perpetrate, the TelexFree Pyramid Scheme with full awareness of its unfair, deceptive, and unlawful nature.

6. A class action is pending in this district based upon the TelexFree Pyramid Scheme against, *inter alia*, TelexFree’s founders and principals, executive office and top-level promoters, certain licensed professionals and certain financial services providers for the knowing role they each played in substantially assisting the Scheme.

7. Through the present action, Plaintiff seeks compensation for the ascertainable economic loss she was caused to suffer as a result of the participation of the below-described Defendants in the illegal Pyramid Scheme.

8. These individual Defendants (each a “Direct Victim Payment Recipient” or “Top-Level Promoter”) profited from ascertainable payments Plaintiff and putative class members -- not TelexFree -- made to those Defendants.²

9. Plaintiff seeks compensation from the Defendant Top-Level Promoters solely for the payments made directly by Net Loser victims to Plaintiff and putative class members because the retention of such funds would be wrongful and unjust enrichment. Only the return of those funds will offset the net loss the Putative class suffered as a result of the unlawful Pyramid Scheme.

10. Each Defendant benefitted from the Scheme, possessed full knowledge of that benefit and accepted and retained such benefit, unjustly, at the expense of the named Plaintiff and/or putative class members. The Defendants’ retention of the monies paid by the victim/class members is patently unjust under the attendant circumstances. As such, the sole cause of action asserted against the Defendants here is for unjust enrichment.

I. JURISDICTION AND VENUE

11. This Court has subject-matter jurisdiction over the instant matter pursuant to 28 U.S.C. § 1332(d) and the Class Action Fairness Act of 2005 (“CAFA”), 28 U.S.C. §§ 1711, *et seq.*, which vest original jurisdiction in the district courts of the United States for any multi-state class action where the aggregate amount in controversy exceeds \$5,000,000 and where

² To avoid doubt, Plaintiffs seek recompense *solely* for monies *they* paid to the Defendants. They do not seek recovery of any monies *TelexFree* paid to those Defendants.

the citizenship of any member of the class of plaintiffs is different from that of any defendant. The amount in controversy is over \$5,000,000 and as evidenced below, the diverse citizenship requirement of CAFA are also satisfied.

12. Venue is proper under 28 U.S.C. § 1391 because a substantial part of the events giving rise to Plaintiff's claims occurred in this District, a substantial portion of the affected interstate trade and commerce described herein was carried out in this District, and one or more of the Defendants reside, are licensed to do business in, are doing business in, had agents in, or are found or transact business in this District.

13. This Court has *in personam* jurisdiction over the Defendants because each, either directly or through the valueless ownership of the fraudulent TelexFree packages, *inter alia*: (a) transacted business and participated in the carrying out and perpetration of a fraud by engaging in substantial activities in Massachusetts; (b) solicited victims in Massachusetts; (c) attended meetings in Massachusetts; (d) regularly spoke with the founders of TelexFree and members of the home office in Massachusetts in furtherance of their obtaining funds from victims; (e) directly or indirectly sold or marketed in Massachusetts; (f) otherwise committed a tort within the Commonwealth of Massachusetts including making use of the resources offered by the Founders or others in Massachusetts; (g) committed a breach of contract within Massachusetts; (h) had substantial aggregate contacts with Massachusetts; (i) were engaged in an illegal pyramid scheme conspiracy that was directed at, and had a direct, substantial, reasonably foreseeable and intended effect of causing injury to, the business or property of persons and entities residing in, located in, or doing business throughout Massachusetts and through that activity were substantially involved in the Commonwealth of Massachusetts' stream of commerce; and (j) to the extent that participants of an unlawful

enterprise purposefully take advantage of the laws of Commonwealth of Massachusetts – each did.

14. Each Defendant Top-Level Promoter communicated regularly with TelexFree’s founders, principals, executive officers, home office employees³, including James Merrill, Carlos Wanzeler, Steven Labriola, Carlos Costa, and other Defendants and others identified as Does in Massachusetts during all material relevant times beginning on February 15, 2012 through approximately April 2014 in furtherance of their taking of funds from the putative class of victims. Each Defendant together with financial service providers, licensed professionals and others conducted business and carried out acts that were substantial and essential to the operation of the TelexFree Pyramid Scheme in Massachusetts, and they have purposefully availed themselves of the laws of the Commonwealth of Massachusetts. Moreover each Defendant was party to acts and transactions giving rise to this action that occurred in this District.

15. By reason of the unlawful activities hereinafter alleged, Defendants substantially affected commerce throughout Massachusetts and the United States, causing injury to the Plaintiffs and members of the putative class. Defendants, directly and through their agents, engaged in activities affecting Massachusetts and other states, to operate and profit from an unlawful Pyramid Scheme.

16. Defendants’ conspiracy and unlawful conduct described herein adversely affected persons in Massachusetts and throughout the United States who purchased TelexFree packages, including Plaintiff and the members of the class.

³ The foregoing terms are meant to comport with their common usage. A further description may be found through a review of the individuals and entities named in the Second Consolidated Amended Complaint in MDL 2566.

II. THE PARTIES

A. PLAINTIFFS

17. Plaintiff Elisangela Oliveira (“Oliveira”) is an individual who resides in Medford, Massachusetts. Oliveira, like many other victims of TelexFree’s Pyramid Scheme, paid funds to one or more of the Defendants with the hope of earning a profit and instead, suffered a Net Loss because TelexFree was an unlawful Pyramid scheme and not a lawful business venture. Ms. Oliveira received no cash or other item of value from any entity or person, at any time, on account of the money she remitted to one or more of the Defendants herein.

B. DEFENDANTS

18. Leonardo Francisco (“Francisco”) is an individual with a last known usual place of abode of 30D Mount Avenue, Marlborough, Middlesex County, Massachusetts 01752. At all relevant times herein, Francisco served as a promoter for TelexFree, and received payment of funds directly from victims. Francisco was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

19. Francisco is the nephew of TelexFree founder and Vice President Carlos N. Wanzeler, and also served as a “straw” investor for Carlos N. Wanzeler, purchasing AdCentral packages in his own name but on Wanzeler’s behalf, and transferring his profits to Wanzeler.

20. Lyvia M. Wanzeler is an individual with a last known usual place of abode of 41A Mount Avenue, Worcester, Worcester County, Massachusetts 01606. At all relevant times herein, Lyvia M. Wanzeler served as a promoter for TelexFree, and received payment of funds directly from victims. Wanzeler was a net winner in that she received funds from

victims that exceeded what she invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because her identity was then unknown.

21. Lyvia M. Wanzeler is also the daughter of TelexFree founder and Vice President Carlos N. Wanzeler, and is believed to have served as a “straw” investor for Carlos N. Wanzeler, purchasing AdCentral packages in her own name but on Carlos N. Wanzeler’s behalf, and transferring her profits to Carlos N. Wanzeler.

22. Wagner Weihrauch (“Weihrauch”) is an individual with a last known usual place of abode of Everett, Middlesex County, Massachusetts 01819. At all relevant times herein, Weihrauch served as a promoter for TelexFree, and received payment of funds directly from victims. Weihrauch was a net winner in that he received funds from victims that exceeded what invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

23. Linda S. Hackett is an individual with a last known usual place of abode of 97 Bellevue Avenue, Melrose, Middlesex County, Massachusetts 02176. At all relevant times herein, Linda S. Hackett served as a Promoter for TelexFree, and received payment of funds directly from victims. Hackett was a net winner in that she received funds from victims that exceeded what she invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because her identity was then unknown.

24. David Hackett is an individual with a last known usual place of abode of 97 Bellevue Avenue, Melrose, Middlesex County, Massachusetts 02176. At all relevant times

28. At all times material herein, DL1 was effectively an alter ego of Defendants Linda S. Hackett and David Hackett, and furthermore, had no legitimate business purpose, failed to maintain corporate formalities, had no independent board of directors and otherwise served as a “facade” for the sole benefit of said Defendants.

32. Bruno Graziani ("Graziani") is an individual with a last known usual place of abode of 80 Lilac Circle, Marlborough, Middlesex County, Massachusetts 01752. At all

33. Renato Ribeiro (“Ribeiro”) is an individual with a last known usual place of abode of 14 Washington Street, Medford, Middlesex County, Massachusetts 02155. At all relevant times herein, Ribeiro served as a promoter for TelexFree, and received payment of funds directly from victims. Ribeiro was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

35. Lair Fernandes (“Fernandes”) is an individual with a last known usual place of abode of 24 Hamilton Street, Apartment 15, Saugus, Essex County, Massachusetts 01906. At all relevant times herein, Fernandes served as a promoter for TelexFree, and received payment of funds directly from victims. Fernandes was a net winner in that he received funds from

37. Rodrigo Montemor (“Montemor”) is an individual with a last known usual place of abode of 8 Boxford Street, Lawrence, Essex County, Massachusetts 01843. At all relevant times herein, Montemor served as a promoter for TelexFree, and received payment of funds directly from victims. Montemor was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

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individual was previously unnamed because his identity was then unknown.

39. Rudnei Da Silva is an individual with a last known usual place of abode of 65 Johnson St., Leominster, Worcester County, Massachusetts 01453. At all relevant times herein, Rudnei Da Silva served as a promoter for TelexFree, and received payment of funds directly from victims. Rudnei DaSilva was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

40. Vagner Dantas Silva is an individual with a last known usual place of abode of 19 Cameron Avenue, Somerville, Middlesex County, Massachusetts 02144. At all relevant times herein, Vagner Dantas Silva served as a promoter for TelexFree, and received payment of funds directly from victims. Vagner Dantas Silva was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

41. David Reis ("Reis") is an individual with a last known usual place of abode in Somerville, Middlesex County, Massachusetts 02144. At all relevant times herein, Reis served as a promoter for TelexFree, and received payment of funds directly from victims. Reis was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

42. Julio Silva is an individual with a last known usual place of abode in Saugus,

45. Euzebio Sudre Neto (“Sudre Neto”) is an individual with a last known usual place of abode of 334 Chestnut Farm Way, Raynham, Bristol County, Massachusetts 02767. At all relevant times herein, Sudre Neto served as a promoter for TelexFree, and received payment of

48. Ruddy Abreau (“Abreau”) is an individual with a last known usual place of abode of 9 Longwood Drive, Methuen, Essex County, Massachusetts 01844. At all relevant times herein, Abreau served as a promoter for TelexFree, and received payment of funds directly from victims. Abreau was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational

what she invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because her identity was then unknown.

59. Frantz Balan (“Balan”) is an individual with a last known usual place of abode of 51 Grover Street, Apt. 2, Everett, Middlesex County, Massachusetts 02149. At all relevant times herein, Balan served as a promoter for TelexFree, and received payment of funds directly from victims. Balan was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

60. Marcelo Dasilva (“Dasilva”) is an individual with a last known usual place of abode of 38 Lyme St., #308, Malden, Middlesex County, Massachusetts 02148. At all relevant times herein, Dasilva served as a promoter for TelexFree, and received payment of funds directly from victims. Dasilva was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously unnamed because his identity was then unknown.

61. Gladys Alvarado (“Alvarado”) is an individual with a last known usual place of abode of 177 Lincoln St., #2, Worcester, Massachusetts 01605. At all relevant times herein, Alvarado served as a promoter for TelexFree, and received payment of funds directly from victims. Alvarado was a net winner in that he received funds from victims that exceeded what he invested in TelexFree. This Defendant was a previously unnamed operational defendant on the same level of involvement with the top-level promoters. This individual was previously

66. Carlos Costa, (“Costa”) is an individual now or formerly of 44A McClintock Avenue, Unit A, in Worcester, Worcester County, Massachusetts 01604. Costa was listed as Manager of TelexFree, LLC with the Massachusetts Secretary of State Corporations Division.

67. Sanderley Rodrigues De Vasconcelos, (“Rodrigues”), is an individual now or formerly of, 100 Stockton Street, Apt. 49, in Chelsea, Suffolk County, Massachusetts 02150. At no time has Rodrigues been registered with the Commonwealth of Massachusetts as a broker or dealer of securities. Rodrigues had been charged by the United States Securities and Exchange Commission with operating a fraudulent Pyramid Scheme under the name of Universo FoneClub Corporation, another Massachusetts corporation formed by Rodrigues, in which he acted as Officer and Director. Rodrigues, settled these charges in 2007 and as condition of this settlement 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 Act. He was further disgorged of about \$1.8 Million in ill-gotten gains.

68. Rodrigues is the sole Officer, Director, and Registered Agent of WWW GLOBAL BUSINESS, INC. (sometimes referred to as “WWW Global Business”), is a corporation duly organized and existing under the laws of the Commonwealth of Massachusetts, having a principal place of business at 189 Squire Road, Suite 40, in Revere, Suffolk County, Massachusetts. WWW Global Business was organized by Rodrigues on or about February 7, 2013, to market and sell TelexFree Investments.

69. Santiago De La Rosa (“De La Rosa”), is an individual now or formerly of 189 Beacon Hill Avenue, Unit 2, in Lynn, Essex County, Massachusetts 01902. De La Rosa appears in internet videos promoting TelexFree and is one of TelexFree’s most successful promoters, having recruited numerous other Promoters/Investors for TelexFree within the Dominican

Middlesex, Commonwealth of Massachusetts 01752 (the “TelexFree Marlborough Office”).⁴

75. TelexFree, LLC is a limited liability company duly organized and existing under the laws of Nevada, having a purported place of business at 4705 S. Durango Drive, #100-J51 (a post office box), Las Vegas, Nevada 89147 (the “Nevada Post Office Box”).⁵ TelexFree, LLC also maintained offices in the Commonwealth of Massachusetts at the TelexFree Marlborough Office between 2012 and late April 2014. At all material times, TelexFree LLC was identified as a limited liability company as registered with the Corporations Division of the Secretary to the Commonwealth of Massachusetts (Identification Number 001105166). TelexFree, LLC registered with the Secretary of State for the Commonwealth of Massachusetts on April 18, 2013.

III. FACTS AND ALLEGATIONS

A. TelexFree’s History

76. This litigation arises out of a Pyramid scheme through which the Defendants including Labriola, defrauded hundreds of thousands of individuals out of hundreds of millions of dollars by falsely promising them a return on investment.

77. Each Defendant was a Top-Level Promoter was encouraged to and did recruit and “build” a network of new investor victims. They worked in conjunction with Pyramid scheme Founders and administrative personal including Merrill Wanzeler and Costa; Steven Labriola; and others whose role has not yet been determined.

78. Each Top-Level Promoter Defendant purported to sell Internet telephone services,

⁴ See Office of the Secretary of the Commonwealth of Mass., Corporations Div., Corporate Summary for TelexFree, Inc., attached hereto as Exhibit 1.

⁵ See Office of the Secretary of the Commonwealth of Mass., Corporations Div., Corporate Summary for TelexFree, LLC, attached hereto as Exhibit 2.

79. A pyramid scheme is a fraudulent business operation whereby an individual or organization pays returns to its investors from new money paid into the operation by new victims, rather than from profit earned by the operator. Inevitably, every pyramid scheme fails.

81. During the putative class period, the Top-Level Promoter Defendants made use of each of the identical stereotypical Pyramid scheme components and marketing program listed hereafter.

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83. **The Scheme is Showered with Credibility:** The victims of pyramid schemes are always given a believable explanation of how their investment will earn the “above normal rate of return on investment.” The explanation must be good enough to convince people to invest and reinvest their money and importantly, to recruit others. The “Credibility Showers” were included in the marketing plan each Defendant participated in or used, and it was an identical and essential component of the same overarching unlawful Pyramid scheme. Here the Defendant Top-Level Promoters made use of the same marketing as put forward by the persons who founded or operated the Pyramid scheme. This included the false representation⁶ that the Founder and Principal Merrill was a college graduate with specialty degrees in a field related to the product they touted as driving the profit. TelexFree also falsely represented that its Principals had been involved in telecommunications for many years. Moreover, the identical marketing program used by each Defendant Top-Level Promoter involved the identical lawyers, certified public accountants (“CPAs”),⁷ and other credible professionals⁸ who had blessed the instant Pyramid scheme as a legal and sound business opportunity. The identical marketing plan that the Top-Level Promoters made use of also involved the same “credible persons” touting the

⁸ Well-known MLM “professionals” with great experience or success were used to state on TelexFree’s behalf that the pyramid scheme was legal and a good investment. TelexFree made such use of Rodrigues, De La Rosa, Crosby, Sloan, Shoyfer, Smith and others.

84. **Initial Investors Paid Off:** In most pyramid schemes, some initial investors will receive the promised return. The “Bait Payoffs” were included in the marketing plan each Defendant participated in or used and were, an identical and essential component of the same overarching unlawful Pyramid scheme. This trick is used to convince victims that the investment is not risky and that a return will be received. The scammers use smaller payouts to bring in bigger ones. Payouts are also used to prompt victims to bring in the investment cash of their family, friends, co-workers and others. It is also used to turn the \$100 dollar investor into a \$1,000 or \$10,000 investor. Participants also become more comfortable after learning of pay outs to the point they eventually recommend others close to them such as family, friends, and business associates to invest. The marketing program the Defendant Top-Level Promoters used and participated in here was identical. The marketing program of the overarching Pyramid scheme that each Defendant Top-Level Promoter relied on and participated in generated the funds that unjustly enriched each Top-Level Promoter including the “Bait Payouts”.

86. In February 2012, founders and principals Carlos Wanzeler and James Merrill formed TelexFree, Inc. in the Commonwealth of Massachusetts.

88. TelexFree falsely advertised itself as a “multi-level marketing” company selling

local and international telephone service plans that used unique groundbreaking “voice over internet protocol” (“VoIP”) technology.

89. The VoIP technology used by TelexFree was not unique or groundbreaking. In fact, it was substandard and offered nothing more than the free Google Voice and Skype.

90. TelexFree’s business plan and operations were an unlawful Pyramid Scheme and not a lawful multi-level marketing (“MLM”) enterprise. At all times relevant to this complaint, TelexFree violated the express terms of Massachusetts General Laws (“M.G.L.”) c. 93, § 69.

91. United States authorities began to investigate TelexFree, and in January and February 2014, the Secretary of the Commonwealth of Massachusetts, Securities Division (the “SOC”) issued subpoenas.

92. On April 14, 2014, TelexFree, Inc. along with two affiliated companies, TelexFree, LLC and TelexFree Financial, Inc. (together, the “Bankrupt Companies”), filed for Chapter 11 bankruptcy protection in Nevada claiming that TelexFree’s revenues were insufficient to meet its obligations.

93. On or about April 15, 2014, the United States Department of Homeland Security (the “DHS”), the Federal Bureau of Investigation (the “FBI”) and others raided the offices of TelexFree, shutting down its operation, seizing records and other evidentiary items.

94. On May 9, 2014, the DHS filed criminal proceedings against two of TelexFree’s founders, Wanzeler and Merrill, for conspiracy to commit wire fraud.

95. Thereafter, the United States Department of Justice (the “DOJ”) brought charges of wire fraud and conspiracy to commit wire fraud against TelexFree’s owners Wanzeler and Merrill, and the same were indicted by grand jury on July 23, 2014.

96. TelexFree’s other principals and operational defendants are currently under state

B. TelexFree Was An Unlawful, Unfair and Deceptive Pyramid Scheme

98. TelexFree's revenues from sales of its VoIP products were inconsequential compared to its overall operations.

100. Participants who purchased memberships could open user accounts and accumulate “credits” in these accounts. The “credits” represented money purportedly owed by TelexFree to the Participant, and could be theoretically redeemed for cash, transferred to another user account, or redeemed in satisfaction of an invoice for another user account.

102. Many later Participants in TelexFree's Pyramid Scheme transferred money directly to earlier Participants in the Scheme. These payments were often made in cash.

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104. The amount theoretically owed to Participants on account of accumulated credits was more than \$5 billion dollars, an amount more than seven hundred times the \$6,600,000 in cash receipts from the sale of VoIP packages over the life of the TelexFree Pyramid Scheme.

105. Victims received nothing in exchange for money paid to the Defendants.

106. There were approximately \$3 billion in reported transactions in the TelexFree Pyramid Scheme, with more than \$1 billion in reported losses.

C. The TelexFree Program Through Which The Defendants Received Payments From Plaintiffs Violated The Law

107. Massachusetts General Laws c. 93, § 69 makes pyramid schemes such as TelexFree, as well as many of their traditional features, unlawful. M.G.L. c. 93, § 69(g) expressly declares that a violation of M.G.L. c. 93, § 69 is a per se violation of M.G.L. c. 93A, § 2(a).

108. At all times material herein, TelexFree was a “multi-level distribution company” as defined by M.G.L., Chapter 93, Section 69(a).

109. M.G.L., Chapter 93, Section 69(d)(2) prohibits any multi-level distribution company from offering or paying any “finder’s fee, bonus, refund, override, commission, cross-commission, dividend or other consideration” to any participant therein “solely for the solicitation or recruitment of other participants.”

110. The standard TelexFree contract (“TelexFree Contract”), on its face, contains numerous instances of promising payment to Promoters merely for recruitment of new Participants⁹ as defined by M.G.L., Chapter 93, Section 69, including but not limited to Clauses 5.7, 5.7.1, 5.8, 6.1, 6.1.1, 6.1.2, and 8.1.

⁹ For ease of reading, the terms “Member”, “Promoter” or “Participant”, regardless of capitalization, are at all times herein to be construed as “Participant” defined by Massachusetts General Laws Chapter 93, Section 69.

remuneration.

117. Not only does the TelexFree Contract explicitly violate M.G.L. Chapter 93, Section 69 – it also lays bare several classic hallmarks of pyramid schemes, including paying participants solely for recruitment of new members, not requiring any meaningful sales or distributive activity by participants, and using coercive measures to prevent participant withdrawal from the scheme.

118. Like the TelexFree Contract, TelexFree’s own website set forth numerous clear violations of M.G.L. c. 93, § 69.

119. The TelexFree Contract, on its face, contains egregious, obvious violations of M.G.L. c. 93, § 69(b), including, but not limited to, Clauses 10.1.2, 10.1.3 and 10.1.4.

120. These terms of cancellation are clearly designed to entangle members in TelexFree’s Pyramid Scheme and prevent members from withdrawing.

121. TelexFree’s founders, Labriola, and Top-Level Promoters engaged in acts of civil conspiracy. The founders controlled the conduct of and colluded with the Top-Level Promoters through meetings, written materials, regular conference calls, and other means.

122. For example, during or about late February 2014 through early March 2014, TelexFree principals, executive office, Labriola, licensed professionals and Top-Level Promoters held an invitation-only meeting at TelexFree’s Marlborough, Massachusetts headquarters with the intent of siphoning off funds and maximizing the exploitation of the rank and file TelexFree Promoters. This was one of several such meetings held by the management of TelexFree to coordinate how best to exploit lower-tier TelexFree Promoters.

123. TelexFree’s Top-Level Promoters regularly met with each other and with TelexFree’ founders and Labriola at other meetings as well, including an “Extravaganza”

M.G.L., c. 110A.

131. The SOC sought injunctions and orders requiring TelexFree, Inc. and TelexFree, LLC to cease and desist from further conduct violating Massachusetts securities laws and regulations, to provide an accounting of all proceeds received because of TelexFree's fraud, to provide restitution to Promoters for losses attributable to the fraud operations, and to disgorge all profits.

132. Also on April 15, 2014, the SEC filed a civil Complaint and Jury Demand against TelexFree, Inc. and TelexFree, LLC as well as Merrill, Wanzeler, Stephen Labriola, and certain top-level promoters, alleging violations of the Securities Act of 1933, the Securities Exchange Act of 1934, and SEC Regulations. The SEC requested and was granted a preliminary injunction and an order freezing the assets of TelexFree. The SEC is also seeking disgorgement of profits and additional civil penalties.

133. Additionally on April 15, 2014, the FBI and the DHS conducted a raid of TelexFree's Marlborough Office.

134. On or about May 1, 2014, the Montana Securities Commissioner filed a cease and desist order against TelexFree.

135. The following day, the United States Bankruptcy Court for the District of Nevada, on motion by the SEC, transferred the matter to the federal district court in Massachusetts, Central Division.

136. During hearings conducted on May 2, 2014, William H. Runge, III, former Chief Restructuring Officer of TelexFree, estimated that as of TelexFree's bankruptcy filing TelexFree had assets of \$31 million in its bank accounts, \$28 million in brokerage accounts, and nearly \$30 million held by payment processing companies.

137. The location of hundreds of millions of dollars received by TelexFree and by Direct Payment Recipients from victims remains unknown.

IV. CLASS ACTION ALLEGATIONS

138. Under Rule 23 of the Federal Rules of Civil Procedure, Plaintiff sues on her own behalf, and on behalf of all other persons similarly situated (the “Class”). The Class that Plaintiff seeks to represent is:

All persons residing in the United States who paid money to one or more of the Top-Level Promoters named herein and invested more funds in the TelexFree Pyramid Scheme than they withdrew and so suffered a net loss during the period from January 1, 2012 to April 16, 2014 (the “Class Period”), and who never received any money or other item of value from any entity or person on account of such payment. Excluded from the class are persons to the extent they seek to recover, directly or indirectly, any payments made by or to TelexFree itself or any other item that is property of TelexFree's bankruptcy estate.

139. Excluded from the Class are Defendants and any party who is a defendant in MDL 2566 (the “MDL Defendants”) and their respective officers, directors, and employees; any entity in which any Defendant or MDL Defendant has a controlling interest; and the legal representatives, attorneys, heirs, and assigns of Defendants and the MDL Defendants.

140. Plaintiff meets the requirements of Federal Rule of Civil Procedure 23(a) because the members of the Class are so numerous that the joinder of all members is impractical. While the exact number of Class members is unknown to Plaintiff, it is in the hundreds of thousands.

141. Plaintiff meets the requirements of Federal Rule of Civil Procedure 23(a) because there is a well-defined community of interest among the members of the Class, common questions of law and fact predominate, Plaintiff's claims are typical of the members of the Class, and Plaintiff can fairly and adequately represent the interests of the Class.

142. This action satisfies the requirements of Federal Rule of Civil Procedure 23(b)(3)

because it involves questions of law and fact common to the members of the Class that predominate or questions affecting only individual members, including, but not limited to:

- whether TelexFree operated a lawful MLM program or an unlawful Pyramid Scheme or a legitimate business
- whether the Top-Level Promoters who received direct victim payment were unjustly enriched;
- whether the funds paid by the Plaintiff Class directly to the Defendants must be repaid, without regard to the individual circumstances of participation in the Scheme, because it constituted an unjust enrichment;
- whether the Form 1099's issued by the Defendants are valid or should be voided by this Court;
- whether TelexFree was a "multi-level distribution company" as defined by Massachusetts General Laws Chapter 93, Section 69(a);
- whether the standard TelexFree Contract contained promises to pay merely for the recruitment of new members in violation of Massachusetts General Laws Chapter 93, Section 69(a);
- whether the standard TelexFree Contract contained offers to pay a "finder's fee, bonus, refund, override, commission, cross-commission, dividend or other consideration" to Participants in the TelexFree program in violation of Massachusetts General Laws Chapter 93, Section 69(a);
- whether the TelexFree program offered its Members payment without requiring them to engage in any "bona fide and essential supervisory, distributive, selling or soliciting," nor exercise any "judgment," "skill," or "control over the operation" in violation of Massachusetts General Laws Chapter 93, Section 69(a); and
- whether Plaintiff and the Class are entitled to damages, civil penalties, punitive damages, and/or injunctive relief;
- what information the Top-Level promoters were given that was not made available to the members of the Putative Class at the same time.

143. Plaintiff's claims are typical of those of other Class members because Plaintiff was defrauded by TelexFree's common Scheme.

144. Plaintiff will fairly and accurately represent the interests of the Class.

146. Class treatment is superior to any other method for adjudicating the controversy. Plaintiff knows of no difficulty likely to be encountered in the management of this litigation that would preclude its maintenance as a class action under Rule 23(b)(3).

148. Defendants have acted or refused to act on grounds that apply to the Class, as alleged above, and certification is proper under Rule 23(b)(2).

FIRST CLAIM FOR RELIEF
UNJUST ENRICHMENT

150. Plaintiff and the putative Class conferred a benefit upon Defendants by furnishing funds, directly or indirectly, to Defendants, who accepted them without protest or defect and retained and benefitted from them.

152. Only through the utilization of the TelexFree Pyramid Scheme's common modes

of operation and marketing was the Scheme able to be established, thereafter perpetuated and ultimately expanded.

153. The success of the TelexFree Pyramid Scheme, and the unjust receipt of Direct Victim Payments by the Defendants, was dependent upon the common participation and wrongful acts of the Top-Level Promoters.

154. The Scheme could not have existed, expanded and thrived without the participation of the Top-Level Promoter in identifying, attracting and securing additional victims, including Plaintiff and the putative class.¹⁰

155. In performing their common roles as Top-Level Promoters, Defendants utilized TelexFree's fraudulent marketing materials and implemented the uniform features of its program.

156. When obtaining an additional victim, and pocketing a Direct Victim Payment, each Defendant relied upon, utilized and implemented the common Scheme's standard modes of operation.

157. Each Defendant benefitted from the efforts of all Top-Level Promoters to market and expand the Scheme.

158. The payments made by the Scheme's victims, including Plaintiff and the putative class, directly to the Defendants were the direct result of the similar, combined efforts of all Top-Level Promoters.¹¹

159. Each Defendant, as a Top-Level Promoter, performed a common, integral role in the commission, expansion and perpetuation of the TelexFree Pyramid Scheme.

¹⁰ Or the participation and services provided by banks, payment processors, licensed professionals and others to the Scheme.

¹¹ As well as the banks, payment processors and licensed professionals that served the Scheme.

- ## VII. DEMAND FOR JURY TRIAL

Respectfully submitted,

/s/ William R. Baldiga

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Ronald P. Passatempo, Esq.
(MA Bar No. 632508)
Ronald P. Passatempo Law Offices
200 Broadway
Lynnfield, MA 01940
Telephone: 781-596-3100
Email: passatempolaw@comcast.net

CERTIFICATE OF SERVICE

I, William R. Baldiga, hereby certify that on June 27, 2016, I caused a copy of the foregoing Amended Complaint to be sent electronically to the registered participants as identified on the Notice of Electronic Filing (NEF) and paper copies will be sent to those indicated as non-registered participants, by first class mail, postage prepaid.

Dated: June 27, 2016
Boston, Massachusetts

/s/ William R. Baldiga
William R. Baldiga

EXHIBIT L

B104 (FORM 104) (08/07)

ADVERSARY PROCEEDING COVER SHEET (Instructions on Reverse)		ADVERSARY PROCEEDING NUMBER (Court Use Only)		
PLAINTIFFS Stephen B. Darr as Trustee of the Estates of Telexfree, LLC, Telexfree, Inc. and Telexfree Financial, Inc.	DEFENDANTS Rita Dos Santos, Individually and as Putative Class Representative			
ATTORNEYS (Firm Name, Address, and Telephone No.) Charles R. Bennett, Jr., Murphy & King, P.C., One Beacon Street, Boston, MA 02108 617-423-0400	ATTORNEYS (If Known)			
PARTY (Check One Box Only) <input type="checkbox"/> Debtor <input type="checkbox"/> U.S. Trustee/Bankruptcy Admin <input type="checkbox"/> Creditor <input type="checkbox"/> Other <input checked="" type="checkbox"/> Trustee	PARTY (Check One Box Only) <input type="checkbox"/> Debtor <input type="checkbox"/> U.S. Trustee/Bankruptcy Admin <input type="checkbox"/> Creditor <input checked="" type="checkbox"/> Other <input type="checkbox"/> Trustee			
CAUSE OF ACTION (WRITE A BRIEF STATEMENT OF CAUSE OF ACTION, INCLUDING ALL U.S. STATUTES INVOLVED) For declaration that District Court action is void as a violation of the automatic stay (11 U.S.C. Section 362). For injunctive relief (11 U.S.C. Section 105).				
NATURE OF SUIT (Number up to five (5) boxes starting with lead cause of action as 1, first alternative cause as 2, second alternative cause as 3, etc.)				
<table style="width: 100%; border: none;"> <tr> <td style="width: 50%; vertical-align: top; border: none;"> FRBP 7001(1) – Recovery of Money/Property <input type="checkbox"/> 11-Recovery of money/property - §542 turnover of property <input type="checkbox"/> 12-Recovery of money/property - §547 preference <input type="checkbox"/> 13-Recovery of money/property - §548 fraudulent transfer <input type="checkbox"/> 14-Recovery of money/property - other FRBP 7001(2) – Validity, Priority or Extent of Lien <input type="checkbox"/> 21-Validity, priority or extent of lien or other interest in property FRBP 7001(3) – Approval of Sale of Property <input type="checkbox"/> 31-Approval of sale of property of estate and of a co-owner - §363(h) FRBP 7001(4) – Objection/Revocation of Discharge <input type="checkbox"/> 41-Objection / revocation of discharge - §727(c),(d),(e) FRBP 7001(5) – Revocation of Confirmation <input type="checkbox"/> 51-Revocation of confirmation FRBP 7001(6) – Dischargeability <input type="checkbox"/> 66-Dischargeability - §523(a)(1),(14),(14A) priority tax claims <input type="checkbox"/> 62-Dischargeability - §523(a)(2), false pretenses, false representation, actual fraud <input type="checkbox"/> 67-Dischargeability - §523(a)(4), fraud as fiduciary, embezzlement, larceny <div style="text-align: center;">(continued next column)</div> </td> <td style="width: 50%; vertical-align: top; border: none;"> FRBP 7001(6) – Dischargeability (continued) <input type="checkbox"/> 61-Dischargeability - §523(a)(5), domestic support <input type="checkbox"/> 68-Dischargeability - §523(a)(6), willful and malicious injury <input type="checkbox"/> 63-Dischargeability - §523(a)(8), student loan <input type="checkbox"/> 64-Dischargeability - §523(a)(15), divorce or separation obligation (other than domestic support) <input type="checkbox"/> 65-Dischargeability - other FRBP 7001(7) – Injunctive Relief <input type="checkbox"/> 71-Injunctive relief – imposition of stay 2 <input checked="" type="checkbox"/> 72-Injunctive relief – other FRBP 7001(8) Subordination of Claim or Interest <input type="checkbox"/> 81-Subordination of claim or interest FRBP 7001(9) Declaratory Judgment 1 <input checked="" type="checkbox"/> 91-Declaratory judgment FRBP 7001(10) Determination of Removed Action <input type="checkbox"/> 01-Determination of removed claim or cause Other <input type="checkbox"/> SS-SIPA Case – 15 U.S.C. §§78aaa <i>et. seq.</i> <input type="checkbox"/> 02-Other (e.g. other actions that would have been brought in state court if unrelated to bankruptcy case) </td> </tr> </table>			FRBP 7001(1) – Recovery of Money/Property <input type="checkbox"/> 11-Recovery of money/property - §542 turnover of property <input type="checkbox"/> 12-Recovery of money/property - §547 preference <input type="checkbox"/> 13-Recovery of money/property - §548 fraudulent transfer <input type="checkbox"/> 14-Recovery of money/property - other FRBP 7001(2) – Validity, Priority or Extent of Lien <input type="checkbox"/> 21-Validity, priority or extent of lien or other interest in property FRBP 7001(3) – Approval of Sale of Property <input type="checkbox"/> 31-Approval of sale of property of estate and of a co-owner - §363(h) FRBP 7001(4) – Objection/Revocation of Discharge <input type="checkbox"/> 41-Objection / revocation of discharge - §727(c),(d),(e) FRBP 7001(5) – Revocation of Confirmation <input type="checkbox"/> 51-Revocation of confirmation FRBP 7001(6) – Dischargeability <input type="checkbox"/> 66-Dischargeability - §523(a)(1),(14),(14A) priority tax claims <input type="checkbox"/> 62-Dischargeability - §523(a)(2), false pretenses, false representation, actual fraud <input type="checkbox"/> 67-Dischargeability - §523(a)(4), fraud as fiduciary, embezzlement, larceny <div style="text-align: center;">(continued next column)</div>	FRBP 7001(6) – Dischargeability (continued) <input type="checkbox"/> 61-Dischargeability - §523(a)(5), domestic support <input type="checkbox"/> 68-Dischargeability - §523(a)(6), willful and malicious injury <input type="checkbox"/> 63-Dischargeability - §523(a)(8), student loan <input type="checkbox"/> 64-Dischargeability - §523(a)(15), divorce or separation obligation (other than domestic support) <input type="checkbox"/> 65-Dischargeability - other FRBP 7001(7) – Injunctive Relief <input type="checkbox"/> 71-Injunctive relief – imposition of stay 2 <input checked="" type="checkbox"/> 72-Injunctive relief – other FRBP 7001(8) Subordination of Claim or Interest <input type="checkbox"/> 81-Subordination of claim or interest FRBP 7001(9) Declaratory Judgment 1 <input checked="" type="checkbox"/> 91-Declaratory judgment FRBP 7001(10) Determination of Removed Action <input type="checkbox"/> 01-Determination of removed claim or cause Other <input type="checkbox"/> SS-SIPA Case – 15 U.S.C. §§78aaa <i>et. seq.</i> <input type="checkbox"/> 02-Other (e.g. other actions that would have been brought in state court if unrelated to bankruptcy case)
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<input type="checkbox"/> Check if this case involves a substantive issue of state law	<input type="checkbox"/> Check if this is asserted to be a class action under FRCP 23			
<input type="checkbox"/> Check if a jury trial is demanded in complaint	Demand \$			
Other Relief Sought				



144098715120200000000001

B104 (FORM 104) (08/07), Page 2

BANKRUPTCY CASE IN WHICH THIS ADVERSARY PROCEEDING ARISES		
NAME OF DEBTOR Telxfree, LLC, Telxfree, Inc., Telxfree Financial, Inc.		BANKRUPTCY CASE NO. 14-40987-MSH
DISTRICT IN WHICH CASE IS PENDING Massachusetts	DIVISION OFFICE Central	NAME OF JUDGE Hoffman
RELATED ADVERSARY PROCEEDING (IF ANY)		
PLAINTIFF	DEFENDANT	ADVERSARY PROCEEDING NO.
DISTRICT IN WHICH ADVERSARY IS PENDING	DIVISION OFFICE	NAME OF JUDGE
SIGNATURE OF ATTORNEY (OR PLAINTIFF)		
/s/ Charles R. Bennett, Jr., Esq.		
DATE October 7, 2015	PRINT NAME OF ATTORNEY (OR PLAINTIFF) Charles R. Bennett, Jr., Esq.	

INSTRUCTIONS

The filing of a bankruptcy case creates an "estate" under the jurisdiction of the bankruptcy court which consists of all of the property of the debtor, wherever that property is located. Because the bankruptcy estate is so extensive and the jurisdiction of the court so broad, there may be lawsuits over the property or property rights of the estate. There also may be lawsuits concerning the debtor's discharge. If such a lawsuit is filed in a bankruptcy court, it is called an adversary proceeding.

A party filing an adversary proceeding must also must complete and file Form 104, the Adversary Proceeding Cover Sheet, unless the party files the adversary proceeding electronically through the court's Case Management/Electronic Case Filing system (CM/ECF). (CM/ECF captures the information on Form 104 as part of the filing process.) When completed, the cover sheet summarizes basic information on the adversary proceeding. The clerk of court needs the information to process the adversary proceeding and prepare required statistical reports on court activity.

The cover sheet and the information contained on it do not replace or supplement the filing and service of pleadings or other papers as required by law, the Bankruptcy Rules, or the local rules of court. The cover sheet, which is largely self-explanatory, must be completed by the plaintiff's attorney (or by the plaintiff if the plaintiff is not represented by an attorney). A separate cover sheet must be submitted to the clerk for each complaint filed.

Plaintiffs and Defendants. Give the names of the plaintiffs and defendants exactly as they appear on the complaint.

Attorneys. Give the names and addresses of the attorneys, if known.

Party. Check the most appropriate box in the first column for the plaintiffs and the second column for the defendants.

Demand. Enter the dollar amount being demanded in the complaint.

Signature. This cover sheet must be signed by the attorney of record in the box on the second page of the form. If the plaintiff is represented by a law firm, a member of the firm must sign. If the plaintiff is pro se, that is, not represented by an attorney, the plaintiff must sign.

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
CENTRAL DIVISION**

In re:

TELEXFREE, LLC,
TELEXFREE, INC. and
TELEXFREE FINANCIAL, INC.,

TelexFree.

Chapter 11 Cases

14-40987-MSH
14-40988-MSH
14-40989-MSH

Jointly Administered

STEPHEN B. DARR AS TRUSTEE
OF THE ESTATES OF TELEXFREE, LLC,
TELEXFREE, INC. and TELEXFREE
FINANCIAL, INC.,

Plaintiffs,

v.

RITA DOS SANTOS, INDIVIDUALLY AND
AS PUTATIVE CLASS REPRESENTATIVE,

Defendant.

Adversary Proceeding
No.

VERIFIED COMPLAINT

Introduction

Stephen B. Darr, as he is the Trustee (the “Trustee”) of the Chapter 11 estates of TelexFree, LLC, TelexFree, Inc. and TelexFree Financial, Inc. (collectively, the “Debtors”), brings this action to enjoin Rita Dos Santos, individually and as putative plaintiff class representative, for the prosecution of certain claims against a class of individuals who are determined to be “Net Winners” on behalf of participants in the Debtors’ scheme who are “Net Losers” and made payments to such Net Winners (“Unjust Enrichment Action”). Count I of this Complaint seeks a declaration that prosecution of the Unjust Enrichment Action against Net

Winners on a theory of unjust enrichment is violative of the automatic stay imposed by § 362 of the Bankruptcy Code in that the Unjust Enrichment Action is exercising control on or over property of the estates, being the estates' right to recover the same monies as fraudulent transfers and/or preferences. Court II of the Complaint seeks an injunction pursuant to Bankruptcy Code § 105(a) to enjoin and restrain Dos Santos from prosecuting so much of the class action that seeks to recover against Net Winners on a theory of unjust enrichment.

A necessary element of the Unjust Enrichment Action is the determination of who are "Net Winners." A determination of Net Winner is a fundamental determination to be made by the Bankruptcy Court. A determination of Net Winner is inextricably linked to the bankruptcy claims allowance process and, as such, the determination of the Net Winner is exclusively within the jurisdiction of the Bankruptcy Court. Whether one is a Net Winner or Net Loser will determine if the individual can share in bankruptcy distributions and on what basis. A determination of who are the Net Winners and Net Losers cannot be made without considering all of the transactions involved in the Debtors' pyramid scheme, including the transactions between the Debtors and the participants, along with the transactions between the participants. No aspect is more crucial to ensuring fairness of distribution than a complete analysis of all the financial transactions involved in the scheme to ensure an accurate determination of Net Winners and Net Losers. The Unjust Enrichment Action directly interferes with the Bankruptcy Court's jurisdiction to make a Net Winner determination because it seeks the same determination in another forum. To permit a parallel action that only accounts for some but not all of the transactions will result in confusion, duplication of effort, increased costs, interference with the administration of the bankruptcy case and create the potential for conflicting determination.

As detailed below, a participant in the Debtors' scheme could earn credits by, among other things, placing valueless advertisements on Internet sites, recruiting other participants, or selling VoIP plans. The credits could be redeemed for cash payment from the Debtors or to buy additional membership plans for the participant or on behalf of others. In those situations where the credits were used to buy a membership for another, the transaction typically consisted of (a) participant recruits new participant, (b) Debtor issues an invoice to recruited participant for the cost of the membership, (c) recruited participant pays recruiting participant cash in the amount of the invoice, and (d) the Debtors would redeem the recruiting participant's credits to satisfy the recruited participant's invoice (these transactions will hereinafter be referred to as "Triangular Transactions"). The Bankruptcy Court should determine who are the Net Winners and in doing so, whether the money received by recruiting participants from recruited participants in a Triangular Transaction, along with amounts paid by the Debtors, should be included in that determination. The Bankruptcy Court will determine whether the money paid by the recruited participant to a recruiting participant is recoverable by the Trustee as a fraudulent transfer or preferential transfer pursuant to §§ 547 and 548 of the Bankruptcy Code. Those payments made in connection with a Triangular Transaction are the same payments that the Unjust Enrichment Action seeks to recover.

Under Count II, the Trustee seeks to enjoin Dos Santos from prosecuting the class action claim pursuant to Bankruptcy Code § 105(a), because, for the reasons set forth above, the Unjust Enrichment Action would interfere with the Bankruptcy Court's determination of claims, which, with the Trustee's rights to pursuant avoidable transfers under Bankruptcy Code §§547 and 548, are the core matters. Accordingly, the continued prosecution of the Unjust Enrichment Action would directly impact a determination as to the allowance of claims in the bankruptcy estates and

the distributions thereon. Further, in order to ensure the efficient and consistent administration of the bankruptcy estates, the treatment of creditors, to preserve the Bankruptcy Court's jurisdiction, and to avoid potentially conflicting rulings, the Court should exercise its equitable powers and restrain Dos Santos from obtaining class certification of a class of Defendants consisting of Net Winners and prosecuting Count IV of the Unjust Enrichment Action against the Net Winners.

Parties

1. The Plaintiff is Stephen B. Darr, as he is the duly appointed and acting Trustee of the Chapter 11 estates of TelexFree, LLC, TelexFree, Inc. and TelexFree Financial, Inc. (collectively, the "Debtors"), who has a usual place of business within this District.

2. The Defendant, Rita Dos Santos ("Dos Santos") is an individual who resides in Massachusetts within this District. Dos Santos is alleged to be a creditor of the Debtors and a representative of those individuals who invested in the Debtors' scheme as part of a transaction whereby those participants paid money to a recruiting participant, were issued an invoice by the Debtors, and the recruiting participant used his/her accumulate credits to satisfy the invoice.

Jurisdiction

3. This Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. § 1334(b). This adversary proceeding is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (O).

4. Venue in this district is proper pursuant to 28 U.S.C. § 1409.

Background

5. On April 13, 2014 (the “Petition Date”), each of the Debtors filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code with the Bankruptcy Court for the District of Nevada.

6. On April 15, 2014, the Securities and Exchange Commission (“SEC”) commenced an action against the Debtors and others in the United States District Court for the District of Massachusetts (“SEC Action”). The SEC Action alleged, among other things, that the Debtors were engaged in an illegal Ponzi/pyramid scheme. Substantially contemporaneously with the commencement of the SEC Action, Homeland Security Investigations seized the Debtors’ assets, books and records. The United States has also commenced criminal proceedings against Carlos Wanzeler and James Merrill, the principals of the Debtors. Mr. Wanzeler has fled the country, and Mr. Merrill was released from jail upon posting of an appropriate bond, and his movements are limited and activities monitored.

7. On May 6, 2014, the Nevada Bankruptcy Court, acting on a motion by the SEC, Ordered that the cases be transferred to the Bankruptcy Court for the District of Massachusetts. The cases were transferred to this District on May 9, 2014.

8. On May 30, 2014, this Court, on the motion of the United States Trustee to appoint a Chapter 11 Trustee, allowed the motion of the United States Trustee. The Trustee was appointed on June 6, 2014.

Ponzi/Pyramid Scheme

9. The Debtors ostensibly operated a multi-level marketing plan (“MLMP”) engaged in the sale of voice over internet protocol (“VoIP”) services. Individuals who wished to participate in the Debtors’ MLMP were required to pay a membership fee. Each plan provided

for a means by which the participant member could earn credits by, among other things, placing advertisements, recruiting other participants or selling VoIP plans.

10. Depending upon which plan a participant chose to purchase, the Debtors represented that a participant could earn credits which would translate to a guaranteed return on their initial investment of between 200% and 265% per annum.

11. A participant could redeem accumulated credits from the Debtors for cash or use the credits to purchase an additional membership plan either for the participant or on behalf of others.

12. During the period of the Debtors' operation, invoices associated with the sale of membership plans (and VoIP packages) had a face value of over \$3 billion. However, of that amount, \$360 million (or approximately 12%) was paid in cash to the Debtors. The balance of these invoices were satisfied either by intra-participant transactions or transactions by which a recruiting participant would (a) recruit a new participant into the scheme; (b) the Debtors would issue an invoice to the recruited participant reflecting the membership fee and contract fee for the plan being acquired by the recruited participant; (c) the recruited participant, instead of paying cash to the Debtors in satisfaction of the invoice, would pay the cash to the recruiting participant; and (d) the recruiting participant would satisfy the invoice issued to the recruited participant by the Debtors redeeming accumulated credits (as previously defined, "Triangular Transactions").

13. While the Debtors asserted that they were operating a multi-level marketing plan, the Debtors were in fact engaged in a Ponzi/pyramid scheme.

14. The continuation of the Debtors' business relied exclusively upon their ability to continue the recruiting of later participants as opposed to the sale of a VoIP product, however,

given the Debtors' virtual total reliance on the sale of memberships as opposed to a sale of the VoIP products, the collapse of the Debtors' business was inevitable.

15. The unsustainability of the Debtors' business is highlighted when considered in light of a calculation of the Debtors' twelve-month trailing liability; that is, the amount due participants over the following year on account of guaranteed returns for placing valueless advertisements on Internet sites.

16. This liability to participants based upon the guaranteed return grew exponentially in the year prior to the petition, eventually rising to more than \$5 billion as of the Petition Date.

17. Further indicia of a Ponzi/pyramid scheme, is acceleration of trailing liability as the scheme approaches saturation. In the Debtors' cases trailing liability more than tripled in the five months leading up to the Chapter 11, far outpacing any cash generated from the sale of VoIP packages.

18. The \$5 billion of trailing liability that existed is more than 700 times the \$6,600,000 cash receipts generated from the sale of the VoIP packages since the inception of the Debtors' business.

Determination of Claims

19. The Debtors' books and records recorded participant transactions not by the name of the individual participant but by "User Accounts." User Accounts were linked to email accounts, but a participant could have multiple User Accounts and many email accounts were associated with numerous (hundreds and sometimes thousands) of User Accounts. The User Accounts reflect (1) the plan purchased, (2) any amounts paid to the owner of the User Account, (3) credits earned by the owner of the User Account, and (4) credits redeemed by the owner of the User Account. The Trustee has sought a determination from this Court that a claim or

portion of a claim of a participant for accumulated credits in a participant's User Account as of the Petition Date should be disallowed.

20. The participant would accumulate credits based upon the posting of advertisements, recruiting of new participants, or sale of VoIP programs.

21. Participants were promised astronomical returns on their initial investment merely by the repetitive posting of Internet advertisements, which served no legitimate purpose, because anyone who used TelexFree as an Internet search term would be led to the Debtors' own Web site, and the repetitive posting or similar advertising had no discernable value.

22. As an example, one Web site, adpost.com, contained more than 33,000 postings submitted by participants of TelexFree, while another, classifiedsgiant.com, contained more than 25,000 postings.

23. The credits issued to the participants for placing advertisements were not reasonable compensation for the performance of legitimate services.

24. Participants did not draft the advertisements or perform any design services for the configuration, and the placing of the ads could be, and often was, outsourced to a third party for a nominal fee.

25. Additionally, credits accumulated for the sale of VoIP packages generated insignificant value to the Debtors and the requirements were easily circumvented by the participants.

26. Accordingly, claims premised upon accumulated credits in the participant's User Account on the Petition Date are analogous to claims based upon fictitious profits and, as such, should be disallowed in calculating a claimant's claim.

27. The Trustee will seek a determination that claims should be allowed only on a net equity basis, meaning that claims should be determined by (a) the amount paid by the participant to the Debtors or to another participant in accordance with a Triangular Transaction, and less (1) any money received by the participant from the Debtors in the form of bonuses, commissions or cash payments for redemption of credits, and (2) less any money received by the participant pursuant to the Triangular Transactions described in paragraph 12, above.

28. To the extent the Net Equity determination results in a participant receiving more money than they invested, the Trustee will seek to recover from these Net Winners. The Trustee will seek to recover these amounts as a fraudulent conveyance pursuant to § 548 and/or preferential payments pursuant to § 547 of the Bankruptcy Code.

Trustee's Avoidance Actions

29. In substance, a Triangular Transaction was a transaction among the Debtors, a recruiting participant and a recruited participant pursuant to which the Debtors authorized monies due the Debtors from the recruited participants for payments of invoices to be paid to the recruiting participants in exchange for the reduction of the recruiting participants' accumulated credits.

30. A Triangular Transaction should be viewed as a single transaction, resulting in a transfer of money from the Debtors to the existing participants in exchange for redemption of valueless accumulated credits.

31. Triangular Transactions, pursuant to which the accumulated credits were being redeemed and the recruiting participants obtained money from a recruited participant, are fraudulent transfers of the Debtors' property, to wit, money due from the recruited participants, and, as such, claims to recover these sums constitute property of the estates.

32. In addition to being fraudulent transfers, to the extent that these Triangular Transactions were consummated within ninety days of the bankruptcy proceeding, the transfers to recruiting participants constitute a preference to the participant who was able to redeem credits in exchange for the cash payments. As such, the transfers are recoverable by the estates and represent property of the estates.

Dos Santos Claim

33. On October 22, 2014, Dos Santos and others commenced an action in the United States District Court for the District of Massachusetts asserting various claims against, among others, the principals of the Debtors, major promoters and various financial institutions, asserting claims for violation of M.G.L. c. 93A, and aiding and abetting violation of M.G.L. c. 93A (the “Consolidated Complaint”)

34. The Consolidated Complaint was amended twice. On September 23, 2015, Dos Santos moved to file a Third Consolidated Amended Complaint. The proposed Third Consolidated Amended Complaint adds a count which asserts a claim by Dos Santos on her behalf and on behalf of all similarly situated individuals who made a payment to an individual Defendant who was a Net Winner, e.g., an individual who received more money from his/her participation in the TelexFree scheme than he/she paid into TelexFree, regardless of whether the payment was from the Debtors or another participant, and who received at least one payment from another participant.

35. The Unjust Enrichment Action characterizes the new claim as one of unjust enrichment.

36. The payments the Unjust Enrichment Action seeks to recover, in a defendant class action, are the same payments made in connection with the Triangular Transactions against

which the Trustee will also be seeking to recover on behalf of all creditors of the Debtors' bankruptcy estates.

37. While the Unjust Enrichment Action purportedly limits the claim to seeking recompense solely for monies paid by Dos Santos and similarly situated individuals to members of the defendant class, which class is defined as Net Winners, who received at least one payment from a participant in connection with the Triangular Transactions, the Unjust Enrichment Action is pursuing individuals who are included in the broad class of individuals to be pursued by the Trustee. Further, the Trustee's recovery will benefit a larger class of Net Losers than found with the Dos Santos plaintiff class. As such, the Unjust Enrichment Action seeks to exercise domain and control over property of the Debtors' estates; e.g., transfer of the Debtors' property to a class of Net Winners.

38. The Unjust Enrichment Action seeks to make such recoveries on behalf of Dos Santos and all similarly situated individuals. As such, she seeks class certification asserting a generalized claim as opposed to a particularized claim relating solely to her injuries.

COUNT I (Declaratory Relief)

39. The Trustee realleges and repeats the allegations contained in paragraphs 1 through 38 above and by reference incorporates them herein.

40. The Trustee seeks a declaration that the Unjust Enrichment Action violates the automatic stay under 11 U.S.C. § 362(a) and, therefore, the Unjust Enrichment Action is *void ab initio*. This declaratory relief is warranted for, but not limited to, the following reasons:

- a. By seeking to recover damages from Net Winners who received payments from participants, the Unjust Enrichment Action improperly contravenes the claims administration process;

- b. By seeking to recover damages from Net Winners who received payments from participants, the Unjust Enrichment Action interferes with the Trustee's exclusive right to seek recovery of fraudulently transferred property in direct violation of 11 U.S.C. § 362(a)(1) and (6).

41. The Unjust Enrichment Action further improperly seeks to obtain possession of the Debtors' property in direct violation of 11 U.S.C. § 362(a)(3).

42. To the extent that Dos Santos contests the Trustee's assertion that her action interferes with property of the estates, an actual controversy exists pursuant to which the Trustee is entitled to a declaration with respect to his property interest in the claims, and that the actions by Dos Santos are in contravention of 11 U.S.C. § 362(a).

43. To the extent that Dos Santos does not contest that the Unjust Enrichment Action interferes with and seeks to exercise control over property of the Debtors' bankruptcy estates, the Trustee is entitled to a judgment declaring her Third Consolidated Amended Complaint void *ab initio*.

44. Even if the transfer between an earlier participant and a new participant is not property of the estates, the Trustee is further entitled to a declaratory judgment that the Unjust Enrichment Action interferes with the efficient and orderly claims administration process and the effective and equitable administration of the Debtors' estates.

COUNT II (Preliminary Injunction)

45. The Trustee realleges and repeats the allegations contained in paragraphs 1 through 44 above and by reference incorporates them herein.

46. The Trustee requests that this Court enter an order enjoining Dos Santos, pursuant to 11 U.S.C. § 105(a), restraining and enjoining Dos Santos from further prosecution of the Unjust Enrichment Action.

47. The Trustee requests that the Court enjoin the prosecution of the Unjust Enrichment Action for, without limitation, the following reasons:

- a. The Unjust Enrichment Action improperly infringes on the jurisdiction of this Court;
- b. The issues in the Unjust Enrichment Action arise out of the bankruptcy proceedings, and any funds recovered in those actions have a strong likelihood of consisting of property of the estates recoverable by the Trustee pursuant to 11 U.S.C. §§ 547 and 548. As such, the proper forum for litigation of those issues raised in the Unjust Enrichment Action is in this Court and by the Trustee;
- c. The prosecution of the Unjust Enrichment Action interferes with the efficient and effective administration of the estates, determination of claims and distributions inasmuch as the calculation of claims is inextricably linked to a determination of Net Winners and Net Losers, which should be determined by considering the transfers made within the context of the Triangular Transactions as part of the claim allowance process conducted by the Bankruptcy Court;
- d. The continued prosecution of the Unjust Enrichment Action would interfere with the Trustee's efforts both to prosecute fraudulent conveyance and

preference actions and to obtain resolution of those actions on behalf of all of the creditors of the Debtors;

- e. There is an inadequate remedy at law to protect and preserve the assets of the estates, and the injunction will serve to preserve and protect the property of the estates and the Trustee's efforts to effectively collect property of the estates for the benefit of all victims who have filed claims.;
- f. An injunction will maximize judicial economy, will avoid the possibility of inconsistent decisions, and will ensure the preservation of uniformity of decision; and
- g. The injunction will not harm the public interest and is, in fact, in the best interests of the Debtors' creditors and orderly administration of the claims administration process.

48. The Trustee believes the injunction requested herein is necessary and appropriate to carry out his duties in accordance with the provisions of the Bankruptcy Code and that further prosecution of the Unjust Enrichment Action prior to completion of the Trustee's actions would seriously impair and potentially defeat the Court's ability to administer the estates.

WHEREFORE, the Trustee respectfully prays that this Court enter a judgment in favor of the Trustee against Rita Dos Santos, individually and as a putative class representative, as follows:

1. After notice and hearing, issue a temporary restraining order to halt the further prosecution of the Unjust Enrichment Action until such time as this Court has ruled on the Trustee's request for a declaratory judgment and any preliminary injunction;

2. After notice and hearing, enjoining and restraining Dos Santos and those acting in concert or participation with her or on her behalf and any of the other parties, in accordance with § 105(a) of the Bankruptcy Code, from further prosecuting the Unjust Enrichment Action or any other action against the “Net Winners” pending a completion of the Trustee’s review and prosecution of claims;
3. Declaring that the Unjust Enrichment Action violates the automatic stay under 11 U.S.C. § 362(a) and, therefore, *void ab initio*; and

4. Granting the Trustee such other and further relief as the Court deems just and proper.

Signed under the pains and penalties of perjury this 7th day of October, 2015.



Stephen B. Darr, Trustee of the Estates
of TelexFree, LLC, TelexFree, Inc.
and TelexFree Financial, Inc.

STEPHEN B. DARR AS TRUSTEE
OF THE ESTATES OF TELEXFREE,
LLC, TELEXFREE, INC. and
TELEXFREE FINANCIAL, INC.

By his attorneys,

Dated: October 7, 2015

/s/ Charles R. Bennett, Jr.

Harold B. Murphy (BBO #326610)
Charles R. Bennett, Jr. (BBO #037380)
Murphy & King, Professional Corporation
One Beacon Street
Boston, MA 02108
(617) 423-0400
CBennett@murphyking.com
HMurphy@murphyking.com

695687

EXHIBIT M

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
CENTRAL DIVISION

In re:

TELEXFREE, LLC,
TELEXFREE, INC. and
TELEXFREE FINANCIAL, INC.,

TelexFree.

Chapter 11 Cases

14-40987-MSH
14-40988-MSH
14-40989-MSH

Jointly Administered

STEPHEN B. DARR AS TRUSTEE
OF THE ESTATES OF TELEXFREE, LLC,
TELEXFREE, INC. and TELEXFREE
FINANCIAL, INC.,

Plaintiffs,

Adversary Proceeding
No. 15-04055

v.

RITA DOS SANTOS, INDIVIDUALLY AND
AS PUTATIVE CLASS REPRESENTATIVE,
AND
MARIA MURDOCH, ANGELA BATISTA
JIMENEZ, ELISANGELA OLIVEIRA AND
DIOGO DE ARAUGO, AS PUTATIVE CLASS
REPRESENTATIVES,

Defendants.

AMENDED COMPLAINT

Introduction

Stephen B. Darr, as he is the Trustee (the “Trustee”) of the Chapter 11 estates (“Estates”) of TelexFree, LLC, TelexFree, Inc. and TelexFrce Financial, Inc. (collectively, the “Debtors”), brings this action against the Defendant, Rita Dos Santos, individually and as putative plaintiff class representative (“Dos Santos”), and Defendants, Maria Murdoch, Angela Batista Jimenez,



Elisangela Oliveira and Diogo DeAraugo, as Putative Class Representative (“Murdoch”) (hereinafter, Dos Santos and Murdoch collectively “Defendants”), for violating the automatic stay on the basis of their prosecution of certain claims characterized as Unjust Enrichment Claims against certain individuals and a class of individuals. The Trustee also seeks to enjoin the Defendants from prosecuting unjust enrichment claims against certain named individuals who they characterize as “Net Winners” or “Top-Level Promoters” (collectively, “Unjust Enrichment Claims”).

The Trustee asserts that the Unjust Enrichment Claims assert substantially the same claims and seek to recover the same property that the Trustee seeks to recover in the class actions he has commenced. Accordingly, Count 1 of this Complaint seeks a declaration that prosecution of the Unjust Enrichment Claims is a violation of the automatic stay imposed by § 362 of the Bankruptcy Code such that prosecution of the claims constitutes an exercise of control over property of the Debtors’ Estates, being the Estates’ right to recover the same monies as fraudulent transfers and/or preferences made as part of Triangular Transactions (as hereinafter defined). Court II of the Complaint seeks an injunction pursuant to Bankruptcy Code § 105(a) to enjoin and restrain the Defendants from prosecuting the Unjust Enrichment Claims.

The Trustee has commenced two Defendant Class Actions seeking to recover transfers made to Participants in the Debtors’ scheme who are “Net Winners” (as that term is defined by Order of this Court dated January 26, 2016 [Document # 687]) on the basis that the transfers, including those made in a Triangular Transaction, are fraudulent transfers and/or preferential payments pursuant to §§ 547, 548 of the Bankruptcy Code. The payments made in connection with a Triangular Transaction that the Trustee seeks to recover are the same payments that the Unjust Enrichment Claims of the Defendants seek to recover.

Parties

1. The Plaintiff is Stephen B. Darr, as he is the duly appointed and acting Trustee of the Chapter 11 Estates of TelexFree, LLC, TelexFree, Inc. and TelexFree Financial, Inc., who has a usual place of business within this District.

3. The Defendants assert to be representative of Participants who lost money as a result of paying money as part of a Triangular Transaction to another Participant who they generally characterize as “Net Winner” or “Top-Level Promoters.”

4. This Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. § 1334(b). This adversary proceeding is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (O).

3

11. The basic features of the Debtors' membership program had all the hallmarks of a Ponzi and pyramid scheme: (1) Participants were promised unusually high returns – over 200% per year – for doing virtually nothing except posting meaningless internet ads; (2) Participants were promised bonuses if they recruited new Participants, who would do virtually nothing except post ads and recruit new Participants (and so on and so on); and (3) while there were some VoIP plans sold, Participants did not have to sell the plans in order to receive redeemable credits. Because Participants were strongly encouraged to recruit new Participants and were not required to sell the VoIP plans, the Debtors were using funds from later Participants to pay earlier Participants.

12. On November 25, 2015, the Court, on motion by the Trustee and after notice and hearing, entered an Order, as amended on December 21, 2015, finding that the Debtors were engaged in a Ponzi scheme and that this ruling was the law of the case in each of the jointly administered cases.

13. On January 26, 2016, the Bankruptcy Court entered an Order finding, in part:

- (i) In determining the amount of claims of Participants, any claim or portion of claim based upon accumulated credits in a Participants' User Accounts as of the Petition Date shall be disallowed;
- (ii) The claim amounts of Participants shall be determined on a Net Equity basis, which shall be defined as follows: the amount invested by the Participant into the Debtors' scheme, including amounts paid pursuant to Triangular Transactions, less amounts received by the Participant from the Debtors' scheme, including amounts received pursuant to Triangular Transactions.
- (vi) The foregoing findings and conclusions shall be applicable for all purposes in these proceedings.

Participant for the purchase of a membership plan, and the new Participant paid the membership fee to the recruiting member, rather than to the Debtors (hereinafter a “Triangular Transaction”).

18. In the case of a new User Account being opened with the use of accumulated credits in another User Account, the process worked, generally, as follows:

- (i) A Participant created his/her online account, or used his/her existing account information, to establish a new User Account;
- (ii) The Debtors’ database recorded the details entered by the new Participant and assigned an identification number to the Participant’s new User Account;
- (iii) The Debtors recorded the purchase, issued an invoice to the Participant’s new User Account, and marked the invoice as ‘pending’;
- (iv) The new Participant forwarded the invoice to the recruiting Participant, who satisfied the invoice with accumulated credits in the existing User Account;
- (v) The new Participant paid the invoice amount to the recruiting Participant (in those cases where there were two separate Participants involved).

19. A Triangular Transaction is a single transaction which is completed at the conclusion of a series of interdependent steps.

20. The substantive result of the Triangular Transaction is that funds otherwise payable to the Debtors from Participants for the purchase of membership plans were paid to the recruiting Participants, who in turn satisfied the invoice issued by the Debtors to the new Participant by reducing the recruiting Participant’s accumulated credits.

21. The money paid by a new Participant to an existing Participant constitutes property of the Debtors, and the consummation of the Triangular Transaction results in a fraudulent transfer of the Debtors’ property (e.g., cash from a new Participant) to an existing Participant in exchange for the Debtors’ redemption of valueless credits.

22. In addition to being fraudulent transfers, to the extent that these Triangular Transactions were consummated within ninety days of the bankruptcy proceeding, the transfers

Defendants' Claim

24. Among the claims asserted in the Consolidated Complaint and in the Amended Consolidated Complaints are claims for unjust enrichment against the named individuals.

26. The Arizona Action largely parallels the Second Amended Consolidated Complaint, except it was expanded to include request for certification of a class of Defendants who are Net Winners and received payments from other Participants, alleging that the “Direct Victim Payments to that class of Net Winners may be recovered on the basis that the New Winners were unjustly enriched by the Direct Victim Payments.”

27. On February 24, 2016, Maria Murdoch, Angela Batista Jimenez, Elisangela Oliveira and Diogo DeAraugo, as Putative Class Representative commenced a civil action in the United States District Court for the District of Massachusetts (4:14-cv-40018) asserting claims against various individuals, asserting among its claims a claim for unjust enrichment (the “Murdoch Action”). (The Murdoch Action, the Consolidated Complaint and the Arizona Action shall be collectively referred to as the “Unjust Enrichment Claims.”)

28. The payments subject to the Unjust Enrichment Claims are the same payments made in connection with Triangular Transactions which the Trustee is seeking to recover on behalf of all creditors of the Debtors’ bankruptcy Estates in the Trustee’s class action Adversary Proceedings.

29. The Unjust Enrichment Claims are not limited to a claim seeking recompense solely for damages suffered by an Individual Plaintiff for a particular harm suffered by that individual, but seek recovery on behalf of the Defendants and all similarly situated individuals against a class of defendants, which class is defined as Net Winners, who received at least one payment from a Participant in connection with the Triangular Transactions. The Unjust Enrichment Claims are general claims against the same individuals who are included in the broad class of individuals being pursued by the Trustee; as such, the Trustee is the proper party to pursue those claims.

30. Further, the Trustee’s recovery will benefit a larger class of Net Losers than found within the Defendants’ plaintiff classes because the Trustee’s class action will benefit all Participants who are Net Losers and include those individuals who lost money as a result of direct transactions with the Debtors as well as those individuals who lost money in Triangular Transactions, whereas the Defendants’ class consists only of those Participants who lost money

as a result of Triangular Transactions and excludes those who lost money as a result of direct transactions with the Debtors.

31. The Unjust Enrichment Claims seek to exercise domain and control over property of the Debtors' Estates, e.g., transfer of the Debtors' property to a class of Net Winners.

32. The Unjust Enrichment Claims brought by the Defendants or on their behalf and those similarly situated individuals assert a general claim, and the Trustee is the proper party to assert and prosecute such claims for the benefit of all creditors.

COUNT I (Declaratory Relief)

33. The Trustee realleges and repeats the allegations contained in paragraphs 1 through 32 above and by reference incorporates them herein.

34. The property transferred as part of Triangular Transactions constitute property of the estate and are recoverable by the Trustee pursuant to §§ 547 and 548 of the Bankruptcy Code.

35. The Unjust Enrichment Claims violate the automatic stay under 11 U.S.C. § 362(a) and, therefore, the Unjust Enrichment Claims are *void ab initio*, because by seeking to recover damages from Net Winners who received payments from Participants, the Unjust Enrichment Claims interfere with the Trustee's exclusive right to seek recovery of fraudulently transferred property in direct violation of 11 U.S.C. § 362(a)(1) and (6).

36. The Unjust Enrichment Claims further improperly seek to obtain possession of the Debtors' property in direct violation of 11 U.S.C. § 362(a)(3).

37. To the extent that the Defendants contest the Trustee's assertion that the Unjust Enrichment Claims exercise control over property of the Estates, an actual controversy exists pursuant to which the Trustee is entitled to a Judgment declaring his property interest in the

money transferred pursuant to Triangular Transactions and that the Unjust Enrichment Claims are in contravention of 11 U.S.C. § 362(a).

**COUNT II
(Damages)**

38. The Trustee realleges and repeats the allegations contained in paragraphs 1 through 37 above and by reference incorporates them herein.

39. Upon a finding that the Defendants' actions are violations of the automatic stay imposed pursuant to 11 U.S.C. § 362(a), award the Trustee damages in the amount of his costs and expenses, including reasonable attorney fees incurred in connection with this litigation.

**COUNT III
(Preliminary Injunction)**

40. The Trustee realleges and repeats the allegations contained in paragraphs 1 through 39 above and by reference incorporates them herein.

41. The Trustee requests that this Court enter an order, pursuant to 11 U.S.C. § 105(a), restraining and enjoining the Defendants from further prosecution of the Unjust Enrichment Claims.

42. The Trustee requests that the Court enjoin the prosecution of the Unjust Enrichment Claims for, without limitation, the following reasons:

- a. The factual bases for the Unjust Enrichment Claims arise out of the same set of facts, and the funds sought to be recovered in the Unjust Enrichment Claims are the same facts and the same funds the Trustee seeks to recover pursuant to 11 U.S.C. §§ 547 and 548. As such, the proper forum to seek to recover those funds is in this Court in the class action commenced by the Trustee;

- e. The injunction will not harm the public interest and is, in fact, in the best interests of the Debtors' creditors and orderly administration of the claims administration process.

seriously impair and potentially defeat the Court's ability to administer the Estates.

Maria Murdoch, Angela Batista Jimenez, Elisangela Oliveira and Diogo DeAraugo, as Putative Class Representative, as follows:

14

EXHIBIT N

1 **APPEARANCES (continued):**

2
3 For Interim Lead Class Brown Rudnick LLP
4 Counsel and Plaintiffs' BY: KIERSTEN A. TAYLOR, ESQ.
5 Interim Executive Committee: WILLIAM R. BALDIGA, ESQ.
6 One Financial Center
7 Boston, MA 02111

8
9 For Stephen Darr, Murphy & King, P.C.
10 Chapter 11 Trustee: BY: ANDREW G. LIZOTTE, ESQ.
11 HAROLD B. MURPHY, ESQ.
12 CHARLES BENNETT, JR., ESQ.
13 One Beacon Street, 21st Floor
14 Boston, MA 02108

15
16 For Carlos N. Wanzeler Partridge Snow & Hahn LLP
17 and James Merrill: BY: WILLIAM MOORMAN, JR., ESQ.
18 30 Federal Street
19 Boston, MA 02110

20
21 ALSO PRESENT: STEPHEN DARR
22 Chapter 11 Trustee
23 265 Franklin Street
24 Boston, MA 02210
25

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1 P R O C E E D I N G S

2 THE COURT: Good afternoon, everyone. Be seated,
3 please.

4 THE COURTROOM DEPUTY: Calling case 14-40987,
5 TelexFree, LLC.

6 Could the parties please identify themselves for the
7 record?

8 MR. MURPHY: Good afternoon, Your Honor. Harry Murphy
9 for Stephen Darr, the Chapter 11 trustee.

10 MR. LIZOTTE: Andrew Lizotte for Stephen Darr,
11 trustee, Your Honor.

12 MR. BENNETT: Charles Bennett for Stephen Darr,
13 trustee.

14 MR. BALDIGA: Good afternoon, Your Honor. William
15 Baldiga, Brown Rudnick, for the plaintiffs in the MDL
16 proceeding and certain victims in this case.

17 MS. TAYLOR: Afternoon, Your Honor. Kiersten Taylor
18 also for the plaintiffs in the MDL proceeding.

19 MR. MOORMAN: Good afternoon, Your Honor. William
20 Moorman from Partridge Snow & Hahn on behalf of Carlos Wanzeler
21 and James Merrill. I'm making a limited appearance today, Your
22 Honor, for purposes of this opposition.

23 THE COURT: Okay.

24 I think we have two matters on for today. One is the
25 trustee's motion for a finding that the TelexFree debtors

1 engaged in a Ponzi and pyramid scheme and the other is the
2 Chapter 11 trustee's motion to establish a bar date.

3 Mr. Murphy, unless you have a preference, I think we
4 should do the Ponzi scheme motion, first.

5 MR. MURPHY: Thank you, Your Honor. We'll proceed on
6 that basis.

7 Both these motions, Your Honor, taken together, and
8 particularly the Ponzi motion, seek to establish procedures and
9 methodology to be utilized in connection with the claims of
10 what now the trustee estimates to be approximately 1.9
11 participants and who purchased membership plans in the debtors
12 during the two-plus years of operation of the, what was
13 ostensibly a multi-level marketing business but, in fact, which
14 we believe and have alleged is a Ponzi and pyramid scheme.

15 Those participants established approximately 11
16 million user accounts with the debtor by which they tracked
17 their activity, their initial investments, amounts that were
18 received by them, amounts that were paid by them, invoices that
19 they satisfied for other participants. And again, you have
20 participants who may have had hundreds, and in some cases,
21 thousands of user accounts and others that might have just one
22 or two user accounts and the complexity associated with
23 determining claims in this case is compounded by the fact that
24 the identity of those participants is not readily ascertainable
25 by the information provided by the participants when they

1 opened those user accounts with the debtors.

2 The trustee has developed, as I said in his papers and
3 you've heard this before, Your Honor, but for the benefit of
4 others who haven't, the trustee has endeavored to reconstruct
5 the debtors' computer records, is able to get it working, has
6 been able to do a number of analysis, and has employed a number
7 of different algorithms, if you will, by which he now feels
8 confident that he'll be able to establish an electric,
9 electronic proof of claim process that will provide
10 participants with the opportunity to submit their claims
11 electronically, answer certain questions regarding payments
12 made and received, provide certain information that they
13 provided the debtor when they opened the user accounts such
14 that the electronic claim portal that will be established by
15 the trustee will enable the participant, actually, to get
16 access to the user accounts that are associated with the
17 information they have provided for the debtor such as
18 passwords, that they, and the like. And through that,
19 heretofore, they haven't had that access, access that shut down
20 since the records were seized by the Federal Government in
21 conjunction with the shutdown and seizures of the debtors'
22 assets. Claimants will be able to identify and register their
23 claims or take issue with the information that's established in
24 the books and records.

25 As far as the trustee's been able to determine, the

1 transactions referenced in the SIG, the database, appear to
2 have integrity. He's been able to tie out on a --- on a -- not
3 each and every one of them, but on a selective basis cash
4 receipts and disbursements, the debtors' case records. In many
5 cases, the debtors' used independent payment processes for the
6 receipt and disbursements of funds.

7 The key here, Your Honor, is, obviously, when you're
8 deal with a case that potentially involve upwards of 1.9
9 million proofs of claim, is to develop a mechanism by which we
10 can test those claims against the database and do it in a
11 fashion so that we don't consume all available assets in the
12 estate and go into the process. In order to do so, we think,
13 practically, we need some requisite pre-findings that are
14 associated with the proof of claim process and the claim
15 allowance process, generally, so that we can move the case
16 forward.

17 One of those is that the credits that have accumulated
18 in user accounts, which was, if you will, the currency that was
19 created by the debtors' Ponzi scheme, really are going to play
20 no role in the allowance of claims or just pursuit of any
21 recovery actions. What's at issue here is going to be how much
22 was, did a particular participant put into the, the debtors'
23 into purchasing a plan and how much did they receive from the
24 plan.

25 The Ponzi motion and affidavit of trustee -- and

1 Mr. Darr is in the courtroom, Your Honor, and is prepared to
2 testify at today's evidentiary hearing -- will be that the
3 debtors' business was, in fact, a Ponzi and pyramid scheme. It
4 promised and paid exorbitant returns to participants for merely
5 posting Internet ads unassociated with the sale of any product.
6 Mr. Darr has put evidence in in his examination that there were
7 *de minimis* product sales and that payments to participants were
8 primarily funded by membership paid by new participants, that
9 there was no independent business here, that the business was
10 unsustainable, that the more memberships they sold, the greater
11 liability, and, and the business, in fact, was destined to
12 collapse, which it did shortly before the filing because they
13 had an overwhelming, they tried to change the rules and, if you
14 will, there was a run on the bank. Those findings that the
15 debtor operated a pyramid and Ponzi scheme, we don't think, can
16 be seriously challenged here. And I don't think that either of
17 the objectors, per se, have challenged that finding but if they
18 do, it's the trustee's feeling that if we're going to move
19 forward with this case, we need to get that issue determined
20 now. This is not an issue that should not be unaddressed.
21 There's a fundamental issue in all of these cases as to whether
22 or not there's a legitimate business and if we're going to
23 design a claim process and if we're going to go forward and
24 pursue avoidance actions, we have to find what the fundamental
25 basis for which people's claims or entitlements are in these

1 cases and this determination is essential.

2 THE COURT: How do you respond to the point raised by
3 one or both of the objectors that the procedure is
4 inappropriate, that to get to a determination that there was a
5 Ponzi scheme you can't do it like this with a motion. Have to
6 file an adversary proceeding or some other process. What do
7 you say about that?

8 MR. MURPHY: I say, Your Honor, that's elevating form
9 over substance. Your Honor approved a order of notice -- and
10 I'm not suggesting that this is binding -- but what we're
11 suggesting here that the process that we're trying to do to
12 bring this forward to the Court is to put the world on notice
13 of the requested relief that we're making and afford every
14 party that has a potential interest in the case to come forward
15 and to request, to object to the requested findings.

16 That, that notice involved over a million separate e-
17 mails, regular or by e-mail, electronic mail to every known
18 participant or known e-mail address we had. It also involved
19 posting on the website maintained for the case in both English,
20 Portuguese, and Spanish the motions. It involved giving
21 notice, as I said, detailed -- the motion is quite detailed as
22 to the relief that we're requesting, the grounds for the
23 relief, the affidavit attached. It -- the notice gave the
24 objection deadline and this Court established this hearing for
25 all creditors, or any creditor that took issue with the

1 requested findings to come forward. That, that process started
2 well over 30 days ago. We received two responses, Your Honor.
3 Those parties are here in the courtroom and they can examine
4 the trustee and hear whether or not there's a basis for these
5 findings.

6 Your Honor, the notion that we have to name an
7 adversary, bring an adversary proceeding and name 1.9 million
8 people to achieve the same result is the substance of a fall.
9 The objections, Mr. Baldiga has requested an opportunity to
10 take the deposition of Mr. Darr. We produced Mr. Darr earlier
11 this week. He was examined by Mr., earlier this week or late
12 last week. I forget which. He was examined by Mr. Baldiga.
13 He was afforded the time. The principals, if they wanted to
14 examine Mr. Darr, they had an opportunity to do so. And if
15 they want to examine him today, obviously that's what we're
16 here for today or tomorrow, or however long it takes, Your
17 Honor.

18 But the notion that we have to bring an adversary
19 proceeding to obtain a fact, a Ponzi finding is just, I think
20 it's just -- there's no basis for it.

21 THE COURT: Let me, let me be clear, that the -- I'm
22 looking at the Certificate of Service. The Ponzi motion
23 itself, not just the notice of this hearing, but the Ponzi
24 motion itself was served by electronic mail on all the
25 participants for whom you had e-mail addresses, is that

1 correct?

2 MR. MURPHY: That is correct, Your Honor.

3 THE COURT: And then a copy of the motion itself, the
4 entire motion in English, Spanish, and Portuguese was posted on
5 the KCC website?

6 MR. MURPHY: That is correct, Your Honor.

7 And for every creditor who filed a proof of claim,
8 they also got the -- I think it was 50 odd thousand proofs of
9 claim --

10 MR. LIZOTTE: Either electronic or hard copy.

11 MR. MURPHY: -- they either got electronic or hard
12 copy as well, Your Honor.

13 So we not only took the debtors' data, database as to
14 e-mail addresses, we also reviewed and obtained all the proofs
15 of claims from the Court and KCC notified them as well and not
16 only the substantive motion as well as the notice of a hearing
17 and the procedural and the deadline and the like, not just the
18 notice of hearing and call, if you want a copy. They got
19 copies of the pleadings, Your Honor.

20 THE COURT: All right.

21 So -- and turning to the motion itself, there are four
22 prayers for relief. One is the, is the finding that, that this
23 was a Ponzi scheme. Another is an order that disallows
24 preemptively accumulated credits from participants' proofs of
25 claim --

1 MR. MURPHY: Yes. We've --

2 THE COURT: -- requiring this net equity approach to
3 determining the claims.

4 MR. MURPHY: WE think that falls, Your Honor, from a
5 Ponzi finding that, on the well-established case law that so-
6 called fictitious profits should not form a basis for a claim.
7 It should be done on net equity and the so-called accumulated
8 credits should not play a part in that. And again, that was
9 front and center in the requested relief.

10 THE COURT: We'll come back to that. Because that
11 seems to be a point of contention.

12 The third prayer is that the Ponzi finding apply
13 jointly and severally -- I'm sorry -- that the debtors jointly
14 and severally be liable to all the participants.

15 MR. MURPHY: Yes, Your Honor. In terms of designing a
16 proof of claim, one of the things we wanted to ensure is I can
17 assure you that every participant we've spoken to -- and the
18 trustee has spoken to many participants directly. Our office
19 has appeared at meetings, community meetings, and the like --
20 participants didn't know which debtor they were doing. They
21 were dealing with TelexFree. We've -- based upon the trustee's
22 affidavit and the information set forth therein, the debtors
23 were all commonly owned. They were all engaged in this
24 particular enterprise together. We allege that it's a
25 fraudulent enterprise and under established law participants in

1 a fraud are all jointly and severally liable for that.

2 The purpose of that for the proof of claim will be, as
3 you know, an individual investor participant will not have to
4 say, "I had a claim against this or this or this." We're going
5 to end up with duplicate claims. For the participants as
6 opposed to any contract creditors, they would only have to file
7 one proof of claim. It would be a claim deemed against all the
8 estates. It may well be we may ultimately go to a substantive
9 consolidation here. There's certainly grounds for that, but
10 we're not seeking that right now.

11 But what right now we're saying is that participant
12 only has to register a claim. It will be deemed a separate
13 claim in each estate without the necessity of filing three
14 different claims.

15 THE COURT: Okay.

16 And the fourth request in your motion is for an order
17 that the Ponzi finding be applicable throughout the bankruptcy
18 proceedings.

19 MR. MURPHY: Yes. And I might suggest, Your Honor,
20 the -- I might say fourth would, might be that net equity, a
21 net equity calculation of how claims should be determined
22 includes what we call the so-called directly amounts in and out
23 as well as the triangular transactions.

24 So the so-called net equity determination, we've asked
25 for that determination as part of this Ponzi motion, credits be

1 disallowed, and claims be determined on a net equity basis.

2 THE COURT: Right.

3 MR. MURPHY: And lastly, we've asked, as Your Honor
4 pointed out, that these findings, that this is a, this is a
5 Ponzi scheme, which I think is -- again, if there's an issue,
6 let's get at it today -- but this is a Ponzi scheme. The
7 credits were fictitious profits. They play no role in trying
8 to determine the losses of victims in this case, which are
9 many. We're going to look at it like every other court has
10 looked at how to address the claims of victims in a case like
11 this, that we're not going to have to relitigate these issues
12 and every single time someone comes forward we're going to have
13 to re-prove that this is a Ponzi scheme. We're not going to
14 have to re-prove that the -- that -- that the credits have any
15 bearing on this process and that as a matter of law, Your
16 Honor, when you look at this the cases well establish that --
17 and these, I think, fall as a matter of law -- but we wanted to
18 put the world on notice that it's the trustee position that
19 findings in this motion will be collateral estoppel issue
20 preclusion to any party who, who's going to challenge this.
21 Because if we end up having to litigate this separately for 1.9
22 million people, there's not going to be any money for anyone
23 here and we're trying to do something full and fair notice to
24 the world. Everyone come forward. If they have an issue, come
25 forward and prove their case. If Your Honor thinks there's not

1 enough notice, we'll give more notice.

2 But the idea that we have to individualize this
3 process for each individual claimant is just inconsistent with
4 any rational approach to how to deal with this problem.

5 THE COURT: All right. Unless you have another
6 suggestion, what I would say is we start with your first prayer
7 for relief, which is a determination that the debtors operated
8 a Ponzi and pyramid scheme and focus on whether you can
9 establish that.

10 MR. MURPHY: Sure, Your Honor.

11 THE COURT: Make an offer of proof as to what you
12 would put on. Because you have Mr. Darr in the courtroom, yes?

13 MR. MURPHY: Yes, Your Honor. Mr. Darr is here. His
14 affidavit is on file with the Court and I would offer
15 Mr. Darr's testimony on this point, on these points or all, all
16 the matters before the Court this morning, or this afternoon.
17 And his affidavit details --

18 THE COURT: I only want to deal with No. 1, finding
19 that the debtor operated a Ponzi and pyramid scheme.

20 MR. MURPHY: Yes.

21 THE COURT: I want to break this down, please.

22 MR. MURPHY: And, Your Honor, we've alleged two
23 things. This is a hybrid and we've looked at, I'd like to
24 think we've considered every reported Ponzi scheme that we've
25 been able to come across of, that have been reported. There's

1 obviously some that are not, but at least that's been a subject
2 of case law in the last 20, 30, 40 years. And this is
3 ingenious, if you would like to describe it that, and it was
4 two parts. And our pleadings talk about the fact that it is a
5 Ponzi scheme because participants who were lured into this
6 scheme were given, were sold the idea that for your initial
7 investment, whether you buy -- whatever -- depending on what
8 membership plan you would apply, you would receive a guarantee
9 return by posting Internet advertisements, which the company
10 supplied you.

11 THE COURT: What you're telling me now is what
12 Mr. Darr would testify to?

13 MR. MURPHY: This is what -- this is exactly what
14 Mr. Darr would testify.

15 -- and it was a guaranteed return and his affidavit
16 speaks to that to the 3 to 400 percent annual return you would
17 get merely by posting Internet ads.

18 Mr. Dar would also testify that the, the percentage of
19 product sales, of actual products sold here unassociated
20 with -- to the -- with the sale of membership plan, i.e., to
21 third parties, is there a legitimate product here, the so-
22 called VOIP service by which you would pay 49.95 and have the
23 opportunity to make unlimited phone calls. The revenues
24 associated to that were *de minimis*, inconsequential, that they
25 couldn't in any way generate enough revenue to service the

1 obligations created by the, by the guaranteed return on the
2 membership plan, that the only way that the obligations could
3 be satisfied by an ever-increasing sale of new family plans or
4 new membership plans and which is a hallmark of every Ponzi
5 scheme that there is, that you can't pay the existing investors
6 without new investors, that there's no legitimate business
7 generating revenues on a standalone basis sufficient to cover
8 the liabilities created to your existing members.

9 Your Honor, it's not proof, but this was, this has
10 been the manner of the similar, same scheme was done in Brazil.
11 The Brazilian authorities found the same thing. Mr. Darr will
12 testify about his involvement, his review of the E&Y report
13 which was retained in the Brazilian proceeding. He will
14 testify that to his discussions with the Brazilian authorities,
15 again that this is the same thing that was done there and that
16 the scheme was unsustainable. It was destined to fail and that
17 by the spring of '14 it was, in fact, failing. And the debtors
18 recognized that.

19 Mr. Darr will also testify that his review of the
20 books and records indicate as early as the spring of, summer of
21 '13 the debtors recognized that the scheme was unsustainable,
22 that it received advice from third parties, including
23 professionals who were retained by it, that the scheme was
24 unsustainable. And notwithstanding that, the debtor continued
25 to operate the scheme until the bitter end, until it blew up.

1 Your Honor, I, I, again, would offer the affidavit of
2 Mr. Darr. I'll point specifically to the numbered paragraphs
3 in his affidavit. Let me pull that out. If Your Honor has any
4 questions or any other party in interest, Your Honor, I think
5 your suggestion that we deal with these one by one. I think it
6 starts at Paragraph 60, in particular, and it goes through
7 Paragraph 69 about the facts that support the finding and
8 existence of a Ponzi scheme.

9 THE COURT: All right. Thank you, Mr. Murphy.

10 I'd like now to offer any of the other parties in the
11 courtroom an opportunity to be heard and cross-examine on the
12 first prayer for relief, the existence of a Ponzi and pyramid
13 scheme.

14 MR. BALDIGA: Thank you, Your Honor. For the record,
15 again, William Baldiga for the Plaintiff Committee in the MDL
16 and the representative of victims in this case.

17 Your Honor, we do not oppose -- there, there is no
18 proposed order which makes this a challenge. I know there was
19 a proposed order filed this morning on a different motion.

20 THE COURT: Uh-huh (indicating an affirmative
21 response).

22 MR. BALDIGA: There is no proposed order here. So, as
23 Mr. Murphy said, there's -- it's -- some of these things are
24 combination-type things. So that makes, without a proposed
25 order, somewhat of a challenge. But I think it's helpful if

1 you understand what we are opposing and what we're not opposing
2 just to help frame, frame the hearing. I won't go for long
3 because I think argument should follow the evidence and not,
4 not the other way around.

5 THE COURT: I agree.

6 MR. BALDIGA: We do not oppose a finding today that
7 this is a Ponzi scheme. We do not oppose the prayer asking
8 that the debtors be jointly and severally liable for the
9 victims' claims in this case. We do not oppose the setting of
10 a bar date.

11 The trustee urges that the claims be solicited on the
12 basis of the difference between the amount invested -- I think
13 throughout we'll use that term in quotes -- and the amounts
14 withdrawn. And so there would be no claim for fictitious
15 profits. We do not oppose that.

16 And we do not oppose that the trustee uses a
17 electronic or other type of claim solicitation process that
18 elicits that information so that claims can be allowed without
19 undue burden on anyone in this case. We all agree that
20 administrative expense, unfortunately, as in every case,
21 reduces victim recovery.

22 We're also, Your Honor, not, even though the papers go
23 on, the trustee's papers go on at length about this, that we're
24 not here today because the, as victim representative we want to
25 sue net losers. In fact, we do not and our papers are specific

1 in that regard. And we have not. And we do not want to
2 interfere with the trustee's definition of net winners and net
3 losers in this case subject to the Court's findings.

4 We're not here because we are suing to recover
5 anything paid by TelexFree to anyone and we're not doing that
6 under any theory.

7 THE COURT: Let me stop you there. Are you saying
8 that you are not opposed to the second prayer for relief in
9 the trustee's motion ordering that any claim of participants
10 that is based on accumulated credits be disallowed and the
11 claims be determined on a net equity basis?

12 MR. BALDIGA: We oppose it to the extent, as follows,
13 Your Honor, and I, and I think, again, argument on that point
14 should follow the evidence because I think the specific
15 evidence on that point is important.

16 We do not oppose the solicitation of information on
17 the trustee's present bar date motion to obtain the information
18 to allow claims to be allowed or disallowed on that basis. We
19 do believe that because no one knows how many of these 1.9
20 million people actually got notice of anything. I mean, we
21 don't even know -- the trustee doesn't even know their names,
22 never mind real addresses. He has a lot, hundreds of thousands
23 of e-mail addresses that may or may not have reached people.

24 But we don't think that claims should actually be
25 allowed or disallowed until, like in every other case,

1 including every other Ponzi scheme case, claims are filed and
2 there's an objection. This is not the first Ponzi scheme case.
3 It is the first Ponzi scheme case, we would suggest, that there
4 has been asked an advisory opinion of you as to once people get
5 around months from now to filing proofs of claim, whether they
6 have already lost their rights prior to, maybe, knowing of the
7 bankruptcy case or knowing of the bar date or having filed a
8 claim or even deciding whether to file a claim, whether they
9 then have already lost their rights as to the resolution of
10 their claim.

11 We, we think that's premature and we don't think that
12 is necessary. We understand why there's some efficiencies
13 which must be imposed on this case, which is why we think the
14 information should be gained that doesn't require a whole new
15 solicitation of information. We fully support that.

16 I think -- I hope that's responsive to your question,
17 but we do think, for the reasons set out in our papers, we
18 think that the trustee goes too far with the advisory opinion,
19 which is sought here.

20 But I, I wanted on the presentation, Your Honor, just
21 this initial opening to stress how much we do not oppose here.
22 We do not oppose two of the three specific requests in the
23 motion.

24 We do think that the second one, as you just
25 mentioned, is, in large part, just fine and we support that as

1 long as it doesn't cut off the rights of specific victims later
2 on in their specific claims. And we would support the trustee
3 at the appropriate time to give notice in an efficient way and
4 so forth. We don't think that, you know, claims objections do
5 not need to be by adversary proceeding or in-hand service and
6 so forth.

7 So there's, there's a right time and a place to do it
8 and, frankly, in every other case, including Ponzi scheme
9 cases, people follow those rules and the case goes in good
10 order.

11 The, the fourth prayer for relief is the one we are
12 most troubled by because it's ill defined. There's no proposed
13 order. We don't know what that means. I don't think anyone
14 has articulated.

15 THE COURT: For all purposes?

16 MR. BALDIGA: For all purposes, what, whatever that
17 means, although Mr. Murphy, I think, was helpful in clarifying
18 or confirming that the trustee would like however much res
19 judicata and collateral estoppel can be gained from that,
20 whatever that means, as the case goes forward and issues come
21 to this Court. We, we certainly oppose that and I think much
22 of today's hearing would be going to that.

23 THE COURT: Well, let me stop you there. Because what
24 if the order finding that there is a Ponzi scheme simply said
25 the words, "These findings are applicable in all, for all

1 purposes in these proceedings," period, end quote. What would
2 you take that to mean? And why would that be a problem for
3 you?

4 MR. BALDIGA: Because there would -- it doesn't mean
5 that the trustee wouldn't later argue that there was some
6 collateral estoppel effect, given that the order was silent.

7 We do have an order, Your Honor, a proposed order,
8 that we -- may I approach, Your Honor?

9 THE COURT: Just tell me what it says about --

10 MR. BALDIGA: Sure. It's -- it's -- it's an order
11 that would allow the trustee's motion -- actually, all parties
12 should have a chance to look at it, including Mr. Moorman --
13 that would have the motion before the Court granted in part,
14 denied in part; have a order, decedral paragraph that the
15 debtors operated a Ponzi and pyramid scheme, exactly the words
16 used by the trustee; that the debtors shall be jointly and
17 severally liable for the allowed claims of participants; that
18 the trustee is authorized -- this is a longer paragraph -- but
19 authorized to do in connection with the bar date solicitation
20 and so forth, exactly what he's proposed to do; and that -- and
21 this is really the paragraph that is most important to us --
22 that the entry of the order and any preliminary determination
23 made by the trustee pursuant hereto as to any participant's
24 claim because that's what the trustee wants to do shall not
25 impair or otherwise affect any participant's right to commence

1 or continue any action to recover funds he or she directly paid
2 to any other person or entity, including in connection with --
3 and I'm paraphrasing. I'm not reading the exact words --
4 including with respect to the Ponzi scheme, not determine today
5 whether funds paid by any one participant to any other
6 participant in connection with the Ponzi scheme constitute
7 property of the estate; not determine today the validity of any
8 interest in those funds enjoyed by the trustee, the debtors, or
9 any participant; not determine today any participant's right to
10 bring an action to recover those funds from the participant to
11 which such funds were paid; not determine today the trustee's
12 request in his two things that he has brought, to determine
13 those issues, which as long as we are not affected by
14 collateral estoppel, res judicata, or any of the other things
15 that Mr. Murphy would like -- we're happy to litigate in due
16 time whether that's today or at another time -- and shall not
17 affect in any way the multi-district litigation proceedings in
18 Worcester before Judge Hillman or any request made in those
19 proceedings.

20 So we think this is an order that gives the trustee
21 everything to which he's entitled today, would allow this
22 hearing to be completed, I think, in good order and allow the
23 trustee to proceed with the Chapter 11 case efficiently, give
24 the relief that is necessary now without unduly cutting off
25 anyone's rights, including important rights as to what

1 constitutes property of the estate, which we do think is very
2 much one that needs to be made after a different type of
3 procedure and not just as an afterthought to a Ponzi scheme
4 motion.

5 THE COURT: Your order doesn't make any reference to
6 the scope of the finding. It doesn't address applicability
7 throughout these proceedings, which is what the trustee wants.

8 MR. BALDIGA: Well, that's right. We say it does --

9 THE COURT: Silent on that point.

10 MR. BALDIGA: No, it doesn't, Your Honor. It's -- and
11 again, I'm happy to hand one up, if you'd like.

12 In connection with Paragraph 4, it says that it would
13 be used to preliminarily determine the claims of participants
14 on an net equity basis. It's, it's the exact same thing that
15 flows from a Ponzi scheme. That's the essence of a Ponzi
16 scheme.

17 So we're saying that the trustee is authorized to get
18 the proofs of claim done exactly on that basis, as articulated
19 in what is the bulk of the paper.

20 THE COURT: Is it your, is it your intention to limit
21 the Ponzi scheme finding to simply that? Is that what you're
22 telling me?

23 MR. BALDIGA: Yes. Well, more specifically, Your
24 Honor, we, we go on to say the, these several ways --

25 THE COURT: What it doesn't do.

1 MR. BALDIGA: I'm sorry?

2 THE COURT: You have a list of what it doesn't --

3 MR. BALDIGA: That's right.

4 THE COURT: -- authorize. I understand that. You've
5 carved out a bunch of stuff.

6 MR. BALDIGA: So we say it does apply to what the
7 trustee deals with in the bulk of his motion. Does not deal
8 with these other things. We can't think of anything that's
9 left out, but certainly, to the extent that the trustee does,
10 we could deal with that. But --

11 THE COURT: The classic purpose of a Ponzi scheme
12 finding is it creates a presumption under the law in connection
13 with a lot of different things, fraudulent transfer claims and
14 so forth. According to your version of the order, is that not
15 going to happen if there's a finding of a Ponzi scheme? Is the
16 presumption --

17 MR. BALDIGA: No. I think --

18 THE COURT: -- not going to be triggered?

19 MR. BALDIGA: I think that could.

20 THE COURT: I mean, that would be -- that's the sense
21 I get as why we're going through this exercise, is to get
22 beyond that point so that the trustee can now proceed with the
23 benefit of the presumption. And I'm not hearing from you
24 anything about that. That was what I understand that fourth
25 prayer to be about.

1 MR. BALDIGA: I have to say I didn't order that, but
2 that would not bother us. Because, as I said in my opening, we
3 don't oppose at all -- and our papers, I hope, made that clear
4 -- the trustee's recovery of any funds distributed by the debtor
5 on any theory, whether it's fraudulent conveyance or preference
6 theory or any other theory and we, we'd like to see the trustee
7 do that. And if, if there are presumptions that are helpful in
8 that regard --

9 THE COURT: What, what I'm really hearing,
10 Mr. Baldiga, is that, that your constituency wants the Ponzi
11 scheme finding to have a series of exceptions you identified in
12 your proposed order --

13 MR. BALDIGA: Yes.

14 THE COURT: -- right? And one of those exceptions is,
15 what, that it shouldn't be applicable in the multi-district
16 litigation that's before the U. S. District Court?

17 MR. BALDIGA: That's right.

18 THE COURT: Right.

19 MR. BALDIGA: In connection with our recoveries of
20 monies paid by one victim to a promoter. That finding is not
21 necessary to it and the trustee's not a party to it and I
22 suppose if we want a presumption, we'll ask Judge Hillman for a
23 presumption in that regard, but it's not necessary.

24 THE COURT: Well, why -- give me a good argument as to
25 why this court should put that kind of a boundary around a

1 final order of the court. Why should I do that? What would be
2 the justification, legally, principally, equitably, for me to
3 make a finding of a Ponzi scheme and say, "But wait a minute.
4 It shouldn't apply to any proceeding outside this court"?
5 Courts don't do that.

6 MR. BALDIGA: Well, the trustee is using, trying to
7 use -- and I think it's, it's pretty obvious from the papers
8 that you've read and have been filed here -- that the trustee,
9 the trustee's primary purpose in the fourth prayer for relief
10 is to use the Ponzi scheme finding to implicitly create a
11 finding that none of the victims here have the right to sue to
12 get their money back in the manner that they wish, but they --
13 they've lost -- there's a property right in the trustee that
14 would preclude that.

15 And to the extent that a Ponzi scheme motion or a
16 Ponzi scheme finding leaps over to explicitly or implicitly
17 into a determination of a property right, we would object.

18 To the extent --

19 THE COURT: See, I had trouble --

20 MR. BALDIGA: -- that it doesn't do that, we don't
21 object.

22 THE COURT: I had trouble connecting the dots on, on
23 that point. I -- I -- I didn't see how the trustee was asking,
24 raise the concern that you are talking about here. There was
25 not one word in this motion about trying, about the ability of

1 the individual participants to proceed against other
2 participants. That my come later. That may be part of an
3 adversary proceeding.

4 But how, how do you make the leap from a Ponzi scheme
5 finding to, "We have a problem proceeding in the multi-district
6 litigation"? I'm not -- I don't get that connection,
7 Mr. Baldiga.

8 MR. BALDIGA: Because they told us that.

9 Your Honor, this, this hearing is --

10 THE COURT: Where -- who's told you what?

11 MR. BALDIGA: They told us exactly that.

12 THE COURT: But does this motion tell you that? Does
13 an order finding it's a Ponzi scheme tell you that? I, I
14 don't --

15 MR. BALDIGA: Not the order that we've submitted. It,
16 it would not. But --

17 THE COURT: Let's assume I just, I just endorse this
18 as allowed and I -- there's a general finding that there was a
19 Ponzi scheme for all purposes in this bankruptcy, in these
20 bankruptcy proceedings. How does that translate into creating
21 a problem for you in the multi-district litigation?

22 MR. BALDIGA: As long as that's not a determination of
23 an interest in property of the estate, we have no problem.

24 THE COURT: Okay. We'll come back to that.

25 MR. BALDIGA: And so, obviously, Your Honor, I have

1 much more argument after the facts are in.

2 And so with respect to your question as to -- we don't
3 have any objection to the introduction of Mr. Darr's affidavit
4 as his testimony in chief. We do have cross-examination.

5 Your question as to whether we have cross-examination
6 as to the finding of a Ponzi scheme, I went into this opening
7 for the purpose of saying it's, it's a little bit unclear, in
8 our mind -- again, because the trustee elected not to file a
9 proposed order so we're, we're all guessing a little bit about
10 this -- but I, I don't think the cross-examination goes
11 specifically to those points because we don't oppose a finding
12 of a Ponzi scheme. But I suppose once you hear the cross-
13 examination altogether, which is not long, you may, you may
14 say, "Well, some of that really was as to Paragraph 60 to 69."
15 I, I don't think so because I didn't know how this, how the
16 hearing was going to be done exactly like that.

17 So with the caveat that I think our questions are all
18 as to other matters, we would be happy to have those paragraphs
19 of the affidavit come in as Mr. Darr's testimony subject to
20 cross-examination later when we get to the other points.

21 THE COURT: What is it that you want to cross-examine
22 him about?

23 MR. BALDIGA: Several points, Your Honor.

24 Excuse me.

25 (Pause)

1 MR. BALDIGA: Generally speaking, Your Honor, some
2 questions regarding the breadth of the scheme here; exactly
3 what is meant by Mr. Darr as to what he means by a Ponzi scheme
4 and a pyramid scheme because those are words that have a lot of
5 different meanings and a lot of different cases. I don't think
6 we necessarily disagree, but we think the record should be
7 absolutely clear in that regard, given the importance. Some
8 things about how notice have been given as to today's
9 proceedings. The -- we'd like -- well, we have several
10 questions regarding how the MDL proceedings and the Chapter 11
11 work together and Mr. Darr's intentions in that regard, which,
12 again, go to the very things that we've just been talking
13 about, how do these things work together, how do today's
14 findings deal with that. Those are the topics.

15 THE COURT: Okay. Thank you. We'll come back to that
16 in a few minutes.

17 Is there anyone else who --

18 MR. BALDIGA: Thank you, Your Honor.

19 THE COURT: You're welcome.

20 Does anyone else want to be heard on the first prayer
21 for relief in the motion?

22 Mr. Moorman?

23 MR. MOORMAN: Good afternoon, Your Honor. Again,
24 William Moorman from Partridge Snow & Hahn on behalf of
25 Mr. Wanzeler and Mr. Merrill.

1 Your Honor, with respect to this particular finding,
2 our objection is primarily to the process, the fact that it is
3 being done by motion. So that does tie some of the issues
4 together. Our concern is that any finding should be limited to
5 this proceeding. We think it should be limited to the claims
6 allowance process which is what this is really about and it
7 should not be extended to any other proceeding. It's certainly
8 not applicable to any criminal proceeding.

9 THE COURT: You mean -- you mean -- let's, let's make
10 sure we have the same, the same definitions here.

11 When you say "this proceeding," you're talking about
12 the Chapter 11 cases?

13 MR. MOORMAN: Correct. It should be --

14 THE COURT: Okay.

15 MR. MOORMAN: It should be limited to this Chapter 11
16 case and should be limited to the, the claims allowance
17 process. I haven't, frankly, thought about fraudulent
18 conveyance adversary proceedings, but I believe that an
19 adversary proceeding is to be brought. There's due process
20 concerns. There's procedural concerns and everyone should have
21 the right to due process and appropriate notice in connection
22 with those types of proceedings.

23 Certainly, we would object to any finding being
24 binding in any other civil proceeding and any proceeding that
25 the trustee might bring against Mr. Merrill or Mr. Wanzeler

1 other than in the claims allowance process.

2 THE COURT: Well, I ask you the same question I asked
3 Mr. Baldiga. What is the principal reason why a court should
4 restrict findings that it makes and rulings that it makes that
5 are final the way you're requesting? Why would I do that?

6 MR. MOORMAN: Well, this was not an action brought
7 against Mr. Wanzeler or Mr. Merrill. If the trustee desires
8 some relief to be binding upon them, applicable to them in this
9 area, it should have been done by adversary proceeding.

10 There are other issues such as whether or not it would
11 be a core proceeding as it relates to seeking a finding that
12 would be binding on them and as --

13 THE COURT: Well, not binding on them, specifically.
14 They're not mentioned at all in any of this. Just binding for
15 all purposes in this case and to the extent that they want to
16 come into this case, why shouldn't they be bound with, with
17 notice?

18 MR. MOORMAN: Only to them coming into this case,
19 that's, that's one thing, but if -- what we're questioning is
20 extending it beyond this case and to some other case.

21 THE COURT: How, how altogether do these individuals
22 have standing in this case in any way? Can you explain that to
23 me, please?

24 MR. MOORMAN: As to whether or not they have standing,
25 Your Honor?

1 THE COURT: Yes.

2 MR. MOORMAN: It appears to us that the debtor is
3 seeking to have a, a finding that is binding upon them. If
4 he's seeking to do that, then I think they have standing to
5 come in and oppose that type of a finding. I think it, it
6 comes about from --

7 THE COURT: Well, you have -- I think you have -- you
8 have the cart before the horse. He's seeking a finding that is
9 for all purposes in this case. If -- if a -- if they don't
10 want to be bound by that finding, they can stay out of the
11 case.

12 MR. MOORMAN: In terms of coming in and filing a claim
13 or something like that.

14 THE COURT: Right.

15 MR. MOORMAN: But they might be brought involuntarily
16 into the case by way an adversary proceeding being filed
17 against them. If that occurs, then they should be able to
18 litigate this issue through a proper adversary proceeding.

19 THE COURT: And how was this, apart from -- I'm
20 looking at 7001, which lists ten, ten different proceedings
21 that are called adversary proceedings. I don't see this
22 particular one here, or anything like it. But apart from the
23 formalities, how is this any different than an adversary
24 proceeding in terms of your clients? They had ample notice of
25 this. They're here opposing it. What else do they need?

1 MR. MOORMAN: I think the formalities are important in
2 terms of service of service, the applicable Rules of procedure.
3 Judge, this was done in a very quick time frame.

4 THE COURT: When was your motion filed, Mr. Murphy?

5 MR. MURPHY: October 7th, Your Honor.

6 THE COURT: Yeah.

7 MR. MOORMAN: The, the other proceedings that they are
8 subjected to are going to take months and months of trial.

9 THE COURT: Not here, not with me. You know,
10 bankruptcy moves quickly.

11 MR. MOORMAN: Right, but they're not, they're not
12 parties to this proceeding. We filed this as a protective
13 measure, Your Honor, to the extent that the trustee seeks to
14 have them bound in some other proceeding.

15 THE COURT: One of the things I think you, that came
16 up in your opposition was a comment about needing to do
17 discovery. Can you elaborate on that? What kind of discovery
18 would your clients need here?

19 MR. MOORMAN: Your Honor, I'm not sure exactly what
20 discovery they would want to engage in here.

21 THE COURT: Okay. Thank you.

22 MR. MOORMAN: I imagine it would be extensive
23 discovery, though, that I'm not -- I'm here for the procedural
24 mechanism of this proceeding, the fact this was done by motion,
25 and the fact that I --

1 THE COURT: Well, one of the reasons that they
2 objected to the, to the procedure was because they said they,
3 that an adversary proceeding, they couldn't engage in
4 discovery.

5 So I'm asking you to give me some insight into what
6 kind of discovery they could possibly want to engage in.

7 MR. MOORMAN: May I, Your Honor?

8 (Pause)

9 THE COURT: Go ahead.

10 MR. MOORMAN: Your Honor, I don't have the detail on
11 the discovery that we would want to engage in.

12 THE COURT: All right. Thank you.

13 Anything else on the first prayer?

14 MR. MOORMAN: I guess the only other issue that's part
15 of our argument, Your Honor, is that to the extent that there
16 is an intent to have the individuals somehow bound by this, we
17 contend that they would have a jury trial right and would have
18 made such a demand.

19 MR. MOORMAN: Thank you.

20 THE COURT: Thank you.

21 Mr. Murphy, can you give me any enlightenment on the
22 trustee's intentions with regard to Messrs. Wanzeler and, and
23 Merrill, please, if you, if you're at liberty to do so? Is it
24 the trustee's intention to go after them?

25 MR. MURPHY: Your Honor, my understanding is is that

1 they are already subject to certain orders in the criminal and
2 the SEC action and that the trustee is restrained from going
3 after those defendants 'cause it's already been restrained.
4 All their assets have been forfeited, that they can be located
5 in the United States. Mr. Wanzeler is a fugitive. He's not
6 been in the United States. He's left. And Mr. Merrill is
7 under indictment, as I understand the last report. The
8 criminal trial is scheduled April of this, April of next year
9 with the potential that might have to be extended.

10 But the trustee has no present intentions of, given --
11 if the, if the criminal case goes as expected, there won't be
12 any reason to pursue either Mr. Merrill or Mr. Wanzeler. If
13 for some reason it should go against the Government, then it is
14 quite possible that we would pursue them for any of their
15 assets for the typical bankruptcy causes of action. But that
16 remains to be seen.

17 We may have to bring those actions prior to the
18 expiration of the two-year avoidance period to have them
19 pending, but we do that -- we'd have to do that in cooperation
20 with the Government, get some sort of relief from the
21 Government to just bring, bring the claim and put it on hold
22 pending the outcome of the criminal case if it's not resolved
23 by April of '16. That's the two-year statute, Your Honor.

24 So the short answer is, that's not our focus, Your
25 Honor. Our focus is is on, again, having determinations here.

1 We don't -- Your Honor, we think that Your Honor's rulings is
2 what it is, as Coach Belichick would say. Your Honor, to the
3 extent we obviously have pointed out in our papers that we
4 don't think it has any applicability to the criminal
5 procedures. There's a different burden of proof. Mr. Merrill
6 and Mr. Wanzeler, should he decide to show up, will, will have
7 their day in court on that. This Court's findings that it is a
8 Ponzi scheme is -- and it's out on notice to everyone here to
9 give everyone an opportunity. We do see any point of trying to
10 parse it out of it's good for this, but not for that and maybe
11 not for this, we just can't have it.

12 This particular case is not going to be conducive to
13 that and, frankly, it's, there's no basis to say it's a Ponzi
14 scheme for this purpose, but not for another purpose. I just
15 don't understand that thinking. It either is or isn't and if
16 there's a question of if it isn't, let's get at it today rather
17 than have these exceptions to the Rule or unproven issues that
18 just requires us to continually revisit this issue as, as new
19 things come out. And if it can't be done today, let's, let's
20 do it as soon as possible.

21 And I appreciate, Your Honor. This has been out there
22 for six weeks now. People have had it. I can tell you, Your
23 Honor, I haven't received anyone's calls other than
24 Mr. Baldiga's office who's been very active, obviously. We've
25 had multiple discussions before and after this about where the

1 trustee's going. There's been no mystery. We've met with
2 community groups. We've met with the SEC. We met with the
3 U. S. Attorney. We've met with the U. S. Trustee, all in
4 conjunction with bringing this motion. We met with the Chelsea
5 Collaborative, Greater Boston Legal Services, everyone we could
6 possibly tell about. There's no mystery here. We're not
7 trying to do this by sleight of hand. We're trying to be
8 straightforward and direct as possible.

9 Our intentions here are to try to get the victims
10 compensated as efficiently as possible with the least amount of
11 overlap, without the least amount of proceedings in two
12 different courts. We don't want to involve the bankruptcy
13 court in the Middle District litigation, MDL litigation
14 involving the aiding and abetting claims of the banks. We've
15 long told Mr. Baldiga's office that that's, because of the
16 notion of *in pari delicto* the estate does not believe it's in a
17 good position to pursue aiding and abetting claims and that to
18 the extent we can be cooperative in that effort, we will
19 cooperate.

20 But to the extent that there is a pursuit of recovery
21 of the estate or assets of the estate or claims against net
22 winners and net losers and how that matter is to be determined,
23 we think Your Honor should make those determinations. It
24 should be done in one court one time and for the benefit of
25 all. 'Cause that's the only way we're going to get this done.

1 THE COURT: Well, you've raised that, the trustee has
2 raised that in an adversary proceeding that is pending here.

3 Putting that aside, how does an order granting this
4 motion advance the trustee's claims in the, in that adversary
5 proceeding, if at all --

6 MR. MURPHY: Your Honor --

7 THE COURT: -- in your opinion?

8 MR. MURPHY: -- we think that the determination of
9 what comprises the claims -- and again, we think that the
10 participants should have a claim whether they paid the debtor
11 or they paid someone who was an existing participant and lured
12 them into the scheme. We think -- the trustee's thought long
13 and hard about that, that the people at the bottom of the
14 pyramid who got in last were put in -- were -- were, if you
15 will, solicited by friends, neighbors, and families and who, I
16 think, unwillingly and said, "Hey, you should get in this deal.
17 Give me the money. I'll, I'll cover your invoice and you're
18 all set. You'll be able to make a lot of money like I'm
19 making." And that person who got, who recruited, the recruiter
20 put \$1425 in his pocket. His neighbor is out \$1425. We think
21 that neighbor should have a claim in this bankruptcy, even
22 though the money didn't come in directly to TelexFree.

23 THE COURT: But how does that have anything to do with
24 what's going on in the multi-district litigation? That's my
25 question. How, how can your opinion --

1 MR. MURPHY: It's a separate issue. It is a separate
2 issue.

3 THE COURT: What, what is it about this motion and
4 order granting it that would in any way impair the rights of
5 the parties in the multi-district litigation, in your opinion?
6 Mr. Baldiga's very worried about this.

7 MR. MURPHY: Well, he should be, Your Honor. We
8 think --

9 THE COURT: Well, tell me why 'cause I'm not getting
10 it.

11 MR. MURPHY: We think that that payment is, that
12 payment of the membership fee is, was payment of property of
13 the estate. We think that that payment should be calculated as
14 part of the claim and the recovery since we are recognizing --

15 THE COURT: I know you think all that and you've --

16 MR. MURPHY: Right.

17 THE COURT: -- addressed that in the adversary
18 proceeding, but what -- what -- how would an order granting the
19 motion impact that thinking or advance your ability to prevail
20 in the adversary proceeding? That's what Mr. Baldiga is
21 worried about.

22 MR. MURPHY: Right.

23 THE COURT: And I don't understand the connection
24 between this motion and that, and that claim of the trustee --

25 MR. MURPHY: Only --

1 THE COURT: -- brought in the other case.

2 MR. MURPHY: Only that the -- Your Honor, I think
3 it's -- one would take it's implicit in the net equity
4 determination, if you include the triangular transactions. The
5 only basis to do that is that that, that's property of the
6 estate. And if it is property of the estate, the question is
7 is whether or not it's appropriate that property of the estate
8 be pursued by anyone other than the trustee.

9 THE COURT: So the -- your definition of "net equity"
10 is, includes the triangular transactions? Where do I -- where
11 do I find that in your motion?

12 MR. MURPHY: Couple of places, Your Honor. Let me
13 point out specifically.

14 (Pause)

15 MR. MURPHY: Your Honor, if I point you, Your Honor,
16 to Page 31 and it's Paragraph 94. And I'll read it for the
17 record:

18 "Based upon the foregoing the net equity claim of
19 participants should be determined, as follows: The
20 amount invested by the participants into the debtors'
21 scheme, including amounts paid by the participant
22 pursuant to a triangular transaction less amounts
23 received by the participant from the debtors' scheme
24 and including amounts received by a participant
25 pursuant to the triangular transaction."

1 We think that that -- that is -- without doing so,
2 you're going to end up with a curious result. Because you have
3 people -- if you just look at one side of the balance sheet, if
4 you will, how much they put in directly and how much they
5 received, you get one result. But if you look, then, at
6 amounts that they have paid or received from participants --
7 and this is with respect to buying membership plans of the
8 debtor -- you're going to get a different result.

9 And the idea that you cut off half the equation and
10 just look at part of the equation, which is this notion that,
11 "Well, we'll, we'll deal with this part up in the Middle
12 District and we'll leave this part down here in the
13 bankruptcy," just doesn't work as a practical matter and you
14 end up with inequitable results.

15 For example, Your Honor, I could be a net winner in
16 the same if I put a hundred dollars into TelexFree and I got
17 \$200 back from TelexFree. I'm a winner of that scenario. If,
18 however, I had to pay Mr. Lazar \$500, I am a net, overall net
19 loser.

20 So if I just look at one side -- and this is what
21 happens. People -- the way this works is you're always going
22 to be saying, all right. And we can tell exactly whether you
23 sent us, when you look at your user account, whether you
24 satisfied someone else's invoice or whether you paid someone
25 else. And, and we're saying is the calculation of the net

1 equity, when you design this thing, you can determine on an
2 overall basis whether you should have a claim in the case or
3 whether you shouldn't have a claim in the case. And if you
4 don't do it, indeed, and when you look at the definition of
5 "net equity" employed by Mr. Baldiga's people -- and I'll refer
6 to Page 17 of 205 of the third amended proposed complaint in
7 Note 5 -- they employ the same definition of "net winner" as
8 the trustee's proposing, which is "a net winner is simply a
9 participant who received more money from their participation in
10 the scheme (whether in the form of earnings, commission,
11 bonuses, or otherwise) than he or she paid to participate in
12 the scheme," taking it, looking at this holistically, globally.

13 THE COURT: What are you reading from?

14 MR. MURPHY: This is the third amended complaint that
15 was filed in the Middle District.

16 THE COURT: Oh, oh. The one you're trying to enjoin?

17 MR. MURPHY: That's correct.

18 So they're using the same definition as we are, which
19 is you got to look at the whole pie here. You can't slice it
20 in half. And we say that's the case. If you say that these --
21 if you say these transactions, participants don't belong in
22 here, that they're not involving property of the estate, then
23 the net equity calculation we're talking about really doesn't
24 work. If you are saying that we should only compensate victims
25 who put money in and got money out and leave out the indirect

1 transactions, that's one result, but you're going to end up
2 leaving about 80 percent of the people out of the recovery.
3 And we don't think that's right.

4 But that's the, that's a logical extension of the
5 argument that this does not involve property of the estate.
6 They don't have a claim here. And, and be careful for what you
7 ask for, is, is the point that we've made.

8 THE COURT: So what I'm hearing, though, is that it's
9 not the finding that there was a Ponzi scheme that should be
10 troubling the plaintiffs in the multi-district litigation.
11 It's your, your request for a determination about claims
12 allowances, net losers, and accumulated credits and so forth in
13 your second prayer that is the problem area.

14 MR. MURPHY: That's what I understand.

15 THE COURT: Mr. Baldiga, am I right about that?

16 MR. BALDIGA: Yes, Your Honor.

17 THE COURT: Okay.

18 MR. MURPHY: I think that's, that's right. And we've,
19 we've had debates with Mr. Baldiga from the -- from the --
20 almost the inception of these cases whether this is part and
21 parcel. And we try to be creative. There's no in the middle.
22 It's either here or it's not. And, and it was brought to a
23 head. We were going down the same road to bring it to the
24 Court. Well, we like to think there was an end run by the
25 initiation of the third amended complaint on the eve of our

1 filing this motion, but we're here.

2 But we got to -- I think that in order to advance the
3 matter, again, we can, we can work around it. We can do a
4 workaround. We can do the Baldiga, Mr. Baldiga's order, which
5 I have never heard of, not seen except for today. But the idea
6 of having an order that kind of does it, but kind of doesn't
7 doesn't seem to make a lot of sense to me and I just as soon
8 get at.

9 And, and just so we're not, we're not holding up
10 victims' payments, Your Honor, and --

11 THE COURT: Say again.

12 MR. MURPHY: We're not holding up victims' payments.
13 Nothing is going to be -- the Government has indicated that
14 they're going to, if they prevail in litigation, they think
15 that the trust, they have confidence that the trustee's going
16 to be able to determine the claims and make distributions.
17 That's why we vetted the proposed claim process with the
18 Government to get them comfortable with it. The Government is
19 in the courtroom. The SEC's in the courtroom. They understand
20 that, what we're trying to accomplish, but we don't have any
21 money to distribute, at least until sometime next year.

22 We don't -- we're -- we have -- again, the two points
23 is we want to get a bar date and then we have the six months
24 left in the statute before we, five months left in the statute
25 before we have to commence avoidance actions. There could be

1 thousands avoidance actions, Your Honor. The best estimate
2 right now of the trustee is that we have 1.9 million
3 participants that, 95 percent of those are losers. About 5
4 percent --

5 About 80,000, Mr. Darr?

6 MR. DARR: 81,000.

7 MR. MURPHY: -- are winners.

8 THE COURT: Do you have any sense of the magnitude of
9 these winners? 'Cause my impression is that no individual
10 winner won that much.

11 MR. MURPHY: Mr. Darr can -- we have charts and
12 Mr. Darr can tell us right now, if you like, Your Honor.

13 THE COURT: Well, we're going to have Mr. Darr take
14 the stand in a minute so we can --

15 MR. MURPHY: We have done that stratification. I can
16 assure you we're going to act, try to act practically here.
17 We're not chasing small -- doesn't make sense, Your Honor.
18 We're going to be very realistic about this. We hope to do it
19 -- we don't -- we think many people -- again, we're not
20 suggesting -- and Your Honor raised this earlier in the
21 proceeding -- that, to use the participants in the scheme. We
22 think 90, 90 percent of the people thought this, didn't think
23 there was anything wrong with this. We're -- they had no evil
24 intent. They were not engaged in anything fraudulent. They
25 thought it was a great opportunity, but it was one of those

1 things that was, frankly, too good to be true. And, and we're
2 going to try to be thoughtful and not hurt anyone, but there is
3 substantial inequities and there's people who've got six-figure
4 and seven-figure money recoveries out of this.

5 But when you determine those amounts, you're not only
6 looking at how much they got directly, but it's also looking at
7 the credits they earned from the company. They utilized and
8 they got Andy and others to buy into it and paid their
9 membership and they put money in their pockets. And we have
10 to, and we have to take those payments into account to
11 determine what they're entitled to get, if anything, out of
12 this bankruptcy estate, or if they have to put money back in to
13 compensate these victims.

14 So that's -- it is complicated, Your Honor. It is the
15 only -- again, going, looking at these cases and the world of
16 Ponzi is not a pretty place -- but this is the only cases --
17 and Mr. Baldiga will agree 'cause he's looked as well -- that
18 has this two-fold aspect in and out, but sideways. Madoff
19 didn't have this and all these cases didn't have this
20 trafficking, paying, I'm going to pay your membership fee in
21 the Madoff scheme. This -- it didn't work like that.

22 THE COURT: Uh-huh (indicating an affirmative
23 response).

24 MR. MURPHY: There was the feeder funds. I became a
25 creditor of a feeder fund and the feeder money's put in.

1 That's different. We're talking about the triangle here.

2 That's a lineal relationship as opposed to a triangular
3 relationship.

4 Thank you, Your Honor.

5 THE COURT: All right.

6 I want to have Mr. Darr take the stand and allow
7 Mr. Baldiga to ask him some questions.

8 But before I do, is there anyone else who is going to
9 oppose the motion to establish the Ponzi scheme who would want
10 to cross-examine Mr. Darr who's in the courtroom here?

11 (No response)

12 THE COURT: All right, Mr. Darr. Please take the
13 stand.

14 MR. DARR: Thank you, Your Honor.

15 THE COURTROOM DEPUTY: Good afternoon.

16 MR. DARR: Good afternoon.

17 MR. MURPHY: Your Honor, if I may --

18 THE COURTROOM DEPUTY: Can you raise your right hand?

19 STEPHEN DARR, TRUSTEE'S WITNESS, SWORN

20 THE COURTROOM DEPUTY: Please be seated.

21 THE WITNESS: Thank you.

22 MR. MURPHY: If I may, Mr., Mr. Bennett's going to
23 examine Mr. Darr.

24 THE COURT: You're not going over the same offer of
25 proof.

1 MR. BENNETT: No, Your Honor. I understood that we
2 would use his affidavit as direct and to the extent I need to
3 redirect, I would.

4 THE COURT: Okay.

5 Okay, Mr. Baldiga. You're on.

6 MR. BALDIGA: Thank you, Your Honor.

7 CROSS-EXAMINATION

8 BY MR. BALDIGA:

9 Q Good afternoon, again, Mr. Darr.

10 A Good afternoon.

11 MR. BALDIGA: I just need to grab.

12 (Pause)

13 MR. BALDIGA: Your Honor, again for the record,
14 William Baldiga for the PIEC in the, in the MDL and the victims
15 in this case.

16 BY MR. BALDIGA:

17 Q Mr. Darr, I'll try not to go over too much of the same
18 ground that I deposed you on.

19 But you remember you were in my office last week and we
20 deposed you for about three hours?

21 A Yes.

22 Q You believe that, your best guess today, there are about
23 1.9 million victims of this Ponzi scheme?

24 A Yes.

25 Q And in your database --

1 A I'm sorry. One -- 1.9 million participants.

2 Q Participants.

3 A Not all of them were victims.

4 Q Thank you.

5 Some, some won, some lost, but --

6 A Yes.

7 Q And the overwhelming majority of the participants are
8 losers, in your belief, correct?

9 A Yes.

10 Q You maintain a database of the information that TelexFree
11 was using to manage its participants, correct?

12 A Yes.

13 Q And, and you have an acronym or something that you use to
14 refer to --

15 A It's called the SIG system, which is, S-I-G, which is the
16 acronym for the system, which I can't remember because it's a
17 Portuguese, a Portuguese name.

18 Q Okay. Well, we can just refer to it as the SIG system?

19 A Yes.

20 Q The SIG system, one of the data points is country codes,
21 correct?

22 A Yes.

23 Q And you don't know for sure where any victim was -- I'm
24 sorry -- where any participant was physically located as they
25 accessed the system, isn't that right?

1 A That's correct.

2 Q But in your database that you are using there are
3 participants that have indicated a, a country code and in fact
4 there are 240 or so country codes reflected in your database,
5 correct?

6 A Yes.

7 Q So sitting here today you don't know that there are
8 participants in 240 countries, or even that there are, in fact,
9 240 countries in the world?

10 A I'm pretty sure there are not 240 countries in the world.
11 There's about 170, but many countries have more than one
12 country code.

13 Q Okay.

14 A For example, Puerto Rico has a different code than the
15 United States.

16 Q So you just don't know how many countries are represented
17 by the physical location of participants as you sit here today?

18 A No, I do not.

19 Q You do know that many of the participants and the victims
20 here, the losers, seem not to have English as their primary
21 language, correct?

22 A I met many of the victims. Many of them are perfectly
23 fluent in English and many are not. I, I don't know what the
24 exact breakout is.

25 Q Okay.

1 You believe that there were at least \$3 billion of
2 transactions in the TelexFree scheme?

3 A Yes.

4 Q And that losses appear to be more than \$1 billion?

5 A Yes. That seems like a fair, fair estimate.

6 Q And you just don't know sitting here today for how many of
7 the victims the losses were most or all of their life savings,
8 isn't that correct?

9 A No. I have no information on, on each individual victim's
10 personal loss.

11 Q I'm going to ask you a number of questions regarding the,
12 what you mean by Ponzi scheme or, or pyramid scheme.

13 A Sure.

14 Q We, we did all this before, but I think the record's
15 important to reflect.

16 You refer in some of the papers that were filed on your
17 behalf to investors, but you don't mean to imply by that there
18 was some true investment, correct?

19 A No, I was more describing them as to their, to their
20 intentions, not that there was an actual investment.

21 Q And TelexFree's revenues were actually inconsequential to
22 its overall operations, isn't that correct?

23 A When you say -- I'm not sure what you're referring to when
24 you say "revenue." You mean revenue from VOIP?

25 Q Yes.

1 A Yes, very inconsequential.

2 Q And TelexFree ostensibly sold a product, isn't that
3 correct?

4 A Yes.

5 Q The VO, VOIP product?

6 A Yes.

7 Q And it's your belief today that these products gave
8 TelexFree the story by which TelexFree could perpetuate or
9 perpetrate the Ponzi scheme, isn't that correct?

10 A I'm sorry. Could you repeat the question?

11 Q Sure.

12 You, you believe today that these so-called products were
13 simply the story by which TelexFree could perpetuate or
14 perpetrate the Ponzi scheme, isn't that correct?

15 A They might have been able to come up with some other
16 product, but that's the product that they ostensibly were
17 selling.

18 Q To perpetrate the Ponzi scheme, correct?

19 A Yes.

20 Q And TelexFree was not, in your words, a viable business,
21 but an illegal operation, correct?

22 A I know it wasn't a viable operation. The question of
23 legality or illegality is really a, a question that is a legal
24 question and I may have described it as an illegal operation,
25 but I'm not really qualified to characterize it as legal or

1 illegal.

2 Q Okay. Well, Mr. Darr, I think we established at the
3 beginning of this on Thursday I deposed you?

4 A Yes.

5 Q You, you remember that and --

6 A Yep.

7 Q -- and you were under oath?

8 A Uh-huh (indicating an affirmative response).

9 Q And do you remember that I asked you the question, "You
10 also made the decision not to attempt to sell the business,
11 correct?"

12 And you said, "Yes."

13 And I asked, "Why was that?"

14 And do you remember the answer that you gave?

15 A Not offhand.

16 MR. BENNETT: Could I have what page you're on,
17 Mr. Baldiga, please?

18 MR. BALDIGA: Page 17.

19 MR. BENNETT: Thank you.

20 MR. BALDIGA: May I approach, Your Honor?

21 THE COURT: Yes.

22 BY Mr. BALDIGA:

23 Q I ask you to read on Page 17 the answer that you gave.

24 A Sure. My answer was:

25 "A Because I believed at the time that there was -- it was not

1 a viable business, that there was nothing to sell, and that it
2 was an illegal operation and it's tough to sell an illegal
3 operation."

4 Q That was your testimony last week, correct, Mr. Darr?

5 A Yes.

6 Q You also believe that at least most of these victims got
7 nothing at all for the money they put in, correct?

8 A I think I was talking there in terms of the VOIP product.
9 I, I don't know -- we haven't done any analysis to say that
10 most of the victims did not receive anything back. I just, I
11 don't know that answer.

12 Q Well, let me ask that differently. And I may have
13 misspoke, myself.

14 You believe that at least some of these victims got nothing
15 at all for their money, correct?

16 A Yes.

17 Q And TelexFree had no right that you can think of with all
18 the work that you've done over the last year and a half to take
19 for itself any of the money that was lost, isn't that correct?

20 A Again, you know, the right to take it is a legal question
21 that I'm not -- I'd have to rely on my counsel for, for that
22 answer.

23 Q Okay.

24 And again, do you remember me asking you that question at
25 Thursday's deposition?

1 A No.

2 MR. BALDIGA: May I approach again --

3 THE WITNESS: I don't remember.

4 MR. BALDIGA: -- Your Honor?

5 THE COURT: Yes.

6 MR. BENNETT: What, what page?

7 MR. BENNETT: I'm sorry, Mr. Bennett. Page 77.

8 MR. BALDIGA: And, Your Honor, I'll read the question.

9 BY MR. BALDIGA:

10 Q (Reading):

11 "Q Do you believe" -- "And do you believe that TelexFree ever
12 had a legal right to extract the money from the victims?"

13 Mr. Bennett objected. Well, there was a debate with
14 Mr. Bennett.

15 MR. BALDIGA: So, Your Honor, Mr. Bennett objected,
16 the witness said that, "Again, you're asking about a legal
17 right which cause, which is a legal conclusion and not being a
18 lawyer, I would have to seek advice of counsel on that
19 question."

20 BY MR. BALDIGA:

21 Q I asked another question:

22 "Q Can you sitting here today with all the work you've done
23 over a year and a half, did TelexFree have any right that you
24 can think of of any type to take for itself any of the money
25 that was lost by any of the victims?"

1 Do you remember answering that question?

2 A No, but I'm sure you'll point it out to me.

3 Q Page 78.

4 A Thank you.

5 "A No. Based on my opinion that is a pyramid -- I'm sorry --
6 a Ponzi or pyramid scheme."

7 Q Thank you.

8 And, Mr. Darr, you also believe sitting here today that the
9 memberships ostensibly sold by TelexFree had no true value
10 because they were just part of a fraudulent enterprise,
11 correct?

12 A Did I say that? Are you asking did I say that, or do I
13 agree with that?

14 Q Do you agree -- is that your testimony today?

15 A Could you repeat the question?

16 Q Sure.

17 Do you believe that the memberships ostensibly sold by
18 TelexFree had no true value because they were just part of a
19 fraudulent enterprise?

20 A Well, I believe it was a fraudulent enterprise.

21 So I think it would logically flow from that that there was
22 no true value.

23 Q Thank you.

24 Mr. Darr, you've had, I believe, two town meetings or so-
25 called town meetings at which some victim groups were invited

1 to?

2 A Yes.

3 Q And you attended those?

4 A I did.

5 Q And you never said at either of those that you were asking
6 any court to deny victims the right to sue in their own name
7 for monies that they paid directly to other participants, is
8 that correct?

9 A Other than one question that came from the audience who
10 asked -- and I'm paraphrasing 'cause I don't, I don't think we
11 took minutes and I certainly don't have the minutes here before
12 me if they do exist -- one participant, or one attendee said,
13 "What are you doing about the," I want to say he used the word
14 "'fat cats' or the, or the guys who were the people who made a
15 lot of money on this and who, who are now sitting on their
16 yachts in Florida?"

17 And I said, if I can recall -- I can't recall my exact
18 words -- but I said it was my job to identify those people and
19 to sue to recover the, their ill-gotten gains, or whatever
20 money they took and redistribute it to the victims and I got a
21 standing ovation from the 6 or 700 people in the crowd.

22 So although many of them were having questions and answers
23 translated, all of them seemed to recognize what that statement
24 said because they all stood up at once and gave me a, a round
25 of applause.

1 Q Okay.

2 MR. BALDIGA: Your Honor, I move to strike that. I've
3 asked -- the question I asked was did Mr. Darr tell the victims
4 as part of his presentation that he sought to prohibit victims
5 from recovering monies themselves. And the response was
6 something I'm sure Mr. Darr wanted to say, but it had nothing
7 to do with my question.

8 THE COURT: Well, the response was, "I did not tell
9 them that, but I told them this," which was relevant to, to
10 your question.

11 So I'm not going to strike it.

12 MR. BALDIGA: Okay.

13 BY MR. BALDIGA:

14 Q Did you tell --

15 MR. BALDIGA: I'm sorry, Your Honor.

16 THE COURT: Go ahead.

17 MR. BALDIGA: I didn't mean to cut you off.

18 BY MR. BALDIGA:

19 Q Did you tell victims at any of these presentations that you
20 intended to prohibit them from suing in their own names to get
21 back the money that they had paid to other participants?

22 A No.

23 Q You sent a notice to participants of today's hearing,
24 correct?

25 A Yes.

1 MR. BALDIGA: Could I have Exhibit 4, please?

2 Your Honor, may I approach the witness?

3 THE COURT: Yes.

4 (Counsel hands exhibit to the witness)

5 THE WITNESS: Thank you.

6 MR. BALDIGA: Your Honor, for ease, I premarked
7 exhibits, prenumbered. This one is premarked Exhibit 4.

8 So I'll -- I'll --

9 BY MR. BALDIGA:

10 Q Mr. Darr, the, in the lower right-hand corner what you
11 have --

12 THE COURT: Are there going to be Exhibits 1 through
13 3?

14 MR. BALDIGA: I don't know how many I'll use, Your
15 Honor, because I'm not sure exactly what's being contested
16 here, but I don't think so. I think this will be the first
17 numbered one.

18 THE COURT: Okay.

19 BY MR. BALDIGA:

20 Q Mr. Darr, do you recognize this piece of paper?

21 A Yes.

22 Q Is this the notice that you caused, or you asked to be sent
23 to participants regarding today's hearing?

24 A Yes.

25 MR. BALDIGA: Your Honor, I'd ask that this be

1 admitted and I, I'm happy to change these to Exhibits 1 or to
2 Exhibit 4, whatever the Court would prefer.

3 THE COURT: Well --

4 MR. BENNETT: Your Honor, my understanding from at
5 least the offer of proof this would be an incomplete exhibit
6 because what was served on everybody was this notice plus the
7 motion itself.

8 So if we're going to offer this to what was served
9 upon the various individuals by way of notice of this hearing,
10 then we should make it complete and it should be noticed that
11 it was this notice plus the motion itself, Your Honor.

12 MR. BALDIGA: I, I don't, in fact, know whether what
13 Mr. Bennett just said was, is correct or not, but I'm sure he
14 can take care of that at redirect.

15 THE COURT: In any case, Gentlemen, we're talking
16 about pleadings that are a matter of record in this case of
17 which I can take judicial notice. I'm not sure that it's
18 necessary to mark them as exhibits, but if you want to take,
19 submit it as an exhibit, Mr. Baldiga, I'll take it.

20 MR. BALDIGA: I think the record should be complete,
21 Your Honor, so I, I would.

22 THE COURT: Sure.

23 And I think, just to keep our record straight, we'll
24 start with No. 1 for this exhibit.

25 MR. BALDIGA: Okay.

1 BY MR. BALDIGA:

2 Q Mr. Darr, you also asked your attorneys to file in the MDL
3 matter pending in Worcester a motion to intervene in that MDL
4 proceeding, do you remember that?

5 A Yes.

6 Q Okay.

7 MR. BALDIGA: Your Honor, may I approach?

8 THE COURT: Yes.

9 (Counsel hands document to the witness)

10 BY MR. BALDIGA:

11 Q Mr. Darr, do you recognize that document?

12 A I'm sorry. Do I remember --

13 Q Well, do -- do -- do you know what -- is this document, in
14 fact, your motion to intervene in the MDL proceeding?

15 A It was filed on my behalf by my attorneys.

16 MR. BALDIGA: Your Honor, this is not part of the
17 bankruptcy court record. I would ask that this be admitted,
18 please, as Exhibit 2.

19 THE COURT: Mr. Bennett?

20 MR. BENNETT: No objection.

21 THE COURT: Fine.

22 THE COURTROOM DEPUTY: Do you want me to take the
23 witness copy, Mr. Baldiga?

24 MR. BALDIGA: I'm sorry. No.

25 BY MR. BALDIGA:

1 Q Mr. Darr, you also had filed on your behalf a complaint in
2 this court, I think it was mentioned a little bit ago by
3 Mr. Murphy, a complaint by which you seek to -- you've sued the
4 victims to keep them from suing in their own name to recover
5 money that they paid to other participants.

6 Do you remember that, asking that that complaint be filed?

7 A I remember the adversary proceeding, yes.

8 MR. BALDIGA: May I approach, Your Honor?

9 THE COURT: Yes.

10 (Counsel hands document to the witness)

11 BY MR. BALDIGA:

12 Q And is that it?

13 A Yes.

14 MR. BALDIGA: Your Honor, may I have this admitted as
15 Exhibit 3?

16 THE COURT: Any problem, Mr. Bennett?

17 MR. BENNETT: No, Your Honor.

18 THE COURT: You may.

19 BY MR. BALDIGA:

20 Q We're not going to mark it, Mr. Darr, because it is
21 something that we've all spent some time on.

22 But you also asked to be filed in this court the Ponzi
23 scheme motion that we're here today on, correct?

24 A Yes.

25 Q And, and you read the Ponzi scheme motion before it was

1 filed, correct?

2 A I did.

3 Q And we spent some time with it in your deposition and with
4 your 30 odd years of bankruptcy expertise are you sure as you
5 sit here today whether the Ponzi scheme motion is asking this
6 court by that motion itself to stop victims from suing to
7 recover monies they paid directly?

8 MR. BENNETT: Objection.

9 THE COURT: Basis?

10 MR. BENNETT: Basis, I think it's improper to ask the
11 witness to interpret and/or discuss legal principles contained
12 within the pleading. Ultimately, it's the Court's
13 determination as to the relief being sought in the pleading.

14 THE COURT: Can you rephrase the question --

15 MR. BALDIGA: Certainly, Your Honor.

16 THE COURT: -- so it's not --

17 MR. BALDIGA: I'll -- I'll -- and I'll, I'll establish
18 some foundation.

19 BY MR. BALDIGA:

20 Q Mr. Darr, how long have you worked as a professional in the
21 bankruptcy world?

22 A More than 35 years.

23 Q Okay. And so you have a great deal of experience in, not
24 in Ponzi scheme cases, but you've been involved in some Ponzi
25 scheme cases, in bankruptcy cases, hundreds of cases, probably,

1 over 35 plus years?

2 A Probably, yes.

3 Q And as you authorized the Ponzi scheme motion to be filed
4 and as you read it yourself sitting here today you're not sure
5 whether that is asking in the prayers for relief for orders of
6 this court to stop victims from suing to recover themselves the
7 money that they paid to participants, correct?

8 MR. BENNETT: Objection, Your Honor. Same basis. The
9 pleadings are prepared by counsel. There's legal arguments
10 that flow from the pleadings. What Mr. Darr does or does not
11 believe in the pleadings is not relevant, Your Honor.

12 THE COURT: Well, I'll take it for what it's worth.

13 MR. BALDIGA: I -- and, Your Honor, be happy to
14 respond. There is an argument made that, by the trustee, that
15 he gave sufficient notice with this Ponzi scheme motion that
16 victims should be aware today that their rights are being
17 affected. My point, where Mr. Darr answers this question, is
18 that, well, if Mr. Darr, with his experience has a hard time
19 knowing exactly what to expect of the Court on this motion
20 today, then the victims, including those here today, like the
21 one million or so who are not, couldn't possibly know more than
22 Mr. Darr, himself.

23 That was the purpose of the question. I think that
24 deserves an answer.

25 MR. BENNETT: Your Honor, that's pure legal argument

1 and I'm willing to address the legal argument, but we shouldn't
2 be engaging in those legal arguments with Mr. Darr.

3 THE COURT: All right. I'll take it for what it's
4 worth. Mr. Darr is the client.

5 THE WITNESS: I'm sorry, Your Honor. I didn't hear
6 what you said.

7 THE COURT: I'll take the -- I'll take the -- I'll
8 overrule the objection -- testimony for what it's worth. As
9 the client, you are entitled to have, you should have an
10 opinion about what you understand your, your attorneys' motion
11 to be.

12 Go ahead, Mr. Darr.

13 THE WITNESS: My understanding is the motion we're
14 here on today seeks a Ponzi scheme motion, order from the Court
15 or a finding that, and from that files, follows, rather, the
16 idea that claimants in the bankruptcy estate will be
17 determined, or claims in the bankruptcy estate will be
18 determined on a net winner or net loser basis on a combined
19 basis. And by "combined" I mean, both arising from
20 transactions directly between participants and TelexFree and
21 the so-called triangular transactions, which involved
22 TelexFree, a recruiting promoter, and a paying participant.
23 Those -- the claims have to be assessed or evaluated or
24 calculated on a combined basis because failing to do so comes
25 up with some inappropriate answers. If -- by the same token --

1 and that's clearly laid out in, in the documents, in my
2 opinion.

3 If the participants are going to have a claim for the,
4 arising from the triangular transactions, I think it's clear
5 that the recipient -- if the claim is a part of the bankruptcy
6 estate, then the transferee who received the money is, is part
7 of the bankruptcy estate. And even more importantly, I think
8 it's abundantly clear from the adversary proceeding that you
9 just placed before me. And I'm sorry. I don't know the
10 exhibit. I guess it's not marked as an exhibit.

11 BY MR. BALDIGA:

12 Q So you think if, if the Ponzi scheme motion might not be
13 clear, you think the complaint certainly tells victims that you
14 are trying to stop them from suing directly, correct?

15 MR. BENNETT: Objection, Your Honor. Again, I think
16 we're drawing legal conclusions here. He -- Mr. Darr has
17 testified to what he believes the Ponzi scheme, Ponzi motion
18 and the Ponzi scheme finding will result in with respect to the
19 determination of net claims. How that flows down to the next
20 step is, to whether or not victims' claims for unjust
21 enrichment should or should not be restrained is a separate
22 matter which is not before the Court at the present time, which
23 is the subject matter of the adversary proceeding. And
24 Mr. Darr shouldn't be expressing opinions with respect to what
25 the legal conclusions are from that motion. He's testified to

1 his understanding.

2 He set forth the factual basis for determination of
3 net claims and why the triangular transaction should be
4 included as part of the net claim determination. Whether or
5 not that does or doesn't affect the MDL's rights will be
6 determined by this Court in the adversary proceeding.

7 THE COURT: All right. I'm going to overrule it and
8 allow Mr. Darr to answer the question about the adversary
9 proceeding, if you still remember what it is.

10 THE WITNESS: I'm sorry, Your Honor.

11 THE COURT: You may answer the question about the
12 adversary proceeding, if you still remember what it is.

13 THE WITNESS: Could you repeat the question?

14 Thank you, Your Honor.

15 BY MR. BALDIGA:

16 Q I'll try to.

17 MR. BALDIGA: Thank you.

18 BY MR. BALDIGA:

19 Q I think you just said that the complaint makes abundantly
20 clear what the trustee is seeking in that regard, correct?

21 A Yes.

22 Q Okay. And you have a website that is operated by KCC under
23 your direction?

24 A Yes.

25 Q Okay. And the purpose of that website, among other things,

1 is to tell participants, victims, what's going on, correct?

2 A Yes.

3 Q And you decide what gets posted on that website and what
4 does not, correct?

5 A No. Everything on the docket gets posted on the website.

6 Q Okay. You posted, for example, the Ponzi scheme motion,
7 correct?

8 A Yes.

9 Q Okay. And you chose not to post the complaint that you
10 just referred to, correct?

11 A Again, it's -- the entire docket is posted. There's a --
12 there's a button on the website that you can go and find every,
13 every document that's filed in the case.

14 For the Ponzi scheme motion, I believe it was at the
15 direction of the Court, but I'm not sure. We had the Ponzi
16 scheme motion translated into both Spanish and Portuguese and
17 had the Spanish and Portuguese versions posted on the website
18 as well as the English version and the English version was also
19 posted on the docket piece.

20 Q Right. I -- the Ponzi scheme motion is there. And we just
21 talked about --

22 A The Ponzi scheme motion is also in the docket piece.

23 And I'm sorry for interrupting.

24 Q Okay. That's okay.

25 And we just had a very long answer and a very long

1 question, some arguments of counsel about what the Ponzi scheme
2 means and what it doesn't mean. At your deposition it was even
3 longer. I don't think anybody's too clear right now what it
4 means.

5 But you said in your testimony that the complaint makes it
6 abundantly clear, correct?

7 A Yes.

8 Q Okay. And my question is, why did you not put the
9 complaint, if the complaint is the document that makes that
10 clear, why did you choose not to put the complaint on your
11 website?

12 A Again, it is on my website. It's not posted in Portuguese
13 or Spanish, but it is on the website through the link with,
14 with PACER.

15 Q All right.

16 Mr. Darr, does your website have a cover page or a home
17 page that you open into?

18 A Yes.

19 Q Okay.

20 MR. BALDIGA: Your Honor --

21 THE WITNESS: Well, there's, there's a front page.

22 BY MR. BALDIGA:

23 Q Okay.

24 A I don't know. You can characterize it any way you want.

25 MR. BALDIGA: Your Honor, I have downloaded that front

1 page. May I approach the witness?

2 THE COURT: Okay.

3 (Counsel hands document to the witness)

4 BY MR. BALDIGA:

5 Q Is that a printout of the home page?

6 A It appears to be, yes.

7 Q Okay.

8 MR. BALDIGA: Your Honor, I'd like to admit that as
9 the next, I think it's No. 4.

10 THE COURT: Mr. Bennett?

11 MR. BENNETT: No objection.

12 MR. BALDIGA: Okay.

13 BY MR. BALDIGA:

14 Q And, Mr. Darr, if you click on the right part of the home
15 page -- we're not doing that live here -- you come to an index
16 of all the court documents that are posted, correct?

17 A Yes.

18 MR. BALDIGA: May I approach, Your Honor?

19 THE COURT: Yes.

20 (Counsel hands document to the witness)

21 MR. BENNETT: I'm sorry, what did you hand Mr. Darr?

22 BY MR. BALDIGA:

23 Q Mr. Darr, I see the Ponzi scheme motion.

24 A Yes.

25 Q I don't see the complaint. Where is that?

1 A I don't know.

2 Q Okay. Well, let me ask you --

3 A I don't --

4 Q -- then, I see the Ponzi scheme motion. There's also a
5 motion to intervene in the MDL and that's a separate place that
6 you've asked that the victims not be able to sue in their own
7 name. Where is that on the website?

8 THE COURT: Hold on.

9 THE WITNESS: I don't see it.

10 THE COURT: Are we dealing with Exhibit 5 here?

11 MR. BALDIGA: Yes, Your Honor. May I?

12 THE COURT: I don't think I have one.

13 THE COURTROOM DEPUTY: Oh. Well, I just didn't mark
14 it yet.

15 MR. BALDIGA: Okay. I'm sorry.

16 THE COURTROOM DEPUTY: 'Cause it hasn't been admitted.

17 MR. BALDIGA: It hasn't been admitted?

18 Your clerk has it, Your Honor --

19 THE COURT: Okay.

20 MR. BALDIGA: -- but --

21 THE COURT: And, Mr. Bennett, any objection to Exhibit
22 5, which is, looks like a docket?

23 MR. BENNETT: There's no objection -- well, the
24 objection is it's obviously not the complete docket and it is,
25 it stops on October 7th and I don't know whether there are

1 other entries for October 7th that hasn't been picked up on
2 here. It's my understanding that the adversary proceeding was
3 filed on or about October 7th, also, Your Honor. So it would
4 have been filed as part of the court docket.

5 So this docket doesn't seem to be complete.

6 MR. BALDIGA: Okay. Well, I'll ask a couple of
7 questions for foundation.

8 BY MR. BALDIGA:

9 Q Mr. Darr, take a look at the second, the court documents,
10 document.

11 A (Witness complies.)

12 Q Look at the bottom right-hand corner.

13 A (Witness complies.)

14 Q I'd like to address Mr. Bennett's comment.

15 Can you read what it says on the bottom right-hand corner
16 the date of the printout and then --

17 A KC --

18 Q Go ahead.

19 A KCC Excel. Download all court documents on website as of
20 11/23/15.

21 Q Okay. Was the complaint filed before yesterday?

22 A Yes.

23 Q And was the motion to intervene to seek the same relief in
24 the MDL filed before yesterday?

25 A Yes.

1 Q And those seem to be the only two things that I can think
2 of that you did not put on the website. Can you think of
3 anything else that you chose not to put on the website?

4 A Not offhand, no.

5 Q Mr. Darr, you and I have known each other for quite a long
6 time, haven't we?

7 A Yes.

8 Q Before when I was trying to decide whether or not to join
9 the MDL leadership team you and I had a, a few conversations,
10 correct?

11 A We did.

12 Q At least one or two at your club for lunch?

13 A We did.

14 Q And I told you during those conversations that cooperation
15 between the trustee and the MDL PIEC -- that is my client here
16 -- was critical to work hand and hand, correct?

17 MR. BENNETT: Objection, Your Honor. If Mr. Baldiga's
18 going to become a witness, I think he should step down from the
19 podium and his associate should step forward on the podium.

20 THE COURT: Where are you going with this,
21 Mr. Baldiga?

22 MR. BALDIGA: To have the trustee -- well, I -- Your
23 Honor, I, I can make an offer of proof, if you'd like, but the
24 trustee has worked with us until very recently doing exactly
25 the things that he's now saying are inappropriate and, in fact,

1 those cooperation --

2 THE COURT: Why don't you just ask him questions along
3 those lines rather than making it personal.

4 MR. BALDIGA: Okay. I could do that.

5 BY MR. BALDIGA:

6 Q Mr. Darr, do you know that we filed in the MDL a second
7 amended complaint on, on or about March 31, 2015?

8 A Yes.

9 Q You've read that complaint?

10 A Truthfully, it's, it's a quite lengthy complaint. I, I
11 can't say that I remember everything that's in it.

12 Q Okay. But we sent you a copy, in any event?

13 A Yes.

14 Q You have to answer verbally. I'm sorry.

15 A I'm sorry?

16 Q Oh. Did --

17 THE COURT: He did.

18 MR. BALDIGA: Okay.

19 THE WITNESS: I said yes.

20 MR. BALDIGA: I'm sorry. Then I just missed it.

21 BY MR. BALDIGA:

22 Q You know that part of the complaint, it's a class action on
23 behalf of all victims, correct?

24 A Yes.

25 Q And do you know one of the defendants that we sued is a

1 Mr. Daniel Schrieffer (phonetic)?

2 A I don't -- I know that you have sued Mr. Schrieffer, but I
3 don't think -- I may be incorrect in my memory -- but I thought
4 Mr. Schrieffer was -- was -- became a defendant -- I'm sorry.
5 I just don't remember when he became a defendant.

6 And you've also got a third, third class, third amended
7 complaint --

8 Q Okay.

9 A -- that you filed in September.

10 Q But you know that we sued Mr. Schrieffer and several other
11 promoters here on account of theories, including unjust
12 enrichment on account of monies paid to them by victims,
13 correct?

14 A Yes.

15 Q And we did that many months ago?

16 A Again, I think I just testified I don't remember exactly
17 the timing of -- I don't remember whether it was in your second
18 amended complaint or your third amended complaint.

19 Q Okay. And in connection with that we asked you for data as
20 to Mr. Schrieffer's activity, correct?

21 A Yes.

22 Q As well as several other promoters?

23 A As I recall, it was one other, one woman. I don't remember
24 her name.

25 Q And we gave you a list of other promoters, senior promoters

1 that we wanted information about, correct?

2 A I don't recall, but I remember at least two.

3 Q Okay. And you did share at least some data with us?

4 A Yes.

5 Q And you never voiced any objection to us bringing those
6 lawsuits, correct?

7 A Which lawsuits?

8 Q The ones against Schrieffer and the other upper-level
9 promoters on a class action basis to recover from them the
10 monies paid directly to them by other victims?

11 A No, we -- I did not object at that time.

12 Q Okay. And we've had much additional discussion as to other
13 promoters as well, correct?

14 A We have.

15 Q Including regularly scheduled Tuesday afternoon cooperation
16 calls?

17 A Yes.

18 Q And do you remember an e-mail from May 25th in which we
19 were asking you additional information regarding other
20 promoters and to talk about cooperation getting the information
21 about those?

22 A I, I don't remember a May 25th e-mail, but if you show it
23 to me I'm sure I, it may jog my memory.

24 MR. BALDIGA: May I approach, Your Honor?

25 THE COURT: Yes.

1 (Counsel hands document to the witness)

2 MR. BALDIGA: May I talk to Mr. Bennett for one
3 minute, Your Honor?

4 THE COURT: Okay.

5 (Pause)

6 MR. BALDIGA: Your Honor, and, and the point that
7 Mr. Bennett and I were talking about, there, there is a joint
8 interest agreement between the trustee and the MDL plaintiffs
9 and we're just trying to be careful that we don't do anything
10 here, nothing is intended to waive any privilege. And, and
11 also not to put into public evidence anything that the trustee
12 or we think should be kept confidential as to within that
13 privilege.

14 So we just need to confer once and a while just to
15 make sure we don't do anything here that violates that.

16 BY MR. BALDIGA:

17 Q Mr. Darr, do you recognize that document?

18 A Yes.

19 Q And is that, in fact, an e-mail to several people, but
20 including you and from you to me and several other people?

21 A Well, it's an e-mail from you to me and, and my counsel and
22 people in your office and a response from me to the same people
23 on the distribution, in your original e-mail distribution list.

24 Q Okay. And in it we are asking you to please get us
25 information as to, to allow us to chase the people to whom

1 they, to whom victims handed cash and checks, correct?

2 MR. BENNETT: Objection, Your Honor.

3 THE WITNESS: Well --

4 THE COURT: Hold on. Hold on.

5 MR. BENNETT: We have two sets of objections. First
6 of all, it's hearsay, Your Honor.

7 And then, secondly, Your Honor, is the question of
8 relevance and how this relates at all to the matters before the
9 Court.

10 THE COURT: Well, in terms of hearsay, the primary
11 participants in the e-mail conversation are right here in the
12 courtroom.

13 So are we really worried about, about that? I don't
14 think, I don't think I have a problem with that.

15 But what's the relevance, Mr. Baldiga, of this e-mail?

16 MR. BALDIGA: The -- well, to the extent that there is
17 a request today for findings that would carry over, which you
18 asked Mr. Murphy that question. I lost track of the answer,
19 but it, it was a definite maybe -- that there is a request by
20 the trustee that the train that's already well down the tracks
21 with the trustee's cooperation now be stopped. And this --
22 this is the last of the exhibits and, frankly, the last of my
23 questions as to the fact that the trustee and the victims'
24 representative have been attempting to cooperate on these
25 things for almost a year now and that this new effort by the

1 trustee is a, is a great change in course which would surprise
2 victims and to which they would not have a reasonable sense
3 coming into court, that the trustee is coming into court today
4 to stop something that they've been pursuing for some time.

5 MR. BENNETT: May I address that, Your Honor? Because
6 Mr. Baldiga has a tendency to mix the 1.9 million victims and
7 his own personal representation.

8 To the extent that there's an exchange of discussions
9 and information regarding the, the potential claims, it was
10 between the trustee and the MDL class action parties. For
11 Mr. Baldiga to stand up now on behalf of the MDL and say that
12 somehow he is surprised by the Ponzi scheme motion and didn't
13 understand it, I find somewhat difficult to follow, given that
14 he's filed an extensive objection and is here objecting to it.

15 So to the extent that he is representing a class of
16 people, those class of people have able representation.
17 Mr. Baldiga fully understood the, apparently fully understood
18 the input of all the, the Ponzi scheme motion, raised an
19 objection, and is at a hearing on it. So for him to now try to
20 argue that somebody has been misled I think is inappropriate.
21 The question is who he represents and whether or not they had
22 appropriate notice and it's clear that they did.

23 THE COURT: All right. Well, I'll, I'll overrule the
24 objection and take it for what it's worth. I don't think it's
25 worth very much.

1 But go ahead, Mr. Baldiga.

2 MR. BALDIGA: Well, I move to admit it, Your Honor. I
3 think that was the final point on that document, whether it
4 just --

5 THE COURT: I'll take it.

6 MR. BALDIGA: -- it would be admitted.

7 THE COURT: Okay.

8 BY MR. BALDIGA:

9 Q Just a couple final questions, Mr. Darr.

10 You tried hard over the last year or more to find some sort
11 of precedent for what you're trying to do now, which is to have
12 a bankruptcy trustee stop victims from recovering payments made
13 directly to other promoters, correct?

14 MR. BENNETT: Objection.

15 THE COURT: Basis?

16 MR. BENNETT: Basis that Mr. Darr sought for
17 precedent? I think that's an inappropriate question for him to
18 ask.

19 THE COURT: Sustained. He's, he's a layperson. You
20 may want to rephrase your question, Mr. Baldiga. I'm not sure
21 where you're going with it, but --

22 MR. BALDIGA: Sure.

23 THE COURT: -- but try again.

24 BY MR. BALDIGA:

25 Q Mr. Darr, you tried very hard over the last year and a half

1 or so to find examples of other bankruptcy trustees, receivers,
2 or other fiduciaries to do what you're trying to do now,
3 correct?

4 A I, I don't think I tried to find examples of other
5 fiduciaries trying to do what is at issue here. I think on
6 Thursday I testified that I tried to find other cases or other
7 incidents or companies that were similar to TelexFree and
8 truthfully, the only -- I, I testified that I could not, but as
9 I sit here today I can, the only example that I can point out
10 is the TelexFree sister operation in Brazil. It operated
11 pretty much the same way, but that, that doesn't impact these
12 proceedings. I, I testified on Thursday, as I said, I could
13 not find another case similar to TelexFree.

14 Q Okay. And by, by that the critical point you found other
15 Ponzi schemes, of course?

16 A Oh, yeah.

17 Q There's plenty of them, unfortunately, out there. What you
18 can't find are other cases or other instances in which a, there
19 were a large number of payments made by lower-level victims
20 directly to promoters without having the money go in or out of
21 the wrongdoer, correct?

22 A Yes, that's correct.

23 Q Okay. And you -- this wasn't something you, you just did
24 on your own one night on the computer, but you asked your team
25 to try to go out and try to find other examples, correct?

1 A Yes.

2 Q And you did a Lexis-Nexis search. You talked to other
3 trustees or receivers. You asked your team at Mesirow or Huron
4 or counsel to go out and find what they could, correct?

5 A Yes.

6 Q And you found none, correct?

7 A Correct.

8 Q And so you also found no examples of a trustee stopping a
9 Ponzi scheme, a set of Ponzi scheme victims from suing to
10 recover monies that he paid directly to upper-level promoters,
11 correct?

12 A I didn't look.

13 Q Okay.

14 MR. BALDIGA: Your Honor, no other questions. Thank
15 you.

16 THE COURT: Thank you.

17 Mr. Bennett?

18 REDIRECT EXAMINATION

19 BY MR. BENNETT:

20 Q Good afternoon, Mr. Darr.

21 MR. BENNETT: Thank you, Your Honor.

22 THE WITNESS: Good afternoon.

23 MR. BENNETT: Charles Bennett on behalf of the
24 trustee.

25 BY MR. BENNETT:

1 Q Mr. Darr, let's back up for a second. Let's talk about,
2 just very briefly, the SIG system.

3 Have you and your team made any efforts in order to be able
4 to ascertain individual identification under the user accounts?

5 A Yes.

6 Q And what have you done to do that?

7 A Well, initially, when we initially got access to the, to
8 the SIG system we discovered there was, as, as previously
9 mentioned, 11 million user accounts and there was approximately
10 900,000 e-mail accounts and an inspection, you know, there was
11 more information in the system than just that. There was all
12 the ins and the outs. There was names and addresses and Social
13 Security numbers or taxpayer I.D. numbers for people outside
14 the United States. There was mobile phone numbers, home
15 addresses, home phone numbers, etc. And we found that a
16 particular e-mail account would have lots and lots and lots of
17 different people assigned to it.

18 So people were -- participants were using, were using a, a
19 particular user account that may or may not have been the owner
20 of the, of the e-mail account.

21 So then we decided we needed to do -- and, and that would
22 have given anomalous results because if you, if you allowed
23 claims based on the e-mail accounts, you would have winners and
24 loser combined and there's no telling who would get the money
25 because you only had contact through the e-mail account.

1 Because in many instances the information that was -- the
2 additional information that was in the user record was clearly
3 not reliable. For example, some people, name, address, etc.,
4 they would just have a period in there. There'd be no letters
5 or numbers, just a period. There was one address I know that
6 said they were on a Spanish name street in Rio de Janeiro,
7 Ohio. I, I assure you there's no city or town in Ohio named
8 Rio de Janeiro.

9 Q And having ascertained those deficiencies --

10 A So, so what we did was we came up with an algorithm that
11 takes certain -- it runs through the SIG system ten times and
12 it starts to identify people based on last name, e-mail
13 address, home address, taxpayer I.D., etc., ten different
14 things, and it allocates them to a particular account. It, it
15 groups them into an account and it's in two groups.

16 The first group is the things that are clearly part of that
17 particular participant's activity and then there may or may not
18 be, but there usually is a group that could be, that requires
19 manual review to determine whether or not. We've done that.

20 We've also segregated those between the claims that arise
21 from direct transactions between the participant and TelexFree
22 and between a participant, another participant, and TelexFree.
23 Because in these transactions between participants cash may
24 have gone from Participant A to Participant B, but then
25 Participant B would redeem some of his credits to pay

1 Participant A's invoice. And by that Participant A got a claim
2 -- I'm sorry -- got an account.

3 So that's how -- that's why it's a triangular transaction.
4 Money went from "A" to "B". "B" kept the money. TelexFree
5 redeemed some of "B's" credits, okay? So he, he made out.
6 TelexFree records it and establishes "A" with a user account.
7 That's why, that's why it's a triangular transaction. It's not
8 something that just went from "A" to "B."

9 Q And having established a user account for, as you said,
10 "A," that would allow user, that user to then start accruing
11 its own -- his own -- his or her own credits, which he or she
12 could then redeem and/or engage in a similar transaction?

13 A Yes.

14 Q Okay. Now you identified user accounts.

15 Were you able, then, to take any -- did you then take any
16 steps to be able to take the identification of the user
17 accounts and identify the individuals themselves that were
18 attached to those user accounts?

19 A In many instances, but not in all.

20 Q And how did you go about doing that?

21 A Again, through that ten-step algorithm. We haven't
22 verified the accounts or the names and addresses as part of the
23 claims process. We anticipate that the first thing that will
24 happen is someone will sign in and we'll have to give us
25 current name and current address and current contact

1 information and we will verify that either through an e-mail
2 directly or through a telephone message to their, their cell
3 phones so that they can short message service text back a, a
4 message to thereby establish that, first of all, that they're a
5 real person or a real -- yeah -- a real person. And secondly,
6 we know how to get in touch with them. And once they get
7 access to that, then they can, they'll be allowed, if you will,
8 entry into the website where they can request using their
9 former usernames, their former passwords, or their former
10 contact information. It's not necessary that they have every
11 bit of information, but there'll be certain indicia or certain
12 requirements to supply information at which point they will be
13 given, first, a listing of all of their accounts.

14 Now, certainly, most or many of the participants only have
15 one account, but many of the participants have hundreds and in
16 some cases thousands of accounts. They'll all be listed and
17 that will start their claim, the claims process.

18 Q And have you also attempted through the various pay
19 processors to try to trace back payments to the individuals to
20 further identify --

21 A The company --

22 Q -- or confirm the identification of the individuals?

23 A The company didn't make payments to participants directly.
24 It used a series of payment processors that can be compared to
25 PayPal. The -- the last -- they used five different payment

1 processors. The last payment processor they used was a company
2 called I-Payout. They used them for some time in October of
3 2013 through the close of business with the bankruptcy in April
4 of 2014. We have downloaded all of that information from -- I-
5 Payout has given us a download of all of that information and
6 we have loaded that into the SIG system and found that 100
7 percent of the disbursements made by I-Payout were accurately
8 reflected in the SIG system.

9 Q Thus --

10 A Similarly --

11 THE COURT: Excuse me. I --

12 THE WITNESS: You started it.

13 Similarly, there's about \$20 million worth of credit
14 card receipts that have been processed postpetition by a, by a
15 bank in London. We're in the process of, of comparing that
16 information or loading that information into the claim system.

17 MR. BENNETT: Go ahead.

18 THE COURT: I need to take a short recess.

19 Court will stand in recess for a few minutes.

20 THE COURTROOM DEPUTY: All rise.

21 (Recess from 4:01 p.m., until 4:13 p.m.)

22 AFTER RECESS

23 THE COURT: Be seated, please.

24 THE COURTROOM DEPUTY: Back on the record in

25 TelexFree.

1 THE COURT: Mr. Darr?

2 MR. DARR: Sorry, Your Honor.

3 STEPHEN DARR, TRUSTEE'S WITNESS, ON THE STAND

4 THE COURT: Okay, Mr. Bennett.

5 MR. BENNETT: Thank you, Your Honor.

6 BY MR. BENNETT:

7 Q Mr. Darr, are you trying to deny the victims the right to
8 compensation?

9 A No. I'm trying to come up with a fair and equitable manner
10 to compensate everybody in the case, especially the, the
11 smaller claimants who, who lost significant amounts of money.

12 Q And why do you believe that including triangular
13 transactions in the net equity determination is the appropriate
14 way to assure that victims will receive compensation?

15 A Well, if you include the triangular and the direct
16 transactions in the calculation, you're faced with two answers.
17 Either a participant is a winner, or he's a loser. And by
18 "he," I obviously include women and corporations, if there are
19 any. And there are some.

20 If, on the other hand, they're separated it doesn't go to
21 four. It goes to six. Because you've got the -- if you can
22 think of it as a winner on direct, winner on triangular for a
23 net winner. Loser on direct, loser on triangular for a net
24 loser. But then when you get in -- you could have a direct
25 winner and an indirect loser. And when you add those two

1 together, depending on the magnitude of each of those two
2 factors, you could have a net winner or a net loser. So
3 there's four.

4 And similarly, you could have a, a direct loser and an
5 indirect winner and you've got another two. And to try and
6 figure out what those claims are and, you know, try to
7 administer them would be a nightmare and it would result in --
8 you could, you could be rewarding a claimant who is over, who
9 had a direct loss, but was overall a winner. That doesn't seem
10 fair.

11 Q And are you and your team developing a protocol so that
12 you'd be able to accomplish this goal by accounting for all of
13 the transactions between all of the various participants so
14 that you can determine an overall net winner and overall net
15 loser?

16 MR. BALDIGA: Objection, Your Honor.

17 THE COURT: Basis?

18 MR. BALDIGA: Only because no one's objected to this
19 and it's all in the affidavit.

20 So I'm not sure where it's going, but this -- we have
21 so little time and a few things that are disputed, but this
22 isn't one of them.

23 THE COURT: So your, your point is that you didn't
24 cross-examine Mr. Darr on this issue and this is not relevant
25 because of that?

1 MR. BALDIGA: Well, it's not relevant to anything
2 disputed and he covered in his affidavit a number of things
3 that were undisputed.

4 So this isn't going to anything that we're talking
5 about.

6 MR. BENNETT: Well, actually, Your Honor, if I could,
7 what Mr. Baldiga was arguing here rather strenuously that
8 somehow we're trying to deprive the victims of their rights to
9 compensation and of their rights to proceed. And what we are
10 establishing here is, first, that Mr. Darr is not intending to
11 do that, that he's developing a system which will maximize the
12 recoveries for the victims.

13 This question here was to ascertain the fact that
14 they're developing a protocol so they can determine the net
15 winners and then the next step would be where does he believe
16 is the appropriate forum and how, how is he going to maximize
17 the recoveries to show that, in fact, we're taking the exact
18 opposite -- we're doing the exact opposite of what Mr. Baldiga
19 is claiming we're trying to do.

20 MR. BALDIGA: Well, that's argument, Your Honor. The
21 disputed issue is whether victims have the right to sue in
22 their own name. That's the --

23 THE COURT: Right.

24 MR. BALDIGA: That's the only issue.

25 THE COURT: Right. Yeah.

1 MR. BENNETT: And that's a legal issue, Your Honor.
2 I'm willing to argue that at any point.

3 THE COURT: All right. I, I understand where you're
4 going with this, Mr. Bennett, so speed it up.

5 But I don't think that, that there's any serious
6 dispute that the trustee is trying to maximize the recovery for
7 the universe of people who got hurt here, that -- I don't --
8 and I don't think that the, the plaintiffs are disputing that.
9 There's just a -- the fight is over whether they can proceed on
10 their own and that's a different issue.

11 MR. BENNETT: That's fine, Your Honor.

12 THE COURT: I get that.

13 MR. BENNETT: I have no further questions.

14 THE COURT: All right. Thank you.

15 Anything else, Mr. Baldiga?

16 MR. BALDIGA: No. Thank you, Your Honor.

17 THE COURT: Does anybody else want to examine the
18 trustee on the issue of the Ponzi scheme finding?

19 (No response)

20 THE COURT: Mr. Darr, you may step down. Thank you.

21 THE WITNESS: Thank you, Your Honor.

22 MR. BALDIGA: Your Honor, the witness' copy of the
23 exhibits, the clerk doesn't need those at all. Okay.

24 THE COURTROOM DEPUTY: I do not. Thank you.

25 THE COURT: We're all set.

1 MR. BALDIGA: Thank you.

2 THE COURT: We have a set of exhibits here.

3 MR. MURPHY: Your Honor, if I may? We, we kind of
4 bled over into the net equity calculation and what should or
5 shouldn't be included. We -- we -- we did discuss as well in
6 his affidavit -- I don't know if anyone wants to cross-examine
7 him further on the net equity or, or the joint and several
8 liability, whether anyone contests that the debtors, to the
9 extent there are net claims against the estate, losses against
10 the estate, whether each of the debtors should be liable for
11 those claims along the lines what I previously articulated.

12 I'd move, again, that Mr. -- I, I think there was some
13 confusion on the record whether the entire affidavit of
14 Mr. Darr has been submitted as his direct testimony on these
15 points. He's here to testify on any of those points, Your
16 Honor, but I think while we're here we should just make sure
17 that there's not, that everything's clear in that regard.

18 I'd ask the Court to take judicial notice of the, of
19 the pleadings, the Certificate of Service, Certificates of
20 Services that have been filed in the case that indicate so
21 there's no controversy. I know we only have a notice of
22 hearing as part of the record, but the Certificates of Services
23 are clear as to what was transmitted to the thousand plus,
24 million plus, rather, participants and creditors in this case.

25 And other than that, I don't think we have anything

1 further to offer today, Your Honor, in support of the motion.

2 THE COURT: Thank you.

3 Does anyone want to cross-examine Mr. Darr on the
4 motion's prayer for an order that the debtors will be jointly
5 and severally liable for the claims?

6 MR. BALDIGA: No, Your Honor.

7 Again, William Baldiga.

8 We -- I have asked Mr. Darr all the questions I had
9 for him today on, on everything that's before the Court today
10 and I don't, to respond to Mr. Murphy. I don't have any
11 objection, now that we've had an opportunity to cross, to the
12 admission of his affidavit as part of the primary case.

13 And I'm going to reserve argument to everything else
14 until evidence is closed.

15 THE COURT: Thank you.

16 MR. BALDIGA: Thank you.

17 THE COURT: Well, I think evidence is closed.

18 MR. BALDIGA: No, Your Honor. We, we have two
19 witnesses.

20 THE COURT: Oh. On what, on what issue?

21 MR. BALDIGA: Your Honor, we have in the courtroom
22 today -- and this would be very short testimony -- one of the
23 victims, Maria Murdoch. She would have a few minutes of
24 testimony as to -- you, you asked earlier in terms of the
25 relevance, you asked Mr. Murphy about, you know, should

1 Mr. Baldiga be worried about the effect of this leaking over to
2 the adversary proceeding. We asked Ms. Murdoch those same
3 things. We had an opportunity a few minutes ago during
4 Mr. Murphy's answer for him to say, "No worry. That's for
5 another day." That was -- it was a much longer answer and it
6 was not to that effect. In fact, he said Mr. Baldiga should be
7 worried.

8 So Ms. Murdoch would be worried and she would testify
9 as to her country transactions so that the Court would have in
10 front of the Court and we would have in the record what an
11 actual transaction is with a real person and not just what a
12 trustee can derive from the system. Not criticizing any of the
13 examples that Mr. Darr used, but the SIG system by his own
14 testimony is in the affidavit and today's testimony at great
15 length, that there are many failures in the system in terms of
16 the ability to know whether there's accurate information or not
17 and her right to sue directly and what she wants to do with
18 that right as opposed to what all of us people in suits and
19 hired professionals would like to do with those.

20 So that's Maria Murdoch. She is here today, Your
21 Honor. It's a burden for her come to court. We've had to hire
22 a translator who's here with us today through the court system
23 for that.

24 So we would like to get that testimony on.

25 And then I have a proffer of lead counsel in the MDL,

1 Robert Bonsignore, as to what has been done in the MDL court.
2 Because it's hard for this Court to take judicial notice of the
3 proceedings in the MDL. That would be a very brief proffer as
4 to things which I don't think is disputed. Mr. Bonsignore is
5 here, if he were to be crossed.

6 But I think all of this together would be just a few
7 minutes.

8 THE COURT: Any -- is there anyone else who's going to
9 be looking to put any evidence on at this hearing?

10 (No response)

11 THE COURT: Do you have a preference for the order?
12 'Cause I prefer to do Mr. Bonsignore's proffer first, if that's
13 okay with you.

14 MR. BALDIGA: It is as long as -- and it's early
15 enough.

16 So that could be very short.

17 THE COURT: Okay.

18 Go ahead, Mr. Baldiga.

19 MR. BALDIGA: Your Honor, Mr. Bonsignore is in the
20 courtroom today. He is lead counsel in, for the plaintiffs in
21 the MDL and he would, if he took the stand here today under
22 oath, swear and state as follows:

23 That he is the managing partner in the law firm of
24 Bonsignore PLLC. He's in good standing and an active member of
25 the state -- this -- the bar of this state and of New

1 Hampshire. He has personal knowledge of the facts that I will
2 state:

3 That he's been involved in the TelexFree matter since
4 April of 2014 when, through Nevada counsel that he hired, there
5 was a, actions filed in the District of Nevada on account of
6 class representative, Waldemara Martin, as early as May 3,
7 2014. The complaint included claims against a class category
8 of defendants referred to as Doe Insider Promoters and further
9 investigation led that class defending group to be renamed as
10 top-level promoters and the scope of those to be considered as
11 top-level promoters expanded to include all TelexFree
12 participants who are net winners.

13 In addition to this class of Doe Inside Promoters, the
14 top-level promoters were named in the original 2014 complaint
15 filed in the MDL, which has been consolidated -- I'm sorry --
16 in the MDL -- and those include, for example, Messrs.
17 Rodriguez, De La Rosa, Crosby, and Sloane. Additional class
18 action complaints were filed throughout the country thereafter.
19 Most, if not all, advanced class claims against top-level
20 promoters, generally, and against some named specific top-level
21 promoters.

22 On October 22, 2014, Mr. Bonsignore would continue as
23 sworn, the Judicial Panel on Multi-District Litigation, or
24 generally referred to as the JPML, JPMDL, transferred all of
25 these related proceedings to the District of Massachusetts

1 pursuant to 28 U.S.C. 1407 for pre-trial matters and which is
2 generally held. And MDL is started. They were centralized
3 before Judge Hillman. The JPMDL specifically found that
4 centralization will eliminate duplicative discovery, prevent
5 inconsistent pre-trial rulings, especially with respect to
6 class certification, and conserve the resources of parties,
7 their counsel, and the judiciary.

8 On July 15, or thereabouts, 2015, there is a request
9 made -- I'm sorry, Your Honor. Strike that.

10 On -- as far back as December 1, 2014, in the MDL the
11 plaintiffs have filed under seal and obtained orders attaching
12 millions of dollars of assets of the top, of certain top-level
13 promoters, including real properties in the Commonwealth of
14 Massachusetts and many of the locations across the country.
15 Judge Hillman has heard those proceedings under seal for
16 obvious reasons, given that they involve very sensitive
17 matters. I'm not going into the details of that. Since that
18 time the plaintiffs have placed many additional motions to
19 attach property of top-level promoters and have obtained
20 injunctions against the dissipation of their assets.

21 In March of 2015, discovery in the MDL was stayed at
22 the request of the Department of Justice, given the pendency of
23 criminal proceedings. We've, obviously, honored that request
24 and there have been orders to that effect.

25 On April 13, 2015, at the request of the defendants in

1 the MDL, there was a further second amended complaint filed.
2 That advanced class claims against top-level promoters again,
3 generally, and named additional top-level promoters. You heard
4 earlier that that's one of the complaints. As far back as
5 March and April of 2015, that was provided to Mr. Darr. In
6 addition, Mr. Schrieffer and, and Miller were added as
7 defendants.

8 On September 23, 2015, in the MDL the plaintiffs filed
9 a motion with Judge Hillman to further amend the complaint to
10 add a defendant class of promoters who earned a, who were net
11 winners, that is, who earned a net profit from the TelexFree
12 scheme as, to be defined, hopefully, in this court as -- we've
13 not asked the District Court to define that. We're happy to go
14 with the, the determination of what that is by this court on
15 the motion of the trustee as part of the cooperative efforts.
16 There is -- that motion is pending.

17 And then, finally, Your Honor, on September 23, 2015,
18 a complaint was filed in the United States District Court for
19 the District of Arizona with that defending class. The JPMDL
20 recently transferred and consolidated that into MDL, into the
21 MDL pending in Worcester.

22 In the MDL and, in part, relying on information that
23 has been kindly shared with us by the trustee, the -- well, I'm
24 not going to go into that, Your Honor. I'm trying to stay away
25 from some things.

1 But -- and the -- some of the lawyers in the lead
2 counsel position and the PIEC themselves represent in excess of
3 500 individual clients who, we believe, are net losers and lost
4 amounts ranging from \$1500 to over \$350,000. Many or most
5 tendered cash to top promoters and do not know where that cash
6 went. There are 500 individual stories with 500 individual
7 clients. We don't intend to present them all.

8 That would be the extent of Mr. Bonsignore's
9 testimony, Your Honor, and it's offered here today.

10 THE COURT: Okay. Thank you.

11 Mr. Bennett?

12 MR. BENNETT: My objection to the proffer, Your Honor,
13 is that it's not relevant to anything before you. I do have
14 one -- I would have a question for Mr. Bonsignore on this
15 matter, if he would take the stand.

16 THE COURT: Okay.

17 Mr. Bonsignore, would you mind stepping forward,
18 please.

19 MR. BONSIGNORE: Yes, Your Honor.

20 THE COURTROOM DEPUTY: Good afternoon.

21 MR. BONSIGNORE: Good afternoon.

22 THE COURTROOM DEPUTY: Would you raise your right
23 hand?

24 ROBERT BONSIGNORE, PIEC'S WITNESS, SWORN

25 THE COURTROOM DEPUTY: Please be seated.

1 CROSS-EXAMINATION

2 BY MR. BENNETT:

3 Q Good afternoon, Mr. Bonsignore.

4 A Good afternoon, Mr. Bennett.

5 Q Mr. Bonsignore, do I understand that you on behalf of
6 various claimants have brought a motion to amend the class
7 action that's currently pending in the United States District
8 Court for the District of Massachusetts?

9 A Yes.

10 Q And that you intend to bring what would be known as a
11 reverse class action?

12 A Yes.

13 Q And in that reverse class action do you intend to name as
14 defendants those individuals that you identify as net winners?

15 A With your cooperation, it would run smoother, but that's
16 the present definition.

17 Q Okay. And your definition --

18 THE COURT: Pull that microphone to your --

19 (Witness complies)

20 THE COURT: Yeah.

21 Thank you.

22 BY MR. BENNETT:

23 Q Your definition of net winners is, is determined by taking
24 all the money an individual paid to the debtor, all the money
25 that an individual paid to other participants, less the money

1 received by that individual from the debtor, less the money you
2 received by that individual from other participants?

3 A The definition is stated in the complaint, so I would
4 rather rely on that writing and not talk off the top of my
5 head --

6 Q Did I --

7 A -- and make a mistake.

8 Q -- misstate something? Well, did I misstate something as
9 to the definition?

10 A If you could put the complaint in front of me, I could be
11 specific and precise.

12 MR. BENNETT: May I approach, Your Honor?

13 THE COURT: Yes.

14 BY MR. BENNETT:

15 Q I'm going to show you --

16 AUDIO OPERATOR: Mr. Bennett, questions from the
17 microphone. It can't pick you up while you're walking. Sorry.

18 (Pause)

19 THE COURTROOM DEPUTY: Mr. Baldiga, do you mind
20 spelling the witness' name while we're on this break?

21 MR. BALDIGA: Sure, Your Honor. Bonsignore,
22 B-O-N-S-I-G-N-O-R-E. And it's Robert J.

23 THE COURTROOM DEPUTY: Thank you.

24 MR. BALDIGA: Thank you.

25 (Counsel hands document to the witness)

1 THE WITNESS: As I understand, the document put before
2 me is the document taken from the docket and the precise
3 language appears in here. I will say that in the class action
4 setting typically you define a class initially following the
5 receipt of initial disclosures, discovery, and the exercise of
6 experience and discussion with others that you're prosecuting.
7 You come up with a more refined definition.

8 So in context and by way of a summary, this is what's
9 presently in the complaint and after we get discovery,
10 cooperate, and work together, it'll be further refined as a
11 rule.

12 BY MR. BENNETT:

13 Q What is missing from these definitions, Mr. Bonsignore?

14 A Discovery, further information, and cooperation with the
15 trustee.

16 Q Now you include -- do you intend, Mr. Bonsignore, to sue in
17 this class action individuals who, net losers on direct
18 payments but direct winners into participant things?

19 A I can't understand that question. I'm sorry. Could you
20 rephrase it?

21 Q Do you intend to sue -- do you intend the class to include
22 participants who, defendants who are net losers with respect to
23 payments from other participants?

24 A Yes.

25 Q Do you intend to take into consideration the tri, what we

1 define as the triangular transactions in order to define a net
2 winner?

3 A From the very beginning of this case, we were very --

4 Q I think that's a yes or no question, Mr. Bonsignore. If
5 you could try to answer it that way.

6 Q I, I can't answer that yes or no.

7 Q You can't answer whether you intend to include the
8 triangular transactions in your definition of net winners?

9 A No.

10 Q Why not?

11 A Because we haven't finished try -- we have not finished to
12 try to cooperate with you and your input is necessary and
13 absent your input and cooperation, I can't answer that
14 question.

15 Q So you're telling me that you don't have enough
16 information, even though you brought this class action to tell
17 us what you meant by net winners?

18 A That's not what I just said at all.

19 Q Does your definition that you're -- is the definition that
20 you're currently using in the matter before the United States
21 District Court include triangular transactions?

22 A You'll have to define triangular class actions.

23 Q As used in the various pleadings, which I'm sure you've
24 read, sir?

25 A Your version of the triangular?

1 Q Yes, sir.

2 A I had a hard time following that.

3 Q Your understanding?

4 A Why don't you explain it to me and we'll be precise rather
5 than me guess what's in your mind?

6 Q Why don't you explain to me what you meant by "net
7 winners," then, sir?

8 A A net winner is someone who received more than they
9 invested.

10 Q More from the debtor?

11 A That's a bankruptcy issue, as I understand it. What we've
12 made clear and what we've struggled and worked with you to do
13 is to not invade your province and what we've tried to do is to
14 cooperate with you and to work efficiently and to divide things
15 up and when things make sense to prosecute together, we've
16 invited you to prosecute with us.

17 Q Okay. Now you want to answer my question? Does it include
18 the payments from, direct payments from the debtor in part of
19 your calculation of net winner?

20 A I don't believe that it does.

21 Q Does it include payments from one participant to another in
22 order to determine a net winner?

23 A I believe that it does.

24 Q Okay. So your net winners is inter-participant
25 transactions? It's a yes or no question.

1 A I think at this point in time that that would require an
2 analysis of the interplay between -- that's why we're trying to
3 cooperate with you.

4 Q Well, I understand --

5 A That's basically it.

6 Q -- you're trying to cooperate, Mr. Bonsignore. You said
7 that.

8 What I'm asking you is you filed the pleading, you've used
9 the word "net winner," you put a definition in the, in that
10 pleading. You're the drafter of the pleading.

11 I'm simply asking you, sir, in drafting the pleading and
12 using the term "net winner" did you intend to include the
13 triangular transactions?

14 A No.

15 Q Thank you, sir.

16 A As I understand what you meant.

17 Q Thank you, sir.

18 THE COURT: Mr. Baldiga?

19 MR. BALDIGA: Yes. Very brief cross, or redirect,
20 Your Honor.

21 REDIRECT EXAMINATION

22 BY MR. BALDIGA:

23 Q Mr. Bonsignore, did you, as part of your leadership team,
24 engage bankruptcy counsel to deal with some of the issues that
25 Mr. Bennett was asking you about?

1 A I engaged bankruptcy counsel to address all of those issues
2 as I'm not competent in bankruptcy and have no clue other than
3 through what my lawyer advises me as to bankruptcy. I have no
4 experience in bankruptcy, none.

5 Q And who's the bankruptcy part of your leadership team on
6 the MDL plaintiffs' side?

7 A Brown Rudnick, who I rely on entirely. I defer to them
8 entirely.

9 Q I want to go to Mr. Bennett's question, just one part of
10 it, "net winner."

11 And you said that you, your understanding as not as a
12 bankruptcy person that, is that a net winner is someone who
13 took more out of the scheme than put in, correct?

14 A Yes. The bankruptcy terms, as I have often said, it's a
15 language in and of itself that three-quarters of the time I do
16 not understand. That's why --

17 Q Yeah, but I want to go, I want to stick to this on the net
18 winner.

19 And you said somebody who's a net winner is someone who
20 took more money out than they put in, correct?

21 A Yes.

22 Q And you understand from TelexFree that there were at least
23 a couple ways that people could put money in. They could give
24 it to a higher-level promoter, or they could possibly send it
25 up to TelexFree directly, correct?

1 A Yes.

2 Q Either way, they were putting money in, right?

3 A Yes.

4 Q And there were at least a couple ways they could get money
5 out. They could possibly get money from TelexFree itself,
6 correct?

7 A Yes.

8 Q And they could possibly get money handed to them by a
9 promoter as a return on their investment, correct?

10 A Yes. That often happened.

11 Q Either way, they're getting money out, right?

12 A Yes.

13 Q So all of those things would go into the equation as to
14 who's a net winner and who's a net loser, correct?

15 A Yes.

16 MR. BALDIGA: Nothing else, Your Honor.

17 THE COURT: Anything else, Mr. Bennett?

18 MR. BENNETT: No, Your Honor. I'm fine.

19 THE COURT: Thank you, Mr. Bonsignore. You may step
20 down.

21 Now, Mr. Baldiga, you had one more person you wanted
22 to call as a witness?

23 MR. BALDIGA: Yes, Your Honor, and with your
24 permission, Ms. Taylor, my colleague, would do, would put on
25 that witness.

1 MR. BENNETT: Your Honor, I would actually take a
2 proffer so we don't have to go through the translation. I
3 seriously doubt I'm going to have any questions for person.

4 But if you want to make a proffer, I'd be happy to let
5 you make the proffer and it's unlikely I'm going to cross-
6 examine. We can move it right along.

7 THE COURT: Can you do that, Mr. Baldiga?

8 MR. BALDIGA: Could I confer for one second?

9 THE COURT: Sure.

10 (Pause)

11 MR. BALDIGA: All right, Your Honor. Including,
12 because of the language issues, it's a very brief direct. We
13 think that would be the most efficient, including because we
14 have a translator here for a reason. We'll do it exact --

15 THE COURT: That's fine. I would actually like to
16 hear from a human being who was involved in this case and get a
17 little bit of, of perspective.

18 t So why don't you call your witness?

19 MR. BALDIGA: And I'll defer to Ms. Taylor.

20 THE COURT: Thank you.

21 MS. TAYLOR: Thank you, Your Honor.

22 (Interpreter, Claudia Azoff, sworn)

23 THE INTERPRETER: Good afternoon, Your Honor. Claudia
24 Azoff.

25 THE COURTROOM DEPUTY: If you could, please, just sit

1 next to the witness. I just want to make sure that we pick you
2 up.

3 THE INTERPRETER: Okay. You will. Thank you.

4 THE COURTROOM DEPUTY: Would you raise your right
5 hand?

6 MARIA MURDOCH, PIEC'S WITNESS, SWORN

7 THE COURTROOM DEPUTY: Could you spell her name,
8 please?

9 MS. TAYLOR: It's Maria, M-A-R-I-A --

10 THE COURTROOM DEPUTY: Yeah.

11 MS. TAYLOR: -- Murdoch, M-U-R-D-O-C-H.

12 THE COURTROOM DEPUTY: Thank you.

13 DIRECT EXAMINATION

14 BY MS. TAYLOR:

15 Q Afternoon, Ms. Murdoch. Thank you for joining us.

16 A Good afternoon.

17 Q Realizing that we're short on time, I will try to keep this
18 brief.

19 Do you speak -- do you speak English?

20 A Little bit.

21 Q But Portuguese is your primary language and you primarily
22 communicate in Portuguese, correct?

23 A Yes.

24 Q Have you ever testified in court before?

25 A No.

1 Q What is your occupation?

2 A I'm a house cleaning.

3 Q And where were you born?

4 A Brazil.

5 Q Are you a permanent resident now of the United States?

6 A Yes. I'm an LPR.

7 Q And how long have you lived here?

8 A Sixteen years.

9 Q And why did you move here?

10 A Because Brazil was very difficult at that time and I
11 brought my, my daughter here so she can study.

12 Q I'm going to ask a couple questions about your
13 participation in TelexFree.

14 When did you first hear about TelexFree?

15 A It was about August of 2013.

16 Q And how were you convinced to get involved?

17 A It was through some friends of mine.

18 Q And did you pay anyone any money to get involved in
19 TelexFree?

20 A Yes, I did.

21 Q Who?

22 A His name is Wagner.

23 Q How did you meet Mr. Wagner?

24 A It's through this group. They're doing some, having some
25 meetings.

1 Sam, Sam Rodriguez, that's the name of the person.

2 Q How many times did you attend a meeting with Mr. Rodriguez,
3 Sam Rodriguez?

4 A About three times.

5 Q Three times.

6 And how much money did you pay Mr. Wagner or Mr. Rodriguez
7 to get involved in TelexFree?

8 A \$25,000.

9 Q And that money was a large part or all of your savings,
10 correct?

11 A Yes. Everything I had.

12 Q And how did you pay that money?

13 A Cash.

14 Q Cash.

15 And you handed that cash directly to Mr. Wagner?

16 A To Wagner, yes.

17 Q Did you ever get any money back from TelexFree?

18 A No.

19 Q And have you filed a claim in the bankruptcy case?

20 A No. No.

21 Q Do you intend to file a claim?

22 A Yes.

23 Q I'm going to ask a couple questions about the motion that's
24 the subject of today's hearing.

25 Are you familiar with this motion?

1 A If I have the knowledge, you mean?

2 Q Do you know, generally, what it's about?

3 A Yeah, it's about TelexFree.

4 Q Okay. Did you receive by e-mail or by mail or by any other
5 means a copy of the motion?

6 A No.

7 Q And did you receive any notice of today's hearing in the
8 mail or by e-mail or by any other motion, or way?

9 A It was, yes.

10 Q It -- excuse me. I don't understand. It was.

11 A My daughter is the one who told me that I have to come here
12 today.

13 Q Okay. But prior to your daughter telling you, you
14 didn't -- did you get anything in the mail, you, saying that
15 there is a hearing today?

16 A No.

17 Q Okay.

18 So not having had a copy of the motion, did you know that
19 the motion, if it's granted today, would stop you or your
20 chosen lawyer from suing to get the money back that you gave to
21 Mr. Wagner?

22 A I didn't understand the question.

23 Q Okay. Let me try to rephrase.

24 Do you want to sue Mr. Wagner to get your money back?

25 A Yes, I do.

1 Q Did you know before today or yesterday that if the motion
2 is granted you won't be able to do that?

3 A No, I didn't.

4 Q Thank you.

5 MS. TAYLOR: I have nothing further.

6 THE COURT: Just a minute, please.

7 Mr. Bennett, anything?

8 MR. BENNETT: Very briefly, Your Honor.

9 THE COURT: Okay.

10 CROSS-EXAMINATION

11 BY MR. BENNETT:

12 Q When you paid the money to this individual did you get a
13 membership in TelexFree?

14 A No.

15 Q Did you get a user account with TelexFree?

16 A No.

17 Q Did -- does your daughter have a user account at TelexFree?

18 A No, she did not.

19 Q And how did your daughter find out about this hearing, if
20 you know?

21 A Through some friends that they were supposed to be here.
22 They told her that I, I was supposed to be here, too.

23 Q Thank you.

24 MR. BENNETT: No further questions on my part.

25 MS. TAYLOR: No further questions. Thank you.

1 THE COURT: I have a question for Ms. Murdoch.

2 BY THE COURT:

3 Q Ma'am, when you gave Mr. Wagner \$25,000 what were you

4 thinking you were getting in return?

5 A Well, through all the friends, that the are making a lot of

6 money. I was told that if I gave this \$25,000 was some kind of

7 bonus. I was going to get like double. That's what he told

8 me.

9 Q Did the name, TelexFree, ever come up in your discussions?

10 A Yeah. Well -- yes, and I thought it was something legal.

11 Q All right. Thank you.

12 THE COURT: You may step down.

13 All right. Let me make sure I, I understand where we,

14 where we are at this point.

15 That concludes the evidentiary portion of the hearing

16 as it relates to the first prayer of the motion, the request

17 that there be a finding that the debtor engaged in a Ponzi and

18 pyramid scheme, is that correct, everyone?

19 MR. MURPHY: Yes, Your Honor --

20 THE COURT: Okay.

21 MR. MURPHY: -- at least from the trustee's

22 perspective.

23 THE COURT: Now in terms of the other prayers for

24 relief, apart from allowing argument to proceed on, on any of

25 those that the parties want to continue to fight about, is

1 there any evidence that would need to be presented on any of
2 the other prayers? Does anyone have anything?

3 (No response)

4 THE COURT: Okay.

5 MR. MURPHY: Nothing, nothing further from the
6 trustee.

7 THE COURT: All right.

8 Mr. Baldiga?

9 MR. BALDIGA: Same with us, Your Honor.

10 THE COURT: Okay. All right.

11 So based on the evidence that has been presented thus
12 far, I'm prepared to find that the debtors did engage in a
13 Ponzi and pyramid scheme. Based on the affidavit of Mr. Darr
14 and the testimony that was presented today I find that the --
15 and based on the legal principles that have been presented by
16 the trustee in his papers as to the factors that determine the
17 existence of a Ponzi scheme and a pyramid scheme -- the
18 investment by consumers; the fact that the company conducted
19 little or no legitimate business; produced little or no profit;
20 that the source of, the predominant source of income from the
21 business was from these, call them investments by the
22 consumers, these payments by the consumers; that that was a
23 whole structure of, a top-down structure whereby individuals
24 were selling or recruiting other participants to go out and
25 find participants and receive awards that really were unrelated

1 to the product that the company was purporting to sell, all of
2 those factors -- and I don't think there's really anybody who
3 disputes that -- clearly militate in favor of such a finding.

4 And that finding that there is a Ponzi, there was a
5 Ponzi and pyramid scheme being perpetrated by the debtors in
6 this case is the law of this case. It applies to this case.

7 And what that means in terms of the collateral
8 estoppel effect, the preclusive effect of that finding, I leave
9 it to the parties and any other court out there that wants to
10 take that matter up.

11 But that's my finding for purposes of this case.

12 Now that covers two out of the four prayers that the
13 trustee has requested.

14 The other prayer that I don't believe is in dispute
15 and, and I'm prepared to rule on here is that the liability of
16 the debtors to the participants or to the claimants that are
17 filed in this case and allowed will be joint and several.

18 And that's as far as I'm prepared to go today.

19 That leaves us with this request as to a determination
20 of the parameters of claims that can be filed in the bankruptcy
21 case. And my problem with that -- and I'm not going to rule on
22 this today. We'll have to have a separate hearing on it
23 because I want, I want better notice on that.

24 The only notice that the potential universe of claim
25 holders received was a copy of this Ponzi scheme motion and a

1 notice of the evidentiary hearing on the motion and we're
2 dealing with lay people and people who -- and granted, the
3 motion was translated into other languages, but they were,
4 nevertheless, they're lay people and I don't believe that there
5 was an adequate understanding or an adequate highlighting to
6 those people about the prayer in which the trustee was
7 requesting a finding that would, the result of which would have
8 a substantive impact on the claims that they are entitled to
9 file.

10 And so what I'm -- what I'm -- what I'd like to have
11 the trustee do is to re-notice to the parties in interest,
12 including the participants a further hearing in which I am
13 going to make a determination, or I'm being asked to make a
14 determination as to the second prayer of the Ponzi scheme
15 motion.

16 And I don't believe that needs to be an evidentiary
17 hearing unless somebody tells me that they have some evidence
18 on that point. I don't think there is because they would have
19 brought it up today. And I'm prepared to hear arguments at
20 that hearing as to why I shouldn't find for the trustee on that
21 prayer.

22 My primary concern, I have to tell you, is the issue
23 of notice, is that the creditors are entitled to know what the,
24 how the trustee is proposing to funnel their claims into the
25 case. And, and then we'll see what kind of objections are

1 elicited from that notice.

2 And then, Mr. Baldiga, you can try to convince me how
3 a finding of these, along these lines, as you put it, leaks
4 over into the multi-district litigation and if it does, why
5 that should matter to me.

6 Is that -- anybody have any questions on where we're
7 going with this?

8 MR. MURPHY: No, Your Honor, other than I -- I --
9 obviously, Your Honor, we did send a motion. Would you like me
10 to try to summarize the motion in plain English and Portuguese
11 as well?

12 THE COURT: That portion -- what's left of the motion
13 is that prayer. Yes.

14 MR. MURPHY: Okay. Kind of a plain language
15 explanation of, as if I was doing a plain language disclosure
16 statement for a reasonable person to try to lay it out in
17 spades exactly what we're, how the net equity calculation would
18 be determined.

19 THE COURT: How they will be affected by, by a ruling
20 accepting the trustee's request on that issue, yes.

21 MR. MURPHY: And just for the record, Your Honor,
22 the -- I think it's -- to be correct, again from the trustee's
23 perspective, it's, it's both pointing out to participants that
24 under this formula they would get claims in the bankruptcy case
25 for amounts that, for example, the last witness -- she

1 transmitted - she would have a claim in this bankruptcy case
2 for that \$25,000 under that determination. That, that would be
3 part of it.

4 And that -- those -- if you will, payments into
5 (indiscernible) would be included in part of their claim and it
6 would not just include direct, but it would also include what
7 we call the triangular transactions. I'll use, probably, a
8 different term for purposes of explaining that to people.

9 Is that what you want me to explain in the notice,
10 Your Honor?

11 THE COURT: Yes. Thank you.

12 MR. MURPHY: Thank you.

13 THE COURT: So now let's talk about the next hearing
14 and how much time we need for this.

15 MR. BALDIGA: And, Your Honor --

16 THE COURT: Yes.

17 MR. BALDIGA: -- you've addressed the first three
18 prayers for relief. Prayer 4, is that also to be argued
19 further at that next hearing?

20 THE COURT: I -- I -- Prayer 4 is the -- I, I
21 addressed that. That's -- I -- I -- I'm finding that the Ponzi
22 scheme, pyramid scheme finding is the law of this case. That's
23 Prayer 4.

24 MR. BALDIGA: And, and the Ponzi scheme finding, yes.
25 And -- and -- I guess I should have been more specific.

1 If there is to then be a ruling on the triangular
2 aspect of it, which is not the Ponzi scheme, the only thing
3 that people really are fighting about today is whether a
4 finding on the triangular aspect of the proof of claim form
5 that you're reserving on, whether that because a law of the
6 case for purposes other than the allowance of claims.

7 THE COURT: Oh, okay.

8 MR. BALDIGA: That is, I think, the entire core of the
9 dispute here. And I just want to be sure that's not lost in
10 the shuffle of today's proceedings.

11 THE COURT: What I've done today does not affect that
12 one was or the other.

13 MR. BALDIGA: That's what I understood.

14 THE COURT: So you still have the opportunity to
15 address that at the next hearing.

16 MR. BALDIGA: Very good. Thank you.

17 THE COURT: And lastly, Your Honor, have you
18 determined that the credits, the disallowance of credits for
19 claim purposes is, is okay for today?

20 THE COURT: Disallowance of credits.

21 MR. MURPHY: That was, I think, one of the --

22 THE COURT: That's --

23 MR. MURPHY: -- one of the prongs we had, that the
24 credits that were in the --

25 THE COURT: No. That, that's part of Prayer 2. That

1 would be part of the notice that --

2 MR. MURPHY: Okay.

3 THE COURT: -- they -- the ---

4 MR. MURPHY: The disallowance of credits in the
5 calculations of claims based upon the trustee's version of the
6 net equity?

7 THE COURT: Right.

8 MR. MURPHY: Okay. Understood.

9 THE COURT: Thank you.

10 MR. MURPHY: Thank you, Your Honor.

11 THE COURT: So if we --

12 Yes, Mr. Baldiga.

13 MR. BALDIGA: Well, just -- you -- we're going to talk
14 about schedule. What I would --

15 THE COURT: Yes.

16 MR. BALDIGA: -- ask, Your Honor, as part of any
17 scheduling that at least the trustee and the MDL plaintiffs as
18 well as anyone else who wishes to do so, we have a date certain
19 by which we file proposed orders. I think it will help the
20 hearing to know exactly what people are doing and I think will
21 help make, streamline the next hearing as well so that there's
22 actual words in front of everybody well in advance of the
23 hearing.

24 THE COURT: On that, on the remaining issue of Prayer
25 2, is that what you're asking?

1 MR. BALDIGA: 2 and 4, the part of 4 that -- yes.

2 THE COURT: Okay.

3 So let's talk about timing. We're in a holiday week
4 here.

5 What's a reasonable time by which you can get a notice
6 out, Mr. Murphy?

7 MR. MURPHY: Well, we probably -- I don't want to -- I
8 want to make it -- get it -- do it right and we have to then
9 deal with the transmittal.

10 I would say a week from this Friday, Your Honor, which
11 would be December --

12 THE COURT: 4th.

13 MR. MURPHY: -- 4th.

14 THE COURT: Then I would say we would give parties 45
15 days to digest this and file any opposition, which would get us
16 to, is that January 5th, or no?

17 January 12th, let's say for -- I mean, February. No,
18 no, no. December 4th for service. January 4th.

19 So January 18th for responses, objections. And you'll
20 put that in your notice, obviously.

21 MR. MURPHY: Mr. Lizotte tells me just service of this
22 is not the easiest thing. If we could have until Monday, Your
23 Honor, to make service. I don't think it makes a difference of
24 the great scheme of things, but that -- it just --

25 THE COURT: Monday, December 7th.

1 MR. MURPHY: For service.

2 THE COURT: Sure.

3 MR. MURPHY: Just to --

4 And that January 18th --

5 THE COURT: Is that --

6 MR. MURPHY: -- is fine, Your Honor, for the response
7 deadline.

8 THE COURT: Is that a holiday? Is that Martin Luther
9 King's --

10 MR. BALDIGA: It is. It is Martin Luther King.

11 THE COURT: Yeah.

12 So I'll make the 19th, that Tuesday.

13 (Court confers with staff)

14 THE COURT: Then we will reconvene on January 26th at
15 10:00 a.m.

16 MR. MURPHY: That's fine with the trustee, Your Honor.
17 Thank you very much.

18 THE COURT: And you can circulate proposed orders or
19 anything else that you have that you'd like to file by the
20 objection deadline of January 19th.

21 MR. BALDIGA: Including proposed orders?

22 THE COURT: Yes. And this will not -- this will be a
23 non-evidentiary hearing.

24 MR. MURPHY: Understood, Your Honor.

25 MR. BALDIGA: At what time, Your Honor? I'm sorry.

1 THE COURT: 10:00 a.m.

2 MR. MURPHY: So responses to the notice would be on
3 the 19th, including proposed orders, and the hearing on 26th?

4 THE COURT: Correct.

5 MR. MURPHY: Thank you, Your Honor.

6 THE COURT: All right.

7 That leaves us with the other matter that was
8 scheduled for today, which is the bar date motion.

9 MR. MURPHY: Your Honor, for the same reason we talked
10 about last time that, Mr. Lizotte points out to me,
11 determination of the design of the website and the claims
12 portal and the E-proof of claim will be affected dramatically
13 whether or not we include or don't include the triangular.
14 It's a -- it's a much simpler process, frankly, from the
15 estate's perspective just to include the directs. Again, it's
16 not a result, I don't think, people appreciate. It's not going
17 to be good for them, but we don't want to design -- there's no
18 point in designing an E-proof of claim asking all about the
19 indirects if they're not going to affect into the calculation
20 of allowed claims and the credits. And also, the determination
21 whether the credits -- we ask people, are these credits correct
22 or not and we start counting credits, keeping track of credits.
23 It just doesn't make any sense, Your Honor. That's -- with the
24 1.9 million potential claims, 50,000 already, we've looked at
25 the claims that are filed to date, or not all of them, but

1 enough sample to know it's, it's completely, frankly, useless
2 information, Your Honor, unless we have some parameters about
3 what the rules of the game are going to be.

4 So I, I'd respectfully ask that that motion, again, be
5 put over until the hearing on the 26th. And as I said, we'll
6 move as much of the case as possible, but we haven't seen a way
7 that we can work around these fundamental issues in designing a
8 process.

9 THE COURT: That probably makes sense.

10 Mr. Baldiga, remind me of what the MDL plaintiffs have
11 raised in response to the bar date motion? What's the issue
12 there?

13 MR. BALDIGA: We have no objection.

14 THE COURT: Okay.

15 I have -- so there have been no formal objections to
16 the, to your motion, Mr. Murphy?

17 MR. MURPHY: No, there haven't been. We -- actually,
18 we received an informal objection from counsel for TD Bank,
19 who's in the courtroom. He wanted to conform the order to the
20 Local Rule proposed form and we have done that for his benefit.
21 I believe we submitted to the Court a blackline.

22 We also -- the Court had raised concerns about we, a
23 couple of the words, "participants in the scheme," as being a
24 pejorative coupling and we've tried to eliminate that and make
25 it much more neutral.

1 But again, I think it's -- because it's going to be a
2 monumental and tremendously expensive task to, to design a
3 claim process, we need to do it -- we should only do it once.

4 THE COURT: That makes sense. I have a couple of
5 other points, though, that I want to bring up on the bar date
6 stuff.

7 As I read the Certificate of Service, the bar date
8 motion itself has not been served on the participants, is that
9 correct?

10 MR. MURPHY: No, Your Honor, just to all appearances
11 in the case. We did not serve it like we did the Ponzi motion.
12 That's correct.

13 THE COURT: And in the bar date motion you are asking
14 for a disqualification of all claims made by the participants
15 previously by filing proofs here, filing proofs with KCC,
16 filing claims with the federal or state authorities, and I
17 think that that request is fine, but I think, again, people
18 need to know that those rights are being taken away from them.
19 And they don't know that now and they're going to find out
20 under your rubric when they get the bar date notice by which
21 point it will be too late.

22 So while you're noticing out your Ponzi scheme motion
23 I would ask you to serve notice of your bar date motion on the
24 same universe of recipients and highlight -- I think that's the
25 only part of the bar date motion that would impact their --

1 their -- that would preempt rights that they may think they
2 already have and let's see if anybody has a problem with that.

3 MR. MURPHY: Understood, Your Honor.

4 So you would like to -- maybe I can include a plain
5 language summary on that, or make that part of the summary?

6 THE COURT: Sure. A notice of motion for bar date and
7 a hearing thereon and highlighting that particular --

8 MR. MURPHY: That participants will have to re-
9 register their claims electronically --

10 THE COURT: Right.

11 MR. MURPHY: -- if this motion's allowed.

12 THE COURT: Right.

13 MR. MURPHY: The motion seeks to acquire that right.
14 I understand.

15 THE COURT: And that they will -- they will not be
16 able to -- that their previous claims are not going to be
17 considered. This language you have in the bar date order and
18 in your notice of bar date, you need to make them aware of
19 that.

20 MR. MURPHY: Fair enough, Your Honor.

21 THE COURT: And I would -- the other thing that I
22 wanted to explore with you before I would approve this is an
23 opportunity to be able to see what this looks like, this
24 electronic proof of claim process. I take it -- is there a way
25 to do a demonstration? Is there a way to have a, create a

1 form? I understand that it would be unofficial because it
2 hasn't yet been approved, but to show us what this is going to
3 look like, if it gets approved?

4 MR. MURPHY: Perfect timing because Mr. Darr -- I
5 think, now that we have this on the 26th, Your Honor, I think
6 we can actually talk about a live demonstration.

7 But let me have Mr. Darr speak to that directly.

8 MR. DARR: Again, Your Honor, Stephen Darr, trustee.

9 Last -- in anticipation of today's hearing a couple of
10 weeks ago, once we really triangulated on what the information
11 was and what we needed to do for the claims process, we sent
12 out an RFP, request for proposal, to seven different technology
13 firms asking them to propose on a, devising a web portal for
14 the, for the proofs of claim.

15 Five of the seven responded with formal proposals and
16 last Friday we heard four of them. And we heard one of them
17 yesterday. And the one -- I hope this doesn't leak out 'cause
18 we haven't told the winners or the losers yet -- but one of the
19 participants has a operative. It's a prototype. It's got to
20 be changed. It's got to be adapted a little bit. But they
21 have a working prototype and, and that's the firm that we
22 intend to select.

23 So we'll be able to get that resolved and, of course,
24 we'll -- before we -- as part of employing them, we'll seek
25 court authorization for their employment. But we'll be able to

1 come up with a fairly robust example of, of the data.

2 The firm that we selected, or we're going to select
3 has a similar, not exactly the same, but a similar application
4 and an SEC receivership in the southeast.

5 THE COURT: So you'll be -- the -- on January 26th
6 you'll be able to present a demonstration of how --

7 MR. DARR: Yes.

8 THE COURT: -- how a hypothetical participant would be
9 able to work through the process of e-filing a participant's
10 claim?

11 MR. DARR: Yes, Your Honor.

12 THE COURT: Very good.

13 And then the, the non-participant proofs of claim,
14 those are just the official forms, right? So there's no --

15 MR. MURPHY: Correct.

16 THE COURT: -- magic in that.

17 MR. MURPHY: Correct, Your Honor.

18 MR. DARR: Your Honor should know that many of the
19 forms, many of the claims that have been received are not on
20 the official forms. Many of them came from outside the United
21 States and some of the problems associated with that, they came
22 in on A4-size paper, which won't feed through the U. S.
23 document feeders. They had to be Xeroxed onto 8-1/2 by 11
24 paper and then put through and processed.

25 So it's been -- it's -- it's a difficult process when,

1 when you're considering so many claims are outside the United
2 States.

3 THE COURT: Right, but all those are going to be wiped
4 out assuming that --

5 MR. DARR: Yes.

6 THE COURT: -- this procedure is approved. And that's
7 the reason why the creditors --

8 MR. DARR: Yes, Your Honor.

9 THE COURT: -- to know about that. Okay.

10 All right, good. So we'll, we'll take that back up
11 again on the 26th.

12 And anything else I can do for you today?

13 MR. BALDIGA: Yes.

14 THE COURT: Mr. Baldiga?

15 MR. BALDIGA: One thing, Your Honor. Thank you for
16 your time today. It's really just 30 seconds.

17 An unusual case, unusual proceeding today. Difficult
18 case and, and difficult issues. Obviously, the -- we're going
19 to get through these mechanical things, but the issue of the
20 victims' right to sue is one that is a very significant issue,
21 both in dollars, the number of people involved, and the outcome
22 on this case. We've had some good discussions about that. I
23 don't want to get into what those are, but they've been
24 unsuccessful, obviously, or we wouldn't be here. It's not for
25 lack of trying on either party's part.

1 For our part, we, we're a fiduciary. They're a
2 fiduciary. It's not a great situation when you have two
3 fiduciaries having proceedings like this. We'd be willing on
4 our part to submit to mediation in that regard. We think it
5 makes sense. At the end of the day, this is all victim money
6 and the less spent on this type of proceeding, the better. We
7 feel very strongly about that. We answer not to this court.
8 We answer to a different court, but I think both courts would
9 feel the same way as well. It's all victim money at the end.

10 And I suggest it and I suggest it openly and I just
11 didn't want a proceeding like this to end in the context of a
12 case like this without that being said.

13 THE COURT: Right. Well, it's on the record. I've
14 heard it. I'm always one to support consensual resolution of
15 these disputes.

16 I think that to the extent that it's possible between
17 now and January 19th when objections are due, there's plenty of
18 time for you to explore that and if you are able to, both sides
19 are able to agree on, on that, then let me know and we can
20 reschedule, if that's what it's going to take, if you need more
21 time.

22 So I'll leave that to the parties to, to consider.

23 MR. BALDIGA: Thank you.

24 THE COURT: All right. Thank you all for coming in.

25 MR. BALDIGA: Thank you.

1 THE COURT: Have a nice evening and a good holiday.

2 MR. MURPHY: Thank you. Happy Thanksgiving, Your
3 Honor.

4 THE COURTROOM DEPUTY: Court is in recess. All rise.

5 MS. TAYLOR: Thank you, Your Honor.

6 (Proceedings concluded at 5:18:26 p.m.)
7
8
9

10 CERTIFICATE

11 I, court approved transcriber, certify that the
12 foregoing is a correct transcript from the official electronic
13 sound recording of the proceedings in the above-entitled
14 matter.

15 /s/ Janice Russell December 4, 2015

16 Janice Russell, Transcriber Date
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EXHIBIT O

UNITED STATES BANKRUPTCY COURT
 DISTRICT OF MASSACHUSETTS
 CENTRAL DIVISION

In Re:

TELEXFREE, LLC ,
 TELEXFREE, INC.,
 TELEXFREE FINANCIAL, INC.,

Debtors.

Chapter 11

Case No. 14-40987-MSH

Case No. 14-40988-MSH

Case No. 14-40989-MSH

Jointly Administered

MOTION BY CHAPTER 11 TRUSTEE FOR ENTRY OF ORDER FINDING THAT DEBTORS ENGAGED IN PONZI AND PYRAMID SCHEME AND RELATED RELIEF

To the Honorable Melvin S. Hoffman, Chief United States Bankruptcy Judge:

Stephen B. Darr, the duly appointed Chapter 11 trustee (the "Trustee") of the bankruptcy estates of TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc. (collectively, the "Debtors"), respectfully requests entry of an order finding that the Debtors were engaged in a Ponzi/pyramid scheme and that such finding be applicable to all matters in these proceedings. The Trustee has filed simultaneously herewith the *Motion by Chapter 11 Trustee for Approval of Method of Service of Motion by Chapter 11 Trustee for Entry of Order Finding that Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* (the "Notice Motion") and the *Affidavit of Stephen B. Darr in Support of Motion by Chapter 11 Trustee for Entry of Order Finding that Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* ("Darr Affidavit").

In support of this motion (the "Motion"), the Trustee states as follows:



INTRODUCTION

The Debtors ostensibly operated a multi-level marketing company engaged in the sale of voice over internet service but, as detailed herein, the Debtors' operations actually were a massive Ponzi/pyramid scheme that ensnared as many as a million or more participants from multiple countries (hereinafter, parties who became members of the Debtors' scheme shall be referred to as "Participants"). Participants opened approximately 11,000,000 User Accounts (as hereafter defined) and purchased membership plans and/or Voice over Internet Protocol ("VoIP") service with a transaction value of approximately \$3,070,000,000 during the approximately two years of the Debtors' operation of their scheme. An affiliate of the Debtors, Ympactus Comercial Ltda. ("Ympactus"), reportedly operated a substantially similar scheme in Brazil which was seized and shut down by the Brazilian authorities in June 2013.¹ Shortly after the Debtors' Chapter 11 filings in April 2014, the Securities and Exchange Commission and the Massachusetts Securities Division commenced litigation against the Debtors and others alleging, among other things, that the Debtors were engaged in the fraudulent sale of securities in violation of numerous securities laws. Contemporaneously therewith, substantially all of the Debtors' assets and records were seized by the federal authorities. Approximately two months later, on June 6, 2014, the Trustee was appointed.

The Trustee has conducted an extensive investigation into the operations of the Debtors' scheme and Participant involvement therein. As a result of the investigation, the Trustee has concluded that and requests a finding from the Court that the Debtors were engaged in a Ponzi/pyramid scheme, that any claim or portion of claim of Participants based upon accumulated credits arising from fictitious profits or commissions in Participants' User Accounts

¹ Reportedly, Ympactus was recently found by a Brazilian court to have been a Ponzi scheme.

as of the Petition Date should be disallowed, and that Participant claims should be determined on a "net equity" basis.

Simultaneously herewith, the Trustee has filed his *Motion by Chapter 11 Trustee for Entry of Order Fixing Bar Date for Filing Proofs of Claim, Approving Form and Manner of Notice, Directing that Claims be Filed Electronically, and Approving Content of Electronic Proofs of Claim (the "Bar Date Motion")*. Pursuant thereto, the Trustee seeks, among other things, approval for the electronic noticing of a Bar Date and approval of the content of electronic proofs of claim to be filed by Participants (the "Participant ePOC") and non-Participants (the "Standard ePOC" and together, the "ePOCs").

I. CASE BACKGROUND AND PROCEDURAL POSTURE

1. On April 13, 2014 (the "Petition Date"), each of the Debtors filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code ("Bankruptcy Code") with the United States Bankruptcy Court for the District of Nevada ("the Nevada Bankruptcy Court").

2. The Debtors initially operated as debtors-in-possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code.

3. On the Petition Date, the Debtors filed a motion for joint administration of the cases, with TelexFree, LLC designated as the lead case. By order dated April 24, 2014, the order for joint administration was approved.

4. Prior to the filings, the Commonwealth of Massachusetts, Office of Secretary of State, Securities Division (the "MSD") commenced an investigation into the Debtors' business practices.

5. On or about April 15, 2014, the MSD commenced an administrative proceeding against the Debtors. Also on April 15, 2014, the Securities and Exchange Commission (the “SEC”) commenced an action against the Debtors and others in the United States District Court for the District of Massachusetts. The foregoing actions alleged, among other things, that the Debtors were engaged in an illegal Ponzi/pyramid scheme and the fraudulent unregistered offering of securities. Substantially contemporaneously with the commencement of the SEC action, Homeland Securities Investigation (“HSI”) seized the Debtors’ assets, books, and records. In connection therewith, the federal government seized more than \$107,000,000 in cash, including funds on deposit and checks payable to the Debtors, their principals, or their affiliates. Federal authorities have also made forfeiture claims against approximately forty (40) other items of real and personal property standing in the name of the Debtors’ principals and their affiliates, including automobiles, real properties, and notes secured by mortgages on real properties.

6. On or about April 22, 2014, the Office of the United States Trustee filed a motion for the appointment of a Chapter 11 Trustee based upon the allegations of illegal activity.

7. On April 23, 2014, the SEC filed a motion to transfer venue of the cases to the United States Bankruptcy Court for the District of Massachusetts (the “Court”). By order dated May 6, 2014, the motion to change venue was approved. The cases were transferred to the Court on May 9, 2014.

8. On May 30, 2014, this Court allowed the United States Trustee’s motion to appoint a Chapter 11 trustee, and the Trustee was appointed on June 6, 2014.

9. The Debtors filed only a list of the alleged thirty (30) largest creditors in the cases and did not file schedules or statements of financial affairs, nor a matrix of creditors.

10. On February 27, 2015, the Trustee filed schedules of assets and liabilities and statements of financial affairs for each of the Debtors, using information obtained from documents produced pursuant to Rule 2004 examinations and Debtor records obtained from the Federal Authorities (as defined below).

11. Carlos Wanzeler and James Merrill were the Debtors' principals along with Carlos Costa, at least through Costa's alleged separation from the Debtors in the fall of 2013. Shortly after the Trustee was appointed, the United States Department of Justice ("DOJ" and, together with the SEC and HSI, the "Federal Authorities") indicted Wanzeler and Merrill based upon their involvement in the Debtors' scheme. Wanzeler has fled the country and is believed to be in Brazil. Merrill was initially detained and has been released pending trial.

12. On February 3, 2015, the Trustee submitted a comprehensive Status Report on outstanding matters in the cases. The Status Report set forth, among other things, the background of the Debtors and their affiliates, the breadth and scope of the scheme, assets recovered to date and potential additional sources of recovery, as well as efforts at coordination with governmental authorities, both in the United States and in Brazil.

13. Prior to the Trustee's appointment, the Federal Authorities shut down, disconnected, and seized the Debtors' computer system, which consisted of forty-six (46) computers and servers containing more than twenty (20) terabytes of data. Accordingly, at the time of his appointment, the Trustee did not have access to any of the Debtors' records. Neither of the Debtors' principals has been available because Wanzeler fled the country and Merrill had been indicted and detained. The Trustee has only had limited access to the Debtors' former employees.

14. Initially without access to the Debtors' books and records, the Trustee has utilized a variety of resources to obtain information regarding the Debtors' activities and the mechanics of their scheme. The Trustee filed motions for authority to obtain documents from, and conduct examinations of, twenty-nine (29) separate entities pursuant to Federal Rule of Bankruptcy Procedure 2004 (the "2004 Motions").² The deponents of the 2004 Motions included prepetition and postpetition professionals retained by the Debtors, financial institutions who had prepetition and/or postpetition relationships with the Debtors, multiple firms who provided payment processing services to facilitate payments between the Debtors and Participants, and firms who provided consulting services to the Debtors or who otherwise were believed to have had business relationships with the Debtors. The Trustee also conducted informal interviews of certain former employees and consultants of the Debtors as well as several Participants.

A. Mechanics of Scheme and Methods of Compensation

15. The Debtors purported to be in the business of selling VoIP that cost \$49.90 per month to conduct international phone calls. The sale of VoIP on a monthly basis is hereinafter referred to as a "VoIP Package". Customers who purchased the VoIP Package registered their phone numbers with the Debtors and received software that enabled their computers to place phone calls through the Debtors' computer servers in Marlborough, Massachusetts to approximately 40 countries.

16. The Debtors ostensibly used a multi-level marketing plan, or "MLMP", to sell the VoIP Packages. An MLMP, also referred to as network marketing or referral marketing, is a direct sales strategy in which the sales force is compensated not only for sales they generate, but also for the sales generated by other sales persons that they recruit. *Whole Living, Inc. v. Tolman*, 344 F. Supp. 2d 739 (D. Utah 2004). MLMP businesses can be legitimate, and notable

² To date, the Trustee has deferred conducting depositions of the 2004 Motion deponents.

examples of MLMP's include Herbalife International (selling nutritional supplements, weight management, sports nutrition, and personal care products), Mary Kay, Inc. (selling cosmetics products), and Amway (selling, among other things, health, beauty, and home care products).

17. Each new distributor in an MLMP recruited by a participant, along with the recruited distributor's recruits (down to six levels in the Debtors' case), becomes part of the first participant's "network", sometimes referred to as the participant's "downline." Eventually one or more pyramid type structures is established underneath the recruiting participant. In addition to earning commission and profits on the products the participant sells, he or she is entitled to receive a commission based on the volume of products or memberships sold by his or her network.

18. Until the Debtors purported to change their MLMP contracts in an unsuccessful attempt to address the existing contract's illegality in March 2014, the Debtors provided Participants with two options (in addition to purchasing VoIP Packages) to become members and to thereby open User Accounts:

- a. "AdCentral Plan": \$339 for a one-year contract (\$50 membership fee plus \$289 contract fee). This contract entitled the User Account holder with the right to sell ten VoIP Packages, for which a Participant could receive a commission if the packages were sold, although there was no sale requirement. Participants were required to place one internet ad per day and, for each week in which the Participant placed the required ads, he/she was entitled to one additional VoIP Package, which could be sold or exchanged for \$20 in credits with the Debtors. Thus, Participants who posted the required ads were eligible to receive \$20 per week for 52 weeks, for a total return of \$1,040 (a return of 207% on the investment of \$339).
- b. "AdCentral Family Plan": \$1,425 for a one-year contract (\$50 membership fee plus \$1,375 contract fee). This contract entitled the User Account holder with the right to sell fifty VoIP Packages, for which a Participant could receive a commission if the packages were sold, although there was no sale requirement. Participants were required to place five internet ads per day and, for each week in which the Participant

placed the required ads, he/she was entitled to five additional VoIP Packages, which could be sold or exchanged for \$100 in credits with the Debtors. Thus, the Participants who posted the required ads were eligible to receive \$100 per week for 52 weeks, for a total return of \$5,200 (a return of 265% on the investment of \$1,425).

19. In addition to credits for posting these advertisements, the Debtors issued credits to Participants for the sale of membership plans and the establishment of new User Accounts as follows:

- a. \$20 in credits for each new AdCentral Plan and \$100 in credits for each new AdCentral Family Plan in a Participant's network.
- b. \$20 in credits for each User Account in one's "network," up to a maximum of \$440, as long as there were two subsidiary User Accounts.
- c. 2% of all payments to each User Account within one's network, down to six "levels" of the network, provided that each User Account had a registered VoIP customer.
- d. 2% of the Debtors' net monthly billing, up to a maximum of \$39,600 in credits, for an AdCentral Family Plan that had ten new AdCentral Family Plans in its network, so long as each plan had five registered VoIP customers.

20. The Debtors also issued credits to Participants for the sale of VoIP Packages as follows:

- a. 90% (or \$44.90 in credits) for the initial sale of a VoIP Package at \$49.90.
- b. 10% (or \$4.99 in credits) per month for the renewal of a VOIP Package by a User Account holder directly in one's network³ and 2% (or \$0.99 in credits) per month for the renewal of a VOIP Package by a User Account holder indirectly in one's network, down to six levels of the network.
- c. 2% from all VoIP Package sales in one's network, down to six levels of the network.

³ In practice, the Debtors appear to have provided Participants with credits equal to ninety percent (90%) of the renewal fees.

21. The credits issued to Participants for placing advertisements and selling membership plans and VoIP Packages could be redeemed for cash, transferred to another User Account, or applied in satisfaction of an invoice for another User Account.

22. Invoices for the purchase of a membership plan could be satisfied in one of two ways. Participants could pay the invoice in cash directly to the Debtors or Participants could pay a recruiting Participant for the purchase of a membership plan through the recruiting Participant's redemption of credits from the Debtors.

23. In the case of a Participant satisfying his/her own invoice by payment in cash to the Debtors, the process worked, generally, as follows:

- a. The Participant joined the Debtors' organization and created an online account with the assistance of a recruiting Participant, who needed to be identified;
- b. The Debtors' database recorded the information entered by the recruited Participant and assigned an identification number to the new User Account;
- c. The Debtors recorded the purchase, issued an invoice number, and marked the invoice as 'pending';
- d. A Participant would pay money directly to the Debtors in the form of cash, check, cashier's check, or wire transfer, or through a third-party online payment processing account. Once the Participant paid the invoice, the Debtors updated the invoice as 'paid', and the account setup would be complete;
- e. The recruited Participant could then start building a pyramid underneath the newly created User Account by recruiting other Participants (or by purchasing new User Accounts themselves) and generating bonuses and commissions in accordance with the scheme.

24. Alternatively, a Participant could satisfy his/her own invoice directly by payment in cash to another Participant, who would, in turn, satisfy the invoice by a redemption of

accumulated credits. Thus, the recruited Participant's membership fee for TelexFree plan was paid to the recruiting Participant, rather than to the Debtors.

25. As set forth above, there are approximately 11,000,000 User Accounts associated with the Debtors' MLMP. A new User Account was generally established each time that a membership plan was purchased, with either cash or accumulated credits.

26. Although some versions of Participant contracts contained prohibitions against Participants opening multiple User Accounts for themselves, other plan descriptions did not. In any case, any such restriction was not enforced and could not be enforced since the Debtors did not verify the Participants' identities. The Debtors' MLMP structure created incentives for Participants to open multiple User Accounts to generate credits for themselves.

27. As noted above, a Participant could monetize accumulated credits by recruiting a Participant to join the Debtors' scheme and using his/her accumulated credits to satisfy the invoice for the later Participant's membership plan in exchange for payment of the membership fee from the new Participant (a "Triangular Transaction"). In a Triangular Transaction, the Debtors issued the membership invoice to the recruited Participant, the recruited Participant paid the membership invoice that was due to the Debtors to the recruiting Participant, and the Debtors redeemed the credits of the recruiting Participant in satisfaction of the invoice.

28. In fact, it was a regular practice of the Debtors' scheme that membership fees were paid by the use of accumulated credits rather than by cash. While invoices associated with the sale of membership plans or VoIP Packages had a face value of approximately \$3,070,000,000, only \$360,000,000, or approximately twelve percent (12%) of that amount, was paid in cash to the Debtors. The balance of these invoices was satisfied by the use of Participants' credits.

29. The Debtors also issued “manual credits” to certain User Accounts. Manual credits were credits issued to User Accounts unrelated to the purchase of a membership plan and not resulting from the placement of advertisements or other components of the compensation scheme. Although some manual credits may have been issued to User Accounts in exchange for cash payment to the Debtors, the Trustee is unable to identify any payment to the Debtors for a significant amount of manual credits that were issued to certain User Accounts. These credits issued without consideration appear to be a fraud within the larger fraud of the Ponzi/pyramid scheme. There also were exchanges of credits between User Accounts unassociated with the issuance and satisfaction of Debtor invoices.

B. SIG/Back Office

30. The Debtors maintained two computer applications for accessing and processing information from the Debtors’ database relating to User Account activity, referred to as “SIG” and the “Back Office”.⁴

31. SIG stands for Sistemas de Informacoes Gerenciais, which is Portuguese and translates roughly to “Information Management System.” SIG tracked the activity for Participants by User Account, and the User Accounts are the only records available to the Trustee to confirm Participant activity.

32. The Trustee’s access to SIG was the culmination of a painstaking data recovery and analysis project implemented by the Trustee and his team of professionals with the assistance of investigators from HIS and the SEC.

33. Following the Trustee’s appointment and beginning in August 2014, HSI provided copies of electronic information contained in the Debtors’ computers and servers to the

⁴ The Back Office was the program used by Participants to obtain information on their User Account activity.

Trustee. Once all of the data from the Debtors' computers and servers were obtained, the Trustee and his team "virtualized" (i.e., created a computer environment replicating the original configuration) the system following a multi-step process, since the Federal Authorities were in possession of the original servers.

34. Extensive testing was performed to determine that the appropriate configurations of the data were achieved. Data from additional servers were later identified that were necessary to operate the network. Once the key components of the system were identified and operating, passwords were obtained through research into document productions received by the Trustee, communications with Federal Authorities, and a variety of investigative tools. Finally, an intensive analysis was performed to better understand the database structure, table relationships, data fields, and process flow.

35. The result was a working version of SIG, which enabled the Trustee and his professionals to conduct search queries and sort data. Because SIG was complicated, written in more than one language, and poorly maintained, and system documentation was unavailable, substantial additional hurdles remained to achieving an understanding of the system and extracting usable data.

36. The Debtors' database was developed by programmers in Brazil and all field references are in Portuguese. The developers apparently lacked the expertise to create and manage a system of this magnitude. As a result, system modifications appear to have been done in a haphazard and disorganized fashion. In addition, the Debtors' system is permeated with unreliable data because of limited efforts at data validation of information provided by Participants in establishing User Accounts.

37. Despite all of these obstacles, as a result of the forensic efforts identified above, the Trustee and his team have been able to reconstruct the Debtors' computer system in a virtual environment and obtain a working understanding of SIG and how it was used to track User Account activity.

38. Each time that a Participant purchased a membership plan or VoIP Package, an account was established with SIG (the "User Account").

39. Each User Account with the Debtors was registered with an electronic mail address (an "Email Address"). There are approximately 900,000 unique Email Addresses in SIG associated with approximately 11,000,000 Debtor User Accounts. The number of User Accounts associated with an Email Address varies widely. A particular Email Address may be associated with only a single User Account or may be associated with hundreds or thousands of User Accounts. Because each User Account may represent a separate Participant and some Participants entered the scheme using the Email Address of another Participant, the number of Participants is unknown but is likely in excess of 1,000,000.

40. After a User Account was established, SIG tracked the activity of the Participant in that User Account, including the accumulation of credits for bonuses and commissions "earned", the use or transfer of credits between User Accounts, and payments made to or from the Participant directly with the Debtors.

41. The Trustee and his team have taken a series of steps to confirm the accuracy and reliability of the transaction data reflected in SIG. The Trustee interviewed the Debtors' bookkeeper to understand the mechanics of SIG and how it was employed on a day to day basis. Testing was performed to reconcile balances and activity using available data, which is somewhat limited. This testing included cross-referencing data in related transactions and

conducting interviews with several Participants to confirm the accuracy of the SIG data as to their User Accounts. Based on the testing performed to date, SIG transaction data appears to have integrity and provides accurate information regarding membership plan sales, issuance of invoices, accumulation and use of credits, and amounts received from and disbursed to the User Accounts.

C. Relationship with Ympactus, and Segregation of Ympactus Information and Debtor Information

42. In February 2012, Ympactus reportedly commenced operations in Brazil to operate a scheme substantially identical to the scheme that is described above. Ympactus initially grew much more rapidly than the Debtors, with growth accelerating in the fall of 2012 through the early summer of 2013. By the spring of 2013, Ympactus had cash receipts of more than \$100,000,000 per month. *See Darr Affidavit, Exhibit "A",* at ¶51. On the other hand, the Debtors' cash receipts were initially much more modest. In the spring of 2013, the Debtors' cash receipts averaged approximately \$6,400,000 per month. *See Darr Affidavit, Exhibit "A",* at ¶51.

43. On June 28, 2013, the Public Prosecutor's Office of the State of Acre, Brazil filed claims against Ympactus, Carlos Wanzeler, Lyvia Mara Campista Wanzeler, and James Merrill, alleging that the VoIP Packages marketed in Brazil were violating consumer rights, since the MLMP constituted a Ponzi/pyramid scheme. The Brazilian authorities suspended the operations of Ympactus and froze its assets. Upon information and belief, the Brazilian authorities seized as much as \$300,000,000 from Ympactus in connection with the shutdown, and civil and criminal proceedings are pending in Brazil.⁵

⁵The Trustee is exchanging information with Brazilian authorities and is trying to develop a common protocol for administering claims and pursuing recoveries in the respective cases of Ympactus and the Debtors.

44. Upon information and belief, on or about September 21, 2015, the Brazilian court entered a decision finding that Ympactus operated a pyramid scheme.

45. Following the shutdown of Ympactus, the Debtors' cash receipts increased dramatically. The Debtors' cash receipts totaled approximately \$200,000,000 in the last three full months of operation, with more than \$96,000,000 in cash receipts in February 2014 alone. *See Darr Affidavit, Exhibit "A", at ¶53.*⁶

46. The SIG system maintained by the Debtors and Ympactus operated with a single database reflecting User Account activity for both operations. After reconstructing the computer network and developing a working understanding of SIG, one of the Trustee's first tasks was to determine how to segregate the Debtors' activity from that of Ympactus, since SIG did not clearly differentiate the User Accounts between Ympactus and the Debtors' Participants.

47. SIG includes more than 17,000,000 distinct User Accounts associated with approximately 2,000,000 Email Addresses for both the US-based and the Brazilian-based operations.

48. In creating a new User Account, each Participant was directed to identify whether such Participant would pay the initial invoices in Brazilian Reais ("Reais") or United States Dollars. Through a review of the currency field data, the Trustee determined the following:

- a. Prior to the shutdown of Ympactus in June 2013, invoices in User Accounts with Brazilian contact information were denominated in Reais and invoices in User Accounts with non-Brazilian contact information were denominated in Dollars;

⁶ Attached as Exhibit 1 to the Darr Affidavit is a summary of cash receipts of the Debtors, by month, for the two years of operation of the scheme.

- b. Fewer than 700 Reais-denominated User Accounts were associated with non-Brazilian addresses. Similarly, fewer than 150 Dollar-denominated User Accounts were associated with Brazilian addresses; and
- c. There was relatively little activity after the shutdown of Ympactus for Reais-denominated User Accounts that were created prior to the shutdown, and all cash activity for Reais-denominated accounts ceased shortly after the shutdown.

49. The Trustee believes that the Debtors' User Accounts can be separated from Ympactus' User Accounts by the currency designation in the data fields as described above.

50. Utilizing the currency designation, it appears that approximately 11,000,000 User Accounts are associated with the Debtors' operations and approximately 4,000,000 User Accounts are associated with Ympactus operations and the remaining 2,000,000 User Accounts had no activity.

II. FINDING OF EXISTENCE OF PONZI AND PYRAMID SCHEME

51. The Debtors conducted a Ponzi/pyramid scheme, not a legitimate MLMP.

52. Pyramid schemes and Ponzi schemes share many similar characteristics and typically involve unsuspecting participants who are duped into paying money to join the scheme by unscrupulous operators promising extraordinary returns. In contrast to a legitimate investment, however, these types of schemes can only provide the promised returns if the number of participants continues to increase exponentially, as the money from later participants is the sole or primary source available to make payments to existing participants. *Webster v. Omnitrition Int'l, Inc.*, 79 F.3d 776, 781 (9th Cir. 1996); *United States v. Gold Unlimited, Inc.*, 177 F.3d 472, 479 (6th Cir. 1999); *In re First Commercial Mgmt. Grp., Inc.*, 279 B.R. 230, 232

(Bankr. N.D. Ill. 2002); *Rieser v. Hayslip (In re Canyon Sys. Corp.)*, 343 B.R. 615, 630 (Bankr. S.D. Ohio 2006); *Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 531 B.R. 439, 470 (Bankr. S.D.N.Y. 2015).

53. A Ponzi scheme is generally based upon a fraudulent investment opportunity. Typically, investors contribute funds to the organizer who promises a high return. Existing investors are paid their returns almost exclusively from the funds contributed by new investors and not from the legitimate profits of the business. *Bear, Stearns Secs. Corp. v. Gredd (In re Manhattan Inv. Fund Ltd.)*, 397 B.R. 1, 8 (S.D.N.Y. 2007); *Eberhard v. Marcu*, 530 F.3d 122, 132 n.7 (2d Cir. 2008); *accord In re Bernard L. Madoff Inv. Secs. LLC*, 654 F.3d 229, 232 (2d Cir. 2011), *cert. denied*, 133 S. Ct. 25 (2012); *see United States v. Moloney*, 287 F.3d 236, 242 (2d Cir. 2002) (“A Ponzi scheme by definition uses the purportedly legitimate but actually fraudulently obtained money to perpetuate the scheme, thus attracting both further investments and, in many cases, new investors to defraud.”), *cert. denied*, 537 U.S. 951 (2002).

54. Some courts have discussed a four factor test to determine whether a Ponzi scheme exists: 1) deposits were made by investors; 2) the debtor conducted little or no legitimate business operations as represented to investors; 3) the purported business operation of the debtor produced little or no profits or earnings; and 4) the source of payments to investors was from cash infused by new investors. *Armstrong v. Collins*, 2010 WL 1141158, at *22 (S.D.N.Y. Mar. 24, 2010)(quoting *Forman v. Salzano (In re Norvergence, Inc.)*, 405 B.R. 709, 730 (Bankr. D.N.J. 2009)(quoting *In re Canyon Sys. Corp.*, 343 B.R. at 630); *accord Carney v. Lopez*, 933 F. Supp. 2d 365, 379 (D. Conn. 2013); *Wiand v. Waxenberg*, 611 F. Supp. 2d 1299, 1312 (M.D. Fla. 2009); *Kapila v. TD Bank, N.A. (In re Pearlman)*, 440 B.R. 900, 904 (Bankr. M.D. Fla. 2010); *Floyd v. Dunson (In re Ramirez Rodriguez)*, 209 B.R. 424, 431 (Bankr. S.D. Tex. 1997).

55. Other courts have identified badges that weigh in favor of finding a Ponzi scheme, including the absence of any legitimate business connected to the investment program, the unrealistic promises of low risk and high returns, commingling of investor money, the use of agents and brokers that are paid high commissions to perpetuate the scheme, misuse of investor funds, the “payment” of excessively large fees to the perpetrator and the use of false financial statements. *See In re Dreier LLP*, 2014 WL 47774, at p. 9 (Bankr. S.D.N.Y. 2014). These badges are, however, merely characteristics of many Ponzi schemes but a Ponzi scheme can exist without all of them. *Id.* At bottom, the label Ponzi scheme applies “to any sort of inherently fraudulent arrangement under which the debtor-transferor must utilize after-acquired investment funds to pay off previous investors in order to forestall disclosure of the fraud.” *In re Manhattan Inv. Fund*, 397 B.R. at 12 (quoting *Bayou Superfund v. WAM Long/Short Fund II, L.P. (In re Bayou Group, LLC)*, 362 B.R. 624, 633 (Bankr. S.D.N.Y. 2007) (“*Bayou I*”)); *see Armstrong*, 2010 WL 1141158 at * 23 (“[E]ven assuming Yagalla did not promise or represent high rates of return, this does not mean that he was not running a Ponzi scheme. ‘Case law has revealed that a clever twist on the Ponzi concept will not remove a fraudulent scheme from the definition of Ponzi.’”) (quoting *In re Norvergence*, 405 B.R. at 730).

56. A pyramid scheme is generally characterized by a participant’s payment to an MLMP operator in return for which participants receive the right to sell a product and the right to receive rewards for recruiting other participants substantially unrelated to the sale of product to ultimate users. *Webster*, 79 F.3d at 781 (quoting *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106 (1975)).

57. A pyramid scheme is a type of Ponzi scheme in that, in both instances, the scheme can only be sustained by the continued influx of new investors/participants to fund amounts

needed to be paid to earlier investors/participants. A Ponzi scheme generally involves only a direct, linear relationship between the owner of the scheme and the investors. The pyramid scheme, however, has two additional elements: the ostensible right to sell a product, and the payment to participants for the recruitment of new participants, thereby creating the pyramid structure.

58. An MLMP is a direct sales strategy in which members are compensated not only for sales the members generates, but also for the sales generated by other members that they recruit. Whether an MLMP operates as a pyramid scheme is determined by how it functions in practice. *Whole Living*, 344 F. Supp. 2d at 745. A lawful MLMP is distinguishable from a pyramid scheme in that the primary purpose of the enterprise and its associated individuals is to sell or market an end-product to end-consumers, and not to reward associated individuals for the recruitment of more participants. *Federal Trade Commission v. SkyBiz.com, Inc.*, 2001 WL 1673645, at *28 (N.D. Okla. Aug. 31, 2001).

59. The Debtors' compensation scheme had elements of both a Ponzi and pyramid scheme.

60. Participants who purchased an Ad Central or Ad Central Family Plan received the right to generate commissions for the sale of certain VoIP Packages but also were able to receive exceedingly high returns on their investments merely by placing meaningless, pre-drafted advertisements on selected websites without the requirement of selling any product. This guaranteed return on initial investment is a hallmark of a Ponzi scheme.

61. Participants who purchased the AdCentral Plan became entitled to receive a VoIP Package each week by placing one internet advertisement per day. These VoIP Packages could be, and routinely were, converted into credits with TelexFree for \$20 weekly for 52 weeks, for a

207% return on the initial investment of \$339. Participants who purchased the more expensive AdCentral Family Plan for \$1,425 were entitled to receive five additional VoIP Packages each week by placing five internet advertisements per day. These VoIP Packages could be, and routinely were, converted into credits with TelexFree for \$100 weekly for 52 weeks, for a return of 265% on the initial investment.

62. The repetitive posting of internet advertisements (which were reportedly supplied by the Debtors) served no legitimate purpose, because anyone who used “telexfree” as an internet search term would be led to the Debtors’ own website; the repetitive posting of similar advertisements had no discernable value. For example, one website, Adpost.com, contained more than 33,000 postings submitted by Participants for TelexFree, while another, ClassifiedsGiant.com, contained more than 25,000 postings

63. The credits issued to Participants for placing advertisements were not reasonable compensation for performance of legitimate services. Participants did not draft the advertisements or perform any design services for their configuration, and the placing of the ads could be, and often was, outsourced to third parties for a nominal fee. The requirement of posting advertisements to receive weekly payments was intended to obfuscate the true nature of the scheme – that the credits were a disguised, “guaranteed” return on the Participant’s initial investment.

64. The guarantee of an astronomical return on the initial investment without the requirement to sell any product created perverse incentives for Participants. Participants opened multiple User Accounts for the sole purpose of leveraging their fictitious profits, without the need to sell any product or recruit any individuals. Some Participants appear to have invested a substantial portion of their life savings into the scheme seeking to quickly triple or quadruple

their investment. Participants opened hundreds of User Accounts, ultimately resulting in an exponential rise in the number of User Accounts.

65. Participants who opened multiple User Accounts on their own behalf could generate credits by essentially recruiting themselves. Participants could receive (1) \$20 worth of credits for recruitment of an AdCentral Plan member and \$100 in credits for recruitment of an AdCentral Family Plan member, and (2) \$20 in credits for each membership plan in one's downline, up to a maximum of \$440 in credits, so long as that Participant recruited two new User Accounts in his/her downline by either opening User Accounts in his/her own name or by recruiting new Participants.

66. While there were certain provisions of the Debtors' MLMP that ostensibly required the sale of VoIP Packages as a requirement for receiving credits with TelexFree, the credits that could be generated for those activities were relatively insignificant and the requirements were easily circumvented by Participants.⁷

67. The Debtors had \$360,000,000 in actual cash sales during the two year operation of the scheme. Of this amount, approximately \$353,000,000 was from the sale of membership plans and \$6,600,000 was from the sale of VoIP Packages. Even more remarkably, seventy-seven percent (77%) of these sales occurred in the six weeks before the filing in a belated attempt by the Debtors to fix their fatally flawed plan by ostensibly requiring the sale of VoIP Packages to receive bonuses and commissions in the future.

68. By and large, the few VoIP Packages that were sold were not used. Of the \$6,600,000 in VoIP Package cash sales, less than one percent (1%) of available minutes

⁷ While certain commissions required activation of VoIP Packages in a Participant's downline, this requirement was circumvented by the purchase of VoIP Packages with accumulated credits. Credits were also issued for the sale of standalone VoIP Packages but, as discussed above, VoIP Packages were rarely sold to third parties.

contained in these packages were actually utilized, further demonstrating that the Debtors were not operating a bona fide MLMP and the VoIP Packages were not a legitimate product.⁸

69. A pyramid scheme exists where payments to participants are based upon recruitment of additional participants, largely or wholly unrelated to product sales. *See Webster*, 79 F.3d at 782 (MLMP which is based principally on recruitment of new participants, as opposed to sale of the end product or service, and where product sales are an insignificant portion of the enterprise's total revenues, constitutes a pyramid scheme); *Gold Unlimited, Inc.*, 177 F.3d at 481 (company grossed \$552,620 from sales of products yet took in \$43,000,000); *Stull v. YTB Int'l, Inc.*, 2011 WL 4476419, at *5 (S.D. Ill. Sept. 26, 2011) (approximately 73% of cash receipts were from membership fees and not from the sales of product); *Federal Trade Commission v. Burnlounge, Inc.*, 753 F.3d 878, 888 (9th Cir. 2014)(existence of negligible amount of sales unrelated to commission opportunity does not negate evidence that commissions were the primary draw of the scheme); *In re Holiday Magic, Inc.*, 84 F.T.C. 748, 1028-30 (1974)(pyramid scheme existed where rewards were paid to participants when they recruited others, and recruits also had to purchase product).

70. The total reliance on the sale of membership plans, as opposed to the sale of a legitimate product, made the collapse of the Debtors' scheme inevitable, which is perhaps the chief hallmark of a Ponzi/pyramid scheme. *Webster*, 79 F.3d at 781; *United States v. Grasso*, 173 F. Supp. 2d 353, 357 (E.D. Pa. 2001)(all Ponzi and pyramid schemes are destined to collapse

⁸ This estimate is based upon joint usage of the Debtors' and Ympactus' VoIP service for the period July 2012 through June 2013 as well as usage of only the Debtors' VoIP service from July 2013 to April 2014. Ernst & Young ("E&Y"), the consultants retained by the court in the Brazilian action, made similar findings as to use of the VoIP Packages. As part of its 220 page report issued in February 2015, E&Y also found that for the period July 2012 to June 2013, less than one percent of total VoIP Package minutes sold were actually used.

because of saturation which is the point at which investments by later participants are inadequate to sustain the scheme).

71. A calculation of the Debtors' twelve month trailing liability, that is, the amount that would be owed to Participants in the following year on account of the guaranteed return, further evidences the unsustainability of the scheme. This liability grew exponentially in the year prior to the Petition Date, eventually rising to more than \$5,000,000,000 as of the Petition Date. Attached as Exhibit 2 to the *Darr Affidavit* is a computation of the 12 month trailing liability as of the Petition Date. This trailing liability more than tripled in the five (5) months leading up to the Chapter 11 filings, far outpacing any cash generated from the sale of VoIP Packages.⁹ The \$5,000,000,000 trailing liability is more than seven hundred times the \$6,600,000 in cash receipts from the sale of VoIP Packages since inception of the Debtors' MLMP. The sale of additional membership plans only deepened the insufficiency.¹⁰ The unsustainability of the Debtors' MLMP is another hallmark of a Ponzi and pyramid scheme. *See Kerrigan v. ViSalus, Inc.*, 2015 WL 3679266, at *8 (E.D. Mich. June 12, 2015); *Webster*, 79 F.3d at 782; *People v. Sweeney*, 228 Cal. App. 4th 142, 152 (Oct. 15, 2014); *see also Wiand v. Lee*, 753 F.3d 1194, 1201 (11th Cir. 2014)(fact that compensation under an MLMP is almost completely dependent upon membership fees paid by new participants, and not from product sales, is a hallmark of a Ponzi/pyramid scheme).

⁹ While one provision of one version of the Participant contracts ostensibly did not require the Debtors to redeem VoIP Packages issued to Participants, this contractual provision is completely undermined by the unequivocal statements in marketing materials and the Debtors' actual practice of paying the guaranteed return on investment without the need to sell any product.

¹⁰ In its report, E&Y similarly found that the TelexFree MLMP was unsustainable. E&Y prepared income and loss projections for TelexFree over a thirty-six (36) month period using various assumptions. The projections reflect that under each set of assumptions, the projected payouts exceed projected revenue from the sale of product, in many instances by \$4,000,000,000 to \$5,000,000,000 over the 36 month term.

III. BECAUSE THE DEBTORS OPERATED A PONZI/PYRAMID SCHEME, CLAIMS FOR ACCUMULATED CREDITS SHOULD BE DISALLOWED.

72. The accumulated credits held by Participants in their User Accounts as of the Petition Date should not form the basis of allowed claims in these cases.

73. Claims based on the accumulated credits should be disallowed because, in a Ponzi/pyramid scheme, investors who had no knowledge that the scheme was fraudulent are generally entitled to a claim only for the net amounts invested in the scheme and not for fictitious profits.¹¹ See *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d at 242; *Donell v. Kowell*, 533 F.3d 762, 772 (9th Cir. 2008); *SIPC v. BLMIS*, 499 B.R. 416, 424-29 (S.D.N.Y. 2013); compare *In re Churchill Mortgage Inv. Corp.*, 256 B.R. 664, 682 (Bankr. S.D.N.Y. 2000); *In re First Commercial Mgmt Grp.*, 279 B.R. at 232; with *Bayou I* at 637-38; *In re Randy*, 189 B.R. 425, 441 (Bankr. N.D. Ill. 1995); *In re Int'l Loan Network, Inc.*, 160 B.R. 1, 12 (Bankr. D.D.C. 1993); see also *Janvey v. Golf Channel, Inc.* 780 F.3d 641 (5th Cir. 2015) (vacated and certified to the Supreme Court of Texas on this issue, *Janvey v. Golf Channel, Inc.*, 792 F.3d 539 (5th Cir. 2015), *certified question accepted* (July 17, 2015)); *Janvey v. Alguire*, 2013 WL 2451738 at *9 (N.D. Tex. 2013); *SEC v. Bernard L. Madoff Investment Securities, LLC (In re Madoff)*, 522 B.R. 41, 47 (Bankr. S.D.N.Y. 2014) (“*BLMIS II*”); *In re Taubman*, 160 B.R. 964, 980 (Bankr. S.D. Ohio 1993); *In re Bayou Grp., LLC*, 439 B.R. 284, 309 (S.D.N.Y. 2010) (“*Bayou II*”).

74. Innocent investors have claims against Ponzi/pyramid schemes based in tort under the theories of rescission and restitution for the amounts they were fraudulently induced to invest. *Scholes v. Lehmann*, 56 F.3d 750, 757 (7th Cir. 1995); *Bayou II* at 309; see also *In re Int'l Mgmt. Assoc., LLC, et al.*, 2009 WL 6506657 at *9 (Bankr. N.D. Ga., Dec. 1, 2009). These

¹¹ This motion seeks a determination that accumulated credits as of the Petition Date should not be considered in calculating allowed claims. Aside from the disallowance of credits, the transactions that should be included in the calculation of Participants' allowed claims in these cases will be subject to separate determination of the Court.

tort claims should be reduced by amounts the Participants received from the scheme. *See In re M & L Bus. Mach. Co.*, 84 F.3d 1330, 1341 (10th Cir. 1996); *In re United Energy Corp.*, 944 F.2d 589, 595 (9th Cir. 1991); *In re Bernard L. Madoff Inv. Sec. LLC*, 424 B.R. 122 (Bankr. S.D.N.Y. 2010).

75. Innocent investors in a Ponzi/pyramid scheme should not have a claim for interest or profits beyond their initial investment because such claims are based on the fictitious profits of the scheme. *BLMIS I* at 427-29; *BLMIS II* at 47; *Scholes* 56 F.3d at 757.

76. The accumulated credits based on the posting of meaningless advertisements are equivalent to the fictitious profits promised in Ponzi schemes. The Participants were guaranteed an astronomical return by merely purchasing a membership plan and posting internet advertisements reportedly supplied by the Debtors. Participants were not required to sell a product to receive payment. Accordingly, claims based on the accumulated credits for the posting of advertisements should be disallowed. *See BLMIS I* at 427-29; *BLMIS II* at 47; *Scholes* 56 F.3d at 757; *M & L Bus. Mach. Co.*, 84 F.3d at 1341.

77. The accumulated credits based on the recruitment of later Participants should also be disallowed because the recruitment activity only contributed to and perpetuated the Debtors' scheme and provided no value to the Debtors' estates. 11 U.S.C. § 502(b)(1); *See In re Vaughan Co. Realtors*, 500 B.R. 778, 794 (Bankr. D.N.M. 2013); *Warfield v. Byron*, 436 F.3d 551, 560 (5th Cir. 2006); *In re Taubman*, 160 B.R. at 980; *Janvey*, 2013 WL 2451738 at *9; *Randy*, 189 B.R. at 441; *In re Independent Clearing House Co.*, 77 B.R. 843, 857 (Bankr. D. Utah 1987).

78. While value arguably may be provided by an innocent third party providing legitimate services to a Ponzi/pyramid operator for a reasonable fee, such is not the case here. Rather, credits that were issued to Participants for recruiting others into the scheme only

perpetuated it and deepened the pool of defrauded investors. *Compare In re Churchill Mortgage Inv. Corp.*, 256 B.R. at 682; *First Commercial Mgmt Grp.*, 279 B.R. at 232; with *Bayou I* at 637-38; *Randy*, 189 B.R. at 438-39; *In re Int'l Loan Network, Inc.*, 160 B.R. at 12; see also Janvey, 780 F.3d at 641.

79. Because the Debtors received no value for the accumulated credits, claims based on such credits should be disallowed. See 11 U.S.C. §502(b)(1); *Independent Clearing House*, 77 B.R. at 857; *Warfield*, 436 F.3d at 560; *Johnson v. Home State Bank*, 501 U.S. 78, 86, 11 S.Ct. 2150, 2155 (1991); *In re Muller*, 479 B.R. 508, 515 (Bankr. W.D. Ark. 2012).

80. Claims based on the accumulated credits should also be disallowed on equitable grounds, which are applicable in resolving claims allowance and distribution issues in Ponzi and pyramid scheme cases. See *Cunningham v. Brown*, 265 U.S. 1(1924); *Abrams v. Eby (In re Young)*, 294 F. 1, 4 (4th Cir. 1923); *In re Taubman*, 160 B.R. at 980; *Int'l Loan Network*, 160 B.R. at 14; *BLMIS II* at 47.

81. Equity requires the disallowance of claims for accumulated credits because these credits could only be satisfied from amounts paid by later Participants and not from earnings of the enterprise or from the sale of product. See *In re Taubman*, 160 B.R. at 980; *BLMIS I* at 427-29.

82. In reality, there are no profits to be paid out of such a scheme. *In re Young*, 294 F. at 4. As one court put it, “if a person invests money with the understanding that he will share in the profits produced by his investment, and it turns out that there are no profits, it is difficult to see how that person can make a claim to receive any more than the return of his principal investment.” *Lustig v. Weisz & Assoc., Inc.*, 2002 WL 32500567 at *8 (June 21, 2002 W.D.N.Y.).

83. When a Ponzi or pyramid scheme collapses, insufficient funds remain to make distributions to later investors equal to the principal amounts they invested, such that recognition of claims for false profits would be inequitable to investors who have not and will not recover their principal investment. *In re Taubman*, 160 B.R. at 980.

84. Recognizing claims based on the accumulated credits would result in favoring Participants who were involved early in the scheme over those that invested later, since the earlier Participants had more time to accumulate the credits. *See In re Young*, 294 F. at 4 (recognizing that allowing a claim for both false profits and the original investment would not be equitable as profits had come at the expense of innocent investors). The Court should therefore disallow the claims based on the accumulated credits under its equitable powers. *Id.*; *see also Official Cattle Contract Holders Comm. v. Commons (In re Tedlock Cattle Co.)*, 552 F.2d 1351, 1353 (9th Cir. 1977).

85. Accordingly, any claim or portion of claim of Participants based upon the accumulated credits in Participants' User Accounts as of the Petition Date should be disallowed.

IV. COMPUTATION OF NET ALLOWED CLAIM OF PARTICIPANTS

86. In resolving claims and distribution issues in Ponzi and pyramid scheme cases, equitable considerations need to be taken into account to properly address the harms suffered by participants in the scheme. *See Cunningham*, 265 U.S. at 13 (all investors in a Ponzi scheme must be treated equally and that "equality is equity and this is the spirit of the bankrupt law"); *In re Young*, 294 F. at 4; *In re Taubman*, 160 B.R. at 980; *Int'l Loan Network*, 160 B.R. at 14; *BLMIS II* at 47. In order to fashion an equitable result, claims in such cases are determined based upon a "Net Equity" analysis, that is, the allowed claim is equal to amounts that a participant paid into the scheme, reduced by amounts a participant received from the scheme.

See, e.g., CFTC v. Topworth Int'l Ltd., 205 F.3d 1107, 1115-16 (9th Cir. 2000); *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d at 242; *Donell*, 533 F.3d at 772; *In re Tedlock Cattle Co.*, 552 F.2d at 1353; *In re Young*, 294 F. at 4; *BLMIS I* at 427-29; *Janvey*, 2013 WL 2451738 at *9; *Bayou II* at 309; *BLMIS II* at 47; *In re Old Naples Sec., Inc.*, 311 B.R. 607, 616-17 (M.D. Fla. 2002). The transfers between a Participant and the Debtors must therefore comprise one component of the Net Equity determination.

87. The Debtor's scheme has elements of both a Ponzi scheme and a pyramid scheme. It is a Ponzi scheme in that Participants were guaranteed an exorbitant return on their initial investment, without the need to sell any product, which was funded from the fees paid by later Participants (since the Debtors had no legitimate business operations or earnings). *See e.g. In re Manhattan Investment Fund Ltd.*, 397 B.R. at 8; *Eberhard* 530 F.3d at 132 n.7; *accord In re Bernard L. Madoff Inv. Secs. LLC*, 654 F.3d at 232. It is a pyramid scheme in that Participants had the right to receive commissions for recruiting Participants and to retain membership fees paid by those Participants. *See e.g. Whole Living*, 344 F. Supp. at 745. The Debtors created an artificial currency in the form of the VoIP Packages and credits. The principal vehicle for monetizing those credits was through the recruitment of Participants and the implementation of Triangular Transactions. Accordingly, the Triangular Transactions need to be taken into account in determining Net Equity.

88. In determining Net Equity, the recruited Participant should have a claim recognized in the bankruptcy cases for the amounts advanced to a recruiting Participant in a Triangular Transaction. Recognition of this claim is necessary to achieve an equitable result. A substantial number of those who joined the Debtors' scheme did so through participation in Triangular Transactions. The claims of these Participants should be treated the same as the

claims of Participants who paid their membership fees to the Debtors. Those later Participants who invested in the Debtors through Triangular Transactions were often at the bottom of the pyramid and were the least likely to know of the suspect nature of the Debtors' scheme.

Equitable considerations require recognition of those claims to achieve a just result.

Cunningham, 265 U.S. at 13.

89. Recognition of the claim of the later Participant in a Triangular Transaction necessitates that the claim of the earlier Participant be reduced for amounts paid to him/her by the later Participant. Otherwise, the Triangular Transaction would result in an increase in aggregate claims against the Debtors' estates even though the membership fees were retained by the recruiting Participant. If the recruiting Participant's claim is not so reduced, the calculation of the recruiting Participant's Net Equity will be overstated, thereby diminishing the recovery for other Participants. This obviously results in an inequitable outcome, perverts the distribution process, and disregards the mechanics of the scheme.

90. Recognizing the Triangular Transactions in the calculation of Net Equity of a Participant who used accumulated credits to purchase new membership plans for himself/herself through multiple User Accounts achieves a fair result as well. No cash was exchanged through these intra-Participant transactions, and there should be no claim in the bankruptcy estate on account of them. The Participant's claim for the purchase of a membership plan in one User Account will be offset by the reduced claim in the other User Account.

91. Recognizing the claim of later Participants and reducing the claim of earlier Participants reflects the economic realities of the Triangular Transactions. The substance of a transaction should prevail over its form when determining how the transaction relates to the rights of parties in a bankruptcy case. *See, e.g., In re PCH Assocs.*, 949 F.2d 585, 597 (2d Cir.

1991) (*citing Pepper v. Litton*, 308 U.S. 295, 304 (1939)); *In re Adelphia Communications Corp.*, 512 B.R. 447 (Bankr. S.D.N.Y. 2014)(series of transactions may be treated as single transaction when it appears that, despite formal structure erected and labels attached, the segments comprise a single integrated scheme when considering knowledge and intent of parties involved in transaction).

92. The collapsing of transactions into an integrated transaction has been employed in varying contexts. In the case of leveraged buyouts, payments made by an acquirer to selling shareholders are considered to be transfers of estate property even though the funds were not paid directly by the debtors. *See, e.g., In re Chas P. Young Company*, 145 B.R. 131 (Bankr. S.D.N.Y. 1992); *In re OODC, LLC*, 321 B.R. 128 (Bankr. D. Del. 2005); *United States v. Tabor Court*, 803 F.2d 1288 (3rd Cir. 1986) (*cert. den. McClellan Realty Co. v. United States*, 483 U.S. 1005, 107 S. Ct. 3229 (1987)); *Wieboldt Stores v. Schottenstein*, 94 B.R. 488 (N.D. Ill. 1988); *In re O'Day Corporation*, 126 B.R. 370 (Bankr. D. Mass. 1991); *In re Jevic Holding Corp.*, 2011 WL 4345204 (Bankr. D. Del. 2011). Similarly, payments made by a purchaser of a debtor's assets to certain of the debtor's creditors are considered to have been made from property of the estate when the payment would have otherwise been part of the purchase price for the assets. *See, e.g., Warsco v. Preferred Technical Group*, 258 F.3d 557, 568-69 (7th Cir. 2001); *In re Food Catering & Housing, Inc.*, 971 F.2d 396 (9th Cir. 1992). The same rationale applies for collapsing the components of the Triangular Transaction to reflect the economic realities of the Debtors' scheme.

93. Collapsing the Triangular Transactions into one justifies the inclusion of the Triangular Transactions in the determination of Net Equity because the membership fees exchanged between Participants constituted property of the estate. The definition of property of

the bankruptcy estate is broad, encompassing all legal or equitable interests of the Debtors in property as of the commencement of the case. *See 11 U.S.C. §541; United States v. Whiting Pools Inc.*, 462 U.S. 198, 205 n. 9 (1983); H.R. Rep. No. 95-595 p. 367 (1977); S. Rep. No. 95-989, P. 82 (1978), U.S. Code Cong. & Admin. News 1978, pp. 5869, 6323. In the Triangular Transaction, the later Participant effectively paid the membership fee to the Debtors and the Debtors became liable to the later Participant for the guaranteed return. For the reasons set forth, the later Participant should have a claim in the bankruptcy cases for the amount of the membership fee. The Debtors, in turn, effectively paid the membership fee to the recruiting Participant in exchange for the redemption of credits. This payment by the Debtors to the recruiting Participant requires the reduction of the recruiting Participant's claim. To the extent recruiting Participants received more from the scheme than they invested, the Bankruptcy Code's avoidance actions provide the method to ensure equality of distribution among Participants.

94. Based upon the foregoing, the Net Equity claim of Participants should be determined as follows: the amount invested by the Participant into the Debtors' scheme, including amounts paid by the Participant pursuant to the Triangular Transactions, less amounts received by the Participant from the Debtors' scheme, including amounts received by the Participant pursuant to the Triangular Transactions.

95. The Net Equity determination will be made on a User Account basis. Many Participants appear to have maintained multiple User Accounts. In these circumstances, determination of the Net Equity for a Participant will require an aggregation of the transactions for such Participant in all of his/her User Accounts to ensure that all activity associated with that Participant has been accounted for.

V. THE DEBTORS ARE JOINTLY LIABLE FOR PARTICIPANT CLAIMS

96. The Debtors worked in concert with one another to develop, market, and operate their Ponzi and pyramid scheme. The Debtors had common ownership and each was controlled by Wanzeler and Merrill, as well as Carlos Costa at least through his alleged separation from the Debtors in the fall of 2013.

97. Each of the Debtors was intimately involved in the scheme. Common Cents Communications, Inc., which was owned and controlled by Wanzeler, Merrill, and Steven Labriola, changed its name to TelexFree, Inc. in early 2012 in conjunction with the marketing and selling of VoIP Packages through the Debtors' MLMP. Shortly thereafter, in July 2012, TelexFree, LLC was formed, to conduct TelexFree's operations outside of Massachusetts.

98. TelexFree, Inc. and TelexFree, LLC worked collaboratively in furtherance of the scheme throughout 2012 and 2013, including joint marketing efforts, promotional materials, and Participant recruitment events. TelexFree, Inc. and TelexFree, LLC alternated responsibility for maintaining bank accounts, because on multiple occasions TelexFree was asked to close accounts with banks because of suspicious account activity.

99. The concerted actions of the Debtors in developing, marketing, and operating the Ponzi and pyramid scheme renders them jointly and severally liable for the claims of Participants. *See Aetna Cas. Sur. Co. v. P&B Autobody*, 43 F.3d 1546, 1564 (1st Cir. 1994)(joint tortfeasors can be vicariously liable for the acts of one another if there exists concerted action to commit the torts; liability requires first, "a common design or an agreement between two or more persons to do a wrongful act and, second, proof of some tortious act in furtherance of the agreement." *Id.*; *Restatement (Second) of Torts* §876 cmt. b (1977).

100. After the seizure and shutdown of Ympactus by the Brazilian authorities, TelexFree, LLC and TelexFree, Inc. saw a substantial increase in activity, which further exacerbated difficulties with banking facilities needed to conduct the TelexFree scheme. TelexFree Financial, Inc. was formed in Florida in December 2013 and opened bank accounts and paid expenses of TelexFree, Inc. and TelexFree, LLC. In late 2013, TelexFree, Inc. and TelexFree, LLC transferred more than \$4,000,000 to an account at TelexFree Financial. TelexFree Financial deposited an additional \$10,000,000 in membership fees and VoIP Package sales in February 2014. The only Debtor with employees was TelexFree, Inc. and these employees were being paid by TelexFree Financial.

101. TelexFree Financial rendered substantial assistance to TelexFree, LLC and TelexFree, Inc. in furtherance of the Ponzi and pyramid scheme and is therefore also jointly liable to Participants as a joint tortfeasor. *See Kurker v. Hill*, 44 Mass. App. Ct. 184, 189 (Mass. App. 1998)(joint tortfeasor liability, also referred to as civil conspiracy, arises when a party knows that the “conduct [of another person] constitutes a breach of duty and gives substantial assistance or encouragement to the other to so conduct himself.” TelexFree Financial, being under common ownership with TelexFree, LLC and TelexFree, Inc. had full knowledge of the actions being perpetrated by the other Debtors. *Kurker*, 44 Mass. App. Ct. at 189; *Kyte v. Philip Morris Inc.*, 408 Mass. 162 (1990); *Stock v. Fife*, 13 Mass. App. Ct. 75, 82 (Mass. App. 1982)(key to joint tortfeasor liability is the rendering of substantial assistance, with the knowledge that such assistance is contributing to a common tortious plan.)

102. The Debtors had a common design or agreement to commit a wrongful act, which was the establishment and implementation of the Ponzi and pyramid scheme. Because the

Debtors engaged in a common enterprise to further their tortious plan, the Debtors are jointly and severally liable for the allowed claims of Participants.

103. Inasmuch as the Debtors are jointly and severally liable for the claims of Participants, the Bar Date Motion proposes that Participants submit only one Participant ePOC, which shall constitute a claim against all three of the Debtors' estates. The Bar Date Motion does propose that non-Participants file a separate Standard ePOC for each Debtor against whom a claim is asserted.

104. A finding of joint and several liability for the claims of Participants does not effect a substantive consolidation of the Debtors' estates. Grounds may exist for the Trustee to seek substantive consolidation of the Debtors' estates and the Trustee reserves the right to seek same. In the event of substantive consolidation, Participants having submitted a Participant ePOC will have a single claim against the consolidated estate.

V. NOTICE

105. The Trustee has filed simultaneously herewith the Notice Motion to prescribe the form and manner for providing notice of the Ponzi Motion to interested parties.

WHEREFORE, the Trustee respectfully requests that this Court enter an Order:

- (i) Finding that the Debtors operated a Ponzi and pyramid scheme;
- (ii) Ordering that any claim or portion of claim of Participants based upon accumulated credits in Participants' User Accounts as of the Petition Date shall be disallowed, and that claims should be determined on a "Net Equity" basis as described herein;
- (iii) Ordering that the Debtors shall be jointly and severally liable for the claims of Participants;

- (iv) Ordering that the findings made pursuant to this Motion shall be applicable throughout these proceedings, for all purposes; and
- (v) Granting such other and further relief as this Court finds just and proper.

STEPHEN B. DARR,
CHAPTER 11 TRUSTEE,

By his attorneys,

/s/ Andrew G. Lizotte

Harold B. Murphy (BBO #362610)

Andrew G. Lizotte (BBO #559609)

Murphy & King, Professional Corporation

One Beacon Street

Boston, MA 02108

Telephone: (617) 423-0400

Facsimile: (617) 423-0498

Email: ALizotte@murphyking.com

Dated: October 7, 2015
696114

EXHIBIT A

)	
In Re:)	
)	Chapter 11
)	
TELEXFREE, LLC ,)	Case No. 14-40987-MSH
TELEXFREE, INC.,)	Case No. 14-40988-MSH
TELEXFREE FINANCIAL, INC.,)	Case No. 14-40989-MSH
)	
Debtors.)	Jointly Administered
)	

I, Stephen B. Darr, hereby submit the following affidavit in support of the *Motion by Chapter 11 Trustee for Entry of Order Finding that Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* (the “Ponzi Motion”).

1. I am the duly appointed Chapter 11 trustee (the “Trustee”) in these cases, having been appointed by order of the Court dated June 6, 2014.

1

I. CASE BACKGROUND AND PROCEDURAL POSTURE

6. The Debtors initially operated as debtors-in-possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code.

8. Prior to the filings, the Commonwealth of Massachusetts, Office of Secretary of State, Securities Division (“MSD”) commenced an investigation into the Debtors’ business practices.

9. On or about April 15, 2014, the MSD commenced an administrative proceeding against the Debtors. Also on April 15, 2014, the Securities and Exchange Commission (“SEC”) commenced an action against the Debtors and others in the United States District Court for the District of Massachusetts. The foregoing actions alleged, among other things, that the Debtors were engaged in an illegal Ponzi/pyramid scheme and the fraudulent and unregistered offering of securities. Substantially contemporaneously with the commencement of the SEC action, Homeland Securities Investigation (“HSI”) seized the Debtors’ assets, books, and records. In connection therewith, the federal government seized more than \$107,000,000 in cash, including checks payable to the Debtors, their principals, or their affiliates. Federal authorities have also made forfeiture claims against approximately forty (40) other items of real and personal property standing in the name of the Debtors’ principals and their affiliates, including automobiles, real properties, and notes secured by mortgages on real properties.

10. On or about April 22, 2014, the Office of the United States Trustee filed a motion for the appointment of a Chapter 11 Trustee based upon the allegations of illegal activity.

11. On April 23, 2014, the SEC filed a motion to transfer venue of the cases to the United States Bankruptcy Court for the District of Massachusetts (the “Court”). By order dated May 6, 2014, the motion to change venue was approved. The cases were transferred to the Court on May 9, 2014.

12. On May 30, 2014, this Court allowed the United States Trustee’s motion to appoint a Chapter 11 trustee, and I was appointed on June 6, 2014.

13. The Debtors filed only a list of the alleged thirty (30) largest creditors in the cases and did not file schedules or statements of financial affairs, nor a matrix of creditors.

14. On February 27, 2015, I filed schedules of assets and liabilities and statements of financial affairs for each of the Debtors, using information obtained from documents produced pursuant to Rule 2004 examinations and Debtor records provided by the Federal Authorities (as defined below).

15. Carlos Wanzeler and James Merrill were the Debtors' principals along with Carlos Costa, at least through his alleged separation with the Debtors in the fall of 2013. Shortly after the Trustee was appointed, the United States Department of Justice ("DOJ" and, together with the SEC and HSI, the "Federal Authorities") indicted Wanzeler and Merrill based upon their involvement in the Debtors' scheme. Wanzeler has fled the country and, upon information and belief, is in Brazil. Merrill was initially detained and has been released pending trial.

16. On February 3, 2015, I submitted a comprehensive Status Report on outstanding matters in the cases. The Status Report set forth, among other things, the background of the Debtors and their affiliates, the breadth and scope of the scheme, assets recovered to date and potential additional sources of recovery, as well as efforts at coordination with governmental authorities, both in the United States and in Brazil.

17. Prior to my appointment, the Federal Authorities shut down, disconnected, and seized the Debtors' computer system, which consisted of forty-six (46) computers and servers containing more than twenty (20) terabytes of data. Accordingly, at the time of my appointment, I did not have access to any of the Debtors' records. Neither of the Debtors' principals has been available because Wanzeler fled the country and Merrill had been indicted and detained. I have had only had limited access to the Debtors' former employees.

18. Initially without access to the Debtors' books and records, I have utilized a variety of resources to acquire information regarding the Debtors' activities and the mechanics of their scheme.

19. I directed counsel to file motions for authority to obtain documents from, and conduct examinations of, twenty-nine (29) separate entities pursuant to Federal Rule of Bankruptcy Procedure 2004 (the "2004 Motions").¹ The deponents of the 2004 Motions included prepetition and postpetition professionals retained by the Debtors, financial institutions who had prepetition and/or postpetition relationships with the Debtors, multiple firms who provided payment processing services to facilitate payments between the Debtors and Participants, and firms who provided consulting services to the Debtors or who otherwise were believed to have had business relationships with the Debtors.

20. I have also conducted or supervised informal interviews of certain former employees and consultants of the Debtors as well as several Participants.

A. Mechanics of Scheme and Methods of Compensation

21. The Debtors purported to be in the business of selling a voice over internet service, or "VoIP" that cost \$49.90 per month to conduct international phone calls. The sale of VoIP on a monthly basis is hereinafter referred to as a "VoIP Package". Customers who purchased the VoIP Package registered their phone numbers with the Debtors and received software that enabled their computers to place phone calls through the Debtors' computer servers in Marlborough, Massachusetts to approximately 40 countries.

22. The Debtors ostensibly used a multi-level marketing plan, or "MLMP", to sell the VoIP Packages.

¹ To date, I have deferred conducting depositions of the 2004 Motion deponents, as the focus has been on retrieving and examining documents and conducting informal interviews.

23. Until they purported to change their MLMP in March 2014, the Debtors provided Participants with two options to become members and to thereby open User Accounts:

- a. “AdCentral Plan”: \$339 for a one-year contract (\$50 membership fee plus \$289 contract fee). This contract entitled the User Account holder with the right to sell ten VoIP Packages, as to which a Participant could receive a commission if the packages were sold, although there was no sale requirement. Participants were required to place one internet ad per day and, for each week in which the Participant placed the required ads, he/she was entitled to one additional VoIP Package, which could be sold or exchanged for \$20 in credits with the Debtors. Thus, Participants who posted the required ads were eligible to receive \$20 per week for 52 weeks, for a total return of \$1,040 (a return of 207% on the investment of \$339).
- b. “AdCentral Family Plan”: \$1,425 for a one-year contract (\$50 membership fee plus \$1,375 contract fee). This contract entitled the User Account holder with the right to sell fifty VoIP Packages, as to which a Participant could receive a commission if the packages were sold, although there was no sale requirement. Participants were required to place five internet ads per day and, for each week in which the Participant placed the required ads, he/she was entitled to five additional VoIP Packages, which could be sold or exchanged for \$100 in credits with the Debtors. Thus, the Participants who posted the required ads were eligible to receive \$100 per week for 52 weeks, for a total return of \$5,200 (a return of 265% on the investment of \$1,425).

24. In addition to credits for posting these advertisements, the Debtors issued credits to Participants for the sale of membership plans and the establishment of new User Accounts as follows:

- a. \$20 in credits for each new Ad Central Plan and \$100 in credits for each new AdCentral Family Plan in a Participant’s network.
- b. \$20 in credits for each User Account in one’s “network,” up to a maximum of \$440, as long as there were two subsidiary User Accounts.
- c. 2% of all payments to each User Account within one’s network, down to six “levels” of the network, provided that each User Account had a registered VoIP customer.
- d. 2% of the Debtors’ net monthly billing, up to a maximum of \$39,600 in credits, for an AdCentral Family Plan that had ten new AdCentral Family

Plans in its network, so long as each plan had five registered VoIP customers.

25. The Debtors also issued credits to Participants for the sale of VoIP Packages as follows:

- a. 90% (or \$44.90 in credits) for the initial sale of a VoIP Package at \$49.90.
- b. 10% (or \$4.99 in credits) per month for the renewal of a VOIP Package by a User Account holder directly in one's network² and 2% (or \$0.99 in credits) per month for the renewal of a VOIP Package by a User Account holder indirectly in one's network, down to six levels of the network.
- c. 2% from all VoIP Package sales in one's network, down to six levels of the network.

26. The credits issued to Participants for placing advertisements and selling membership plans and VoIP Packages could be redeemed for cash, transferred to another User Account, or applied in satisfaction of an invoice for another User Account.

27. Invoices for the purchase of a membership plan could be satisfied in one of two ways. Participants could pay the invoice in cash directly to the Debtors or Participants could pay a recruiting Participant for the purchase of a membership plan through the recruiting Participant's redemption of credits in an existing User Account.

28. In the case of a Participant satisfying his/her own invoice directly by payment in cash to the Debtors, the process worked, generally, as follows:

- a. The Participant joined the Debtors' organization and created an online account with the assistance of a recruiting Participant, who needed to be identified;
- b. The Debtors' database recorded the details entered by the new Participant and assigned an identification number to the new User Account;
- c. The Debtors recorded the purchase, issued an invoice number, and marked the invoice as 'pending';

² In practice, the Debtors appear to have provided Participants with credits equal to ninety percent (90%) of the renewal fees.

- d. A Participant could pay money directly to the Debtors in the form of cash, check, cashier's check, or wire transfer, or through a third-party online payment processing account. Once the Participant paid the invoice, the Debtors updated the invoice as 'paid', and the account setup would be complete;
- e. The new Participant could then start building a pyramid underneath the newly created User Account by recruiting other Participants (or by purchasing new User Accounts themselves) and generating bonuses and commissions in accordance with the scheme.

29. Alternatively, as described below, a Participant could satisfy his/her own invoice directly by payment in cash to another Participant, who would satisfy the invoice by a redemption of accumulated credits. Thus, the new Participant's membership fee was paid directly to the recruiting Participant, rather than to the Debtors.

30. There are 10,987,617 User Accounts associated with the Debtors' MLMP. A new User Account was generally established each time that a membership plan was purchased, with either cash or accumulated credits.

31. Although some versions of Participant contracts contained prohibitions against Participants opening multiple User Accounts, other plan descriptions did not. In any case, any such restriction was not enforced and could not be enforced since the Debtors did not verify the Participants' identities. The Debtors' MLMP structure created incentives for Participants to open multiple User Accounts to generate commissions for themselves.

32. As noted above, a Participant could monetize accumulated credits by recruiting a new Participant to join the Debtors' scheme and using his/her accumulated credits to satisfy the invoice for the new Participant's membership plan in exchange for payment of the membership fee from the new Participant (a "Triangular Transaction"). In a Triangular Transaction, the Debtors issued the membership invoice to the recruited Participant, the recruited Participant paid

the membership invoice that was due to the Debtors instead to the recruiting Participant, and the Debtors redeemed the credits of the recruiting Participant in satisfaction of the invoice.

33. In a Triangular Transaction, the process generally worked in the same manner outlined above except that:

- a. The new Participant paid the invoice amount to the recruiting Participant (in those cases where there were two separate Participants involved, that is, not an intra-Participant transaction) and forwarded the initial invoice to the recruiting Participant; and
- b. The recruiting Participant, in turn, satisfied the initial invoice with accumulated credits in his/her existing User Account.

34. In fact, it was a regular practice of the Debtors' scheme for membership fees to be paid by the use of accumulated credits rather than by cash.

35. While invoices associated with the sale of membership plans or VoIP Packages had a face value of \$3,073,471,326, only \$359,792,242, or approximately twelve percent (11.7%) of that amount, was paid in cash to the Debtors. The balance of these invoices, totaling \$2,713,679,084, was satisfied by the use of Participants' credits.

36. The Debtors also issued "manual credits" to certain User Accounts in some instances. Manual credits were credits issued to User Accounts unrelated to the purchase of a membership plan and not resulting from the placement of advertisements or other components of the compensation scheme. Although some manual credits may have been issued to User Accounts in exchange for cash payment to the Debtors, a significant amount of manual credits appear to have been issued to certain User Accounts without any payment to the Debtors. There also were exchanges of credits between User Accounts unassociated with the issuance and satisfaction of Debtor invoices.

B. SIG/Back Office

37. The Debtors maintained two computer applications for accessing and processing information from the Debtors' database relating to User Account activity, referred to as "SIG" and the "Back Office".³

38. SIG stands for Sistemas de Informacoes Gerenciais, which is Portuguese and translates roughly to "Information Management System." SIG tracked the activity for Participants by User Account, and the User Accounts are the only records available to confirm Participant activity.

39. Access to SIG was the culmination of a painstaking data recovery and analysis project implemented with the assistance of my professionals and investigators from HSI.

40. Following my appointment and beginning in August 2014, HSI provided copies of electronic information contained in the Debtors' computers and servers. Once all of the data from the Debtors' computers and servers were obtained, I and my team reassembled the system following a multiple step process.

41. The first step involved identification of a key server that appeared to contain much of the Debtors' 'big data'. Extensive testing was then performed to determine the appropriate configurations of the data and to restore the data in a virtual machine environment. Once the physical configuration of the hard drives was determined, the servers were 'virtualized', which was necessary because the Federal Authorities were in possession of the original servers. Additional servers were later identified that were necessary to operate the network. Once the key components of the system were identified and operating, passwords were obtained through research into document productions received, communications with Federal

³ The Back Office was the program used by Participants to obtain information on their User Account activity.

Authorities, and a variety of investigative tools. Finally, an intensive analysis was performed to better understand the database structure, table relationships, data fields, and process flow.

42. Once access to a working version of SIG was obtained, I and my professionals were able to conduct search queries and sort data. Because SIG was complicated, written in more than one language, and poorly maintained, and system documentation was unavailable, substantial additional hurdles remained to achieving an understanding of the system and extracting usable data.

43. The Debtors' database was developed by programmers in Brazil and all field references are in Portuguese. System modifications appear to have been done in a haphazard and disorganized fashion. The Debtors' system is permeated with unreliable data because of limited efforts at data validation in establishing User Accounts.

44. Despite all of these obstacles, as a result of the forensic efforts identified above, I and my team have been able to reconstruct the Debtors' computer system in a virtual environment and obtain a working understanding of SIG and how it was used to track User Account activity.

45. Each time that a Participant purchased a membership plan or VoIP Package, an account was established with SIG (the "User Account").

46. Each User Account with the Debtors was registered with an electronic mail address ("Email Address"). There are approximately 900,000 unique Participant Email Addresses in SIG associated with 10,987,617 User Accounts. The number of User Accounts associated with an Email Address varies widely. A particular Email Address may be associated with a single User Account or may be associated with hundreds or thousands of User Accounts. Because each User Account may represent a separate Participant and some Participants entered

the scheme using the Email Address of another Participant, the number of Participants is unknown but is likely to be well in excess of 1,000,000.

47. After a User Account was established, SIG tracked the activity of the Participant in that User Account, including the accumulation of credits for bonuses and commissions ‘earned’, the use or transfer of credits between User Accounts, and payments made to or from the Participant directly with the Debtors.

48. SIG contains more than 100 tables of data. These tables include an Account Table (which contains a unique record for each User Account), an Invoice Table (which contains a unique record of each invoice generated by the Debtors), a Transfer Table (which contains information about each transfer of credits within the TelexFree system, including withdrawals of funds), and a Bonus Table (which contains information about each increase in credits into a User Account).

49. I and my advisors have taken a series of steps to confirm the accuracy and reliability of the transaction data reflected in SIG. My advisors interviewed the Debtors’ bookkeeper, Andrea Cabral, to understand the mechanics of SIG and how it was employed on a day to day basis. Limited testing was performed to reconcile balances and activity using available data, including cross-referencing data in related transactions, conducting interviews with several Participants to confirm the accuracy of the SIG data as to their User Accounts, and reconciling payment data with third party processor records. Based on the testing performed to date, SIG provides accurate information regarding membership plan sales, issuance of invoices, accumulation and use of credits, and amounts received from and disbursed to the User Accounts.

C. Relationship with Ympactus, and Segregation of Ympactus Information and Debtor Information

50. In February 2012, Ympactus commenced operations in Brazil and reportedly operated a scheme substantially identical to the scheme that is described above. The Debtors commenced operations in April 2012. Ympactus initially grew much more rapidly than the Debtors, with growth accelerating in the fall of 2012 through the early summer of 2013. By the spring of 2013, Ympactus had cash receipts of more than \$100,000,000 per month. *See Exhibit “I”*. On the other hand, the Debtors’ cash receipts were initially much more modest. In the spring of 2013, the Debtors’ cash receipts averaged approximately \$6,400,000 per month. *See Exhibit “I”*.

51. On June 28, 2013, the Public Prosecutor’s Office of the State of Acre, Brazil filed claims against Ympactus, Carlos Wanzeler, Lyvia Mara Campista Wanzeler, and James Merrill, alleging that the VoIP Packages marketed in Brazil were violating consumer rights, since the MLMP constituted a Ponzi/pyramid scheme. The Brazilian authorities suspended the operations of Ympactus and froze its assets in Brazil. Upon information and belief, the Brazilian authorities seized as much as \$300,000,000 from Ympactus in connection with the shutdown, and civil and criminal proceedings are pending in Brazil. On or about September 21, 2015, the Brazilian court entered a decision finding that Ympactus operated a pyramid scheme.

52. Following the shutdown of Ympactus, the Debtors’ cash receipts increased dramatically. The Debtors’ cash receipts totaled approximately \$198,500,000 in the last three full months of operation, with more than \$96,600,000 in cash receipts in February 2014 alone. *See Exhibit “I”*.

53. The SIG system maintained by the Debtors and Ympactus ran off a single database reflecting User Account activity for both operations. After reconstructing the computer

network and developing a working understanding of SIG, one of the first tasks was to determine how to segregate the Debtors' activity from that of Ympactus, since SIG did not clearly differentiate the User Accounts between the two.

54. SIG includes 17,016,780 distinct User Accounts associated with 2,166,955 Email Addresses for both the US-based and the Brazilian-based operations.

55. I believe that a valid basis exists to separate the Debtors' User Account data based upon the currency designation in the data fields.

56. The Debtors' system assigned a currency to be used to pay invoices based on the Participant's country of residence. Participants entering Brazil as their home address paid invoices denominated in Brazilian Reais ("Reais") and all others paid invoices denominated in United States Dollars, although for accounting purposes, all transactions in the database were recorded in United States Dollars. The Invoice Table distinguishes between invoices paid in United States Dollars and invoices converted to United States Dollars from Reais.

57. The Invoice Table contains a "cambio" or "exchange rate" field. In 99.7% of transactions, by amount, where the currency field is denominated as "D" or United States Dollars, the cambio field is populated with a "0". In 99.8% of the transactions where the currency field is denominated as "R" or Brazilian Reais, the cambio field is populated with a range of values from 1.98 to 2.37 (that is, 1.98 to 2.37 Reais for each 1 Dollar). I have confirmed that the two currencies traded in this conversion range during the time that the Debtors and Ympactus were simultaneously in operation.

58. Through a review of the currency field data, I have further determined the following:

- a. Prior to the shutdown of Ympactus in June 2013, invoices in User Accounts with Brazilian contact information were denominated in Reais and invoices in User Accounts with non-Brazilian contact information were denominated in Dollars;
- b. Fewer than 700 Reais-denominated User Accounts were associated with non-Brazilian addresses. Similarly, fewer than 150 Dollar-denominated User Accounts were associated with Brazilian addresses; and
- c. There was relatively little activity after the shutdown of Ympactus for Reais-denominated User Accounts that were created prior to the shutdown, and all cash activity for Reais-denominated accounts ceased shortly after the shutdown.

59. Utilizing the currency designation, 10,987,617 User Accounts are associated with the Debtors' operations and 4,006,422 User Accounts are associated with Ympactus operations. The remaining User Accounts have no activity.

II. FINDING OF EXISTENCE OF PONZI AND PYRAMID SCHEME

60. Participants who purchased the AdCentral Plan became entitled to receive a VoIP Package each week by placing one internet advertisement per day. These VoIP Packages could be, and routinely were, converted into credits for \$20 weekly for 52 weeks, for a 207% return on the initial investment of \$339. Participants who purchased the more expensive AdCentral Family Plan were entitled to receive five additional VoIP Packages each week by placing five internet advertisements per day. These VoIP Packages could be, and routinely were, converted into credits for \$100 weekly for 52 weeks, for a return of 265% on the initial investment of \$1,425.

61. The repetitive posting of internet advertisements (which were reportedly supplied by the Debtors) served no legitimate purpose, because anyone who used “telexfree” as an internet search term would be led to the Debtors’ own website, and the repetitive posting of similar advertisements had no discernable value. For example, one website, Adpost.com, contained more than 33,000 postings submitted by Participants for TelexFree, while another, ClassifiedsGiant.com, contained more than 25,000 postings

62. Participants did not draft the advertisements or perform any design services for their configuration, and the placing the ads could be, and often was, outsourced to third parties for a nominal fee. The requirement of posting advertisements to receive weekly payments obfuscated the true nature of the scheme – that the credits were a disguised, “guaranteed” return on the Participant’s initial investment.

63. The guarantee of an astronomical return on the initial investment without the requirement to sell any product created perverse incentives for Participants. Participants opened multiple User Accounts for the sole purpose of leveraging their fictitious profits, without the need to sell any product or recruit any individuals. Some Participants appear to have invested a substantial portion of their life savings into the scheme seeking to quickly triple or quadruple their investment. Participants opened hundreds of User Accounts, ultimately resulting in an exponential rise in the number of User Accounts.

64. Participants who opened multiple User Accounts on their own behalf could generate credits by essentially recruiting themselves. Participants could receive (1) \$20 worth of credits for recruitment of an AdCentral Plan member and \$100 in credits for recruitment of an AdCentral Family Plan member, and (2) \$20 in credits for each membership plan in one’s downline, up to a maximum of \$440 in credits, so long as that Participant recruited two new User

Accounts in his/her downline by either opening User Accounts in his/her own name or by recruiting new Participants.

65. While there were certain provisions of the Debtors' MLMP that ostensibly required the sale of VoIP Packages as a requirement for receiving credits, the credits that could be generated for those activities were relatively insignificant and the requirements were easily circumvented by Participants.⁴

66. The Debtors had \$359,792,242 in actual cash sales during the two year operation of the scheme. Of this amount, approximately \$353,000,000 was from the sale of membership plans and \$6,600,000 was from the sale of VoIP Packages. Even more remarkably, seventy-seven percent (77%) of sales occurred in the six weeks before the filing in a belated attempt by the Debtors to fix their fatally flawed plan by ostensibly requiring the sale of VoIP Packages to receive bonuses and commissions in the future.

67. By and large, the few VoIP Packages that were sold were not used. Of the \$6,600,000 in VoIP Package cash sales, less than one percent (1%) of available minutes contained in these packages were actually utilized, further demonstrating that the Debtors were not operating a bona fide MLMP and the VoIP Packages were not a legitimate product.⁵ Approximately \$477,888,000 in VoIP Packages were sold through the use of accumulated credits. Approximately eighty percent (80%) of these sales occurred in the six weeks leading up to the Petition Date in connection with implementation of the new compensation scheme.

⁴ While the generation of certain commissions required activation of VoIP Packages in a Participant's downline, this requirement was circumvented by the purchase of VoIP Packages with accumulated credits. Credits were also issued for the sale of standalone VoIP Packages but VoIP Packages were rarely sold to third parties.

⁵ This estimate is based upon information contained in the Disk A Vantage database (which includes VoIP service for both the Debtors and Ympactus) for the period July 2012 through June 2013, as well as usage of only the Debtors' VoIP service for the period July 2013 to April 2014.

68. The total reliance on the sale of membership plans, as opposed to the sale of a legitimate product, made the collapse of the Debtors' scheme inevitable.

69. A calculation of the Debtors' twelve month trailing liability, that is, the amount due to Participants over the following year on account of the guaranteed return, further evidences the unsustainability of the scheme. This liability grew exponentially in the year prior to the Petition Date, eventually rising to more than \$5,000,000,000 as of the Petition Date. Attached as *Exhibit "2"* hereto is a computation of the 12 month trailing liability as of the Petition Date. This trailing liability more than tripled in the five (5) months leading up to the Chapter 11 filings, far outpacing any cash generated from the sale of VoIP Packages.⁶ The \$5,000,000,000 trailing liability is more than seven hundred times the \$6,600,000 in cash receipts from the sale of VoIP Packages since inception of the Debtors' MLMP. The sale of additional membership plans only deepened the insufficiency.

IV. THE DEBTORS ARE JOINTLY LIABLE FOR PARTICIPANT CLAIMS

70. The Debtors worked in concert with one another to develop, market, and operate their Ponzi and pyramid scheme. The Debtors had common ownership and each was controlled by Wanzeler and Merrill, as well as Carlos Costa at least through his alleged separation from the Debtors in the fall of 2013.

71. Each of the Debtors was intimately involved in the scheme. Common Cents Communications, Inc., which was owned and controlled by Wanzeler, Merrill, and Steven Labriola, changed its name to TelexFree, Inc. in early 2012 in conjunction with the marketing

⁶ While certain provisions of Participant contracts did not require the payment to Participants for VoIP Packages issued to them, this contractual provision is completely undermined by the unmistakable statements in marketing materials and some of the Participant contracts promising Participants the right to a guaranteed return on investment without the need to sell any product.

and selling of VoIP Packages through the Debtors' MLMP. Shortly thereafter, in July 2012, TelexFree, LLC was formed, to conduct TelexFree's operations outside of Massachusetts.

72. TelexFree, Inc. and TelexFree, LLC worked collaboratively in furtherance of the scheme throughout 2012 and 2013, including joint marketing efforts, promotional materials, and Participant recruitment events. TelexFree, Inc. and TelexFree, LLC alternated responsibility for maintaining bank accounts, because on multiple occasions TelexFree was asked to close accounts with banks because of suspicious account activity.

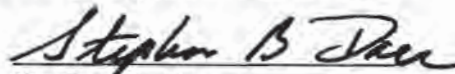
73. After the seizure and shutdown of Ympactus by Brazilian authorities, TelexFree, LLC and TelexFree, Inc. saw a substantial increase in activity, which further exacerbated difficulties with banking facilities needed to conduct the TelexFree scheme. TelexFree Financial, Inc. was formed in Florida in December 2013 and opened bank accounts and paid expenses of TelexFree, Inc. and TelexFree, LLC. In late 2013, TelexFree, Inc. and TelexFree, LLC transferred more than \$4,000,000 to an account at TelexFree Financial. TelexFree Financial deposited an additional \$10,000,000 in membership fees and VoIP Package sales in February 2014. The only Debtor with employees was TelexFree, Inc. and these employees were being paid by TelexFree Financial.

74. TelexFree Financial rendered substantial assistance to TelexFree, LLC and TelexFree, Inc. in furtherance of the Ponzi and pyramid scheme.

75. The Debtors had a common design or agreement to establish and implement the Ponzi and pyramid scheme. The Debtors engaged in a common enterprise to further their plan.

I attest that, to the best of my knowledge, the foregoing is true and accurate.

Dated: October 7, 2015


Stephen B. Darr
Chapter 11 Trustee

695349

Exhibit 1

In re: TelexFree, LLC, *et al.*

Cash Receipts by Month - TelexFree and Ympactus

Month	TelexFree	Ympactus
February 2012	\$ 150	\$ 22,942
March 2012	1,884	84,503
April 2012	14,709	336,350
May 2012	43,983	1,847,443
June 2012	53,606	4,764,547
July 2012	84,986	8,948,617
August 2012	375,556	15,030,324
September 2012	768,207	34,346,283
October 2012	290,450	12,987,841
November 2012	693,672	34,128,986
December 2012	616,314	55,083,742
January 2013	1,764,966	143,425,971
February 2013	4,972,733	257,513,534
March 2013	3,800,994	121,512,314
April 2013	5,983,150	149,372,999
May 2013	9,467,356	284,144,633
June 2013	13,949,543	184,497,992
July 2013	12,180,176	-
August 2013	18,850,084	-
September 2013	9,279,178	-
October 2013	14,929,643	-
November 2013	27,738,566	-
December 2013	33,310,766	-
January 2014	48,483,827	-
February 2014	96,630,356	-
March 2014	53,385,849	-
April 2014	2,121,537	-
	<u>\$ 359,792,242</u>	<u>\$ 1,308,049,021</u>

Note: Determination of TelexFree vs. Ympactus based on Invoice Table data as described in Darr Affidavit.

Source: Debtors' Participant database.

Exhibit 2

In re: TelexFree, LLC, *et al.*

Trailing Liability Calculation - Advertising Bonus^{1,2,3}

Trailing Liability	Outstanding ADCentral Payments	Outstanding ADCentral Family Payments	ADCentral Liability (\$20 per week)	ADCentral Family Liability (\$100 per Week)	Total Liability
February 2012	\$ -	\$ -	\$ -	\$ -	\$ -
March 2012	-	-	-	-	-
April 2012	-	-	-	-	-
May 2012	-	102	-	10,200	10,200
June 2012	-	1,871	-	187,100	187,100
July 2012	-	2,881	-	288,100	288,100
August 2012	-	5,659	-	565,900	565,900
September 2012	1,237	5,735	24,740	573,500	598,240
October 2012	5,640	20,526	112,800	2,052,600	2,165,400
November 2012	9,989	39,832	199,780	3,983,200	4,182,980
December 2012	19,484	94,394	389,680	9,439,400	9,829,080
January 2013	31,697	182,875	633,940	18,287,500	18,921,440
February 2013	78,520	356,527	1,570,400	35,652,700	37,223,100
March 2013	164,655	506,542	3,293,100	50,654,200	53,947,300
April 2013	283,453	761,101	5,669,060	76,110,100	81,779,160
May 2013	494,359	1,261,216	9,887,180	126,121,600	136,008,780
June 2013	739,166	1,798,677	14,783,320	179,867,700	194,651,020
July 2013	1,096,143	2,411,703	21,922,860	241,170,300	263,093,160
August 2013	1,684,888	3,656,684	33,697,760	365,668,400	399,366,160
September 2013	2,559,676	5,852,955	51,193,520	585,295,500	636,489,020
October 2013	3,583,231	9,169,675	71,664,620	916,967,500	988,632,120
November 2013	4,826,215	13,775,043	96,524,300	1,377,504,300	1,474,028,600
December 2013	6,357,701	20,343,202	127,154,020	2,034,320,200	2,161,474,220
January 2014	8,284,248	31,105,685	165,684,960	3,110,568,500	3,276,253,460
February 2014	10,409,821	45,926,764	208,196,420	4,592,676,400	4,800,872,820
March 2014	10,611,602	50,826,455	212,232,040	5,082,645,500	5,294,877,540
April 13, 2014	10,021,920	48,251,878	200,438,400	4,825,187,800	5,025,626,200
April 2014	9,432,888	45,682,130	188,657,760	4,568,213,000	4,756,870,760

Notes

1. Trailing liability calculated as of the last day of each month based on the weekly Advertising Bonus as described in TelexFree Participant contracts
2. Includes purchases of AdCentral and AdCentral Family plans and excludes commission other than weekly Advertising Bonus
3. Assumes Participants purchasing AdCentral or AdCentral Family plans would place required advertisements and receive Advertising Bonus each week.

Source: Debtors' Participant database.

EXHIBIT 3

In re:) Chapter 11
)
) Case No. 14-40987
TELEXFREE LLC., <u>et al.</u> , ¹)
) Jointly Administered
Debtors.)
)
)
STEPHEN B. DARR AS TRUSTEE OF)
THE ESTATES OF TELEXFREE, LLC,)
TELEXFREE, INC. and TELEXFREE)
FINANCIAL, INC.,)
) Adversary Proceeding No. 15-04055
Plaintiffs,)
)
v.)
)
RITA DOS SANTOS, INDIVIDUALLY)
AND AS PUTATIVE CLASS)
REPRESENTATIVE,)
AND)
MARIA MURDOCH, ANGELA BATISTA)
JIMINEZ, ELISANGELA OLIVEIRA)
AND DIOGO DE ARAUGO, AS)
PUTATIVE CLASS REPRESENTATIVES,)
)
Defendants.)

INTRODUCTION

¹ The debtors (the “Debtors”) in these cases (collectively, the “Chapter 11 Cases”) are TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc.

clear the Trustee's lack of standing to prosecute such claims. Recognizing that prohibition, the Trustee instead encourages this Court to make new law by asserting that the payment of dollars by individual "Victim-Participants" to non-debtor Promoter-Participants was sufficiently entwined with the hybrid Ponzi/pyramid scheme operated by the Debtors that such payments should be considered "property of the debtors' estate" and the individual Victims' claims nothing more than "disguised fraudulent transfer claims" that the Trustee has the exclusive right to prosecute. Notwithstanding the intellectual gymnastics this novel approach requires, the Trustee cannot escape the undisputed facts that negate the proposition that the Victims' payments were ever property of the Debtors' estate. In particular:

- the Debtors never possessed any of the monies paid by a Victim-Participant to a Promoter-Participant;
- the Debtors never commingled such monies with TelexFree's other assets so as to render them traceable;
- the Debtors never themselves made a transfer of the commingled monies to the Promoter-Participants;
- the Debtors experienced no diminishment of their estate in connection with the payment of these monies;
- the Debtors had no legal right to the monies so transferred; and
- the Victims suffered a particularized injury for which the Trustee is not authorized to recover.

The Trustee's claims fail for any one of these reasons, each of which is individually and independently sufficient to defeat the Trustee's standing to recover payments made by Victim-Participants to Promoter-Participants. Try as he might, the Trustee further cannot ignore that the Debtors ran a Ponzi scheme that relied, in part, on the actions of various non-debtor third parties such as banks, payment processors, attorneys, accountants, and the Promoter-Participants. Those

third parties committed independent torts against the Victim-Participants and, as a result, the Victims' direct claims against these third parties are theirs and theirs alone to bring.

As there are no material facts in dispute, summary judgment dismissing the Trustee's complaint in its entirety is appropriate.

VICTIMS' CLAIMS²

The Plaintiffs' Interim Executive Committee (the "PIEC") is the authorized representative of Victims of the TelexFree Ponzi and pyramid scheme, charged with prosecuting litigation on their behalf. See SUF ¶ 1, Exhibit A at 1-2. The PIEC has filed actions in the United States District Court for the District of Massachusetts to recover "Participant-to-Participant Payments" for the benefit of TelexFree's Victims, including complaints consolidated within the MDL Proceedings and an additional action filed on February 24, 2016 in the District Court for this District for consolidation into the MDL Proceedings. See SUF ¶¶ 2-8, Exhibits B-K.

In actions filed in June 2014, Victims of TelexFree brought several actions against the master-minds behind TelexFree and certain other major non-debtor promoters and co-conspirators. See SUF ¶ 2, Exhibits B-E. By order dated October 22, 2014, the District Court transferred these actions to the MDL Proceedings. See SUF ¶ 3, Exhibit F. The PIEC consolidated the complaints filed in the prior actions in the *Second Consolidated Amended Complaint*, filed on April 30, 2015 (the "SCAC"). See SUF ¶ 4, Exhibit G. In the SCAC, the PIEC named over forty (40) defendants, including James Merrill and Carlos Wanzeler, the

² All citations in this section refer to the *Local Bankruptcy Rule 7056-1 Statement of Undisputed Material Facts in Support of PIEC's Motion for Summary Judgment* ("SUF"), filed contemporaneously herewith. Exhibits A-M attached to the SUF are pleadings filed in various court actions, as to which the Court may take judicial notice. See *Martin v. Mead Johnson Nutrition Co.*, Civil Action No. 09-11609-NMG, 2010 WL 3928710, at *1-2 (D. Mass. Sept. 13, 2010). Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the SUF.

master-minds behind TelexFree, and certain major non-debtor promoters and co-conspirators for fraud, securities fraud, and a variety of other torts. See SUF ¶ 4, Exhibit G at ¶¶ 39-100, 1004-1098. The suit also named various banks, payment processors, attorneys, and accountants for aiding and abetting these torts. See id. The PIEC brought unjust enrichment claims against all defendants, including specifically several Promoter-Participants, in the SCAC.³ See SUF ¶ 4, Exhibit G at ¶¶ 1037-1043.

In an additional action filed on February 24, 2016, styled *Murdoch et al. v. TelexElectric, LLLP et al.*, the PIEC commenced a civil action in the United States District Court for the District of Massachusetts asserting claims against forty-seven Promoter-Participants, including a claim for unjust enrichment (the “Oliveira Action” and together with the SCAC, the “Unjust Enrichment Claims”).⁴ See SUF ¶ 7, Exhibit J.

On October 7, 2015, the Trustee initiated this Adversary Proceeding seeking a declaratory judgment that the PIEC’s Unjust Enrichment Claims in both suits violated the automatic stay and an injunction prohibiting further prosecution of the Unjust Enrichment Claims insofar as they name the Promoter-Participants as defendants.⁵ See SUF ¶ 9, Exhibit L at ¶¶ 39-48. The Trustee’s proceeding is predicated on his allegation that all dollars paid by a Victim-Participant directly to a Promoter-Participant constitute a fraudulent transfer of TelexFree property which the Trustee has the exclusive authority to recover. See SUF ¶ 10, Exhibit M at ¶¶ 33-43.

³ On September 23, 2015, the PIEC commenced an action in the United States District Court for the District of Arizona against the same defendants named in the SCAC (the “Arizona Action”). See SUF ¶ 5, Exhibit H. On October 21, 2015, the Arizona Action was transferred to the United States District Court for the District of Massachusetts. See SUF ¶ 6, Exhibit I at 1. The Arizona Action Complaint largely parallels the SCAC, except that it was expanded to include a request for certification of a class of Defendants who are “Net Winners” and received payments from other Participants. See SUF ¶ 5, Exhibit H at ¶¶ 1012-1021.

⁴ The Oliveira Action was amended on June 27, 2016 to remove Maria Murdoch, Angela Batista Jiminez, and Diogo de Araujo as named plaintiffs. See SUF ¶ 8, Exhibit K.

⁵ The Trustee filed an amended complaint on February 26, 2016. See SUF ¶ 9, Exhibit M.

FACTS⁶

TelexFree operated a hybrid Ponzi and pyramid scheme that ostensibly revolved around the sale of membership plans and monthly voice over internet phone (“VoIP”) packages. See SUF ¶ 11, Exhibit M at ¶¶ 11, 14. A person could become a participant (“Participant”) in the TelexFree scheme by purchasing either a membership plan or VoIP package. See SUF ¶ 12, Exhibit M at ¶¶ 9, 14.

Each time a Participant purchased a membership plan or VoIP package, the Debtors established a user account (“User Account”) to track the activity of that Participant. See SUF ¶ 12, Exhibit M at ¶ 14. Purchase of a membership plans could occur in two discrete ways. See SUF ¶ 14, Exhibit M at ¶ 15. One way was for a new Participant to purchase his or her membership plan directly from TelexFree. See id. In this transaction, the new Participant paid the membership fee directly to TelexFree. See SUF ¶ 15, Exhibit M at ¶ 16. TelexFree received the money and opened a User Account that would then track the Participant’s subsequent activity. See id.

Alternatively, a new Participant (a “Victim-Participant” or “Victim”) could purchase a TelexFree membership plan directly from an existing Participant (a “Promoter-Participant”). See SUF ¶ 16, Exhibit M at ¶¶ 17-18. In this latter transaction, the Victim-Participant would pay the membership fee directly to the Promoter-Participant (hereinafter, a “Participant-to-Participant Payment”) and TelexFree would establish a User Account for the Victim-Participant. See SUF ¶ 16, Exhibit M at ¶ 18. TelexFree would issue the Victim-Participant an invoice for the membership fee, the Promoter-Participant would satisfy the invoice with credits previously

⁶ All citations in this section refer to the SUF. As stated above, Exhibits A-M attached to the SUF are pleadings filed in various court actions, as to which the Court may take judicial notice. Exhibits N-O attached to the SUF are part of the evidentiary record with respect to papers filed and evidence admitted in the main bankruptcy cases of TelexFree, LLC, TelexFree, Inc. and TelexFree Financial, Inc., Case Nos. 14-40987 through 14-40989, which the parties have agreed that the Court may consider.

accumulated by the Promoter-Participant, and the Victim-Participant paid the invoice amount directly to the Promoter-Participant. See id. This alternative transaction is now characterized by the Trustee as a “Triangular Transaction.” See SUF ¶ 16, Exhibit M at ¶ 17. In this alternative transaction, the Debtors never received or had possession of the membership fees paid by the Victim-Participant to the Promoter-Participant. See SUF ¶ 16, Exhibit M at ¶ 17-18.

To evaluate the merits of the Trustee’s assertions and the propriety of the relief requested, it is critical to understand the novel scheme created by the Debtors. As stated above, the TelexFree scheme exhibited features of both a Ponzi scheme and a pyramid scheme. See SUF ¶ 13, Exhibit M at ¶ 11. Its Ponzi scheme features were the promise of significant returns on investment simply for paying money over to TelexFree (or a Promoter-Participant) and the generation of credits by posting internet ads for a VoIP product that was more mirage than real.⁷ See id. The pyramid feature of the scheme is found in the Participant-to-Participant relationship, where an existing Participant could recruit new Participants and receive payments directly from those Participants. See id. The Participant-to-Participant Payments were facilitated by the redemption of accumulated “credits” by the Promoter-Participant in TelexFree. See SUF ¶ 16, Exhibit M at ¶ 18. But the credits previously issued by TelexFree to the Promoter-Participant were simply one aspect of an illegal scheme and had no actual value or utility outside of perpetrating the fraud upon the next unwitting Victim. See SUF ¶ 18, Exhibit N at 54:14-16, Exhibit O at ¶ 35.

What truly makes the TelexFree scheme unique is that only some of the dollars extracted from Victims were paid to and came into the possession of TelexFree. See SUF ¶ 14-16, Exhibit M at ¶¶ 14-18. Most of the monies extracted from the Victims were extracted by other

⁷ TelexFree’s revenues from the sales of VoIP packages were inconsequential compared to its overall operations and the vast majority of TelexFree’s revenue came from the purchase of membership plans by Participants. See SUF ¶ 19, Exhibit O at ¶ 35.

individual, non-debtor, non-insider Participants. See SUF ¶ 19, Exhibit O at ¶ 35. While TelexFree issued invoices associated with the sale of both membership plans and VoIP packages and purported to show a face value of \$3,073,461,326, only \$359,792,242, or approximately twelve percent (11.7%) of that amount, was paid in cash to the Debtors by Victims. See SUF ¶ 19, Exhibit O at ¶ 35. The near 90% balance of these invoices, totaling over \$2,713,679,084, were actually Participant-to-Participant cash transactions, with the fictitious invoices and associated credits constituting the only aspects involving the Debtors. See id.

The Unjust Enrichment Claims brought by the Victim-Participants are brought only against Promoter-Participants who received those Participant-to-Participant Payments. See SUF ¶ 20, Exhibit G at ¶¶ 51-62, Exhibit H at ¶¶ 1012-1021, Exhibit K at ¶¶ 18-72. The Victim-Participants themselves can be broken down into two categories: (1) new Participants who made one or more Participant-to-Participant Payments and did not thereafter recruit additional Participants; and (2) new Participants who made one or more Participant-to-Participant Payments and did thereafter recruit some new Participants but nonetheless ended up on a net basis suffering damage (that is a Victim-Participant who originally paid in \$X and received \$X-Y, with Y being less than X). See SUF ¶ 17, Exhibit M at ¶¶ 14-18. As will be shown below, the distinction between these two groups of plaintiffs is not legally relevant. In both scenarios, no monies were ever paid to or possessed by the Debtors, and hence not commingled with the Debtors' other assets or subject to any later potential transfer to third parties. See SUF ¶ 16, Exhibit M at ¶¶ 14-18. In fact, none of the Participant-to-Participant Payments involved a transfer of money from the Debtors to any Promoter-Participant. See id.

ARGUMENT

The Trustee concedes, as he must, that he lacks standing to sue, on behalf of Victim-Participants in their capacity as TelexFree's creditors, the non-debtor Promoter-Participants to

recover the Participant-to-Participant Payments. See Caplin v. Marine Midland Grace Tr. Co. of N.Y., 406 U.S. 416, 428 (1972) (trustee under Chapter X of the Bankruptcy Act did not have standing to sue indenture trustee on behalf of holders of debentures issued by debtor); In re Ozark Rest. Equip. Co., 816 F.2d 1222 (8th Cir. 1987) (Congress, in enacting the Bankruptcy Code in 1978, chose not to overrule Caplin); see also E.F. Hutton & Co. v. Hadley, 901 F.2d 979 (11th Cir. 1990); Williams v. California 1st Bank, 859 F.2d 664 (9th Cir. 1988) (trustee lacked authority to sue on behalf of debtor’s creditors). Instead, the Trustee asserts that he is not attempting to usurp those direct and personal claims; rather he is simply attempting to prevent the Victim-Participants from maintaining “disguised fraudulent transfer” claims. It is the Trustee, however, in this Adversary Proceeding, who seeks to disguise, as fraudulent transfer claims, what are clear direct and personal claims of the Victim-Participants.

Granting the relief requested in the Adversary Proceeding would allow the Trustee to recover monies that the Debtors never themselves possessed, controlled, or transferred to any third party, and to which they never had any legally valid claim. See SUF ¶ 16, Exhibit M at ¶¶ 14-18. This would create an entirely new common-law based theory of fraudulent conveyance law, as neither the Bankruptcy Code nor applicable case law grants the Trustee such broad authority. It would also fly in the face of prior Supreme Court teachings. See Caplin, 406 U.S. at 434 (“Congress has not yet indicated even a scintilla of an intention” to confer on bankruptcy trustee standing to sue third parties); see also Ozark, 816 F.2d at 1228 (“[W]e believe Congress’ message is clear – *no* trustee . . . has power under Section 544 of the Code to assert general causes of action [] on behalf of the bankrupt estate’s creditors.”). The claims to recover the Participant-to-Participant Payments instead belong to the individual Victims who suffered injury at the hands of the Promoter-Participants.

I. The Summary Judgment Standard

Summary judgment is appropriate when the moving party shows that “there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law.” Fed. R. Civ. P. 56(a). A fact is material only if it may affect the outcome of the litigation. See Volkswagenwerk Aktiengesellschaft v. Wheeler, 814 F.2d 812, 815 (1st Cir. 1987); Williams v. City of Brockton, 146 F. Supp. 3d 290, 301 (D. Mass. 2015). “[A]n issue is genuine if it may reasonably be resolved in favor of either party.” Vineberg v. Bissonette, 548 F.3d 50, 56 (1st Cir. 2008) (quotations and citations omitted).

“Essentially, Rule 56[] mandates the entry of summary judgment ‘against a party who fails to make a showing sufficient to establish the existence of an element essential to that party’s case, and on which that party will bear the burden of proof at trial.’” Coll v. PB Diagnostic Sys., 50 F.3d 1115, 1121 (1st Cir. 1995) (quoting Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986)). As set forth below, there are no material facts in dispute: the Trustee concedes, indeed champions the fact, that TelexFree was a Ponzi scheme designed to defraud; the structure of the scheme could, and more often than not did, result in non-debtor Promoter-Participants engaging in direct and fraudulent transactions with Victims through which these Victims paid the Promoter-Participants directly the monies which the PIEC now seeks to recover. The Trustee acknowledges that the Debtors never came into possession of the monies at issue. From these undisputed facts flows the legal conclusions that the Victims own direct claims covering particularized harm that do not involve property of the Debtors’ estates. Summary judgment in favor of the PIEC, dismissing the Adversary Proceeding, is thus compelled.

I. The Participant-to-Participant Payments Do Not Constitute Property Of The Estate And Are Not Recoverable By The Trustee

In his effort to manufacture standing, the Trustee argues that the Participant-to-Participant Payments were in effect transfers of property of the Debtors' estate and he, and only he, has the authority to sue to recover these monies from the Promoter-Participants. In reality, the circumstances surrounding the TelexFree scheme demonstrate that the funds transferred by Victims to Promoter-Participants – that is, the Participant-to-Participant Payments at issue here – were never property of the estate. The right to recover the Participant-to-Participant Payments indisputably belongs to the individual Victim-Participants, regardless of whether such Victim later recruited additional Participants, because such payments were never delivered to or in the possession of the Debtors, were never held in any accounts controlled by the Debtors or commingled in a common account, and the Debtors never transferred those monies to third parties. See SUF ¶ 16, Exhibit M at ¶¶ 17-18. Even more, the Debtors had no *legal right* to possess or control these funds.

A. The Participant-to-Participant Payments Were Never In The Possession of the Debtors

This Court has already ruled that TelexFree operated as a Ponzi scheme. See Amended Order on Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief, Case No. 14-40987 [Docket No. 668]. Ponzi schemes often end in bankruptcy when the scheme inevitably collapses. There is thus a long list of bankruptcy cases in which a trustee has successfully prosecuted fraudulent transfer claims on behalf of the estate for transfers made by the debtor/fraudster to non-debtor third parties. See, e.g., Floyd v. Dunson (In re Ramirez Rodriguez), 290 B.R. 424 (Bankr. S.D. Tex. 1997); Sender v. Buchanan (In re Hedger-Invs. Assocs., Inc.), 163 B.R. 841 (Bankr. D. Colo. 1994), aff'd 84 F.3d 1286 (10th Cir. 1996); Dicello v. Jenkins (In re Int'l Loan Network, Inc.), 160 B.R. 1

(Bankr. D.D.C. 1993); In re Taubman, 160 B.R. 964 (Bankr. S.D. Ohio 1993); Merrill v. Dietz (In re Universal Clearing House Co.), 62 B.R. 118 (D. Utah 1986). In every such case, however, the debtor had “title” to the property transferred.

In the context of a Ponzi scheme, it is axiomatic that the property acquired by the debtor from the victim bestows upon the debtor voidable title only. See In re Universal Clearing House Co., 62 B.R. at 123 (“An agreement induced by fraud [] is merely voidable, not void.”). But such voidable title only arises from the fact that the fraudster had actual possession of the property later transferred. See id. at 124 (“[A]lthough it may be true that one who steals or embezzles money obtains no title to it, one who obtains money by fraud obtains some interest, namely, a defeasible title.”). That is why, in *every* bankruptcy case involving a Ponzi scheme in which a trustee successfully brings a fraudulent transfer action, the assets transferred by the debtor were in the debtor’s actual possession prior to the transfer. See In re Ramirez Rodriguez, 209 B.R. at 429 (purchase price for contracts *paid directly by investors to the debtors*, deposited in accounts held or controlled by the debtors, and commingled with other investors’ funds); In re Universal Clearing House Co., 62 B.R. at 123 (payments made pursuant to “investor contracts” *paid directly by the investor to the debtors* and commingled in a common fund controlled by the debtors); In re Hedged-In. vs. Assoc., Inc., 163 B.R. at 850 (Ponzi scheme “*debtor came into possession of all of these funds by the voluntary payment of the investors*” (emphasis added)); In re Int’l Loan Network, Inc., 160 B.R. at 7-8 (investors purchased memberships by *transferring funds directly to the debtor* at their corporate headquarters, which funds the debtor commingled with its other money); In re Taubman, 160 B.R. at 972, 978 (*investors transferred funds directly to the debtors*, which funds were held in bank accounts controlled by the debtor and commingled with the funds of other investors); Raforth v. First Nat’l Bank of Barnesville (In re Baker &

Getty Fin. Servs. Inc.), 98 B.R. 300, 306 (Bankr. N.D. Ohio 1989) (*investors transferred funds directly to the debtors* and the debtor held and commingled funds in common accounts); Geltzer v. Barish (In re Geltzer), 502 B.R. 760, 764, 768 (Bankr. S.D.N.Y. 2013) (*investors transferred money directly to the debtor* and all investor funds were held in commingled accounts controlled by the debtor).

As this long list of cases demonstrates, the critical element leading to a finding that the property later transferred by the debtor was property of the estate was *possession*. Without possession, a fraudster can make no claim to title, even voidable title, over transferred assets. Here, the Trustee concedes that the Debtors never had possession of any of the monies transferred between non-debtor Victim-Participants and non-debtor Promoter-Participants. See SUF ¶ 16, Exhibit M at ¶ 18. As such, they never held title to such monies. That alone is the beginning and the end of the analysis and compels dismissal of the Trustee's complaint with prejudice.

But there are other reasons as well. These very same cases make clear that what substantiates a fraudulent transfer case in a Ponzi scheme situation is both possession *and commingling* of funds. The commingling is likewise critical because commingling eliminates the ability to trace the funds that are thereafter transferred and to maintain a direct action. See, e.g., In re Baker & Getty Fin. Servs. Inc., 98 B.R. at 306 (where a debtor obtains money by fraud and mingles it with other money so as to preclude any tracing the money is property of the debtor under sections 547 and 548 of the Bankruptcy Code); In re Universal Clearing House, 62 B.R. at 124 (“[W]here a debtor obtains money by fraud and mingles it with other money so as to preclude any tracing and where the defrauded party does not timely avoid the transaction, the money is ‘property’ of the debtor within the meaning of section 548 of the Code.”) Of course,

since the Debtors here never had possession of the Participant-to-Participant Payments, the Debtors could not and did not commingle those payments with the monies fraudulently obtained from other Victims who paid the Debtors directly for membership plans.⁸ See SUF ¶ 16, Exhibit M at ¶¶ 14-18.

The Trustee has not cited a single Ponzi scheme/fraudulent transfer case that grants a trustee standing to recover monies that were never in the possession of the debtors, never commingled with the debtors' other assets, and never transferred by the debtor to a third party, from those commingled assets. Instead, the Trustee urges the Court to create entirely new law, asking for a finding that the payments made by Victims to Promoter-Participants should be treated *as if* they were transfers made by the Debtors to those Promoter-Participants because the transactions were aided and abetted by the Debtors. The dozens of trustees for the dozens of estates for the dozens of prior Ponzi and pyramid schemes did not seek or obtain such novel relief, and for good reason: the Trustee's request for a radical expansion of standing here lacks the key element present in all of the cited cases in which relief WAS granted, possession. The Trustee cannot overcome the fact that the Debtors at no time received, possessed, controlled or transferred the monies constituting the Participant-to-Participant Payments. The Debtors thus never held title to those monies, and the Trustee cannot claim that these funds were at any point property of the Debtors' estate.

Based on the foregoing, the Trustee cannot establish that the Participant-to-Participant Payments are transfers of property of the Debtors' estate and therefore has no right to pursue

⁸ In the absence of possession and commingling, there could not be and was no actual transfer of funds by the Debtors to any Promoter-Participant third party. See SUF ¶ 16, Exhibit M at ¶¶ 14-18. Again, without possession of the money, commingling or not, there was nothing for the Debtors to transfer; and indeed there were no transfers by the Debtors.

causes of action to recover the Participant-to-Participant Payments on behalf of the Debtors' estate.

B. The Debtors Never Had Any Legal Right To The Participant-to-Participant Payments

In an effort to overcome the fatal lack of possession over the Participant-to-Participant Payments, the Trustee next attempts to cast the Participant-to-Participant Payments as property of the estate by asserting that they were obligations owed by the Victims to the Debtors, which obligations were satisfied by the Promoter-Participants' surrender of previously accrued credits simultaneously with the actual payment of money by the Victim to the Promoter. This co-dependency, as it were, the Trustee labels a "Triangular Transaction," which he then analogizes to leveraged buyouts and other collapsible transactions. This tortured logic does not hold up on these facts.

First, it is incontrovertible that the Trustee cannot succeed to any greater rights in property than pre-bankruptcy TelexFree had. See Sender v. Buchanan (In re Hedged-Invs. Assocs., Inc.), 84 F.3d 1281, 1284-85 (10th Cir. 1996) (concluding that no exception in the Bankruptcy Code allowed chapter 7 trustee to take "greater rights than the debtor himself had" in a Ponzi scheme). The Trustee must have a *legal right* to the funds transferred as Participant-to-Participant Payments in order to recover those funds on behalf of the Debtors' estate. But because TelexFree was itself a criminal enterprise, it had no legal right to the cash transferred by Victims as Participant-to-Participant Payments to third party Promoters. See, e.g., Manta Mgmt. Corp. v. City of San Bernadino, 44 Cal. Rptr.3d. 35, 48 (Cal. Ct. App. 2006) (stating that company "is not entitled to recover any portion of its profits that were generated by illegal activity"), rev'd on other grounds, 181 P.3d 159 (Cal. 2008). Moreover, as detailed above, where fraud is involved, the fraudster only acquires any sort of title—in this case voidable title—

once the fraudster takes physical possession of the property. Since the Debtors never had possession of the Victim-Participant's monies, and those Participant-to-Participant Payments were the product of an illegal scheme, the Debtors had no form of title and no right to demand any.

Second, the fact that the Promoter-Participant's fraud upon the Victim-Participant was facilitated by the utilization of the fictitious credits minted indiscriminately by TelexFree and then fraudulently "issued" to the Promoter-Participant, and the phony "invoice" issued by TelexFree to the Victim, neither created a legal debt owed to TelexFree that was satisfied nor involved property of the estate (i.e., credits) utilized by the Victim-Participant to "satisfy" that fictitious debt. The invoices issued by TelexFree to the Victim-Participants were merely an element of the fraudulent Ponzi/pyramid scheme. See SUF ¶¶ 11-12, 16, 19, Exhibit M at ¶¶ 14, Exhibit O at ¶ 35. The invoice was thus illegal, illegitimate and wrongful, and did not create in favor of TelexFree a legally enforceable claim against the Victim-Participant. See Manta Mgmt. Corp., 44 Cal. Rptr. 3d. at 48 (stating that company "is not entitled to recover any portion of its profits that were generated by illegal activity"); Wilson v. HSBC Mortg. Servs., Inc., 744 F.3d 1, 9-10 (1st Cir. 2014) (agreements induced by fraudulent misrepresentation are voidable); Berwind Prop. Grp. Inc. v. Env'tl. Mgmt. Grp., Inc., Civil Action No. 04-11411-NMG, 2007 WL 4707647, at *3 (D. Mass. Feb. 5, 2007) (same); see also W. Capital Partners, LLC v. Allegiance Tit. & Escrow, Inc., 520 F. Supp. 2d 777, 781 (E.D. Va. 2007) ("When a party's assent to a contract is obtained by fraud, the contract is voidable.").

Similarly, the utilization by the Promoter-Participant of the "credits" previously issued to that Participant were not property. Not only were they a mere element of the Ponzi/pyramid scheme, but the credit had no value or utility outside of perpetrating the fraud. See SUF ¶ 19,

Exhibit N at 54:14-16, Exhibit O at ¶ 35. The obvious proof of the utter lack of value of these credits is to ask the following question: What could TelexFree have done if the Promoter-Participant failed or refused to “transfer” its credit to TelexFree in “satisfaction” of the “invoice” from TelexFree to the Victim-Participant? As shown above, TelexFree could not sue the Victim-Participant and compel payment to it, as the invoice was the product and tool of fraud. Even assuming the Promoter-Participant had an obligation to turn over any money received from a Victim-Participant to TelexFree, and instead had taken the money for himself or herself, TelexFree could not bring a claim against the Promoter-Participant for either the credits or the money itself because both were (witting or unwitting) parties to the fraud. See Shearman Lehman Hutton, Inc. v. Wagoner, 944 F.2d 114, 118 (2d Cir. 1991) (“[W]hen a bankrupt corporation has joined with a third party in defrauding its creditors, the trustee cannot recover against the third party for the damage to the creditors.”); Picard v. JPMorgan Chase & Co. (In re Bernard L. Madoff Invs. Secs. LLC), 721 F.3d 54, 63 (2d Cir. 2013) (“Picard I”) (trustee appointed in Madoff Ponzi scheme could not bring claims of creditors against third parties for unjust enrichment, breach of fiduciary duty, aiding and abetting fraud and negligence, among others, because, “the doctrine of *in pari delicto* bar[s] a debtor from suing third parties for a fraud in which he participated”).

In short, inasmuch as both the “invoices” and “credits” were mere fabricated tools to perpetrate the fraudulent scheme, the Trustee’s reliance on the collapsible transaction cases literally collapses under its own logic. In *every* collapsible transaction case cited previously by the Trustee in connection with the *Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* (the “Ponzi Scheme Motion”), Case No. 14-40987 [Docket No. 623], the transfers of property involved property to

which the debtor had valid legal title. None were cases in which the debtor's only claim to title was itself predicated upon fraud. For example, the Trustee cited to several cases in which courts collapsed transactions in the context of leveraged buyouts. In each of these cases, the target company had a *legal right* to the proceeds of the loan secured by the transfer of an interest in its tangible assets that were themselves legally owned. See CPY Co. v. Ameriscribe Corp. (In re Chas P. Young Co.), 145 B.R. 131 (Bankr. S.D.N.Y. 1992) (purchaser used assets of the target to finance acquisition); OODC, LLC v. Majestic Mgmt., Inc. (In re OODC, LLC), 321 B.R. 128 (Bankr. D. Del. 2005) (purchaser used assets of target to finance acquisition); U.S. v. Tabor Court Realty Corp., 803 F.2d 1288 (3d Cir. 1986) (purchaser's loan secured by assets of target), cert. denied, McClellan Realty Co. v. U.S., 483 U.S. 1005 (1987); Wieboldt Stores, Inc. v. Schottenstein, 94 B.R. 488 (N.D. Ill. 1988) (purchaser financed acquisition using target's assets); Murphy v. Meritor Savs. Bank (In re O'Day Corp.), 126 B.R. 370 (Bankr. D. Mass. 1991) (purchaser's loan secured by target's assets); Jevic Holding Corp. v. The CIT Grp. (In re Jevic Holding Corp.), Bankruptcy No. 08-11006 BLS, 2011 WL 4345204 (Bankr. D. Del. Sept. 15, 2011) (purchaser used assets of the target to finance acquisition).

The Trustee also previously cited to two similarly inapposite cases outside of the leveraged buyout context. Both of these cases involved a situation in which the debtor sold its *validly owned* assets, but allowed a portion of the sale price to be paid to a third party. See Food Catering & Housing, Inc. v. Chemcarb, Inc. (In re Food Catering & Housing, Inc.), 971 F.2d 396 (9th Cir. 1992) (purchaser of debtor's assets, as component of purchase price otherwise payable to the debtor, assumed and then paid the debtor's liability to a third party); Warsco v. Preferred Tech. Grp., 258 F.3d 557 (7th Cir. 2011) (asset purchaser satisfied note

issued by debtor as part of asset sale). Neither of these cases support the Trustee's right to recover monies to which the Trustee never had a legal right or valid title. Finding trustee standing in these decisions required no novel expansion of the law; each case was predicated on the loss of something to which the debtor was legally entitled in favor to a preferred creditor or for less than fair value.

Another way to prove the emptiness of the Trustee's argument is to ask whether the transfer of fabricated "credits" by the Promoter-Participant to TelexFree in "satisfaction" of the Victim-Participant's phony invoice resulted in diminution the TelexFree's estates. See Picard v. Fairfield Greenwich Ltd., 762 F.3d 199, 208 (2d Cir. 2014) ("Picard III") ("A fraudulent conveyance (or fraudulent transfer) action seeks to recover or avoid transfers that wrongfully reduce the pool of asset available to creditors."); Marshall v. Picard (In re Bernard L. Madoff Invs. Secs. LLC), 740 F.3d 81, 93 (2d Cir. 2014) ("Picard II") (enjoining creditors' claims against third parties because claimed damages were "mere secondary harms flowing from the [] defendants' fraudulent withdrawals and the resulting depletion of BLMIS funds"); see also Warsco, 258 F.3d at 564 (courts considering whether property is property of the debtor "have focused on whether the transfer diminished the debtor's estate"); In re Baker & Getty Fin. Servs. Inc., 98 B.R. at 305 ("A transfer is avoidable as a preference only if the transferred property or interest in property diminished or depleted the debtor's estate.").

Unlike the transactions at issue in these cases, the Debtors here did not experience any diminishment in the value of their estates in connection with the Participant-to-Participant Payments. The Trustee plainly ignores the fact that the issuance of any particular credit did not diminish TelexFree's ability to simply fabricate additional credits as the need arose. See SUF ¶ 18-19, Exhibit N at 54:14-16, Exhibit O at ¶ 35. The "credits" issued by TelexFree were merely

constructs of an illegal scheme and manufactured at will to perpetuate that scheme. TelexFree did have possession, and hence voidable title, of the cash paid to it directly by certain victims; but those monies are not the subject of the PIEC's claims or what the Trustee now wrongly seeks to enjoin.

While it is true that a Victim who made a Participant-to-Participant Payment, thereby gaining entry into the TelexFree scheme, could later recruit additional Participants and receive cash from these Participants, this fact also does not establish that the Trustee had a legal right to the Participant-to-Participant Payments. See SUF ¶ 13, 16, Exhibit M at ¶¶ 11, 17-18. As the perpetrators of an illegal scheme, the Debtors never had a right to possess or compel payment of the Participant-to-Participant Payments. Had a Participant failed to pay any promised funds to another participant, the Debtors would have had no legal recourse to compel such payment.

Given that the Participant-to-Participant Payments were transactions between non-debtors and did not involve any property of the Debtors' estate, other than "property created by fraud," the Trustee, cannot, through the artifice of "collapsing" the transaction, turn an illegal claim to property into a legal one. Thus, the Trustee lacks standing to pursue the recovery of the funds involved in the Participant-to-Participant Payments under the Bankruptcy Code.

II. The Trustee Is Not Authorized To Sue Third Parties On Behalf Of Creditors Suffering Particularized Injury

The Trustee's assertion of a stay violation is also baseless because the PIEC claims are direct claims for particularized injuries of the Victims it represents -- not disguised fraudulent transfer claims. There can be no serious dispute that a claim for injury that is particular to certain creditors, rather than general to all creditors, may be brought *only* by the injured creditors. See Picard III, 762 F.3d at 211 ("[W]hen creditors . . . have a claim for injury that is particularized as to them, they are exclusively entitled to pursue that claim, and the bankruptcy

trustee is precluded from doing so.”); Wagoner, 944 F.2d at 118 (“It is well-settled that a bankruptcy trustee . . . may only assert claims held by the bankrupt corporation itself.”).

The question here, then, is necessarily whether the Victims’ unjust enrichment claims seek to recover for direct, particularized harm. They unequivocally do. The Second Circuit’s most recent analysis in the *Picard* trilogy of cases is particularly illuminating. In *Picard III*, the Second Circuit addressed the right of victims of the Madoff Ponzi scheme to bring breach of fiduciary duty and other claims against investment funds that invested the victims’ assets with Madoff. See 762 F.3d 199 (2014) (*Picard III*). As the court stated there, “In order to qualify as ‘disguised fraudulent transfer actions,’ . . . the complaints . . . would have to be contingent on [the debtors’] wrongful transfer of the funds sought” in those actions. Id. at 209. In rejecting that characterization, the court concluded that the non-debtor defendants owed independent duties to their customers, and their liability to customers was not dependent on Madoff’s liability to investors. See id. at 209. As a result, the customers’ claims were not “disguised” fraudulent transfer claims because, although the Madoff scheme may have been the “but-for” cause of the customers’ losses, the claims against the funds were independent of claims against Madoff. See id. at 210. Moreover, the court found that the claims were not dependent on funds wrongfully transferred by the debtors to the non-debtor third parties. Id. at 209. The unjust enrichment claims brought now by the Victims here are even further removed than those in *Picard III*, as the TelexFree Debtors made no transfers of any property whatsoever to the Promoter-Participants.

Similarly, in *Picard I*, 721 F.3d 54, 67-70 (2d Cir. 2013) (*Picard I*), the Second Circuit denied the trustee standing to bring unjust enrichment claims on behalf of creditors of Madoff’s Ponzi scheme against third parties because the asserted claims were based upon the defendants’ “handling of individual investments made on various dates in varying amounts.” Here, the PIEC

is bringing unjust enrichment claims on behalf of victims against non-debtor promoters in the exact amount of the Participant-to-Participant Payments passing between any given two. In other words, the Victims' claims are for the direct harm they suffered at the hands of the promoter with whom they interacted. See also In re Park S. Sec. LLC, 326 B.R. 505, 513-14 (Bankr. S.D.N.Y. 2005) (holding that trustee could not bring unjust enrichment claims under section 105(a) of the Bankruptcy Code and stating that "absent another basis for standing, the Trustee may not pursue a claim on the estate's behalf if it is particular only to certain creditors").

By contrast, the Victim-Participants' unjust enrichment claims are unlike the claims brought by individual creditors in *Picard II*, 740 F.3d 81 (2d Cir. 2014) (*Picard II*), which the Second Circuit found were derivative of the estate's claims. There, the creditors attempted to sue Madoff's co-conspirators to recover funds that the defendants had improperly withdrawn from the debtors' possession (i.e., BLIMS accounts). Id. at 85. The Second Circuit concluded that the claims were in fact derivative of the estate's claims and not "particularized" as to the individual creditors because their alleged injuries were "inseparable from, and predicated upon, a legal injury to the estate, namely the [] defendants' fraudulent withdrawals from their BLMIS accounts of what turned out to be other BLMIS customers' funds." Id. at 92. The court emphasized that the reason the claims by creditors were not "particularized" as to them was because there were no allegations that the defendants "directly participated in defrauding BLMIS customers by inducing them to invest." Id. at 93. That allegation missing there is of course the gravamen of the Victim-Participants' claims against the Promoter-Participants. Here, the Victim-Participants and Promoter-Participants directly interacted with one another in the actual transaction that resulted in the Participant-to-Participant Payment; that is, the Promoter-Participants directly induced the Victim-Participants to pay them (the Promoter-Participants)

money. Thus, unlike the creditors in *Picard II*, the Victims here seek to recover against the Promoter-Participants at whose hands they suffered direct and particularized harm, in the form of Participant-to-Participant Payments which had no impact whatsoever on the Debtors' estate.

Simply put, the Victims' unjust enrichment claims, then, are not merely "disguised" fraudulent transfer claims. Like the customers in *Picard III*, TelexFree's fraud may have been the "but-for" cause of Victims' losses, but the Victims' claims are not dependent on TelexFree's liability to creditors. The TelexFree scheme was the apparatus that facilitated the Participant-to-Participant Payments, but its existence does not shield the Promoter-Participants from liability for their own tortious conduct. A Victim took cash from his or her own pocket and paid it under false pretenses to the Promoter-Participants who were thus unjustly enriched. See SUF ¶ 16, Exhibit M at ¶¶ 17-18. No other creditor has any interest in that specific cash payment or suffered from that injury; and those monies were never transferred to the Debtors or commingled with the assets of TelexFree as to render them untraceable. A Victim's right to recover illegally taken cash belongs solely to the Victim and the Trustee may not assert these claims.

The fact that the wrongs committed by the Promoter-Participants against the Victim-Participants are bound up with the Ponzi scheme promoted by TelexFree does not change the result. While TelexFree may have conspired with or aided and abetted the Promoter-Participants' wrongful conduct and thus *also* wronged the Victim-Participants, those wrongs are independent and do not affect the claims by the Victim-Participants against the Promoter-Participants. As the Second Circuit held in *Picard III*, "that plaintiffs in both [state court] Actions are creditors of the Madoff estate...[is irrelevant as] the plaintiff's right to enforce duties owed to them is not qualified by the fact that they may also have claims against the Madoff estate." *Picard III*, 762 F.3d at 21; see also *Picard II*, 740 F.3d at 91 ("[T]here is nothing

illogical or contradictory about saying that [a third-party defendant] might have inflicted direct injuries on both the [estate's creditors] and [the debtor estate] during the course of dealings that form the backdrop of both sets of claims.” (citation omitted)).

Based on the foregoing, the Trustee has no standing to sue to recover the Participant-to-Participant Payments on behalf of TelexFree's creditors and granting the relief requested in the Adversary Proceeding would constitute a novel and inappropriate expansion of the Trustee's powers under the Bankruptcy Code.

CONCLUSION

The Trustee's attempt to enjoin the PIEC from maintaining the direct and particularized claims of the Victim-Participants is bedeviled by the singular fact that the Debtors never had possession of the Participant-to-Participant Payments. Those direct payments simply are not, and never were, property of the Debtors or their bankruptcy estate. Why did TelexFree structure its fraudulent scheme as a hybrid Ponzi/pyramid scheme such that only some monies (\$390,000,000) were paid directly to Debtors, while the rest (\$2 billion+) were paid directly by Victims to non-debtor promoters? Who knows! But that “why” is irrelevant. Because the payments were always the product of a fraud, TelexFree never had right to title to any monies. Only possession could give it colorable title; without possession it owned nothing. And because the Debtors never had possession of the Participant-to-Participant Payments, they never had the opportunity to commingle those payments into an indistinguishable pool, and never had the chance to thereafter make payments from that pool. Instead, the Participant-to-Participant Payments were the product of one-on-one interactions between Victims and non-debtor promoters and thus the claims are particularized to those Victims. The Trustee lacks standing to usurp their prosecution. Accordingly, the Trustee's complaint should be dismissed, in its entirety and with prejudice.

Dated: August 5, 2016
Boston, Massachusetts

BONSIGNORE, PLLC

/s/ Robert J. Bonsignore

Robert J. Bonsignore
NH Bar 21241
3771 Meadowcrest Drive
Las Vegas, Nevada 89121
Telephone: 781-856-7650
rbonsignore@classactions.us
Interim Lead Counsel

BROWN RUDNICK LLP

/s/ William R. Baldiga

William R. Baldiga (BBO #542125)
James W. Stoll (BBO # 544136)
Jill C. Wexler (BBO #691811)
One Financial Center
Boston, MA 02111
Telephone: (617) 856-8200
Facsimile: (617) 856-8201
wbaldiga@brownrudnick.com
jstoll@brownrudnick.com
jwexler@brownrudnick.com
For the Plaintiffs' Interim Executive Committee

CERTIFICATE OF SERVICE

The undersigned certifies that on August 5, 2016, the foregoing document was filed electronically, and therefore was sent by email to those receiving CM/ECF notices from the Court's electronic filing system. I further certify that I have caused to be sent by first class mail a copy to the following parties on this 5th day of August, 2016.

Charles R. Bennett, Jr., Esq.
Murphy & King, Professional Corporation
One Beacon Street
Boston, MA 02108

Richard King, Asst. United States Trustee
Office of the United States Trustee
446 Main Street
14th Floor
Worcester, MA 01608

/s/ Carol S. Ennis
Carol S. Ennis

62511629

EXHIBIT 4

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS**

In re:

TELEXFREE, LLC,
TELEXFREE, INC. and
TELEXFREE FINANCIAL, INC.,

Debtors.

Chapter 11 Cases

14-40987-MSH
14-40988-MSH
14-40989-MSH

Jointly Administered

STEPHEN B. DARR AS TRUSTEE
OF THE ESTATES OF TELEXFREE, LLC,
TELEXFREE, INC. and TELEXFREE
FINANCIAL, INC.,

Plaintiffs,

Adversary Proceeding
No. 15-04055

v.

RITA DOS SANTOS, INDIVIDUALLY AND
AS PUTATIVE CLASS REPRESENTATIVE,
AND MARIA MURDOCH, ANGELA
BATISTA JIMENEZ, ELISANGELA
OLIVEIRA AND DIOGO DE ARAUGO, AS
PUTATIVE CLASS REPRESENTATIVES,

Defendants.

CROSS-MOTION BY TRUSTEE FOR SUMMARY JUDGMENT

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, as incorporated by Rule 7056 of the Federal Rules of Bankruptcy Procedure, Stephen B. Darr, the Chapter 11 Trustee (“Trustee”) of TelexFree LLC, TelexFree Inc., and TelexFree Financial Inc., hereby moves for summary judgement on Counts I and II of this action. There are no material facts in dispute and the Trustee is entitled to judgment as a matter of law.

In further support of this motion, the Trustee relies upon the following:

1. Trustee's Memorandum of Law in Support of Opposition by Trustee to PIEC Motion for Summary Judgment and Cross-Motion by Trustee for Summary Judgment;
2. Opposition by Trustee to PIEC Motion for Summary Judgment
3. Trustee's Statement of Undisputed Material Facts in Support of Cross-Motion for Summary Judgment,
4. Trustee's Response to Defendants' Statement of Undisputed Material Facts in Support of PIEC Motion for Summary Judgment; and
5. Affidavit of Stephen B. Darr in Opposition to the PIEC Motion for Summary Judgment and in Support of the Trustee's Cross Motion for Summary Judgment.

Wherefore, the Trustee requests that judgment enter as follows:

1. Declaring that the funds transferred in Triangular Transactions constitute property of the Debtors' estates;
2. Declaring that the Defendants' prosecution of the Unjust Enrichment Claims violates the automatic stay under 11 U.S.C. §362(a) and therefore is void *ab initio*;
3. Pursuant to 11 U.S.C. §105(a), permanently enjoining and restraining the Defendants, individually and as class representatives, and those acting in concert or participation with them or on their behalf or any other parties from further prosecuting the Unjust Enrichment Claims or any other action against the Net Winners;
4. Awarding damages to the Trustee in an amount reasonable to compensate the Debtors' estates for the costs and expenses of bringing this action, including awards of reasonable attorney fees; and

5. Granting the Trustee such other and further relief as the Court deems just and proper.

Respectfully submitted,

STEPHEN B. DARR, CHAPTER 11
TRUSTEE,
By his counsel:

Dated: September 2, 2016

/s/ Andrew G. Lizotte

Harold B. Murphy (BBO #362610)
Charles R. Bennett, Jr. (BBO #037380)
Andrew G. Lizotte (BBO #559609)
MURPHY & KING,
Professional Corporation
One Beacon Street
Boston, MA 02108
Telephone: (617) 423-0400
ALizotte@murphyking.com

714351

EXHIBIT 5

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS**

In re:

TELEXFREE, LLC,
TELEXFREE, INC. and
TELEXFREE FINANCIAL, INC.,

TelexFree.

Chapter 11 Cases

14-40987-MSH
14-40988-MSH
14-40989-MSH

Jointly Administered

STEPHEN B. DARR AS TRUSTEE
OF THE ESTATES OF TELEXFREE, LLC,
TELEXFREE, INC. and TELEXFREE
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RITA DOS SANTOS, INDIVIDUALLY AND
AS PUTATIVE CLASS REPRESENTATIVE,
AND MARIA MURDOCH, ANGELA
BATISTA JIMENEZ, ELISANGELA
OLIVEIRA AND DIOGO DE ARAUGO, AS
PUTATIVE CLASS REPRESENTATIVES,

Defendants.

**TRUSTEE’S STATEMENT OF UNDISPUTED MATERIAL FACTS
IN SUPPORT OF HIS CROSS-MOTION FOR SUMMARY JUDGMENT**

Stephen B. Darr as Trustee (“Trustee”) of the Chapter 11 Estates of TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc. (“TelexFree”), pursuant to Rule 7056 of the Rules of Bankruptcy Procedure, submits the following Statement of Undisputed Material Facts:

1. On November 25, 2015, the Court, on motion by the Trustee and after notice and hearing, entered an Order, as amended on December 21, 2015, determining TelexFree perpetrated a fraud upon the public, primarily targeting the immigrant community. TelexFree’s

fraud was premised upon the sale of membership plans to individuals and incorporated elements of both a Ponzi and pyramid scheme. Docket No. 668, annexed hereto as Exhibit A.

2. The Ponzi aspect of the fraud involved the promise of astronomical returns to all Promoters who purchased a membership plan in TelexFree, merely for posting meaningless internet advertisements. By posting these advertisements, among other things, Promoters could “earn” credits with TelexFree that were redeemable for cash. The more membership plans that a Promoter acquired, the faster that Promoter could acquire credits. Each time a Promoter purchased a membership plan he/she was assigned a “User Account.” Many Promoters had multiple User Accounts. Affidavit of Stephen B. Darr in Support of His Cross-Motion for Summary Judgment, ¶ 5 (hereinafter, “Darr ¶ ____”). See also Affidavit of Special Agent John S. Soares submitted in support of Search Warrant as annexed to Document 252 in Criminal Action 4:14-cv-40028-TSH and annexed hereto as Exhibit B ¶¶ 59-62 (hereinafter, “Soares ¶ ____”).

3. The pyramid aspect of the fraud was the promise to compensate Promoters for recruiting individuals into the TelexFree scheme. Although TelexFree was structured as a multi-level marketing company, there was no need for Promoters to buy or sell the internet telephone product it offered. As with most pyramid schemes, the more individuals that one recruited, the more money that the recruiting Promoter could make. For example, for each new recruit, a Promoter would receive a “fast start” bonus, either of \$20 or \$100, depending upon the type of membership plan that the new Promoter purchased. Further, once a Promoter was recruited into another Promoter’s pyramid, the recruiting Promoter would earn credits as each of his/her ‘downline’ recruits purchased memberships or became Promoters themselves by bringing in their own new recruits. TelexFree encouraged this “team building” activity by offering “team builder

bonus” compensation, which a Promoter could earn by, among other things, recruiting ten (10) additional Promoters into the scheme. Darr ¶ 6, Soares ¶¶ 59-62, and form of Contract annexed hereto as Exhibit C.

4. The pyramid aspects of the TelexFree fraud was prominently featured in TelexFree’s website content, PowerPoint presentations, internet videos, and in-person recruitment meetings. All of these materials extolled the virtues of developing a Promoter’s pyramid in order to maximize compensation. Darr ¶ 7 and Exhibits to Soares Affidavit.

5. A Promoter’s activity in recruiting individuals into the scheme and accounting for the membership fees collected and credits redeemed by Promoters was detailed in the Debtors’ books and records (hereinafter referred to as “SIG”) and reported on TelexFree’s financial statements. Darr ¶ 8.

6. One of the principal methods by which TelexFree encouraged and enabled the recruitment of new Promoters was by permitting existing Promoters to earn credits by recruiting individuals into the program and redeeming those credits, referred to by TelexFree as “commissions” or “agent commission,” from the fees paid by new recruits. Darr ¶ 9.

7. Pursuant to this, an individual would purchase a membership plan from TelexFree through a Promoter. TelexFree would issue an invoice for the purchase of a membership plan being sold to that individual through a Promoter. The Promoter collected from the individual the amount of membership fee set forth on the invoice as agent for TelexFree. The Promoter could redeem his earned credits from the membership fee the Promoter collected from newly recruited individuals. The Triangular Transaction was reflected on SIG, the invoice marked satisfied, Promoter credits reduced, and the new recruit became a member of the TelexFree program and could begin recruiting others.

Darr ¶ 10.

8. The economic substance of the Triangular Transaction was, in fact, a payment of the membership fee to TelexFree and a payment by TelexFree to the Promoter in exchange for recruiting a new individual into the program. Darr ¶ 11.

9. The Triangular Transaction was the predominant method of entry into the TelexFree system. Invoices associated with the sale of membership plans or phone packages had a total value of \$3,073,471,326. Of this amount, approximately \$2,700,000, or nearly ninety percent (90%) of the membership fees sold by TelexFree were effected through a Triangular Transaction. Darr ¶ 12.

10. The membership fee paid by an individual to a Promoter was income to TelexFree and so characterized by TelexFree on its financial statements and tax returns. Darr ¶ 13.

11. Similarly, the credits redeemed by the Promoter from the collected memberships in a Triangular Transaction was an expense of TelexFree and characterized on TelexFree's financial records as such under the category of "Agent Commission." Darr ¶ 14.

12. TelexFree's Profit and Loss Statement for 2013 expressly separated TelexFree's revenue into 2 categories: (1) "payments through bank," which is a direct payment from the individual purchasing a membership program from TelexFree, and (2) "payments through system," which is a payment of a membership fee received by TelexFree through Triangular Transactions. Darr ¶ 15.

13. The Profit and Loss Statement for TelexFree for calendar year 2013 reflects \$119 million in income "paid through bank", reflecting membership fees paid by individuals directly to TelexFree to join the program. Scheduled on the Profit and Loss Statement is an additional

\$572 million in income “paid through system”. That entry reflects membership fees collected by Promoter from individuals through a Triangular Transaction. Darr ¶ 16.

14. The Profit and Loss Statement separately identifies expenses attributable to Triangular Transactions as commissions paid to Promoters in Triangular Transactions. The Income Statement reflects an expense of \$572 million for “Agent Commission – paid through system”, representing payments received by Promoters as part of a Triangular Transaction. Darr ¶ 17, and Profit and Loss Statement Exhibit D.

15. The treatment on the Profit and Loss Statement appropriately reflects the economic substance of the Triangular Transactions. The membership fees collected by a Promoter were revenue of TelexFree, e.g., property of TelexFree, and the corresponding distribution to Promoters was treated as an expense, e.g., payment by TelexFree of an “agent’s commission”. Darr ¶ 18.

16. TelexFree issued Forms 1099 to Promoters in calendar year 2013 for income earned by Promoters from their involvement in TelexFree for that year. Darr ¶ 19.

17. The 1099 forms reported as income to Promoters both credits redeemed directly with TelexFree and income earned by Promoters for recruiting individuals into the scheme through Triangular Transactions. Darr ¶ 20.

18. The 1099 forms provide further evidence of the economic substance of the Triangular Transaction, money paid by TelexFree to Promoters for recruiting an individual into the scheme is treated as income to TelexFree, and the payment retention by the Promoters of those membership fees is treated as income to the Promoter and an expense of TelexFree. Darr ¶ 21.

19. The Ponzi Motion describes the mechanics of the TelexFree system, including the integral nature of the Triangular Transactions. See Docket No. 623, 623-1, Ponzi Motion and supporting Affidavit annexed as Exhibit D.

20. A central premise of the Ponzi Motion as filed and approved by the Court was that claims should not be limited to payments made by individuals directly to TelexFree to join the program but needed to include fee collected from individuals and cash paid to promoters as part of the Triangular Transactions. Darr ¶ 23 and Exhibit D.

21. The Order entered by the Court directed the use of the Net Equity formula for determining allowance of claims would include both aspects of the Triangular Transactions. This formulation for allowance of claims expressly provided that fees collected by Promoters from individuals would be deemed paid to TelexFree and the amount retained by a Promoter deemed a payment by TelexFree to the Promoter. Docket entry no. 687 Order annexed as Exhibit E, and Darr ¶ 24.

22. The Net Equity formula recognized that individuals recruited into the TelexFree program through a Triangular Transaction transferred money to TelexFree in exchange for the right to participate in the TelexFree program and the right to earn credits, thereby creating an obligation between TelexFree and that recruited individual which should be treated on the same basis as an individual who had paid the membership fee directly to TelexFree. Darr ¶ 25, and Exhibit E.

23. The “Net Losers” in the scheme would thereby be treated equally under the Net Equity determination regardless of how their investment was made. Darr ¶ 26, and Exhibit E.

24. Similarly, it was important that the claims of Promoters who recruited the individuals into the program and collected a “commission” for doing so should be reduced to

reflect amounts paid to, and retained by, them through Triangular Transactions in order to avoid a windfall. Darr ¶ 27.

25. The Ponzi Motion set forth the inequities that would result if Triangular Transactions were not included in the calculation of the amount of a Promoter's claim. Darr ¶ 28, and Exhibit D.

26. First, the individual recruited by the Promoter would be denied a claim for amounts paid to the Promoter to purchase a membership plan from the Debtors. Darr ¶ 29.

27. This would have created an inequitable result since a substantial portion of Net Losers would be denied compensation because they were recruited into the scheme through a Triangular Transaction as opposed to having been recruited directly by TelexFree. Darr ¶ 30.

28. Second, the Promoter who recruited the individual into the scheme would profit by having redeemed credits through retaining the recruited individual's membership fee without a corresponding reduction in the Promoter's claim amount to reflect this payment. Darr ¶ 31.

29. This inequity is rectified by including the Triangular Transactions in the calculation of Net Winners and Net Losers. Darr ¶ 32, and Exhibits D and E.

30. The approval of the Net Equity formula for determining claims in the case appropriately addresses the equities of the case by recognizing the economic realities of the Triangular Transaction. Darr ¶ 33, and Exhibit E.

31. The PIEC recognized the inherent fairness of the application of the Net Equity determination to include the Triangular Transactions and, therefore, did not object to the allowance of claims using the Net Equity determination. Rather, the Defendants reserved their rights to argue the inconsistent position that the fees paid by individuals recruited into the scheme through Triangular Transactions constituted a claim against the Debtors, but the

corresponding payment to a Promoter by TelexFree is not a transfer of property of the Debtors. *Opposition to Certain Aspects of the Relief Sought in the Motion by Chapter 11 Trustee for Entry of Order Finding that Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief*, Docket No. 649; *see also excerpts of Transcript of Hearing before the United States District Court on the Trustee's Motion to Intervene*, annexed as Exhibit F.

32. The Trustee has commenced two class actions seeking to recover from Net Winners, under theories of both fraudulent transfer and preferential transfer, amounts they received through direct and Triangular Transactions in excess of amounts they contributed into the TelexFree program. Adversary Proceeding 16-4006 and Adversary Proceeding 16-4007, Darr ¶ 34.

33. The first class action adversary proceeding, Adv. Proc. No. 16-4006, was commenced against all Net Winners who are alleged to reside within the United States. There are approximately 14,818 Net Winners falling within this category. 105 participants have been named as individual Defendants and proposed class representatives in the domestic class action, who are believed to be Net Winners in the aggregate amount of approximately \$109 million. A substantial portion of the \$109 million is attributable to the Triangular Transactions. Complaint, Adversary Proceeding No. 16-4006, and Darr ¶ 35.

34. The second class action adversary proceeding, Adv. Proc. No. 16-4007, was commenced against all Net Winners who are alleged to reside outside of the United States. I estimate that there are 78,487 Net Winners falling within this category. I have named 96 participants as individual Defendants and proposed class representatives in the foreign class action, who are believed to be Net Winners in the aggregate amount of approximately \$76

35. In these Adversary Proceedings the Trustee seeks recoveries on behalf of all Net Losers, including those who lost money through direct transactions, Triangular Transactions, or any combination thereof. A predicate to the Trustee's pursuit of recoveries from Net Winners arising from Triangular Transactions is a finding that the membership fees paid to and retained by recruiting Promoters in Triangular Transactions comprised property of TelexFree. Darr ¶ 37.

36. When the economic substance of the Triangular Transactions is considered, the payments received by the Promoters in Triangular Transactions constitutes property of the TelexFree Estate and are recoverable by the Trustee as fraudulent transfers or preferential transfers. Darr ¶ 37.

37. Each of the Defendants named in this Adversary Proceeding were plaintiffs in actions pending before the United States District Court for the District of Massachusetts or United States District Court for the District of Arizona. Each represented in their pleadings that they were Net Losers. Each further represented they were representative of Net Losers who suffered losses as a result of Triangular Transactions. Second Amended Complaint (Docket No. 144) in Civil Action Nos. 14-MD-02566-TSH and Complaint in Civil Action No. 16-CV-40018-TSH, Darr ¶ 38.

38. An examination of the Defendants' activity reveals, however, that these representations are in some instances inaccurate. Darr ¶ 39.

39. In advancing these claims, the Defendants have also alleged at various times to have had no involvement or affiliation with the TelexFree operations. Darr ¶ 40.

40. A review of the facts, however, indicates that the Defendants have in each instance been intimately involved in the TelexFree scheme. Darr ¶ 41.

41. Maria Murdoch testified in Court at an evidentiary hearing in October 2015 that she had invested approximately \$25,000 in the TelexFree scheme but that she had no contact with the Debtors, never became a member of TelexFree, and never received an invoice. Darr ¶ 42, Transcript of Ms. Murdock Testimony annexed hereto as Exhibit G.

42. The Debtors' books and records reflect, however, that Ms. Murdock maintained *seventy-five* (75) accounts ("User Accounts") with the Debtors, with each User Account representing the purchase of a plan. Darr ¶ 43.

43. In fact, all of the Defendants had multiple User Accounts with TelexFree as follows: Rita Dos Santos: 12; Angela Batista Jiminez: 55; Elisangela Oliveira: 3; Diogio De Araugo: 65; and Celio Da Silva: 142. Each of the Defendants had the opportunity to earn credits and to recruit other individuals into the scheme. Darr ¶ 44.

44. In the case of Dos Santos, not only did she open multiple User Accounts with TelexFree but she received \$8,035.91 in payments directly from TelexFree. Darr ¶ 45.

45. The evidence of these payments directly contradicts representations made by the Defendants in the multi-district litigation that Dos Santos never received any money from TelexFree. *In re TelexFree Securities Litigation*, MDL No. 4:14-md-2566 (D. Mass.) (hereinafter, the "MDL Action"), Docket No. 253-1, ¶ 38, and Darr ¶ 46.

46. Indeed, some of the Defendants are actually Net Winners in the TelexFree scheme. The Debtors' records indicate that Da Silva was a Net Winner in the amount of \$15,343 and Jiminez was a Net Winner in the amount of \$347.80. Darr ¶ 47.

47. The Defendants have made attempts to bring class actions against Net Winners in Triangular Transactions on behalf of all Net Losers in Triangular Transactions and on each occasion, their efforts fail. Docket Entry 367 in the MDL Action annexed as Exhibit H, and *Elisangela Oliveira et al. v. TelexElectric LLLP et al.*, Case No. 4:16-cv-40018 (the “Oliveira Action”), Docket No. 6 annexed as Exhibit I.

48. The Defendants’ attempts, on at least two occasions, to bring Unjust Enrichment Claims in District Court, on a class action basis, against Promoters who became Net Winners based upon the receipt of membership fees from other Promoters in Triangular Transactions, have appropriately been denied. MDL Action, Docket No. 367, Exhibit H; Oliveira Action, Docket No. 6, Exhibit I.

49. In one instance, the District Court denied the Defendants’ motion to amend their Complaint to sue the Net Winners in Triangular Transactions as a class. Docket No. 367 in the MDL Action, Exhibit H.

50. In the second instance, the Defendants’ action was stayed because it was found to be an improper attempt to circumvent the order in the first case. Oliveira Action, Docket No. 6, Exhibit I.

STEPHEN B. DARR AS TRUSTEE
OF THE ESTATES OF TELEXFREE,
LLC, TELEXFREE, INC. and
TELEXFREE FINANCIAL, INC.

By his attorneys,

Dated: September 2, 2016

/s/ Andrew G. Lizotte
Harold B. Murphy (BBO #326610)
Charles R. Bennett, Jr. (BBO #037380)
Andrew G. Lizotte (BBO #559609)
Murphy & King, Professional Corporation
One Beacon Street
Boston, Massachusetts 02108
(617) 423-0400
CBennett@murphyking.com

714588

In re:) Chapter 11
)
) Case No. 14-40987
TELEXFREE LLC, <u>et al.</u> , ¹)
) Jointly Administered
Debtors.)
)
)

A hearing (the “Hearing”) having been held on November 24, 2015, on the *Motion by Chapter 11 Trustee* (the “Trustee”) *for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* [# 623] (the “Motion”)²; and it appearing that this Court has jurisdiction to consider the Motion pursuant to 28 U.S.C. §§ 157 and 1334; and it appearing that venue of these jointly administered chapter 11 cases and the Motion in this district is proper pursuant to 28 U.S.C. §§ 1408 and 1409; and it appearing that this matter is a core proceeding pursuant to 28 U.S.C. § 157(b); and the Court having considered the evidence admitted and arguments made at the Hearing, the Motion and the oppositions filed thereto; and the Court having entered a Proceeding Memorandum/ Order on the Motion on November 25, 2015 [# 654]; and the Plaintiffs Interim Executive Committee having filed a motion to alter or amend the November 25, 2015 Order; and the chapter 11 trustee having filed an opposition thereto; and the Court having considered the positions of the parties; and after due deliberation thereon; and good and sufficient

² Capitalized terms used but not defined herein have the meaning ascribed to them in the Motion.

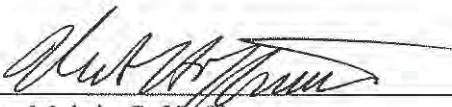
cause appearing therefor; it is hereby **ORDERED** that the Motion is **GRANTED** in part and **CONTINUED FOR FURTHER PROCEEDINGS** in part as follows:

1. This Order hereby amends, and, to the extent of any inconsistency, supersedes the November 25, 2015 Order.
2. All creditors and parties in interest, including Participants, received adequate notice and an opportunity to be heard as to prayers (i) and (iii) of the Motion, and prayer (iv) as it applies to prayers (i) and (iii).
3. The relief sought by the Trustee in prayers (i) and (iii) of the Motion did not require the commencement of an adversary proceeding pursuant to Fed. R. Bankr. P. 7001.
4. Each of the Debtors in these jointly administered cases operated a Ponzi and pyramid scheme. This ruling is the law of the case in each of the jointly administered cases.
5. The Debtors shall be jointly and severally liable for the claims of Participants (as defined in the Motion) in these Chapter 11 cases. This ruling is the law of the case in each of the jointly administered cases.
6. The entry of this Order does not constitute any finding, and the Court makes no finding whatsoever, as to prayer (ii) of the Motion (including as to whether all or any part of the relief sought by prayer (ii) of the Motion required the commencement of an adversary proceeding pursuant to Fed. R. Bankr. P. 7001), or as to prayer (iv) of the Motion insofar as prayer (iv) of the Motion requests a finding related to prayer (ii) of the Motion.
7. A further non-evidentiary hearing shall be held as to prayer (ii) of the Motion, and prayer (iv) of the Motion insofar as prayer (iv) of the Motion requests a finding related to prayer (ii) of the Motion, on **January 26, 2016 at 10:00 a.m. (Prevailing Eastern Time)**. Responses, including proposed orders, shall be filed no later than **January 19, 2016 at 4:30 p.m. (Prevailing**

Eastern Time). On or before **December 7, 2015**, the Trustee shall serve notice of such hearing and response deadline as well as a plain language explanation of the relief sought on the same parties and in the same manner as the Motion was previously served, and shall file a certificate of such service.

8. The Court shall retain jurisdiction to hear and determine all matters arising from or related to the construction, performance, enforcement and implementation of the terms of this Order.

Dated: December 21, 2015
Boston, Massachusetts



Hon. Melvin S. Hoffman
Chief United States Bankruptcy Judge

In re:)	Chapter 11
)	
TELEXFREE LLC., <u>et al.</u> , ¹)	Case No. 14-40987
)	
Debtors.)	Jointly Administered
)	
)	

Lead Counsel and the Plaintiffs' Interim Executive Committee (together, the "PIEC") appointed by the United States District Court in this District as the representative of the victims of the Debtors' Ponzi scheme by orders entered in the multi-district litigation proceedings captioned *In re TelexFree Securities Litigation*, MDL No. 14-02566 (D. Mass) (the "MDL Proceeding"), hereby move (this "Motion") to amend or alter the Court's order [Dkt. No. 654] (the "Order") on the *Motion by Chapter 11 Trustee* (the "Trustee") *for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* [Dkt. No. 623] (the "Ponzi Scheme Motion") in certain limited respects as described below to more precisely follow the rulings made in open court at the hearing on the Ponzi Scheme Motion and so as to avoid the risk of later misinterpretation. In support thereof and as grounds therefor, the PIEC respectfully states as follows:

1. On October 7, 2015, the Trustee filed the Ponzi Scheme Motion seeking entry of an order:

¹ The debtors (the “Debtors”) in these cases (collectively, the “Chapter 11 Cases”) are TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc.

- Thus, the fourth prayer for relief appears to relate to each of the previous three prayers.

3. The Court held an evidentiary hearing on the Ponzi Scheme Motion on November 24, 2015 (the “Hearing”). The Court heard argument on the Trustee’s first, third and fourth prayers for relief, including as to whether the Trustee’s request for a determination that the Debtors operated a Ponzi/pyramid scheme (the first prayer for relief) properly should have been brought as an adversary proceeding. See, e.g., Tr. of Nov. 24, 2015 Hr’g at 34:15-35:3.² The Court did not hear argument on the Trustee’s second prayer for relief, including the legal basis

² Relevant excerpts of the transcript of the November 24 hearing are attached hereto as **Exhibit 1**.

4. At the end of the Hearing, the Court made certain findings as to the first, third and fourth prayers for relief. The Court also ruled that it was making no findings whatsoever either on (i) the Trustee's second prayer for relief, as pertains to the proposed "Net Equity" calculation of claims, or (ii) the Trustee's fourth prayer for relief, inasmuch as it requested that findings on the Trustee's second prayer for relief apply throughout the case, "for all purposes." See Tr. of Nov. 24, 2015 Hr'g at 121:17-122:15. The Court likewise ruled that it was making no findings on whether the Trustee's second prayer for relief should have been brought as an adversary proceeding. The Court instead took those matters under advisement pending a further hearing.

RELIEF REQUESTED

3

7. Federal Rule Civil Procedure 59(e) (“FRCP 59(e)”), made applicable to this case by Federal Rule of Bankruptcy Procedure 9023, provides that a motion to amend or alter judgment may be brought within 14 days of entry of the judgment.

8. The trial court has broad discretion in determining whether to grant a motion to amend under FRCP 59(e). See ACA Fin. Guar. Corp. v. Advest, Inc., 512 F.3d 46, 55 (1st Cir. 2008) (stating that Rule 59(e) “does not state what grounds would justify [] alteration” and that trial courts therefore “enjoy considerable discretion in deciding Rule 59(e) motions”); Robinson v. Watts Detective Agency, Inc., 685 F.2d 729, 743 (1st Cir. 1982) (“[A] Rule 59(e) motion is addressed the discretion of the [trial] court.”).

9. In two respects, the Order may be read to appear to extend the very specific rulings made at the Hearing in a way the PIEC respectfully believes the Court did not intend. First, the Order, after making certain findings related to the first and third prayer for relief, goes on to say that “the relief sought by the trustee in [the Ponzi Scheme Motion] did not require the commencement of an adversary proceeding pursuant to FRBP 7001.” This language (“the relief sought”) is subject to the interpretation that *none* of the relief requested required the commencement of an adversary proceeding. But the question of whether the Trustee’s second prayer for relief is an attempt to determine the validity of an interest in property, and thus requires the Trustee to commence an adversary proceeding, was not reached at the Hearing. It is respectfully submitted, therefore, that the Order should be clarified on this point to address only those matters reached at the Hearing and not reserved for further argument: (specifically, whether the Trustee’s first and third prayer for relief required the commencement of an adversary proceeding).

- (i) that adequate notice was given of the Trustee's request that all findings regarding whether the Debtors operated a Ponzi and pyramid scheme apply "throughout these proceedings, for all purposes" (undisputed);
- (ii) that adequate notice was given of the Trustee's request that any finding that the Debtors are jointly and severally liable for the claims of participants in the scheme likewise apply "throughout these proceedings, for all purposes" (also undisputed); and
- (iii) that adequate notice was given of the Trustee's request that all findings on the "Net Equity" calculation (and any other aspects of the second prayer for relief reserved for further hearing) apply "throughout these proceedings, for all purposes."

11. This third meaning is contrary to the Court's noting at the Hearing that it was making no findings whatsoever related to the Trustee's second prayer for relief or any matters reserved for further hearing, including as to whether adequate notice was given as to the Trustee's request that any findings on the second prayer apply "throughout these proceedings, for all purposes." (Indeed, the Court has ordered extensive re-noticing of the Trustee's second prayer for relief.) Accordingly, without clarification that the Order's finding on the fourth prayer for relief does not relate to, and has no effect on, the intersection of the fourth prayer and the second prayer (or any matters reserved for further hearing), the Order

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CONCLUSION

WHEREFORE, for the foregoing reasons, the PIEC respectfully requests that this Court (a) amend or alter the Order to reflect that it has made no findings (i) on the Motion's second prayer for relief, or (ii) on the Ponzi Scheme Motion's fourth prayer for relief, insofar as prayer four requests a finding related to prayer two, and (b) grant such other and further relief as this Court finds just and proper.

Dated: December 8, 2015
Boston, Massachusetts

BONSIGNORE, PLLC

/s/ Robert B. Bonsignore
Robert B. Bonsignore
NH Bar 21241
3771 Meadowcrest Drive
Las Vegas, Nevada 89121
Telephone: 781-856-7650
rbonsignore@classactions.us
Interim Lead Counsel

BROWN RUDNICK LLP

/s/ William R. Baldiga
William R. Baldiga (BBO #542125)
Kiersten A. Taylor (BBO #681906)
Jill C. Wexler (BBO #691811)
One Financial Center
Boston, MA 02111
Telephone: (617) 856-8200
Facsimile: (617) 856-8201
wbaldiga@brownrudnick.com
ktaylor@brownrudnick.com
jwexler@brownrudnick.com
For the Plaintiffs' Interim Executive Committee

EXHIBIT 1

1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38 39 40 41 42 43 44 45 46 47 48 49 50 51 52 53 54 55 56 57 58 59 60 61 62 63 64 65 66 67 68 69 70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 100 101 102 103 104 105 106 107 108 109 110 111 112 113 114 115 116 117 118 119 120 121 122 123 124 125 126 127 128 129 130 131 132 133 134 135 136 137 138 139 140 141 142 143 144 145 146 147 148 149 150 151 152 153 154 155 156 157 158 159 160 161 162 163 164 165 166 167 168 169 170 171 172 173 174 175 176 177 178 179 180 181 182 183 184 185 186 187 188 189 190 191 192 193 194 195 196 197 198 199 200 201 202 203 204 205 206 207 208 209 210 211 212 213 214 215 216 217 218 219 220 221 222 223 224 225 226 227 228 229 230 231 232 233 234 235 236 237 238 239 240 241 242 243 244 245 246 247 248 249 250 251 252 253 254 255 256 257 258 259 260 261 262 263 264 265 266 267 268 269 270 271 272 273 274 275 276 277 278 279 280 281 282 283 284 285 286 287 288 289 290 291 292 293 294 295 296 297 298 299 300 301 302 303 304 305 306 307 308 309 310 311 312 313 314 315 316 317 318 319 320 321 322 323 324 325 326 327 328 329 330 331 332 333 334 335 336 337 338 339 340 341 342 343 344 345 346 347 348 349 350 351 352 353 354 355 356 357 358 359 360 361 362 363 364 365 366 367 368 369 370 371 372 373 374 375 376 377 378 379 380 381 382 383 384 385 386 387 388 389 390 391 392 393 394 395 396 397 398 399 400 401 402 403 404 405 406 407 408 409 410 411 412 413 414 415 416 417 418 419 420 421 422 423 424 425 426 427 428 429 430 431 432 433 434 435 436 437 438 439 440 441 442 443 444 445 446 447 448 449 450 451 452 453 454 455 456 457 458 459 460 461 462 463 464 465 466 467 468 469 470 471 472 473 474 475 476 477 478 479 480 481 482 483 484 485 486 487 488 489 490 491 492 493 494 495 496 497 498 499 500 501 502 503 504 505 506 507 508 509 510 511 512 513 514 515 516 517 518 519 520 521 522 523 524 525 526 527 528 529 530 531 532 533 534 535 536 537 538 539 540 541 542 543 544 545 546 547 548 549 550 551 552 553 554 555 556 557 558 559 560 561 562 563 564 565 566 567 568 569 570 571 572 573 574 575 576 577 578 579 580 581 582 583 584 585 586 587 588 589 590 591 592 593 594 595 596 597 598 599 600 601 602 603 604 605 606 607 608 609 610 611 612 613 614 615 616 617 618 619 620 621 622 623 624 625 626 627 628 629 630 631 632 633 634 635 636 637 638 639 640 641 642 643 644 645 646 647 648 649 650 651 652 653 654 655 656 657 658 659 660 661 662 663 664 665 666 667 668 669 670 671 672 673 674 675 676 677 678 679 680 681 682 683 684 685 686 687 688 689 690 691 692 693 694 695 696 697 698 699 700 701 702 703 704 705 706 707 708 709 710 711 712 713 714 715 716 717 718 719 720 721 722 723 724 725 726 727 728 729 730 731 732 733 734 735 736 737 738 739 740 741 742 743 744 745 746 747 748 749 750 751 752 753 754 755 756 757 758 759 760 761 762 763 764 765 766 767 768 769 770 771 772 773 774 775 776 777 778 779 780 781 782 783 784 785 786 787 788 789 790 791 792 793 794 795 796 797 798 799 800 801 802 803 804 805 806 807 808 809 810 811 812 813 814 815 816 817 818 819 820 821 822 823 824 825 826 827 828 829 830 831 832 833 834 835 836 837 838 839 840 841 842 843 844 845 846 847 848 849 850 851 852 853 854 855 856 857 858 859 860 861 862 863 864 865 866 867 868 869 870 871 872 873 874 875 876 877 878 879 880 881 882 883 884 885 886 887 888 889 890 891 892 893 894 895 896 897 898 899 900 901 902 903 904 905 906 907 908 909 910 911 912 913 914 915 916 917 918 919 920 921 922 923 924 925 926 927 928 929 930 931 932 933 934 935 936 937 938 939 940 941 942 943 944 945 946 947 948 949 950 951 952 953 954 955 956 957 958 959 960 961 962 963 964 965 966 967 968 969 970 971 972 973 974 975 976 977 978 979 980 981 982 983 984 985 986 987 988 989 990 991 992 993 994 995 996 997 998 999 1000 1001 1002 1003 1004 1005 1006 1007 1008 1009 1010 1011 1012 1013 1014 1015 1016 1017 1018 1019 1020 1021 1022 1023 1024 1025 1026 1027 1028 1029 1030 1031 1032 1033 1034 1035 1036 1037 1038 1039 104

Proceedings recorded by electronic sound recording; transcript produced by transcription service.

1 APPEARANCES (continued):

2 For Interim Lead Class
3 Counsel and Plaintiffs'
 Interim Executive Committee:

Brown Rudnick LLP
BY: KIERSTEN A. TAYLOR, ESQ.
WILLIAM R. BALDIGA, ESQ.
One Financial Center
Boston, MA 02111

6 For Stephen Darr,
Chapter 11 Trustee:

Murphy & King, P.C.
BY: ANDREW G. LIZOTTE, ESQ.
HAROLD B. MURPHY, ESQ.
CHARLES BENNETT, JR., ESQ.
One Beacon Street, 21st Floor
Boston, MA 02108

10 For Carlos N. Wanzeler
and James Merrill:

Partridge Snow & Hahn LLP
BY: WILLIAM MOORMAN, JR., ESQ.
30 Federal Street
Boston, MA 02110

12	ALSO PRESENT:
----	---------------

STEPHEN DARR
Chapter 11 Trustee
265 Franklin Street
Boston, MA 02210

1 | other than in the claims allowance process.

2 THE COURT: Well, I ask you the same question I asked
3 Mr. Baldiga. What is the principal reason why a court should
4 restrict findings that it makes and rulings that it makes that
5 are final the way you're requesting? Why would I do that?

6 MR. MOORMAN: Well, this was not an action brought
7 against Mr. Wanzeler or Mr. Merrill. If the trustee desires
8 some relief to be binding upon them, applicable to them in this
9 area, it should have been done by adversary proceeding.

10 There are other issues such as whether or not it would
11 be a core proceeding as it relates to seeking a finding that
12 would be binding on them and as --

13 THE COURT: Well, not binding on them, specifically.
14 They're not mentioned at all in any of this. Just binding for
15 all purposes in this case and to the extent that they want to
16 come into this case, why shouldn't they be bound with, with
17 notice?

18 MR. MOORMAN: Only to them coming into this case,
19 that's, that's one thing, but if -- what we're questioning is
20 extending it beyond this case and to some other case.

21 THE COURT: How, how altogether do these individuals
22 have standing in this case in any way? Can you explain that to
23 me, please?

24 MR. MOORMAN: As to whether or not they have standing,
25 Your Honor?

11-24-2015

1 MR. MOORMAN: I think the formalities are important in
2 terms of service of process, the applicable Rules of procedure.
3 Judge, this was done in a very quick time frame.

4 THE COURT: When was your motion filed, Mr. Murphy?

5 MR. MURPHY: October 7th, Your Honor.

6 THE COURT: Yeah.

7 MR. MOORMAN: The, the other proceedings that they are
8 subjected to are going to take months and months of trial.

9 THE COURT: Not here, not with me. You know,
10 bankruptcy moves quickly.

11 MR. MOORMAN: Right, but they're not, they're not
12 parties to this proceeding. We filed this as a protective
13 measure, Your Honor, to the extent that the trustee seeks to
14 have them bound in some other proceeding.

15 THE COURT: One of the things I think you, that came
16 up in your opposition was a comment about needing to do
17 discovery. Can you elaborate on that? What kind of discovery
18 would your clients need here?

19 MR. MOORMAN: Your Honor, I'm not sure exactly what
20 discovery they would want to engage in here.

21 THE COURT: Okay. Thank you.

22 MR. MOORMAN: I imagine it would be extensive
23 discovery, though, that I'm not -- I'm here for the procedural
24 mechanism of this proceeding, the fact this was done by motion,
25 and the fact that I --

1 transmitted - she would have a claim in this bankruptcy case
2 for that \$25,000 under that determination. That, that would be
3 part of it.

4 And that -- those -- if you will, payments into
5 (indiscernible) would be included in part of their claim and it
6 would not just include direct, but it would also include what
7 we call the triangular transactions. I'll use, probably, a
8 different term for purposes of explaining that to people.

9 Is that what you want me to explain in the notice,
10 Your Honor?

11 THE COURT: Yes. Thank you.

12 MR. MURPHY: Thank you.

13 THE COURT: So now let's talk about the next hearing
14 and how much time we need for this.

15 MR. BALDIGA: And, Your Honor --

16 THE COURT: Yes.

17 MR. BALDIGA: -- you've addressed the first three
18 prayers for relief. Prayer 4, is that also to be argued
19 further at that next hearing?

20 THE COURT: I -- I -- Prayer 4 is the -- I, I
21 addressed that. That's -- I -- I -- I'm finding that the Ponzi
22 scheme, pyramid scheme finding is the law of this case. That's
23 Prayer 4.

24 MR. BALDIGA: And, and the Ponzi scheme finding, yes.

25 And -- and -- I guess I should have been more specific.

1 If there is to then be a ruling on the triangular
2 aspect of it, which is not the Ponzi scheme, the only thing
3 that people really are fighting about today is whether a
4 finding on the triangular aspect of the proof of claim form
5 that you're reserving on, whether that because a law of the
6 case for purposes other than the allowance of claims.

7 THE COURT: Oh, okay.

8 MR. BALDIGA: That is, I think, the entire core of the
9 dispute here. And I just want to be sure that's not lost in
10 the shuffle of today's proceedings.

11 THE COURT: What I've done today does not affect that
12 one was or the other.

13 MR. BALDIGA: That's what I understood.

14 THE COURT: So you still have the opportunity to
15 address that at the next hearing.

16 MR. BALDIGA: Very good. Thank you.

17 THE COURT: And lastly, Your Honor, have you
18 determined that the credits, the disallowance of credits for
19 claim purposes is, is okay for today?

20 THE COURT: Disallowance of credits.

21 MR. MURPHY: That was, I think, one of the --

22 THE COURT: That's --

23 MR. MURPHY: -- one of the prongs we had, that the
24 credits that were in the --

25 THE COURT: No. That, that's part of Prayer 2. That

5. The facts in this affidavit are drawn from my review of documents and data obtained during the investigation, my training and experience, and information obtained from other agents. This affidavit is only intended to show that there is sufficient probable cause for the requested warrants. It does not contain all facts relevant to this matter.

6. **Xand Corporation**: Based on open source information and information provided by James Merrill, the President of TelexFree, during sworn testimony before the Massachusetts Securities Division on March 25, 2014,¹ Xand Corporation, a/k/a Access Northeast, is a business that hosts data for other companies. According to Xand’s website, its Massachusetts “data center,” located at 34 Saint Martin Drive, Marlborough, Massachusetts, is one of six it maintains nationwide. According to Merrill’s testimony, TelexFree maintains servers at Xand’s Marlborough data center; TelexFree itself owns the servers, but they are held by Xand in its facility, where Xand can provide a secure environment and service the machines as needed.

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According to Merrill, TelexFree, at least as of the date of his testimony, had begun the process of “migrating” data from Xand to Exigo, a company based in Texas.

7. **Exigo Office, Inc.**: Based on open source information and Merrill’s testimony to the MSD, Exigo is a company based in Dallas, Texas, at 8130 John W. Carpenter Freeway, that markets specifically to “multi-level marketing” businesses. “Multi-level marketing” is a term for businesses that market their products through a hierarchy of people who sign up to make money pursuing that activity, and who recruit others to do so. Certain businesses that purport to be legitimate multi-level marketing (“MLM”) enterprises are in fact illegal pyramid schemes. On its web site, Exigo touts its MLM “business platform.” In his MSD testimony, Merrill referred to Exigo as a “more friendly environment,” confirmed that TelexFree has a contract with Exigo and, as above, said that TelexFree had begun “migrating” its data to Exigo. Based on Exigo’s web site, it has only one location.

8. **TelexFree Headquarters:** According to TelexFree’s public filings and Merrill’s testimony, TelexFree’s business headquarters are located at 225 Cedar Hill Street, Suite 118, Marlborough, Massachusetts. As more fully described in Attachment A, based on surveillance by federal agents, 225 Cedar Hill Street is a multi-unit, multi-story brick façade commercial property located on the east side of Cedar Hill Street in Marlborough, Massachusetts. The number “225” is plainly visible in grey lettering and “REGUS Fully Furnished Offices” is plainly visible in blue lettering on the façade of the building. The TelexFree offices are located on the first floor within the building; “TELEXFREE INC. Employee Entrance” in white and blue lettering, as well as the company logo, is plainly visible on the glass door to the office. According to Merrill’s sworn testimony, TelexFree’s business is run out of Suite 118 of the building, although the business “used to be upstairs in the Regus Suite, Suite 200.” Merrill

explained that the initial space became too small for the company's operations, and that the new area "downstairs" at Suite 118 had about 4,500 square feet. Merrill described the new space as having about 12 "individual spaces" and five "executive offices," a conference room and a training area. The headquarters appears to employ about 30 people.²

9. With regard to the search warrants to be executed at Xand and Exigo above, I am informed that warrants issued under 18 U.S.C. § 2703 do not require an officer to be present for service or execution of the search warrant. *See* 18 U.S.C. § 2703(g).³ If the Court issues the warrants,

a. As to Xand, because it appears that TelexFree itself owns the servers maintained at Xand's Marlborough location and that, therefore, those servers are discrete storage devices containing only TelexFree data, the government intends to have agents serve the warrant on Xand personnel and, at that time, take physical possession of TelexFree's servers.⁴

b. As to Exigo Office, Inc., to minimize the level of government intrusion, the United States does not intend to execute that warrant by entering Exigo's Dallas office location, but by serving a copy of the warrant on Exigo and awaiting production of the requested data.

² "[W]e were able to re-engineer some [of the 12] cubicles to fit 30 people in the same area that there is 12."

³ Section 2703(g) says that "[n]otwithstanding § 3105 of this title, *the presence of an officer shall not be required for service or execution of a search warrant* issued in accordance with this chapter requiring disclosure by a provider of electronic communications service or remote computing service of the contents of communications or records or other information pertaining to a subscriber to or customer of such service." (Emphasis added.)

⁴ The government seeks authorization for the search warrant on Xand pursuant to both Federal Rule of Criminal Procedure Rule 41 and 18 U.S.C. § 2703.

Allegations Pertaining to Probable Cause to Believe that TelexFree is a Pyramid Scheme

13. People operating pyramid schemes usually go to great lengths to layer the program with jargon, procedural complexities, a formalized hierarchy of participation, and other trappings that create the appearance of a legitimate company pursuing a (legal) multi-level marketing program. But, as in “Ponzi”-type schemes, the organizers simply take in money from newly-invested participants and use those funds to pay the returns promised to earlier participants.

14. Again like Ponzi schemes, pyramid schemes are ultimately unsustainable because the returns promised to an ever-growing number of participants must be paid using funds deposited by a necessarily finite pool of new participants. At some point the scheme must become too big, that is, it must run out of new participants depositing sufficient cash to cover commitments to earlier participants and, because the underlying product is not in fact profitable, most of the scheme's participants lose their money.

15. In this case, between about January 2012 and March 2014, TelexFree purported to aggressively market its VOIP service by recruiting thousands of “promoters” to post ads for the product on the internet. Each promoter was required to “buy in” to TelexFree at a certain price, after which they were compensated by TelexFree, under a convoluted compensation structure, on a weekly basis so long as they post ads for TelexFree’s VOIP service on the internet. What TelexFree failed to disclose, however, was that it was not concerned with advertising the VOIP service; the ad-posting requirements were a meaningless exercise, in which promoters cut and paste ads into various classified ad sites provided by TelexFree and already saturated with ads posted by earlier participants.

16. Meanwhile, as TelexFree’s bank records and “back office” business data attest, it derived a miniscule amount of revenue from sales of VOIP service – less than 1% of TelexFree’s hundreds of millions of dollars in revenue over the last two years. The overwhelming majority of its revenue – the other roughly 99% – came from new people buying into the scheme. In fact, TelexFree was only able to pay the returns it had promised to its existing promoters by bringing in money from newly-recruited promoters.

17. On or about March 8, 2014, TelexFree announced changes to its compensation system that appear to have been prompted by an investigation by the Massachusetts Securities

19. The day of the bankruptcy filing, TelexFree's web site, which all TelexFree promoters use to manage their accounts and transfer funds paid to them by TelexFree, became inoperative, with a screen posting by the company notifying its investors that the situation was temporary and that TelexFree looked forward to reorganizing and continuing to do business.

II. The Brazilian Investigation of TelexFree⁵

20. In June 2013, open-source query about TelexFree revealed that it was under investigation by law enforcement authorities in Brazil, where TelexFree was originally based. Documents provided by Brazilian law enforcement authorities showed that they had concluded that TelexFree was a pyramid scheme, operating with the same modus operandi later used in the United States (that is, that the company ostensibly provided VOIP services, but in fact derived revenue principally from new promoter buy-in fees). The Brazilians also determined that Carlos Wanzeler, James Merrill, and Carlos Costa were connected to the Brazilian entity. For example, in 2010, Wanzeler registered a company in Brazil named “Ympactus,” which began doing business as TelexFree in 2012.

21. The Brazilian investigation resulted in the Brazilian government suing TelexFree in June 2013, including seeking an injunction prohibiting TelexFree from recruiting new promoters and from taking in funds or paying money to existing TelexFree promoters. As of the date of this affidavit, the Brazilian injunction is still in effect. Also, according to sworn testimony provided by Carlos Wanzeler to the MSD, the Brazilian government has also frozen about \$350,000,000 in funds that apparently belongs to TelexFree.

22. Records from the Brazilian Ministry of the Treasury showed that, since TelexFree began recruiting promoters in Brazil in 2012, TelexFree bank accounts in Brazil had received about \$446,000,000 in U.S. dollars. The records also noted that on February 19, 2013, TelexFree’s Brazilian bank balances totaled over \$200,000,000. The Brazilian Ministry of Treasury materials also showed that transfers were made from TelexFree bank accounts to

⁵ At this point, TelexFree has been investigated and prohibited from operating in several countries, including Rwanda, the Dominican Republic, and the British Crown Dependencies of Jersey and Guernsey.

III. TelexFree's Corporate Structure in the United States and Its Relationship with Other Entities

25. Through a query on the Commonwealth of Massachusetts, Secretary of State's website I learned that TelexFree was originally known as "Common Cents Communications." Common Cents Communications was incorporated in Massachusetts in December 2002 and listed Carlos Wanzeler as President and James Merrill as Treasurer. In February 2012, Common Cents Communications filed an article of amendment with the Massachusetts Secretary of State, changing the name of the corporation to "TelexFree, Inc." The article of amendment was filed by Carlos Wanzeler in his capacity as President. In October 2012, TelexFree, Inc., filed an annual report with the Massachusetts Secretary of State, in which Wanzeler and Merrill were listed as the sole officers and directors of the company. The incorporation documents for TelexFree list a corporate address of 225 Cedar Hill Street, Suite 200, Marlborough, Massachusetts.

28. It appears that TelexFree is also intertwined with other entities, as summarized below. The government seeks authorization to review materials pertain to these additional entities, because they may in fact contain evidence related to the activities of TelexFree, Wanzeler, Merrill, and/or other co-conspirators.

30. On March 26, 2014, in sworn testimony before the MSD, Wanzeler described the relationship among several entities, including Brazilian Help, TelexFree, Inc., and TelexFree LLC, and others called Diskavontade, Ympactus, and TelexFree Financial. Wanzeler testified that in or about 2002 he formed Brazilian Help, Inc., which does business under the name Diskavontade. Wanzeler is the president and owner of Diskavontade, and both Wanzeler and

32. When asked to describe the TelexFree corporate structure, Wanzeler stated, “Yeah, we have a TelexFree LLC in Nevada and we have a TelexFree Inc. and we have a TelexFree International we never use 'cuz everything comes to LLC and the Inc. and we have Ympactus in Brazil, that's construction.” Wanzeler went on to state the he has an ownership interest in each entity and that the only other individuals with an ownership interest in them are Merrill and another man.

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okay, TelexFree Financial is open because the problem we have in the banks and if all our bank shut down by TelexFree we need some bank; you know, we try get some place we can pay our employees, pay our debt, you know, and that's what TelexFree – TelexFree Financial will just let you guys know that it's another TelexFree company.”

IV. TelexFree's U.S.-Based Business Operations

34. TelexFree maintains a website, www.telexfree.com. An internet registry search showed that the name was registered by Diskavontade, a company operated by Wanzeler. Again based on open-source domain name registries, in 2008 Wanzeler registered the domain name www.diskavontade.com and, based on his testimony before the MSD, he is the president and owner of that entity.

35. As further discussed below, TelexFree's VOIP product, usually called 99TelexFree, could be bought directly through the TelexFree site or the websites TelexFree provides to its promoters. A few factors, however, distinguish TelexFree and its product from the operations of a legitimate company:

- a. The product, however, appears poorly designed for actually securing and keeping customers.
- b. The way TelexFree compensated those who signed up to “promote” the VOIP product had little or nothing to do with actually *selling* the VOIP product, and the compensation system was not based on a sustainable business model.
- c. An analysis of the bank and credit card processing accounts behind TelexFree’s publicly-stated income and revenue figures shows that TelexFree was deriving less than 1% of its revenue from its VOIP products, about 99% from investments by new promoters, and that it could not meet its massive payment

log-in name and password. He/She then entered a telephone “number of origin,” so TelexFree could determine which local access numbers the new customer should use.

40. The TelexFree site then created an invoice for \$49.90 for the VOIP purchase. But to pay that invoice, the site required UC2 to create an “eWallet,” and to follow the same process summarized above – entering extensive personal information and generating a log-in name and password. The site then required UC2 to validate his/her credit card by scanning and uploading to the TelexFree site a copy of his/her driver’s license and credit card, and to complete a credit card authorization form and a “pre-authorization validation” in which TelexFree tested the credit card by making “a small random temporary charge on your credit card account.” A disclaimer during the validation process warned that UC2 should “please allow 1 to 2 business days to process your document.”⁷

41. Beyond credit card sales, it appears that a customer could buy the VOIP service by paying the \$49.90 monthly fee to a promoter, after which TelexFree subtracts that amount from what TelexFree owes the promoter in “buy back” fees or commissions (discussed below). It is unlikely, however, that significant retail sales of 99TelexFree to genuine third party customers are accomplished in this manner. First, the site itself allows for the use of a credit card for payment, an especially likely option in scenarios, like this one, where automatic monthly payments are needed. Second, paying via a promoter – instead of simply paying the site itself – implies a level of familiarity and trust between the promoter and the new customer, that is, that the promoter knows the customer, who apparently is willing to give the promoter \$49.90 a month. Anyone paying for the VOIP product in that manner – even assuming they actually use

⁷ Signing up for competing sites providing similar services, like Skype, takes a matter of minutes.

45. An analysis of the TelexFree site, made while the original compensation system was operating (about January 2012 to March 2014), showed that when a promoter joined TelexFree he was required to have a user name to access the “back office” area of the site. This was the area from which TelexFree promoters managed their sales activities. Once a promoter accessed the “back office,” he was able to copy advertisements already prepared by TelexFree, after which the promoter pasted those pre-made ads into various other websites that allowed free “classified” advertising. TelexFree provided the links to those sites; the promoter could post the ads to whichever of these sites he chose.

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47. For purposes of illustration, if someone bought into TelexFree and selected the user name “Bambi,” when a retail customer tried to buy the 99TelexFree VOIP product from an ad placed by “Bambi,” the purchase would link the retail buyer to www.telexfree.com/Bambi. The promoter would then be notified in the back office that somebody had purchased a VOIP product or signed up as a promoter through his or her website, and the promoter would receive credit for that sale.

48. I and other agents, on multiple dates, have reviewed the sites to which TelexFree directed its promoters to posted advertisements.⁸ An understanding of this ad-placing activity is important to understanding the fundamentally fraudulent nature of TelexFree as a business. These sites, each of which allowed people to post small ads for free, bear hundreds of ads for TelexFree, all of which are essentially identical. A “screen shot” of a typical site, retrieved by HSI personnel investigating this matter, appears below:

⁸ The sites include www.epage.com, www.zamzata.com, www.snnap.com, www.zikbay.com, www.classifiedgiant.com, www.citynews.com, www.adpost.com, www.freeclassifieds.com, www.wantedwants.com, and www.freeadsplanet.com. In November 2013, TelexFree began referring its promoters to a site called www.telexpub.com. A review of publicly-available site registry information shows that whoever registered that site chose to make their participation anonymous by using the service Domains by Proxy which, for a fee, substitutes itself as the named registrant. As of this date, we have not yet received additional information about the true registrant for the site.

49. The sum of these factors is that TelexFree's ad-posting appears to have been busywork, designed to disguise what TelexFree was really offering its hundreds of thousands of promoters: a guaranteed return on an initial investment, financed by funds from later investors, for doing essentially nothing. Cutting and pasting ads from TelexFree's site to one of the above

50. Overall, between in or about January 2012 and early March 2014, TelexFree's compensation structure appeared needlessly opaque and, like the ad-posting exercises described above, had no obvious business rationale. Based on my training and experience, these are typical features of pyramid schemes.

52. The information below is based on a review of the TelexFree site, YouTube postings by TelexFree personnel and various promoters; and conversations between an HSI undercover agent and a successful TelexFree promoter (discussed further below).

53. All new promoters were required to first pay a \$50 membership fee. After paying the fee, TelexFree would set up a new “back office” site for that user. After paying this fee, the user then had the option of buying two different “AdCentral” packages, priced at \$289 and \$1,375.

2. The \$289 Buy-In Level (Ad Central)

54. At the \$289 buy-in level,⁹ however, the promoter was compensated *regardless* of whether there were any retail sales of the VOIP product. The company called this plan “Ad Central.” As with the \$50 buy-in, TelexFree provided ads and free websites on which to post the ads. In the event of a retail sale based on one of those ads, the promoter received a 90% commission, that is, \$44.99 out of the \$49.99 the retail customer paid for the first month of TelexFree’s VOIP service. As in the \$50 buy-in, if that retail customer renewed on a monthly basis, that Ad Central promoter earned an additional 10% commission each time.

55. In the Ad Central plan, the company provided the promoter a “stock” of ten VOIP products to sell that week, and then each week thereafter for 52 weeks. But there was no physical product – for example, no CD or DVD containing the 99TelexFree product, or a software key for downloading it. There was only an entry in the TelexFree virtual “back office” listing the stock “available” to the Ad Central promoter. Moreover, if an Ad Central promoter posted ads for seven consecutive days, the company agreed to “buy back” any unsold stock from the promoter for \$20, and to continue to do so every week for a year. This was even though the promoter paid no money to TelexFree for the stock in the first place.

56. In short, an investment of \$350 (the Ad Central promoter's initial buy-in amount), results in an annual return of \$1,040 ($\20×52)— without selling a single VOIP product – so long as the promoter posted advertisements, among the hundreds of pre-existing advertisements, on a site identified by TelexFree.

⁹ The cost of this buy-in level may have changed slightly over time. For example, according to Merrill's TelexFree PowerPoint presentation discussed above, the cost for this level was at some point \$299.

would be able to choose whether Dan should appear in Ben’s left or right side stream. If Chuck was able to recruit a new member (“Ed”), Ed would appear on Al’s right side stream. Al would earn an additional \$20 (or \$80 at the Ad Central Family level) cycle bonus for the people recruited by Ben and Chuck, even though Al did not recruit them himself.

64. The YouTube videos explaining the TelexFree compensation structure also discuss “uni-level” compensation. This form of compensation was tied both to selling the 99TelexFree VOIP product and to the recruits beneath a promoter in the binary plan above. As discussed above, each individual AdCentral or AdCentral Family promoter posted free ads on the Internet, supposedly in an effort to bring in retail sales of 99TelexFree. When a promoter failed to make any retail sales, TelexFree “bought back” the unsold stock for \$20 (Ad Central), or \$100 (Ad Central Family). In the uni-level compensation scheme, TelexFree paid a promoter an additional 2% commission on each “buy back” for each recruit beneath him in his binary stream. For recruits who bought in at the Ad Central level, the promoter earned \$.40 each week a recruit failed to sell any 99TelexFree products, and for recruits who bought in at the Ad Central Family level, the promoter earns \$2.00 each week. The uni-level payment system paid the original promoter for buy backs going six levels deep.

65. According to YouTube videos posted by promoters (and corroborated by a promoter who discussed compensation with an HSI undercover agent), promoters could benefit from yet another form of “uni-level” earnings when recruits in their right or left side streams actually sold the 99TelexFree product. As noted above, 99TelexFree VOIP service was billed monthly at \$49.90, and the Ad Central promoter making the direct sale earned a 90% commission on that amount in the first month. Each promoter in the binary stream above the direct seller earned a \$.99 commission for each sale by a promoter in his binary stream and for

online ads for TelexFree, and could earn additional money by recruiting other people to join TelexFree. Person A drew out for the UC a diagram showing how “binary” recruitment would work.

71. The UC met Person A again the next day, and successfully joined TelexFree as a new promoter. The UC bought the Ad Central Plan for \$1,425 (a \$50 membership fee plus \$1,375 for the AdCentral package), using a check made payable to the Person A. Person B, an associate of Person A, helped the UC register and verify the UC's new TelexFree "back office" account. This consisted of entering a name, date of birth, Social Security number, cellular telephone number, email address, and mailing/billing address. In order to access the back office, the UC created a unique log-in name and password.

72. Starting on October 21, 2013, using the UC's access to the TelexFree system, an HSI Intelligence Research Specialist placed online advertisements as a promoter for TelexFree. Following the system discussed above, the Specialist copied advertisements created by TelexFree and made available to her in the back office area of TelexFree's site, and pasted them to another website TelexFree recommended. As required under the Ad Central Family plan, the Specialist did this five times a day. The entire process took about 25 minutes per day.

73. Between October 21, 2013, and the date of this affidavit, the Specialist posted more than 700 advertisements. The ads have resulted in no retail sales of TelexFree's VOIP product. As described above, the sites on which these ads were posted contained page after page after page of hundreds of nearly identical ads placed by various TelexFree promoters for the identical VOIP service.

74. During a conversation with Person A on November 2, 2013, Person A told the UC that the UC did not need to sell TelexFree's VOIP product in order to make money, but just post

76. In light of the above, from a business standpoint the TelexFree business model was nonsensical unless it was a pyramid scheme. There is no legitimate business model that can sustain “giving” inventory to its sellers at no cost; limiting advertising to a handful of classified ad sites already saturated with company ads; paying promoters a 90% commission on initial retail sales; “buying back” from promoters the unsold stock that had been provided for free in the first place; and finding ways to compensate promoters even more for recruiting other promoters.

F. TelexFree’s Revenue

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various state regulatory agencies, including Idaho, Washington, and Tennessee. There are various inconsistencies among these submissions.

79. In April 2013, a lawyer for TelexFree, Inc., and TelexFree LLC submitted to MSD a profit and loss statement for TelexFree, Inc., for the year 2012, followed by another version in February 2014. The figures on the two statements differ substantially; for example, the April 2013 statements listed about \$1.8 million in total income for TelexFree, Inc., in 2012, while the February 2014 statement listed \$2.8 million.

80. The government has also reviewed the 2013 profit and loss statements and balance sheets for TelexFree Inc. and TelexFree LLC, as submitted to MSD in February 2014. The Profit and Loss statements for TelexFree for the period January through December 2013 (as submitted to the MSD) report in part the following:

Description	TelexFree LLC	TelexFree Inc.	Combined
Income – Paid through Bank	\$119,468,920.12	\$56,195,790.54	\$175,664,710.66
Income – Paid through System	<u>\$572,240,960.21</u>	<u>\$268,930,757.53</u>	<u>\$841,171,717.74</u>
Total Income	\$691,709,880.33	\$325,126,548.07	\$1,016,836,428.40
Total Cost of Goods Sold	\$2,263,476.65	\$397,736.51	\$2,661,213.16
Agent Commissions – Paid through Bank	\$50,670,290.64	\$20,666,027.60	\$71,336,318.24
Agent Commissions – Paid through System	\$571,917,743.23	\$268,930,757.53	\$840,848,500.76
Total Agent Commissions	\$622,588,033.87	\$289,596,785.13	\$912,184,819.00

81. The Profit and Loss statement for TelexFree LLC reflects additional income of \$174,183,644.66 from Ympactus, TelexFree's operation in Brazil, which is not reflected here.

1. *Incoming Funds to TelexFree Bank Accounts*

82. TelexFree takes in funds from two sources: fees people pay to become TelexFree promoters and sales of the company's 99TelexFree VOIP service, which has been sold for

a. A review of Bank of America account XXXXXXXX7408 opened in the name of TelexFree, Inc., in February 2012 revealed that between June 2012 and May 2013, the accounts received 1,133 deposits, totaling \$12,203,496.48. Included in that sum were 534 cash deposits totaling \$924,231.40. Between September 2012 and May 2013 there were 813 deposits in the exact amount of an Ad Central Family buy-in (\$1,425 or \$1,375 (the earlier requirement)) totaling \$1,142,625. During that same period there were nine deposits in the amount of \$49.90 – the VOIP purchase price (totaling \$449.10).

b. Similarly, in September 2012 accounts were opened at TD Bank in the name of TelexFree Inc. and TelexFree LLC. In account #XXXXXXX8409, in the

name of TelexFree LLC, between October 9, 2013, and January 17, 2014, there were 478 incoming wires ranging from \$309 to \$142,500, totaling \$2,638,712. In the same period, there were 957 currency deposits ranging from \$50 to \$20,000, totaling \$21,277,040.72. Of the deposits, there were 2,474 in the amount of \$1,425, totaling \$3,525,450. Deposits were made in multiple states along the eastern coast of the United States. During that same period there was one deposit for \$49.90.

c. As to account #XXXXXX2808 at TD Bank, in the name of TelexFree LLC, between September 2012 and July 2013, there were 1,550 deposits by cash, check, money order or wire transfer in the exact amount of \$1,425 (again, the Ad Central buy in price). During that same period there was one deposit for \$49.90 (VOIP purchase price).

d. As to account #XXXXXXX334 at TD Bank, in the name of TelexFree LLC, between June and October 2013 there were 1800 deposits in the amount of \$1,425. There was one deposit of \$49.90.

2. Incoming Funds Paid Through Credit Card Processing Services

84. TelexFree also employs credit card processors to process payments to TelexFree's website, creating another potential avenue for customers to pay for VOIP service (as mentioned above, the site allows customers to use a credit card to pay for 99TelexFree). A review of the EFT deposits and payouts from the TelexFree accounts indicates credit card processors have made large deposits to TelexFree accounts, as has PayPal. Based on an analysis of the accounts, ProPay Inc., a credit card processor, processed credit card transactions for TelexFree from September 2012 to June 2013. Global Payroll Gateway Inc. (operating as Phoenix Payments),

another such processor, processed credit card transactions for TelexFree from June 2013 to September 2013, and I-Payout has recorded and tracked credit card payments processed through three other credit card processors since October 2013.

85. A review of the credit card processor records further confirms that while TelexFree in fact sold some 99TelexFree VOIP packages, the overwhelming percentage of incoming revenue was from new people investing in TelexFree to become promoters. For example,

a. I reviewed business records from ProPay, Inc. In 2013, ProPay processed 32,471 credit card sales (net of refunds and chargebacks) for TelexFree, totaling \$29,150,021.19. ProPay also processed 6,098 credit card sale transactions (net of refunds and chargebacks) in the amount of \$49.90 – the price of TelexFree’s VOIP product. These sales totaled only \$304,283.74.

b. I also reviewed business records received from Global Payroll Gateway (“GPG”). Between June 2013 and September 2013, GPG/Phoenix Payments processed total sales of \$37,419,522.69 for TelexFree. Based on the records and additional information provided by GPG, GPG processed 49,656 credit card transactions for TelexFree between June 12, 2013, and September 4, 2013. Of those transactions, 7,362 (approximately 15%) were for less than \$50 and, assuming every one of these transactions were to buy the VOIP product (which is unlikely), the sales revenue attributable to VOIP sales in this period was \$367,363.80, or about 1% of total sales processed by GPG, a ratio similar to ProPay above.¹¹

¹¹ There were also 31,129 credit card transactions in excess of \$1,000.

c. I also reviewed records provided by i-Payout, a payment processing company that disbursed funds for TelexFree and provided record-keeping services for certain credit card payments made by promoters for buy-ins, and by purchasers of the VOIP product. The records show that in 2013 i-Payout recorded 52,562 payments to TelexFree totaling \$66,036,927.99. Of these, there were 2,153 invoices for \$49.90 (the monthly VOIP cost), totaling \$107,434.70, or less than .2%

86. In total, in our review of TelexFree's bank account and credit card merchant account activity for the period January through December 2013, we identified approximately 15,630 payments to TelexFree, totaling \$779,930.54, for monthly purchases of the 99TelexFree VOIP product. Based on TelexFree's reported sales of \$1.016 billion, known sales of the 99TelexFree VOIP product represented less than 0.1% percent of TelexFree's total revenues.

3. *Outgoing Funds from TelexFree Accounts*

87. Just as sales of the VOIP product represented a fraction of TelexFree's revenue, the rest coming from new investors, the overwhelming majority of disbursements by TelexFree were to pay monies owed to existing promoters.

88. First, a review of funds disbursed from TelexFree’s bank accounts showed that some funds have been paid to vendors that appear to support the necessary infrastructure for the 99TelexFree VOIP system. For example, payments, totally about \$4,000,000, were identified going to iBasis, IDT Telecom, Liga Telecom, Exigo Office, Access Northeast (Xand), and Amazon Web Services. We also isolated other payments to law firms and consulting firms specializing in the “multi-level marketing” industry.

91. Lastly, TelexFree, Inc., reported commissions payable of \$7,642,550.42 on its balance sheet as of December 31, 2013, and TelexFree LLC reported no (\$0) commissions payable at the same date. At the same time, the company has reported over a billion dollars in sales. Further, assuming for the sake of argument that even half of TelexFree's revenue came from the sale of the TelexFree VOIP product, this would leave some \$500,000,000 in promoter

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buy-ins during the period January through December 2013. If all of these promoter buy-ins were all at the AdCentral Family level (and the promoters sold no product but placed advertisements as required by TelexFree), this \$500,000,000 would translate into 350,877 promoters, each expecting the receipt of \$100 per week for 52 weeks – a payment stream aggregating \$1.824 billion. After crediting the full \$912 million in commissions reported as paid in 2013 by TelexFree (although some of these payments doubtless relate to contracts begun in 2012), there would still remain additional commissions owed or coming due of *\$912 million*.¹³

V. Examples of TelexFree's Public Statements

92. On March 9, 2014 members of HSI, some in an undercover capacity, attended the TelexFree “New Compensation Plan” Conference at the Marriott Copley Place Hotel, 110 Huntington Avenue, Boston, Massachusetts. TelexFree periodically hosted conferences (as did successful promoters) to generate excitement for TelexFree. These events had a vaguely evangelical quality; senior TelexFree personnel tried to whip up the crowd of supporters with general exclamations about TelexFree’s products and the chance to make money.

93. Merrill and Wanzeler spoke at the Boston conference, along with other TelexFree personnel and successful promoters. Several people, including a TelexFree marketing executive and the head of “IT,” enthusiastically touted the quality of TelexFree’s VOIP product, its

¹³ Overall, TelexFree’s accounts received thousands of deposits directly to its bank accounts and also through credit card processors who, after receiving payments from card users, transferred those payments in batches to TelexFree accounts. These automated clearing house (“ACH”) credit transactions were transmitted via wire communications in interstate commerce. For example, on July 5, 2013, Global Payroll Gateway (also known as Phoenix Payments), recorded 176 sales transactions for TelexFree totaling \$214,700.80. On July 8, 2013, the proceeds from these sales transactions were credited to a Telexfree Citizens Bank account, no. XXXXXX9078, through an ACH credit transaction originating at Phoenix Payments in Tempe, Arizona, and terminating in the bank account of Telexfree at Citizens Bank in Massachusetts. There are many similar wirings. Similarly, in 2012 and 2013 there were thousands of payments by bank-to-bank or wire transfer out of TelexFree’s accounts in Massachusetts to TelexFree promoters. Citizens Bank’s servers for processing banking transactions are in Rhode Island.

95. Wanzeler continued, “We have a product and service no one else have; none of them. What company here in the U.S. can give you guys the opportunity have mobile, call from mobile phone to over 40 countries unlimited? ATT do that? Sprint? T-Mobile? Anyone do that? 40 countries? Cell and landline? Anybody? Yes? No? TelexFree only.” Wanzeler also said, in the preceding month, “Over 600,000 customers paid \$49.90 to TelexFree99.”

¹⁴ Based on an open source internet search, Skype, for one.

can help your friends and family for years and years to come.” Another TelexFree employee told the audience, “We just heard an incredible number: 580,000 retail customers [for TelexFree’s VOIP product] in February.”

97. During this and other conferences, Merrill, Wanzeler and the other speakers generated an excited, cheerleading atmosphere, apparently intended to give the appearance that TelexFree’s VOIP product was groundbreaking and selling well. For example, in a statement recorded for public consumption on October 8, 2013, Merrill spoke about how “excited” he was about “new products about to launch.” Similarly, at a TelexFree conference appearance on March 5, 2014, Merrill asked the crowd of TelexFree promoters to do “the wave,” and then urged them to “get the product out there.” He asked the audience to “touch people’s lives” with “a billion cell phones,” and told them TelexFree was trying to “put its best product together.”

98. In light of TelexFree's actual financial picture, however, the repeated public statements by TelexFree personnel about TelexFree's VOIP products amounted to misdirection: Neither Merrill, Wanzeler, nor any other TelexFree executive mentioned that the company generated a miniscule amount of revenue from selling the VOIP product (about 1% or less), and instead was founded on, and depended on, generating revenue from new promoters that could be used to cover TelexFree's payment obligations to existing promoters. According to TelexFree's finances, the company was not profiting from TelexFree's legion of promoters selling more VOIP products, but instead depended on a continuous flow of new promoters, a distinction absent from TelexFree's public statements.

99. Moreover, based on extensive review of TelexFree’s banking activity, credit card activity, and portions of its back office data, Wanzeler’s statement to the crowd that TelexFree had brought in “over 600,000 customers paying \$49.90” in or about February 2014 was false. In

their testimony to the MSD, both Wanzeler and Merrill re-affirmed that 580,000 people bought VOIP packages in February 2014. For his part, Wanzeler “guaranteed” that most of those people were “outside” retail customers, not promoters buying packages themselves, and he insisted that each of the 580,000 or so users paid \$49.90 that month for the service.

100. But 580,000 customers paying \$49.90 would have generated \$28,942,000 in revenue from VOIP sales, and thousands of \$49.90 entries in TelexFree’s bank and credit card processing records. But that revenue appears nowhere in TelexFree’s financial activity in that time frame. In the alternative, despite Wanzeler’s representations to the MSD, the figure was derived from TelexFree promoters *themselves* “buying” the VOIP product on the TelexFree system to stay eligible for TelexFree commissions, that is, from promoters using their own “back office” credits with TelexFree (the money TelexFree owes them under the compensation system discussed above) to buy, in a virtual sense, the VOIP product. Thus, there would have been no genuine retail sales to third party customers, but only virtual purchases by people who have already invested in the TelexFree system.¹⁵

Further Allegations Concerning the Nexus Between TelexFree's Illegal Activities and the Properties to be Searched

101. As described above, TelexFree is a fundamentally fraudulent business. Although it maintains an actual VOIP service, only about 1% or less of the company's revenues come from that service and, at no time in its U.S. existence, could TelexFree's revenue from that service cover the massive payment obligations TelexFree had to its promoters. Meanwhile, about 99% of TelexFree's revenues came from investment dollars deposited by newly-recruited promoters,

¹⁵ This strategy of calculating sales, revenue or other seeming legitimate figures from virtual electronic transactions is common to modern pyramid schemes.

and it is those funds – amounting to hundreds of millions of dollars – that were used to pay existing promoters.

102. Moreover, as discussed above, TelexFree’s compensation system was maintained through its web site portal, and each promoter was given a “back office” location tied to the TelexFree site, through which the promoter could maintain his account, review records of what amounts TelexFree owed him, and seek transfers of funds, among other things. In short, much of TelexFree’s system of managing and compensating promoters was electronically-based and, according to Merrill’s sworn testimony, that promoter-related data was maintained on servers at Xand and Exigo.

103. Consequently, most or all of TelexFree's business records are evidence of an ongoing pyramid scheme, and so subject to seizure. This would include, for example, all accounting and financial records; all promoter-related records; all web site-related records (*e.g.*, instructions to promoters, advertising, etc.); and all records related to VOIP design and implementation.

I. The Marlborough Office Location

104. Based on public filings, sworn testimony by Merrill and Wanzeler, and other information, TelexFree’s operations in the United States are based at 225 Cedar Hill Street, Suite 118, Marlborough, Massachusetts (the “Marlborough Office Location”). As noted above, TelexFree’s registered corporate address is that address, although it states Suite 200. As Merrill explained in sworn testimony, however, the company moved from Suite 200 downstairs to Suite 118 because it needed more space.

105. As Merrill made clear during his testimony, TelexFree actually conducts business from this address. Moreover, on March 24, 2014, in a sworn filing with the Tennessee

106. As Merrill said during his testimony, TelexFree's maintains the servers supporting its business operations at Xand Corporation's data center in Marlborough, Massachusetts. Merrill noted that the company was in the process of transferring that data to Exigo, a Dallas company that appears to provide similar services, but targeted to the MLM market.

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ATTACHMENT A

The premises to be searched are located at 225 Cedar Hill Street, Suite 118, Marlborough, MA 01752. Below are photographs of the premises to be searched:





The following is a photograph of James Merrill in front of the office building located at 225 Cedar Hill Street. This photograph is from www.telexfree.com as it existed in or about Spring of 2013.



- 5

- II. All computer hardware, computer software, computer-related documentation, and storage media (“computer equipment”). Off-site searching of the computer equipment shall be limited to searching for the items described in Section I above.

If the computer equipment cannot be returned, agents will make available to the computer system's owner, within a reasonable period after the execution of the warrant, copies of files that do not contain or constitute contraband; passwords, account information, or personally-identifying information of victims; or the fruits or instrumentalities of crime.

The user, by accessing the website of TELEXFREE.COM can become a member through payment of the respective fee, which will provide access to the TelexFREE Multilevel Marketing network for the period of one year, without extension or renewal. At this stage, the member is called a PARTNER. The PARTNER will have the right to acquire, at an exclusive discount, products that

are offered on the website www.telexfree.com, with the principal VOIP telephony accounts called 99TELEXFREE. The PARTNER, upon acquiring them in the form of a kit (ADCENTRAL or FAMILY kit) assumes the title of PROMOTER and, as such, receives a space on the site www.telexfree.com to promote the products/services that he has acquired. He also receives training and access to materials also made available on the TELEXFREE website so that he can undertake to promote the latter and avail himself of the opportunity to be a PARTNER and PROMOTER to others in his circle of relationships. All activities are performed by the PARTNER/PROMOTER without any employment relationship, and they are able individually to manage the team and the resources it seeks to make available for such purpose, of their own free will. For the promotion of products/services he will receive a bonus in direct proportion to his results, based on the levels explained in a separate section in these GENERAL REGULATIONS. He must obey all the clauses of these GENERAL REGULATIONS so that the name of TELEXFREE and the juridical persons associated with it remain unblemished.

2.2.2 Scope of services

2.2.2.1 - Upon becoming a member, the natural person in question can acquire the kit of VOIP accounts. In doing so, he shall assume the title of PROMOTER and, at this stage, he is to be provided with a channel for virtual broadcasting - the website www.telexfree.com - so that he can post his announcements. If he wishes to post them daily, and manages to do so without interruption, he shall receive remuneration for each seven-day cycle, considering that, in addition to promoting the sale of the kits of products/services that he has acquired, he is also promoting the TELEXFREE brand. The form of remuneration is explained in a separate section of these GENERAL REGULATIONS

2.2.2.2 - While this contract is in force, the PROMOTER shall have unlimited access to the content of the tools intended for his use, as long as they are used in a manner that is in keeping with the TERMS OF USE AND THE PRIVACY POLICY available at the site of the advertisers and the CONTRACTOR, TELEXFREE.

2.2.2.3 - Access to virtual tools shall only be given to promoters who have fulfilled all the essential requirements, a process also referred to as 'qualification,' which is discussed below.

2.2.3 Limits of the obligations of TELEXFREE

2.2.3.1 - The supplying of printed material such as calling cards, pamphlets, folders or even panels, banners or variations thereof for advertising are not included in the services and materials supplied by TELEXFREE or its advertisers, and neither is underwriting provided for any meetings that PROMOTERS, individually or in groups, may organize.

2.2.3.2 - The supplying of the materials indicated above can, however, be arranged as a matter of generosity by TELEXFREE, the advertisers or any related entity, which shall not imply a binding link or the acquisition of a right. It may also provide them through reimbursement of the respective cost for all promoters, for optimization of scale, for cases in which there is an express prior agreement in writing between the parties to this effect.

2.3 SUPPORT SERVICES AND LIABILITY OF TELEXFREE

2.3.1 - THE PROMOTER shall have everything necessary so that he can commence and undertake his activities in the MULTILEVEL MARKETING system, and will be provided with oversight of the results obtained in the respective system where he is operating.

2.3.2 However, in the event of failures of public utilities to supply electricity that overwhelm TELEXFREE's own capacity to keep the energy grid for its systems up and running, and moreover, in the event of an interruption of internet services or the effects of cataclysmic events, inasmuch as *force majeure* or acts of God are involved, TELEXFREE assumes no liability for solving the problem of resuming the operation of the site and the services associated with it.

2.3.2.1 In such cases, PROMOTERS must await the return to normality of public services to recommence their activities.

2.3.2.2 For as long as situations resulting from acts of God and *force majeure* may persist that prevent the TELEXFREE site from being made available (when the site is off the air) the PROMOTERS shall not incur any loss for failure to post daily advertisements. This exception, however, does not apply in cases where a parallel situation occurs on the premises of the PROMOTER, unless the fact is commonly known or proven by a document issued by the service provider, covering all of the 24 hours in the period when the activity (posting of the advertisement) is supposed to take place.

2.3.2.3 Schedules for the posting of ads or for any operation that uses the TELEXFREE system shall be those of its servers in Boston (Eastern Time Zone).

2.3.3 - THE PROMOTER does not have any liability for the services and/or products of the ADVERTISERS, since such liability is assumed directly by the latter.

2.4 RELATIONSHIP REGIMEN

2.4.1 -PROMOTERS do not have an employment relationship, inasmuch as their working regimen is autonomous, free of any imposition of routines, goals or regularity, and there is no hierarchical relationship, since they can establish on their own the pace, routine, or geographic area, and must, however, diligently seek to preserve the good name, image and brand of TELEXFREE and its advertisers or suppliers of products and services.

2.4.2 - The remuneration received by PROMOTERS involves the bonuses and commissions earned by applying the binary system multilevel marketing methodology, in amounts that depend exclusively on the commitment of the individual and the group/network/category in which he operates; the stepped increases in pay serve as an incentive, and do not involve the imposition of a hierarchical order.

2.4.3 - The PROMOTER is expressly notified that it is prohibited for him to present himself as acting in the name of TELEXFREE in relation to public or private institutions, nor is he authorized to make purchases or sign commitments or obligations on behalf of TELEXFREE, YMPACTUS or the advertisers or suppliers of products or services offered by TELEXFREE.

2.4.4 - THE PROMOTER, upon registering and accepting the content of these GENERAL REGULATIONS, is fully aware that he will have ample ability to conduct his extracontractual activities, doing things entirely at his convenience, and able to engage in other activities, paid or not, with or without an employment relationship, with the understanding that there is no employment relationship with the CONTRACTOR.

2.4.4.1 The PROMOTER may not, however, be part of another Multilevel Marketing network whose activities are similar to TelexFREE's , or that may in any way create a conflict of interest.

2.5 -REQUIREMENTS FOR ENTRY AND REMAINING IN THE MULTILEVEL MARKETING SYSTEM

2.5.1 - Individuals interested in entering the TELEXFREE Multilevel Marketing System must become members through nomination by another PROMOTER, by: a) completely filling out the respective registration forms, b) sending in the registration form; c) payment of the membership fee.

2.5.2 - Membership must be paid for in one single installment through payment of the respective bank payment ticket, and this date will serve as the start of the 12-month period of its duration. As of the last day of expiration of the contract, it will only be possible to remain in the CONTRACTOR's Multilevel Marketing System through a new membership, with the following rules applying to this 2nd year, or subsequent years:

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2.5.2.5 -PROMOTERS not applying for membership for the following year within the deadline must wait for one year from the expiration to re-enter the system, through a new membership as a PARTNER.

2.5.3 - "Position" is understood to refer to a promoter's location in the multilevel network, which qualifies him to receive the respective bonuses, pursuant to the specific rules.

2.5.4 - When a position becomes vacant because of the exclusion of a PARTNER or PROMOTER or because of the latter's not being contracted for a second (or subsequent) year, or else because of contracting for a second, the position shall belong to TELEXFREE, including the respective remuneration, and TELEXFREE may transfer the rights of the position to a promoter.

2.5.9 - As a required procedure for membership and admission into the multilevel marketing system, candidates must fill out all data requested on the application form available at: <http://www.telexfree.com>. No other electronic address should be used for registration or for daily access. TELEXFREE does not recognize any other electronic addresses and, moreover, hereby gives notice that the use and information provided at other electronic addresses should not be used, under any circumstances. The effects of such use, if it should take place, shall be exclusively the liability of the user as well as the assignment of passwords to third parties.

2.5.10 - The Marketing System network of TELEXFREE allows only one registration for each person based on a valid, active ID

2.5.11 - A PROMOTER may transfer his position and the respective benefits to others as long as he respects the legislation in force and adheres to the rules of the Market Network Multilevel Marketing System itself.

2.5.12 - A PROMOTER who wishes to sell his position in the marketing system network should understand that this can only be done following the analysis and acceptance of the CONTRACTOR, and, if authorized, he will be charged administrative expenses equivalent to 10% (ten percent) of the amount already received in the position of the PROMOTER conveying it, upon executing the transfer, payable to TELEXFREE.

2.6 ETHICAL PRINCIPLES

2.6.1 - Acts of discrimination on the part of promoters are at variance with the ethical principles of TELEXFREE and may entail expulsion from the system, through express communication to such effect.

2.6.2 - Upon registering at the TELEXFREE site, the PROMOTER undertakes to use the resources offered strictly within the rules and schedules established by the TELEXFREE system at its website: <http://www.telexfree.com>, and furthermore, undertakes to observe these terms of use and to obey all federal, state and municipal laws and regulations in force.

2.6.3 - THE PROMOTER undertakes to use the TELEXFREE site only to consult the Market Network System for his respective area, download authorized content and send invitations to participate in the group, or disseminate his announcements, it being the case that any other unauthorized commercial use is expressly prohibited, under penalty of [forfeiture] of membership.

2.6.4 - As a condition for the use of the TELEXFREE site, for all legal purposes, the PROMOTER undertakes not to use resources for any purpose that is illicit, not regulated in this contract or prohibited. In such cases, TELEXFREE reserves the right to refuse service, close accounts, remove or edit content, or to cancel orders at its sole discretion.

2.6.5 - THE PROMOTER agrees to respect all applicable local, municipal, state, federal and international laws and regulations, being exclusively responsible for any actions or omissions carried out with his password, including on the content of his transmissions through the System, agreeing moreover that in particular he must not:

- a) use the TELEXFREE Network Marketing System in connection with surveys, contests, chain-mails, pyramids, spamming or unsolicited messages (whether commercial or otherwise);
- b) slander, defame, disturb the peace of others, persecute, threaten or in any other way violate the rights of third parties, such as rights to privacy and publicity;
- c) publish, distribute or disseminate any materials or information of discriminatory content that violates the rights of freedom of belief, or are defamatory, offensive, obscene, indecent or illegal;
- d) obtain or in any way collect information about others, including e-mail addresses, without the due consent of the owner;
- e) create a false identity to deceive others with regard to the identity of the sender or the source of the message;
- f) attempt to obtain unauthorized access to the TELEXFREE Network Marketing System, other accounts, computer systems or networks connected to the TELEXFREE Network Marketing System, through illegal password searching or in any other way;
- g) violate any applicable laws or regulations, including and without limitation, laws concerning the transmission of technical data;

3.5.4 - If at presentations a PARTNER or PROMOTER fails to comply with the instructions set forth above, he shall have his login blocked immediately and be subject to the disciplinary procedure of these GENERAL REGULATIONS, without impairment to civil and criminal liability.

4 - REMUNERATION AND PAYMENT METHOD

4.1 - The payment of bonuses and incentives to the PROMOTER, when in the form of money, shall be made by a bank check, or deposit to the checking account or savings account payable to the PROMOTER - ACCOUNT HOLDER.

4.2 - All payments by the PROMOTER to the CONTRACTOR/TELEXFREE, when made available in the financial system of the PROMOTER's country shall be made in the official currency. However, for the contract between TELEXFREE INC and YMPACTUS, the bases for calculation shall be established in U.S. dollars, always indicated by the symbol "US\$" since all operational activities are conducted at the headquarters of TELEXFREE INC in the United States of America.

4.3 - In all cases, TELEXFREE reserves the right to retain the total amount of the remuneration of the PROMOTER, taxes and/or benefits, as well as administrative expenses, if any, that result from any legal issue raised, defined as follows:

a) Administrative Expense - expenses that are charged by the banking system, whose stipulated amount shall be disclosed via the website: www.telexfree.com.br; with it being up to the user to check the information.

b).

4.4 - Amounts for monthly payments charged for use of the services that are the object of this instrument, as well as credit for promotion paid by the TELEXFREE Network Marketing System to the PROMOTER, for the marketing and incentive campaigns in effect, shall be specified on the registration page of the TELEXFREE site, and should be paid in accordance with the rules established therein, which may be altered for the adjustment of the campaign in progress, or at any time that TELEXFREE may deem it necessary, with its members to be so notified forthwith.

4.5 - In the event of a change in the currency or the national monetary system, the amount shall be converted to the new standard according to the official standards of equivalency in force.

4.6 - In the event of fluctuations or alterations in the economy to the degree of compromising the contractual balance, the amounts stated herein in national currency could undergo an adjustment to re-establish the necessary balance between the parties.

5 -TELEXFREE ADVERTISING CENTRAL - ADCentral or ADCentral FAMILY

5.1 - MEMBERSHIP: A Partner who wishes to enter the TelexFREE Multilevel Marketing system must establish his MEMBERSHIP as a "Partner Member," and to such end, pay the equivalent of US\$ 50.00 (fifty U.S. dollars).

5.1.1 - With membership, the PROMOTER: a) guarantees for 12 (twelve) months his position in the marketing system network and, b) is entitled to acquire the kit of VOIP accounts with exclusive discounts characterized as follows: AdCentral kit and/or Family kit, c) the right to sell 99TELEXFREE VOIP accounts through his sub-domain, at face value, and receiving in such cases a commission of 10% on the amount of the sale.

5.2 PROMOTER: this refers to the person who, after receiving his membership, (see following clause), may acquire a kit of VOIP accounts with an exclusive discount, which may be: a)

5.5.2 - He must, in turn, post 1 (one) announcement (prepared by TELEXFREE) per day at internet announcement sites (whether free of charge or not) on each one of the 5 (five)

ADCentral sites. At the end of the 35 (thirty-five) announcements the PROMOTER shall receive 5 (five) 99TELEXFREE accounts as remuneration for these announcements.

5.5.3 - If for any reason the PROMOTER does not achieve the goal of 7 (seven) announcements per week, on each one of the 5 (five) ADCentral sites, the PROMOTER will not receive a 99TELEXFREE account for that particular week in which he did not meet the goal, from the respective ADCENTRAL.

5.5.4 - Other weeks begin normally and he can meet the goal and receive the compensation.

5.5.5 - Upon confirmation of payment of his membership fee, the promoter shall also receive, just once, 50 (fifty) 99TelexFREE packets that he can sell for as long as his contract remains in force, for the face value of the product, as disclosed by the TelexFREE site, and receiving credit for the sale of this product, which, however, will not generate any commission, either for the upline or the downline, and not accruing any rights if he does not put through the sale within this period, with the offer ceasing without any indemnification.

5.6 - An ADCentral can become a FAMILY ADCentral, making upgrades for each additional ADCentral with payment for this purpose of US\$ 289.00 (two hundred and eighty-nine U.S. dollars), for each additional one up to a total of 4 (four).

5.7 - A PROMOTER will achieve TEAM BUILDER status when he is active in an ADCentral FAMILY position (in the marketing network) that has 10 (ten) ADCentral FAMILIES on the incentive plan registered directly by him on his site.

5.7.1 - As long as he is fulfilling the qualification in clause 5.9.2, a TEAM BUILDER will earn a payment of 2% (two percent) of the company's net billing in the following month, received on the 10th day following the registration of the earning; the maximum amount for this earning, by contract, which is for one year, is up to US\$ 39,600.00 (thirty-nine thousand U.S. dollars), or the end of the 12- (twelve) month contract, whichever occurs first.

5.7.2 - The qualification referred to in clause 5.9.1 consists of the PROMOTER TEAM BUILDER's having sold 5 99TELEXFREE VOIP accounts as well as each one of the 10 PROMOTER ADCENTRAL FAMILIES in his network that formed the TEAM BUILDER.

5.8 - THE PROMOTER shall receive as an incentive a bonus of US\$ 20.00 (twenty U.S. dollars), for each VOIP ADCentral kit that his direct lower PARTNER acquires and a US\$ 100.00 (one hundred U.S. dollars) bonus for each VOIP FAMILY kit that his direct lower PARTNER acquires; in all cases, this promoter receiving the bonus must have at least one active 99TELEXFREE client plan.

5.9 - VOIP accounts acquired for each one of the plans, must be activated within the period of validity of the PROMOTER's registration, and shall not be computed as a "CLIENT" account that qualifies the PROMOTER to receive bonuses.

6 - BINARY PLAN QUALIFICATION - Earnings from Binary Cycles:

6.1 -A PROMOTER who directly registers 2 (two) new promoters, with one on the left side and the other on the right side of his marketing network, qualifies for direct and indirect binary

9.1.2 - The promoter shall be paid directly For 99TELEXFREE accounts, and only for such accounts, the promoter shall be paid directly, For that is to say, when the client buys an individual VOIP 99TELEXFREE account on his site - he will receive a direct commission of 10% (ten percent) of the amount paid, and 2% (two percent) of indirect commission, from the 1st

(first) level to the 5th (fifth) level, for clients of his direct and indirect promoters, as long as the following requirements are satisfied:

9.1.2.1 - if each level has a direct 99TELEXFREE client with its active plan; thus, in order to receive the 2% commission at five levels, as mentioned in the previous clause, he must have five direct clients with active 99TELEXFREE; moreover, if he only has 4 direct clients with active 99TELEXFREE he shall receive a commission of 2% only on the first four levels, and so on, successively.

10 - CANCELLATION AND BLOCKAGE OF REGISTRATION

10.1 -CANCELLATION OF REGISTRATION

10.1.1 Through the procedures set forth in this section of this membership contract, TELEXFREE may cancel the registration of a PARTNER and a PROMOTER who violates the terms of the code of ethics, or fails to discharge any of the duties assigned to him, and also on grounds of material damaging to other promoters and their activities, or to other suppliers of information.

10.1.2 - A PARTNER or PROMOTER can cancel his membership within 7 (seven) days of becoming a member, and receive a full refund of what he actually paid to TELEXFREE, including the membership fee and the price of the VOIP accounts he has not activated; if the payment has been made with a credit card, he will be asked to cancel the purchase through the credit card company.

10.1.3 - To be disconnected from the TELEXFREE NETWORK Marketing System, a member must request cancellation of his participation on a specific form provided on his personal page, or in the event of absence or inability to use this resource, through a letter written and signed by him, with certified signature recognition, sent to the headquarters of the CONTRACTOR, correctly stating all of the information requested; if these data rigorously match the data reported when putting through the application, which is to be ascertained for reasons of security, the cancellation shall be approved in an irreversible manner.

10.1.4 If a PARTNER or PROMOTER seeks cancellation of membership after the legal deadline, he is aware that he will not receive any reimbursement of any amount, since his position will continue to entail expenses for its maintenance.

10.2 CANCELLATION OF PAYMENT

10.2.1 If a PARTNER or PROMOTER should cancel the payment for his membership, all logins having the same CPF/ss# or e-mail shall be suspended, and they shall be released upon payment of 10% of the amount of the purchases of the VOIP 99TELEXFREE kits (Partner, Adcentral, Family or Team Builder), in addition to reimbursement for all amounts that the promoter has received in the cancelled position.

10.2.2 Cancellation of payment shall also entail the cancellation of the amounts for the respective bonuses generated in the uplines of the binary system.

10.3 - BLOCKAGE OF REGISTRATION

10.3.1 The TELEXFREE NETWORK Marketing System can block the registration of a PARTNER/PROMOTER at any time, which becomes effective immediately, with notification to the PARTNER/PROMOTER,

if it believes that the latter has committed an act that directly or indirectly violates the provisions of this contract, in particular:

a) with the lapse of 15 (five [sic, i.e., 'fifteen']) days from the expiration of membership or the payment due date of any installment of the VOIP kits that he purchased, when purchased in installments.

b) if improper enticement of members of his own network of TELEXFREE promoters is proven.

c) if, with the lapse of 5 (five) days from the confirmation of his membership a PARTNER has not put through payment of the amounts specified for his membership.

10.3.2 Blockage consists of the total suspension of activities connected to the Back office area.

10.3.3 Concomitant with the blockage, while in this situation, the PROMOTER may not engage in any activity pertaining to his status.

10.4 - If actions are ascertained that are in violation of this contract, the PARTNER/PROMOTER shall be given the opportunity to present a written defense within 10 days, or to submit his resignation in the same manner and timeframe. If the acts in violation of this contract are confirmed, the blockage shall be converted into definitive Cancellation of Registration for membership, as well as the prohibition of a new registration/membership.

10.5 - A PARTNER/PROMOTER whose registration is cancelled by TELEXFREE as a result of what is set forth in this section, shall lose the right to all privileges offered by the TELEXFREE Network Marketing System, and cannot enjoy in any way the benefits that he held as a PROMOTER without the express consent in writing of the management of TELEXFREE.

10.6 - TELEXFREE shall not return, on any grounds or justification, the monthly payments made by the PROMOTER for the purchase of VOIP kits or other products, considering that he is fully aware that such amount was paid for the use of the resources provided by the TELEXFREE Network Marketing System as accessories in the conduct of the marketing campaign under way and/or, at the discretion of the PROMOTER himself, as an ongoing investment in the Network Marketing program made available, such that no request for reimbursement of amounts already transferred to TELEXFREE NETWORK Marketing System will be accepted.

11 - INTELLECTUAL PROPERTY RIGHTS

11.1 - The PARTNER/PROMOTER recognizes that the content, without limitation, of text, software, music, sound, photographs, videos, graphics or any other material contained in the advertising of sponsors or distributed electronically, as well as information produced commercially that has been presented to him by TELEXFREE, by advertisers of TELEXFREE or by other suppliers of content, is protected by the laws of copyright and Trademark protection. Included also in this protection are brands of advertisers or sellers of products and services that have contracted with TELEXFREE to promote and commercialize their products and services, including Computer programs, Brands and Patents, although as long as it is authorized by TELEXFREE, it possible to obtain a copy, of such content solely for its use in the non-commercial promotion of the TELEXFREE Network Marketing System, as long as the Copyright notices and other notifications of intellectual property and image are kept intact, with any modification, copying, reproduction, republication or sending of altered data to another computer or by some other manner of distribution being prohibited.

13.5 - TELEXFREE Network Marketing System does not declare or guarantee that it shall not be interrupted, or that it shall be free of errors, that defects will be immediately corrected.

or that the system itself or the server that makes it available will be free of viruses or other harmful elements.

13.5.1 - It does affirm, however, that upon discovering any abnormality in its domain, it shall take the most urgent measures to regularize the situation.

13.6 - THE PROMOTER agrees to indemnify TELEXFREE and hold it harmless, along with any of its partners, subsidiaries and affiliates, as well as its offices, employees and staff, of any liability for any claims, lawsuits or losses and damages, including attorneys' fees, that may be claimed by third parties, due to or arising from their use of the TELEXFREE Network Marketing System, or conduct relating to same.

13.7 - The TELEXFREE NETWORK Marketing System reserves the right to alter the terms of use or guidelines concerning the use of the system at any time and without any need for prior notice, proceeding thereupon to publish an updated version on its website.

13.7.1 - THE PROMOTER is responsible for periodically reviewing the current content of the TELEXFREE site and of these GENERAL REGULATIONS since they may be altered, always subject to ample notification, after which alterations shall be considered tacitly accepted by those who have become members.

13.8 - Compliance with what is set forth in these GENERAL REGULATIONS by all parties at TELEXFREE is subject to the laws of the USA and the state of Nevada (with the exception of Louisiana Member/Promoters. Louisiana Promoters may choose Louisiana Laws) and relevant legal procedures, and no provision thereof contravenes the right of TELEXFREE to comply with administrative or judicial requirements or orders imposed by the competent authorities, with regard to the use by the PROMOTER of the TELEXFREE Network Marketing System or the information provided by TELEXFREE, or collected by it as the result of such use, and if any provisions of this agreement are declared null or void in the light of the legislation in force, including, without limitation, provisions concerning exemption and limitation of the liabilities mentioned above, such null and void provisions shall be replaced by valid and effective provisions that respect the intention and purpose of the original provisions, with the remaining provisions of these Terms of use in full force and effect.

13.9 - Unless otherwise provided in this document, these GENERAL REGULATIONS constitute the entire agreement between the PROMOTER and TELEXFREE with relation to the use of the System itself, except with regard to the use of any software that may be governed by an end-user license agreement, and replaces any and all communications or proposals, prior or current, whether through electronic, spoken or written communication between the user and TELEXFREE with regard to the Market Network System.

13.10 - The printed version of this agreement and of any notification or notice delivered in electronic form shall be admissible in legal or administrative proceedings resulting from or related to these GENERAL REGULATIONS, and subject the same conditions as other documents and commercial records originally generated and maintained in hard copy.

13.11 - Laws of the USA and the state of Nevada (with the exception of Louisiana Member/Promoters. Louisiana Promoters may choose Louisiana Laws), is chosen to settle any issues arising from this instrument, with the express renunciation of any other now matter how privileged it may be, or may become, except for questions having to do with consumers, when

the jurisdiction or competency shall be established on the basis of what is provided in the Code of Consumer Protection.

13.12 - This version of this membership contract shall take effect starting February 10, 2013, rescinding any provisions of the previous membership agreement that may be at variance with this one.

Signature: the original copy of this agreement is signed.

TELEXFREE

Chapter 11

Case No. 14-40987-MSH

Case No. 14-40988-MSH

Case No. 14-40989-MSH

Jointly Administered

In support of this motion (the “Motion”), the Trustee states as follows:

INTRODUCTION

The Debtors ostensibly operated a multi-level marketing company engaged in the sale of voice over internet service but, as detailed herein, the Debtors’ operations actually were a massive Ponzi/pyramid scheme that ensnared as many as a million or more participants from multiple countries (hereinafter, parties who became members of the Debtors’ scheme shall be referred to as “Participants”). Participants opened approximately 11,000,000 User Accounts (as hereafter defined) and purchased membership plans and/or Voice over Internet Protocol (“VoIP”) service with a transaction value of approximately \$3,070,000,000 during the approximately two years of the Debtors’ operation of their scheme. An affiliate of the Debtors, Ympactus Comercial Ltda. (“Ympactus”), reportedly operated a substantially similar scheme in Brazil which was seized and shut down by the Brazilian authorities in June 2013.¹ Shortly after the Debtors’ Chapter 11 filings in April 2014, the Securities and Exchange Commission and the Massachusetts Securities Division commenced litigation against the Debtors and others alleging, among other things, that the Debtors were engaged in the fraudulent sale of securities in violation of numerous securities laws. Contemporaneously therewith, substantially all of the Debtors’ assets and records were seized by the federal authorities. Approximately two months later, on June 6, 2014, the Trustee was appointed.

The Trustee has conducted an extensive investigation into the operations of the Debtors' scheme and Participant involvement therein. As a result of the investigation, the Trustee has concluded that and requests a finding from the Court that the Debtors were engaged in a Ponzi/pyramid scheme, that any claim or portion of claim of Participants based upon accumulated credits arising from fictitious profits or commissions in Participants' User Accounts

¹ Reportedly, Ympactus was recently found by a Brazilian court to have been a Ponzi scheme.

7. On April 23, 2014, the SEC filed a motion to transfer venue of the cases to the United States Bankruptcy Court for the District of Massachusetts (the “Court”). By order dated May 6, 2014, the motion to change venue was approved. The cases were transferred to the Court on May 9, 2014.

9. The Debtors filed only a list of the alleged thirty (30) largest creditors in the cases and did not file schedules or statements of financial affairs, nor a matrix of creditors.

12. On February 3, 2015, the Trustee submitted a comprehensive Status Report on outstanding matters in the cases. The Status Report set forth, among other things, the background of the Debtors and their affiliates, the breadth and scope of the scheme, assets recovered to date and potential additional sources of recovery, as well as efforts at coordination with governmental authorities, both in the United States and in Brazil.

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15. The Debtors purported to be in the business of selling VoIP that cost \$49.90 per month to conduct international phone calls. The sale of VoIP on a monthly basis is hereinafter referred to as a “VoIP Package”. Customers who purchased the VoIP Package registered their phone numbers with the Debtors and received software that enabled their computers to place phone calls through the Debtors’ computer servers in Marlborough, Massachusetts to approximately 40 countries.

² To date, the Trustee has deferred conducting depositions of the 2004 Motion deponents.

17. Each new distributor in an MLMP recruited by a participant, along with the recruited distributor's recruits (down to six levels in the Debtors' case), becomes part of the first participant's "network", sometimes referred to as the participant's "downline." Eventually one or more pyramid type structures is established underneath the recruiting participant. In addition to earning commission and profits on the products the participant sells, he or she is entitled to receive a commission based on the volume of products or memberships sold by his or her network.

- a. “AdCentral Plan”: \$339 for a one-year contract (\$50 membership fee plus \$289 contract fee). This contract entitled the User Account holder with the right to sell ten VoIP Packages, for which a Participant could receive a commission if the packages were sold, although there was no sale requirement. Participants were required to place one internet ad per day and, for each week in which the Participant placed the required ads, he/she was entitled to one additional VoIP Package, which could be sold or exchanged for \$20 in credits with the Debtors. Thus, Participants who posted the required ads were eligible to receive \$20 per week for 52 weeks, for a total return of \$1,040 (a return of 207% on the investment of \$339).
- b. “AdCentral Family Plan”: \$1,425 for a one-year contract (\$50 membership fee plus \$1,375 contract fee). This contract entitled the User Account holder with the right to sell fifty VoIP Packages, for which a Participant could receive a commission if the packages were sold, although there was no sale requirement. Participants were required to place five internet ads per day and, for each week in which the Participant

19. In addition to credits for posting these advertisements, the Debtors issued credits to Participants for the sale of membership plans and the establishment of new User Accounts as follows:

20. The Debtors also issued credits to Participants for the sale of VoIP Packages as follows:

- ³ In practice, the Debtors appear to have provided Participants with credits equal to ninety percent (90%) of the renewal fees.

23. In the case of a Participant satisfying his/her own invoice by payment in cash to the Debtors, the process worked, generally, as follows:

24. Alternatively, a Participant could satisfy his/her own invoice directly by payment in cash to another Participant, who would, in turn, satisfy the invoice by a redemption of

30. The Debtors maintained two computer applications for accessing and processing information from the Debtors' database relating to User Account activity, referred to as "SIG" and the "Back Office".⁴

32. The Trustee's access to SIG was the culmination of a painstaking data recovery and analysis project implemented by the Trustee and his team of professionals with the assistance of investigators from HIS and the SEC.

⁴ The Back Office was the program used by Participants to obtain information on their User Account activity.

34. Extensive testing was performed to determine that the appropriate configurations of the data were achieved. Data from additional servers were later identified that were necessary to operate the network. Once the key components of the system were identified and operating, passwords were obtained through research into document productions received by the Trustee, communications with Federal Authorities, and a variety of investigative tools. Finally, an intensive analysis was performed to better understand the database structure, table relationships, data fields, and process flow.

36. The Debtors' database was developed by programmers in Brazil and all field references are in Portuguese. The developers apparently lacked the expertise to create and manage a system of this magnitude. As a result, system modifications appear to have been done in a haphazard and disorganized fashion. In addition, the Debtors' system is permeated with unreliable data because of limited efforts at data validation of information provided by Participants in establishing User Accounts.

39. Each User Account with the Debtors was registered with an electronic mail address (an “Email Address”). There are approximately 900,000 unique Email Addresses in SIG associated with approximately 11,000,000 Debtor User Accounts. The number of User Accounts associated with an Email Address varies widely. A particular Email Address may be associated with only a single User Account or may be associated with hundreds or thousands of User Accounts. Because each User Account may represent a separate Participant and some Participants entered the scheme using the Email Address of another Participant, the number of Participants is unknown but is likely in excess of 1,000,000.

41. The Trustee and his team have taken a series of steps to confirm the accuracy and reliability of the transaction data reflected in SIG. The Trustee interviewed the Debtors' bookkeeper to understand the mechanics of SIG and how it was employed on a day to day basis. Testing was performed to reconcile balances and activity using available data, which is somewhat limited. This testing included cross-referencing data in related transactions and

42. In February 2012, Ympactus reportedly commenced operations in Brazil to operate a scheme substantially identical to the scheme that is described above. Ympactus initially grew much more rapidly than the Debtors, with growth accelerating in the fall of 2012 through the early summer of 2013. By the spring of 2013, Ympactus had cash receipts of more than \$100,000,000 per month. *See Darr Affidavit, Exhibit "A"*, at ¶51. On the other hand, the Debtors' cash receipts were initially much more modest. In the spring of 2013, the Debtors' cash receipts averaged approximately \$6,400,000 per month. *See Darr Affidavit, Exhibit "A"*, at ¶51.

⁵The Trustee is exchanging information with Brazilian authorities and is trying to develop a common protocol for administering claims and pursuing recoveries in the respective cases of Ympactus and the Debtors.

44. Upon information and belief, on or about September 21, 2015, the Brazilian court entered a decision finding that Ympactus operated a pyramid scheme.

45. Following the shutdown of Ympactus, the Debtors' cash receipts increased dramatically. The Debtors' cash receipts totaled approximately \$200,000,000 in the last three full months of operation, with more than \$96,000,000 in cash receipts in February 2014 alone. *See Darr Affidavit, Exhibit "A", at ¶53.*⁶

46. The SIG system maintained by the Debtors and Ympactus operated with a single database reflecting User Account activity for both operations. After reconstructing the computer network and developing a working understanding of SIG, one of the Trustee's first tasks was to determine how to segregate the Debtors' activity from that of Ympactus, since SIG did not clearly differentiate the User Accounts between Ympactus and the Debtors' Participants.

47. SIG includes more than 17,000,000 distinct User Accounts associated with approximately 2,000,000 Email Addresses for both the US-based and the Brazilian-based operations.

48. In creating a new User Account, each Participant was directed to identify whether such Participant would pay the initial invoices in Brazilian Reais ("Reais") or United States Dollars. Through a review of the currency field data, the Trustee determined the following:

- a. Prior to the shutdown of Ympactus in June 2013, invoices in User Accounts with Brazilian contact information were denominated in Reais and invoices in User Accounts with non-Brazilian contact information were denominated in Dollars;

⁶ Attached as Exhibit 1 to the Darr Affidavit is a summary of cash receipts of the Debtors, by month, for the two years of operation of the scheme.

50. Utilizing the currency designation, it appears that approximately 11,000,000 User Accounts are associated with the Debtors' operations and approximately 4,000,000 User Accounts are associated with Ympactus operations and the remaining 2,000,000 User Accounts had no activity.

51. The Debtors conducted a Ponzi/pyramid scheme, not a legitimate MLMP.

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53. A Ponzi scheme is generally based upon a fraudulent investment opportunity. Typically, investors contribute funds to the organizer who promises a high return. Existing investors are paid their returns almost exclusively from the funds contributed by new investors and not from the legitimate profits of the business. *Bear, Stearns Secs. Corp. v. Gredd (In re Manhattan Inv. Fund Ltd.)*, 397 B.R. 1, 8 (S.D.N.Y. 2007); *Eberhard v. Marcu*, 530 F.3d 122, 132 n.7 (2d Cir. 2008); *accord In re Bernard L. Madoff Inv. Secs. LLC*, 654 F.3d 229, 232 (2d Cir. 2011), *cert. denied*, 133 S. Ct. 25 (2012); *see United States v. Moloney*, 287 F.3d 236, 242 (2d Cir. 2002) (“A Ponzi scheme by definition uses the purportedly legitimate but actually fraudulently obtained money to perpetuate the scheme, thus attracting both further investments and, in many cases, new investors to defraud.”), *cert. denied*, 537 U.S. 951 (2002).

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57. A pyramid scheme is a type of Ponzi scheme in that, in both instances, the scheme can only be sustained by the continued influx of new investors/participants to fund amounts

59. The Debtors' compensation scheme had elements of both a Ponzi and pyramid scheme.

61. Participants who purchased the AdCentral Plan became entitled to receive a VoIP Package each week by placing one internet advertisement per day. These VoIP Packages could be, and routinely were, converted into credits with TelexFree for \$20 weekly for 52 weeks, for a

62. The repetitive posting of internet advertisements (which were reportedly supplied by the Debtors) served no legitimate purpose, because anyone who used “telexfree” as an internet search term would be led to the Debtors’ own website; the repetitive posting of similar advertisements had no discernable value. For example, one website, Adpost.com, contained more than 33,000 postings submitted by Participants for TelexFree, while another, ClassifiedsGiant.com, contained more than 25,000 postings

64. The guarantee of an astronomical return on the initial investment without the requirement to sell any product created perverse incentives for Participants. Participants opened multiple User Accounts for the sole purpose of leveraging their fictitious profits, without the need to sell any product or recruit any individuals. Some Participants appear to have invested a substantial portion of their life savings into the scheme seeking to quickly triple or quadruple

III. BECAUSE THE DEBTORS OPERATED A PONZI/PYRAMID SCHEME, CLAIMS FOR ACCUMULATED CREDITS SHOULD BE DISALLOWED.

72. The accumulated credits held by Participants in their User Accounts as of the Petition Date should not form the basis of allowed claims in these cases.

73. Claims based on the accumulated credits should be disallowed because, in a Ponzi/pyramid scheme, investors who had no knowledge that the scheme was fraudulent are generally entitled to a claim only for the net amounts invested in the scheme and not for fictitious profits.¹¹ See *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d at 242; *Donell v. Kowell*, 533 F.3d 762, 772 (9th Cir. 2008); *SIPC v. BLMIS*, 499 B.R. 416, 424-29 (S.D.N.Y. 2013); compare *In re Churchill Mortgage Inv. Corp.*, 256 B.R. 664, 682 (Bankr. S.D.N.Y. 2000); *In re First Commercial Mgmt Grp.*, 279 B.R. at 232; with *Bayou I* at 637-38; *In re Randy*, 189 B.R. 425, 441 (Bankr. N.D. Ill. 1995); *In re Int'l Loan Network, Inc.*, 160 B.R. 1, 12 (Bankr. D.D.C. 1993); see also *Janvey v. Golf Channel, Inc.* 780 F.3d 641 (5th Cir. 2015) (vacated and certified to the Supreme Court of Texas on this issue, *Janvey v. Golf Channel, Inc.*, 792 F.3d 539 (5th Cir. 2015), *certified question accepted* (July 17, 2015)); *Janvey v. Alguire*, 2013 WL 2451738 at *9 (N.D. Tex. 2013); *SEC v. Bernard L. Madoff Investment Securities, LLC (In re Madoff)*, 522 B.R. 41, 47 (Bankr. S.D.N.Y. 2014) (“*BLMIS II*”); *In re Taubman*, 160 B.R. 964, 980 (Bankr. S.D. Ohio 1993); *In re Bayou Grp., LLC*, 439 B.R. 284, 309 (S.D.N.Y. 2010) (“*Bayou II*”).

74. Innocent investors have claims against Ponzi/pyramid schemes based in tort under the theories of rescission and restitution for the amounts they were fraudulently induced to invest. *Scholes v. Lehmann*, 56 F.3d 750, 757 (7th Cir. 1995); *Bayou II* at 309; *see also In re Int’l Mgmt. Assoc., LLC, et al.*, 2009 WL 6506657 at *9 (Bankr. N.D. Ga., Dec. 1, 2009). These

¹¹ This motion seeks a determination that accumulated credits as of the Petition Date should not be considered in calculating allowed claims. Aside from the disallowance of credits, the transactions that should be included in the calculation of Participants' allowed claims in these cases will be subject to separate determination of the Court.

76. The accumulated credits based on the posting of meaningless advertisements are equivalent to the fictitious profits promised in Ponzi schemes. The Participants were guaranteed an astronomical return by merely purchasing a membership plan and posting internet advertisements reportedly supplied by the Debtors. Participants were not required to sell a product to receive payment. Accordingly, claims based on the accumulated credits for the posting of advertisements should be disallowed. *See BLMIS I* at 427-29; *BLMIS II* at 47; *Scholes* 56 F.3d at 757; *M & L Bus. Mach. Co.*, 84 F.3d at 1341.

78. While value arguably may be provided by an innocent third party providing legitimate services to a Ponzi/pyramid operator for a reasonable fee, such is not the case here. Rather, credits that were issued to Participants for recruiting others into the scheme only

79. Because the Debtors received no value for the accumulated credits, claims based on such credits should be disallowed. *See 11 U.S.C. §502(b)(1); Independent Clearing House*, 77 B.R. at 857; *Warfield*, 436 F.3d at 560; *Johnson v. Home State Bank*, 501 U.S. 78, 86, 11 S.Ct. 2150, 2155 (1991); *In re Muller*, 479 B.R. 508, 515 (Bankr. W.D. Ark. 2012).

81. Equity requires the disallowance of claims for accumulated credits because these credits could only be satisfied from amounts paid by later Participants and not from earnings of the enterprise or from the sale of product. *See In re Taubman*, 160 B.R. at 980; *BLMIS I* at 427-29.

85. Accordingly, any claim or portion of claim of Participants based upon the accumulated credits in Participants' User Accounts as of the Petition Date should be disallowed.

86. In resolving claims and distribution issues in Ponzi and pyramid scheme cases, equitable considerations need to be taken into account to properly address the harms suffered by participants in the scheme. *See Cunningham*, 265 U.S. at 13 (all investors in a Ponzi scheme must be treated equally and that “equality is equity and this is the spirit of the bankrupt law”); *In re Young*, 294 F. at 4; *In re Taubman*, 160 B.R. at 980; *Int’l Loan Network*, 160 B.R. at 14; *BLMIS II* at 47. In order to fashion an equitable result, claims in such cases are determined based upon a “Net Equity” analysis, that is, the allowed claim is equal to amounts that a participant paid into the scheme, reduced by amounts a participant received from the scheme.

88. In determining Net Equity, the recruited Participant should have a claim recognized in the bankruptcy cases for the amounts advanced to a recruiting Participant in a Triangular Transaction. Recognition of this claim is necessary to achieve an equitable result. A substantial number of those who joined the Debtors' scheme did so through participation in Triangular Transactions. The claims of these Participants should be treated the same as the

93. Collapsing the Triangular Transactions into one justifies the inclusion of the Triangular Transactions in the determination of Net Equity because the membership fees exchanged between Participants constituted property of the estate. The definition of property of

95. The Net Equity determination will be made on a User Account basis. Many Participants appear to have maintained multiple User Accounts. In these circumstances, determination of the Net Equity for a Participant will require an aggregation of the transactions for such Participant in all of his/her User Accounts to ensure that all activity associated with that Participant has been accounted for.

V. THE DEBTORS ARE JOINTLY LIABLE FOR PARTICIPANT CLAIMS

96. The Debtors worked in concert with one another to develop, market, and operate their Ponzi and pyramid scheme. The Debtors had common ownership and each was controlled by Wanzeler and Merrill, as well as Carlos Costa at least through his alleged separation from the Debtors in the fall of 2013.

97. Each of the Debtors was intimately involved in the scheme. Common Cents Communications, Inc., which was owned and controlled by Wanzeler, Merrill, and Steven Labriola, changed its name to TelexFree, Inc. in early 2012 in conjunction with the marketing and selling of VoIP Packages through the Debtors' MLMP. Shortly thereafter, in July 2012, TelexFree, LLC was formed, to conduct TelexFree's operations outside of Massachusetts.

98. TelexFree, Inc. and TelexFree, LLC worked collaboratively in furtherance of the scheme throughout 2012 and 2013, including joint marketing efforts, promotional materials, and Participant recruitment events. TelexFree, Inc. and TelexFree, LLC alternated responsibility for maintaining bank accounts, because on multiple occasions TelexFree was asked to close accounts with banks because of suspicious account activity.

99. The concerted actions of the Debtors in developing, marketing, and operating the Ponzi and pyramid scheme renders them jointly and severally liable for the claims of Participants. *See Aetna Cas. Sur. Co. v. P&B Autobody*, 43 F.3d 1546, 1564 (1st Cir. 1994)(joint tortfeasors can be vicariously liable for the acts of one another if there exists concerted action to commit the torts; liability requires first, “a common design or an agreement between two or more persons to do a wrongful act and, second, proof of some tortious act in furtherance of the agreement.” *Id.*; *Restatement (Second) of Torts* §876 cmt. b (1977).

100. After the seizure and shutdown of Ympactus by the Brazilian authorities, TelexFree, LLC and TelexFree, Inc. saw a substantial increase in activity, which further exacerbated difficulties with banking facilities needed to conduct the TelexFree scheme. TelexFree Financial, Inc. was formed in Florida in December 2013 and opened bank accounts and paid expenses of TelexFree, Inc. and TelexFree, LLC. In late 2013, TelexFree, Inc. and TelexFree, LLC transferred more than \$4,000,000 to an account at TelexFree Financial. TelexFree Financial deposited an additional \$10,000,000 in membership fees and VoIP Package sales in February 2014. The only Debtor with employees was TelexFree, Inc. and these employees were being paid by TelexFree Financial.

101. TelexFree Financial rendered substantial assistance to TelexFree, LLC and TelexFree, Inc. in furtherance of the Ponzi and pyramid scheme and is therefore also jointly liable to Participants as a joint tortfeasor. *See Kurker v. Hill*, 44 Mass. App. Ct. 184, 189 (Mass. App. 1998)(joint tortfeasor liability, also referred to as civil conspiracy, arises when a party knows that the “conduct [of another person] constitutes a breach of duty and gives substantial assistance or encouragement to the other to so conduct himself.” TelexFree Financial, being under common ownership with TelexFree, LLC and TelexFree, Inc. had full knowledge of the actions being perpetrated by the other Debtors. *Kurker*, 44 Mass. App. Ct. at 189; *Kyte v. Philip Morris Inc.*, 408 Mass. 162 (1990); *Stock v. Fife*, 13 Mass. App. Ct. 75, 82 (Mass. App. 1982)(key to joint tortfeasor liability is the rendering of substantial assistance, with the knowledge that such assistance is contributing to a common tortious plan.)

102. The Debtors had a common design or agreement to commit a wrongful act, which was the establishment and implementation of the Ponzi and pyramid scheme. Because the

103. Inasmuch as the Debtors are jointly and severally liable for the claims of Participants, the Bar Date Motion proposes that Participants submit only one Participant ePOC, which shall constitute a claim against all three of the Debtors' estates. The Bar Date Motion does propose that non-Participants file a separate Standard ePOC for each Debtor against whom a claim is asserted.

V. NOTICE

WHEREFORE, the Trustee respectfully requests that this Court enter an Order:

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- (iv) Ordering that the findings made pursuant to this Motion shall be applicable throughout these proceedings, for all purposes; and
- (v) Granting such other and further relief as this Court finds just and proper.

STEPHEN B. DARR,
CHAPTER 11 TRUSTEE,

By his attorneys,

/s/ Andrew G. Lizotte

Harold B. Murphy (BBO #362610)
Andrew G. Lizotte (BBO #559609)
Murphy & King, Professional Corporation
One Beacon Street
Boston, MA 02108
Telephone: (617) 423-0400
Facsimile: (617) 423-0498
Email: ALizotte@murphyking.com

Dated: October 7, 2015
696114

EXHIBIT A

Jointly Administered

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3. The statements provided herein are based upon information and knowledge I have derived through my involvement in these Chapter 11 cases, as further set forth herein.

4. During the course of my investigative duties in these cases, my colleagues and I have examined the Debtors' books and records that were seized from the Debtors by federal authorities, electronic copies of which were provided to me, as well as documents produced by third parties in response to numerous motions for Federal Rule of Bankruptcy Procedure 2004 examinations. I and my professionals have conducted interviews of the Debtors' former employees and consultants, as well as professionals retained by the Debtors during the Chapter 11 cases. I have also reviewed the docket in these cases.

I. CASE BACKGROUND AND PROCEDURAL POSTURE

5. On April 13, 2014 (the "Petition Date"), each of TelexFree, Inc., TelexFree, LLC, and TelexFree Financial, Inc. (collectively, the "Debtors") filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code ("Bankruptcy Code") with the United States Bankruptcy Court for the District of Nevada ("the Nevada Bankruptcy Court").

6. The Debtors initially operated as debtors-in-possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code.

7. On the Petition Date, the Debtors filed a motion for joint administration of the cases, with TelexFree, LLC designated as the lead case. By order dated April 24, 2014, the order for joint administration was approved.

8. Prior to the filings, the Commonwealth of Massachusetts, Office of Secretary of State, Securities Division ("MSD") commenced an investigation into the Debtors' business practices.

9. On or about April 15, 2014, the MSD commenced an administrative proceeding against the Debtors. Also on April 15, 2014, the Securities and Exchange Commission (“SEC”) commenced an action against the Debtors and others in the United States District Court for the District of Massachusetts. The foregoing actions alleged, among other things, that the Debtors were engaged in an illegal Ponzi/pyramid scheme and the fraudulent and unregistered offering of securities. Substantially contemporaneously with the commencement of the SEC action, Homeland Securities Investigation (“HSI”) seized the Debtors’ assets, books, and records. In connection therewith, the federal government seized more than \$107,000,000 in cash, including checks payable to the Debtors, their principals, or their affiliates. Federal authorities have also made forfeiture claims against approximately forty (40) other items of real and personal property standing in the name of the Debtors’ principals and their affiliates, including automobiles, real properties, and notes secured by mortgages on real properties.

10. On or about April 22, 2014, the Office of the United States Trustee filed a motion for the appointment of a Chapter 11 Trustee based upon the allegations of illegal activity.

11. On April 23, 2014, the SEC filed a motion to transfer venue of the cases to the United States Bankruptcy Court for the District of Massachusetts (the “Court”). By order dated May 6, 2014, the motion to change venue was approved. The cases were transferred to the Court on May 9, 2014.

12. On May 30, 2014, this Court allowed the United States Trustee’s motion to appoint a Chapter 11 trustee, and I was appointed on June 6, 2014.

13. The Debtors filed only a list of the alleged thirty (30) largest creditors in the cases and did not file schedules or statements of financial affairs, nor a matrix of creditors.

14. On February 27, 2015, I filed schedules of assets and liabilities and statements of financial affairs for each of the Debtors, using information obtained from documents produced pursuant to Rule 2004 examinations and Debtor records provided by the Federal Authorities (as defined below).

15. Carlos Wanzeler and James Merrill were the Debtors' principals along with Carlos Costa, at least through his alleged separation with the Debtors in the fall of 2013. Shortly after the Trustee was appointed, the United States Department of Justice ("DOJ" and, together with the SEC and HSI, the "Federal Authorities") indicted Wanzeler and Merrill based upon their involvement in the Debtors' scheme. Wanzeler has fled the country and, upon information and belief, is in Brazil. Merrill was initially detained and has been released pending trial.

16. On February 3, 2015, I submitted a comprehensive Status Report on outstanding matters in the cases. The Status Report set forth, among other things, the background of the Debtors and their affiliates, the breadth and scope of the scheme, assets recovered to date and potential additional sources of recovery, as well as efforts at coordination with governmental authorities, both in the United States and in Brazil.

17. Prior to my appointment, the Federal Authorities shut down, disconnected, and seized the Debtors' computer system, which consisted of forty-six (46) computers and servers containing more than twenty (20) terabytes of data. Accordingly, at the time of my appointment, I did not have access to any of the Debtors' records. Neither of the Debtors' principals has been available because Wanzeler fled the country and Merrill had been indicted and detained. I have had only had limited access to the Debtors' former employees.

18. Initially without access to the Debtors' books and records, I have utilized a variety of resources to acquire information regarding the Debtors' activities and the mechanics of their scheme.

19. I directed counsel to file motions for authority to obtain documents from, and conduct examinations of, twenty-nine (29) separate entities pursuant to Federal Rule of Bankruptcy Procedure 2004 (the "2004 Motions").¹ The deponents of the 2004 Motions included prepetition and postpetition professionals retained by the Debtors, financial institutions who had prepetition and/or postpetition relationships with the Debtors, multiple firms who provided payment processing services to facilitate payments between the Debtors and Participants, and firms who provided consulting services to the Debtors or who otherwise were believed to have had business relationships with the Debtors.

20. I have also conducted or supervised informal interviews of certain former employees and consultants of the Debtors as well as several Participants.

A. Mechanics of Scheme and Methods of Compensation

21. The Debtors purported to be in the business of selling a voice over internet service, or "VoIP" that cost \$49.90 per month to conduct international phone calls. The sale of VoIP on a monthly basis is hereinafter referred to as a "VoIP Package". Customers who purchased the VoIP Package registered their phone numbers with the Debtors and received software that enabled their computers to place phone calls through the Debtors' computer servers in Marlborough, Massachusetts to approximately 40 countries.

22. The Debtors ostensibly used a multi-level marketing plan, or "MLMP", to sell the VoIP Packages.

¹ To date, I have deferred conducting depositions of the 2004 Motion deponents, as the focus has been on retrieving and examining documents and conducting informal interviews.

23. Until they purported to change their MLMP in March 2014, the Debtors provided Participants with two options to become members and to thereby open User Accounts:

- a. “AdCentral Plan”: \$339 for a one-year contract (\$50 membership fee plus \$289 contract fee). This contract entitled the User Account holder with the right to sell ten VoIP Packages, as to which a Participant could receive a commission if the packages were sold, although there was no sale requirement. Participants were required to place one internet ad per day and, for each week in which the Participant placed the required ads, he/she was entitled to one additional VoIP Package, which could be sold or exchanged for \$20 in credits with the Debtors. Thus, Participants who posted the required ads were eligible to receive \$20 per week for 52 weeks, for a total return of \$1,040 (a return of 207% on the investment of \$339).
- b. “AdCentral Family Plan”: \$1,425 for a one-year contract (\$50 membership fee plus \$1,375 contract fee). This contract entitled the User Account holder with the right to sell fifty VoIP Packages, as to which a Participant could receive a commission if the packages were sold, although there was no sale requirement. Participants were required to place five internet ads per day and, for each week in which the Participant placed the required ads, he/she was entitled to five additional VoIP Packages, which could be sold or exchanged for \$100 in credits with the Debtors. Thus, the Participants who posted the required ads were eligible to receive \$100 per week for 52 weeks, for a total return of \$5,200 (a return of 265% on the investment of \$1,425).

24. In addition to credits for posting these advertisements, the Debtors issued credits to Participants for the sale of membership plans and the establishment of new User Accounts as follows:

- a. \$20 in credits for each new Ad Central Plan and \$100 in credits for each new AdCentral Family Plan in a Participant’s network.
- b. \$20 in credits for each User Account in one’s “network,” up to a maximum of \$440, as long as there were two subsidiary User Accounts.
- c. 2% of all payments to each User Account within one’s network, down to six “levels” of the network, provided that each User Account had a registered VoIP customer.
- d. 2% of the Debtors’ net monthly billing, up to a maximum of \$39,600 in credits, for an AdCentral Family Plan that had ten new AdCentral Family

Plans in its network, so long as each plan had five registered VoIP customers.

25. The Debtors also issued credits to Participants for the sale of VoIP Packages as follows:

- a. 90% (or \$44.90 in credits) for the initial sale of a VoIP Package at \$49.90.
- b. 10% (or \$4.99 in credits) per month for the renewal of a VOIP Package by a User Account holder directly in one's network² and 2% (or \$0.99 in credits) per month for the renewal of a VOIP Package by a User Account holder indirectly in one's network, down to six levels of the network.
- c. 2% from all VoIP Package sales in one's network, down to six levels of the network.

26. The credits issued to Participants for placing advertisements and selling membership plans and VoIP Packages could be redeemed for cash, transferred to another User Account, or applied in satisfaction of an invoice for another User Account.

27. Invoices for the purchase of a membership plan could be satisfied in one of two ways. Participants could pay the invoice in cash directly to the Debtors or Participants could pay a recruiting Participant for the purchase of a membership plan through the recruiting Participant's redemption of credits in an existing User Account.

28. In the case of a Participant satisfying his/her own invoice directly by payment in cash to the Debtors, the process worked, generally, as follows:

- a. The Participant joined the Debtors' organization and created an online account with the assistance of a recruiting Participant, who needed to be identified;
- b. The Debtors' database recorded the details entered by the new Participant and assigned an identification number to the new User Account;
- c. The Debtors recorded the purchase, issued an invoice number, and marked the invoice as 'pending';

² In practice, the Debtors appear to have provided Participants with credits equal to ninety percent (90%) of the renewal fees.

- d. A Participant could pay money directly to the Debtors in the form of cash, check, cashier's check, or wire transfer, or through a third-party online payment processing account. Once the Participant paid the invoice, the Debtors updated the invoice as 'paid', and the account setup would be complete;
- e. The new Participant could then start building a pyramid underneath the newly created User Account by recruiting other Participants (or by purchasing new User Accounts themselves) and generating bonuses and commissions in accordance with the scheme.

29. Alternatively, as described below, a Participant could satisfy his/her own invoice directly by payment in cash to another Participant, who would satisfy the invoice by a redemption of accumulated credits. Thus, the new Participant's membership fee was paid directly to the recruiting Participant, rather than to the Debtors.

30. There are 10,987,617 User Accounts associated with the Debtors' MLMP. A new User Account was generally established each time that a membership plan was purchased, with either cash or accumulated credits.

31. Although some versions of Participant contracts contained prohibitions against Participants opening multiple User Accounts, other plan descriptions did not. In any case, any such restriction was not enforced and could not be enforced since the Debtors did not verify the Participants' identities. The Debtors' MLMP structure created incentives for Participants to open multiple User Accounts to generate commissions for themselves.

32. As noted above, a Participant could monetize accumulated credits by recruiting a new Participant to join the Debtors' scheme and using his/her accumulated credits to satisfy the invoice for the new Participant's membership plan in exchange for payment of the membership fee from the new Participant (a "Triangular Transaction"). In a Triangular Transaction, the Debtors issued the membership invoice to the recruited Participant, the recruited Participant paid

the membership invoice that was due to the Debtors instead to the recruiting Participant, and the Debtors redeemed the credits of the recruiting Participant in satisfaction of the invoice.

33. In a Triangular Transaction, the process generally worked in the same manner outlined above except that:

- a. The new Participant paid the invoice amount to the recruiting Participant (in those cases where there were two separate Participants involved, that is, not an intra-Participant transaction) and forwarded the initial invoice to the recruiting Participant; and
- b. The recruiting Participant, in turn, satisfied the initial invoice with accumulated credits in his/her existing User Account.

34. In fact, it was a regular practice of the Debtors' scheme for membership fees to be paid by the use of accumulated credits rather than by cash.

35. While invoices associated with the sale of membership plans or VoIP Packages had a face value of \$3,073,471,326, only \$359,792,242, or approximately twelve percent (11.7%) of that amount, was paid in cash to the Debtors. The balance of these invoices, totaling \$2,713,679,084, was satisfied by the use of Participants' credits.

36. The Debtors also issued "manual credits" to certain User Accounts in some instances. Manual credits were credits issued to User Accounts unrelated to the purchase of a membership plan and not resulting from the placement of advertisements or other components of the compensation scheme. Although some manual credits may have been issued to User Accounts in exchange for cash payment to the Debtors, a significant amount of manual credits appear to have been issued to certain User Accounts without any payment to the Debtors. There also were exchanges of credits between User Accounts unassociated with the issuance and satisfaction of Debtor invoices.

B. SIG/Back Office

37. The Debtors maintained two computer applications for accessing and processing information from the Debtors' database relating to User Account activity, referred to as "SIG" and the "Back Office".³

38. SIG stands for Sistemas de Informacoes Gerenciais, which is Portuguese and translates roughly to "Information Management System." SIG tracked the activity for Participants by User Account, and the User Accounts are the only records available to confirm Participant activity.

39. Access to SIG was the culmination of a painstaking data recovery and analysis project implemented with the assistance of my professionals and investigators from HSI.

40. Following my appointment and beginning in August 2014, HSI provided copies of electronic information contained in the Debtors' computers and servers. Once all of the data from the Debtors' computers and servers were obtained, I and my team reassembled the system following a multiple step process.

41. The first step involved identification of a key server that appeared to contain much of the Debtors' 'big data'. Extensive testing was then performed to determine the appropriate configurations of the data and to restore the data in a virtual machine environment. Once the physical configuration of the hard drives was determined, the servers were 'virtualized', which was necessary because the Federal Authorities were in possession of the original servers. Additional servers were later identified that were necessary to operate the network. Once the key components of the system were identified and operating, passwords were obtained through research into document productions received, communications with Federal

³ The Back Office was the program used by Participants to obtain information on their User Account activity.

Authorities, and a variety of investigative tools. Finally, an intensive analysis was performed to better understand the database structure, table relationships, data fields, and process flow.

42. Once access to a working version of SIG was obtained, I and my professionals were able to conduct search queries and sort data. Because SIG was complicated, written in more than one language, and poorly maintained, and system documentation was unavailable, substantial additional hurdles remained to achieving an understanding of the system and extracting usable data.

43. The Debtors' database was developed by programmers in Brazil and all field references are in Portuguese. System modifications appear to have been done in a haphazard and disorganized fashion. The Debtors' system is permeated with unreliable data because of limited efforts at data validation in establishing User Accounts.

44. Despite all of these obstacles, as a result of the forensic efforts identified above, I and my team have been able to reconstruct the Debtors' computer system in a virtual environment and obtain a working understanding of SIG and how it was used to track User Account activity.

45. Each time that a Participant purchased a membership plan or VoIP Package, an account was established with SIG (the "User Account").

46. Each User Account with the Debtors was registered with an electronic mail address ("Email Address"). There are approximately 900,000 unique Participant Email Addresses in SIG associated with 10,987,617 User Accounts. The number of User Accounts associated with an Email Address varies widely. A particular Email Address may be associated with a single User Account or may be associated with hundreds or thousands of User Accounts. Because each User Account may represent a separate Participant and some Participants entered

the scheme using the Email Address of another Participant, the number of Participants is unknown but is likely to be well in excess of 1,000,000.

47. After a User Account was established, SIG tracked the activity of the Participant in that User Account, including the accumulation of credits for bonuses and commissions ‘earned’, the use or transfer of credits between User Accounts, and payments made to or from the Participant directly with the Debtors.

48. SIG contains more than 100 tables of data. These tables include an Account Table (which contains a unique record for each User Account), an Invoice Table (which contains a unique record of each invoice generated by the Debtors), a Transfer Table (which contains information about each transfer of credits within the TelexFree system, including withdrawals of funds), and a Bonus Table (which contains information about each increase in credits into a User Account).

49. I and my advisors have taken a series of steps to confirm the accuracy and reliability of the transaction data reflected in SIG. My advisors interviewed the Debtors’ bookkeeper, Andrea Cabral, to understand the mechanics of SIG and how it was employed on a day to day basis. Limited testing was performed to reconcile balances and activity using available data, including cross-referencing data in related transactions, conducting interviews with several Participants to confirm the accuracy of the SIG data as to their User Accounts, and reconciling payment data with third party processor records. Based on the testing performed to date, SIG provides accurate information regarding membership plan sales, issuance of invoices, accumulation and use of credits, and amounts received from and disbursed to the User Accounts.

C. Relationship with Ympactus, and Segregation of Ympactus Information and Debtor Information

50. In February 2012, Ympactus commenced operations in Brazil and reportedly operated a scheme substantially identical to the scheme that is described above. The Debtors commenced operations in April 2012. Ympactus initially grew much more rapidly than the Debtors, with growth accelerating in the fall of 2012 through the early summer of 2013. By the spring of 2013, Ympactus had cash receipts of more than \$100,000,000 per month. *See Exhibit “I”*. On the other hand, the Debtors’ cash receipts were initially much more modest. In the spring of 2013, the Debtors’ cash receipts averaged approximately \$6,400,000 per month. *See Exhibit “I”*.

51. On June 28, 2013, the Public Prosecutor’s Office of the State of Acre, Brazil filed claims against Ympactus, Carlos Wanzeler, Lyvia Mara Campista Wanzeler, and James Merrill, alleging that the VoIP Packages marketed in Brazil were violating consumer rights, since the MLMP constituted a Ponzi/pyramid scheme. The Brazilian authorities suspended the operations of Ympactus and froze its assets in Brazil. Upon information and belief, the Brazilian authorities seized as much as \$300,000,000 from Ympactus in connection with the shutdown, and civil and criminal proceedings are pending in Brazil. On or about September 21, 2015, the Brazilian court entered a decision finding that Ympactus operated a pyramid scheme.

52. Following the shutdown of Ympactus, the Debtors’ cash receipts increased dramatically. The Debtors’ cash receipts totaled approximately \$198,500,000 in the last three full months of operation, with more than \$96,600,000 in cash receipts in February 2014 alone. *See Exhibit “I”*.

53. The SIG system maintained by the Debtors and Ympactus ran off a single database reflecting User Account activity for both operations. After reconstructing the computer

network and developing a working understanding of SIG, one of the first tasks was to determine how to segregate the Debtors' activity from that of Ympactus, since SIG did not clearly differentiate the User Accounts between the two.

54. SIG includes 17,016,780 distinct User Accounts associated with 2,166,955 Email Addresses for both the US-based and the Brazilian-based operations.

55. I believe that a valid basis exists to separate the Debtors' User Account data based upon the currency designation in the data fields.

56. The Debtors' system assigned a currency to be used to pay invoices based on the Participant's country of residence. Participants entering Brazil as their home address paid invoices denominated in Brazilian Reais ("Reais") and all others paid invoices denominated in United States Dollars, although for accounting purposes, all transactions in the database were recorded in United States Dollars. The Invoice Table distinguishes between invoices paid in United States Dollars and invoices converted to United States Dollars from Reais.

57. The Invoice Table contains a "cambio" or "exchange rate" field. In 99.7% of transactions, by amount, where the currency field is denominated as "D" or United States Dollars, the cambio field is populated with a "0". In 99.8% of the transactions where the currency field is denominated as "R" or Brazilian Reais, the cambio field is populated with a range of values from 1.98 to 2.37 (that is, 1.98 to 2.37 Reais for each 1 Dollar). I have confirmed that the two currencies traded in this conversion range during the time that the Debtors and Ympactus were simultaneously in operation.

58. Through a review of the currency field data, I have further determined the following:

- a. Prior to the shutdown of Ympactus in June 2013, invoices in User Accounts with Brazilian contact information were denominated in Reais and invoices in User Accounts with non-Brazilian contact information were denominated in Dollars;
- b. Fewer than 700 Reais-denominated User Accounts were associated with non-Brazilian addresses. Similarly, fewer than 150 Dollar-denominated User Accounts were associated with Brazilian addresses; and
- c. There was relatively little activity after the shutdown of Ympactus for Reais-denominated User Accounts that were created prior to the shutdown, and all cash activity for Reais-denominated accounts ceased shortly after the shutdown.

59. Utilizing the currency designation, 10,987,617 User Accounts are associated with the Debtors' operations and 4,006,422 User Accounts are associated with Ympactus operations. The remaining User Accounts have no activity.

II. FINDING OF EXISTENCE OF PONZI AND PYRAMID SCHEME

60. Participants who purchased the AdCentral Plan became entitled to receive a VoIP Package each week by placing one internet advertisement per day. These VoIP Packages could be, and routinely were, converted into credits for \$20 weekly for 52 weeks, for a 207% return on the initial investment of \$339. Participants who purchased the more expensive AdCentral Family Plan were entitled to receive five additional VoIP Packages each week by placing five internet advertisements per day. These VoIP Packages could be, and routinely were, converted into credits for \$100 weekly for 52 weeks, for a return of 265% on the initial investment of \$1,425.

61. The repetitive posting of internet advertisements (which were reportedly supplied by the Debtors) served no legitimate purpose, because anyone who used “telexfree” as an internet search term would be led to the Debtors’ own website, and the repetitive posting of similar advertisements had no discernable value. For example, one website, Adpost.com, contained more than 33,000 postings submitted by Participants for TelexFree, while another, ClassifiedsGiant.com, contained more than 25,000 postings

62. Participants did not draft the advertisements or perform any design services for their configuration, and the placing the ads could be, and often was, outsourced to third parties for a nominal fee. The requirement of posting advertisements to receive weekly payments obfuscated the true nature of the scheme – that the credits were a disguised, “guaranteed” return on the Participant’s initial investment.

63. The guarantee of an astronomical return on the initial investment without the requirement to sell any product created perverse incentives for Participants. Participants opened multiple User Accounts for the sole purpose of leveraging their fictitious profits, without the need to sell any product or recruit any individuals. Some Participants appear to have invested a substantial portion of their life savings into the scheme seeking to quickly triple or quadruple their investment. Participants opened hundreds of User Accounts, ultimately resulting in an exponential rise in the number of User Accounts.

64. Participants who opened multiple User Accounts on their own behalf could generate credits by essentially recruiting themselves. Participants could receive (1) \$20 worth of credits for recruitment of an AdCentral Plan member and \$100 in credits for recruitment of an AdCentral Family Plan member, and (2) \$20 in credits for each membership plan in one’s downline, up to a maximum of \$440 in credits, so long as that Participant recruited two new User

Accounts in his/her downline by either opening User Accounts in his/her own name or by recruiting new Participants.

65. While there were certain provisions of the Debtors' MLMP that ostensibly required the sale of VoIP Packages as a requirement for receiving credits, the credits that could be generated for those activities were relatively insignificant and the requirements were easily circumvented by Participants.⁴

66. The Debtors had \$359,792,242 in actual cash sales during the two year operation of the scheme. Of this amount, approximately \$353,000,000 was from the sale of membership plans and \$6,600,000 was from the sale of VoIP Packages. Even more remarkably, seventy-seven percent (77%) of sales occurred in the six weeks before the filing in a belated attempt by the Debtors to fix their fatally flawed plan by ostensibly requiring the sale of VoIP Packages to receive bonuses and commissions in the future.

67. By and large, the few VoIP Packages that were sold were not used. Of the \$6,600,000 in VoIP Package cash sales, less than one percent (1%) of available minutes contained in these packages were actually utilized, further demonstrating that the Debtors were not operating a bona fide MLMP and the VoIP Packages were not a legitimate product.⁵ Approximately \$477,888,000 in VoIP Packages were sold through the use of accumulated credits. Approximately eighty percent (80%) of these sales occurred in the six weeks leading up to the Petition Date in connection with implementation of the new compensation scheme.

⁴ While the generation of certain commissions required activation of VoIP Packages in a Participant's downline, this requirement was circumvented by the purchase of VoIP Packages with accumulated credits. Credits were also issued for the sale of standalone VoIP Packages but VoIP Packages were rarely sold to third parties.

⁵ This estimate is based upon information contained in the Disk A Vantage database (which includes VoIP service for both the Debtors and Ympactus) for the period July 2012 through June 2013, as well as usage of only the Debtors' VoIP service for the period July 2013 to April 2014.

68. The total reliance on the sale of membership plans, as opposed to the sale of a legitimate product, made the collapse of the Debtors' scheme inevitable.

69. A calculation of the Debtors' twelve month trailing liability, that is, the amount due to Participants over the following year on account of the guaranteed return, further evidences the unsustainability of the scheme. This liability grew exponentially in the year prior to the Petition Date, eventually rising to more than \$5,000,000,000 as of the Petition Date. Attached as *Exhibit "2"* hereto is a computation of the 12 month trailing liability as of the Petition Date. This trailing liability more than tripled in the five (5) months leading up to the Chapter 11 filings, far outpacing any cash generated from the sale of VoIP Packages.⁶ The \$5,000,000,000 trailing liability is more than seven hundred times the \$6,600,000 in cash receipts from the sale of VoIP Packages since inception of the Debtors' MLMP. The sale of additional membership plans only deepened the insufficiency.

IV. THE DEBTORS ARE JOINTLY LIABLE FOR PARTICIPANT CLAIMS

70. The Debtors worked in concert with one another to develop, market, and operate their Ponzi and pyramid scheme. The Debtors had common ownership and each was controlled by Wanzeler and Merrill, as well as Carlos Costa at least through his alleged separation from the Debtors in the fall of 2013.

71. Each of the Debtors was intimately involved in the scheme. Common Cents Communications, Inc., which was owned and controlled by Wanzeler, Merrill, and Steven Labriola, changed its name to TelexFree, Inc. in early 2012 in conjunction with the marketing

⁶ While certain provisions of Participant contracts did not require the payment to Participants for VoIP Packages issued to them, this contractual provision is completely undermined by the unmistakable statements in marketing materials and some of the Participant contracts promising Participants the right to a guaranteed return on investment without the need to sell any product.

and selling of VoIP Packages through the Debtors' MLMP. Shortly thereafter, in July 2012, TelexFree, LLC was formed, to conduct TelexFree's operations outside of Massachusetts.

72. TelexFree, Inc. and TelexFree, LLC worked collaboratively in furtherance of the scheme throughout 2012 and 2013, including joint marketing efforts, promotional materials, and Participant recruitment events. TelexFree, Inc. and TelexFree, LLC alternated responsibility for maintaining bank accounts, because on multiple occasions TelexFree was asked to close accounts with banks because of suspicious account activity.

73. After the seizure and shutdown of Ympactus by Brazilian authorities, TelexFree, LLC and TelexFree, Inc. saw a substantial increase in activity, which further exacerbated difficulties with banking facilities needed to conduct the TelexFree scheme. TelexFree Financial, Inc. was formed in Florida in December 2013 and opened bank accounts and paid expenses of TelexFree, Inc. and TelexFree, LLC. In late 2013, TelexFree, Inc. and TelexFree, LLC transferred more than \$4,000,000 to an account at TelexFree Financial. TelexFree Financial deposited an additional \$10,000,000 in membership fees and VoIP Package sales in February 2014. The only Debtor with employees was TelexFree, Inc. and these employees were being paid by TelexFree Financial.

74. TelexFree Financial rendered substantial assistance to TelexFree, LLC and TelexFree, Inc. in furtherance of the Ponzi and pyramid scheme.

75. The Debtors had a common design or agreement to establish and implement the Ponzi and pyramid scheme. The Debtors engaged in a common enterprise to further their plan.

I attest that, to the best of my knowledge, the foregoing is true and accurate.

Dated: October 7, 2015


Stephen B. Darr
Chapter 11 Trustee

695349

Exhibit 1

In re: TelexFree, LLC, *et al.*

Cash Receipts by Month - TelexFree and Ympactus

Month	TelexFree	Ympactus
February 2012	\$ 150	\$ 22,942
March 2012	1,884	84,503
April 2012	14,709	336,350
May 2012	43,983	1,847,443
June 2012	53,606	4,764,547
July 2012	84,986	8,948,617
August 2012	375,556	15,030,324
September 2012	768,207	34,346,283
October 2012	290,450	12,987,841
November 2012	693,672	34,128,986
December 2012	616,314	55,083,742
January 2013	1,764,966	143,425,971
February 2013	4,972,733	257,513,534
March 2013	3,800,994	121,512,314
April 2013	5,983,150	149,372,999
May 2013	9,467,356	284,144,633
June 2013	13,949,543	184,497,992
July 2013	12,180,176	-
August 2013	18,850,084	-
September 2013	9,279,178	-
October 2013	14,929,643	-
November 2013	27,738,566	-
December 2013	33,310,766	-
January 2014	48,483,827	-
February 2014	96,630,356	-
March 2014	53,385,849	-
April 2014	2,121,537	-
	<u>\$ 359,792,242</u>	<u>\$ 1,308,049,021</u>

Note: Determination of TelexFree vs. Ympactus based on Invoice Table data as described in Darr Affidavit.

Source: Debtors' Participant database.

Exhibit 2

In re: TelexFree, LLC, *et al.*

Trailing Liability Calculation - Advertising Bonus^{1,2,3}

Trailing Liability	Outstanding ADCentral Payments	Outstanding ADCentral Family Payments	ADCentral Liability (\$20 per week)	ADCentral Family Liability (\$100 per Week)	Total Liability
February 2012	\$ -	\$ -	\$ -	\$ -	\$ -
March 2012	-	-	-	-	-
April 2012	-	-	-	-	-
May 2012	-	102	-	10,200	10,200
June 2012	-	1,871	-	187,100	187,100
July 2012	-	2,881	-	288,100	288,100
August 2012	-	5,659	-	565,900	565,900
September 2012	1,237	5,735	24,740	573,500	598,240
October 2012	5,640	20,526	112,800	2,052,600	2,165,400
November 2012	9,989	39,832	199,780	3,983,200	4,182,980
December 2012	19,484	94,394	389,680	9,439,400	9,829,080
January 2013	31,697	182,875	633,940	18,287,500	18,921,440
February 2013	78,520	356,527	1,570,400	35,652,700	37,223,100
March 2013	164,655	506,542	3,293,100	50,654,200	53,947,300
April 2013	283,453	761,101	5,669,060	76,110,100	81,779,160
May 2013	494,359	1,261,216	9,887,180	126,121,600	136,008,780
June 2013	739,166	1,798,677	14,783,320	179,867,700	194,651,020
July 2013	1,096,143	2,411,703	21,922,860	241,170,300	263,093,160
August 2013	1,684,888	3,656,684	33,697,760	365,668,400	399,366,160
September 2013	2,559,676	5,852,955	51,193,520	585,295,500	636,489,020
October 2013	3,583,231	9,169,675	71,664,620	916,967,500	988,632,120
November 2013	4,826,215	13,775,043	96,524,300	1,377,504,300	1,474,028,600
December 2013	6,357,701	20,343,202	127,154,020	2,034,320,200	2,161,474,220
January 2014	8,284,248	31,105,685	165,684,960	3,110,568,500	3,276,253,460
February 2014	10,409,821	45,926,764	208,196,420	4,592,676,400	4,800,872,820
March 2014	10,611,602	50,826,455	212,232,040	5,082,645,500	5,294,877,540
April 13, 2014	10,021,920	48,251,878	200,438,400	4,825,187,800	5,025,626,200
April 2014	9,432,888	45,682,130	188,657,760	4,568,213,000	4,756,870,760

Notes

1. Trailing liability calculated as of the last day of each month based on the weekly Advertising Bonus as described in TelexFree Participant contracts
2. Includes purchases of AdCentral and AdCentral Family plans and excludes commission other than weekly Advertising Bonus
3. Assumes Participants purchasing AdCentral or AdCentral Family plans would place required advertisements and receive Advertising Bonus each week.

Source: Debtors' Participant database.

In Re:

Debtors.

Case No. 14-40989-MSH

Jointly Administered

PROCEDURAL BACKGROUND

3. After conducting the evidentiary hearing, the Court made partial rulings on the Ponzi Motion by order dated November 25, 2015, as amended on December 21, 2015. The

4. The Trustee provided supplemental notice to Participants of the continued hearing and the additional relief sought on or about December 7, 2015. On or about such date, the Trustee filed a copy of the supplemental notice of the Ponzi Motion and filed a certificate of service.

ORDER

5. The Court, having conducted the continued hearing on the Ponzi Motion, upon the evidence submitted and the arguments of counsel made at the hearings, and the Court having reviewed all documents in connection with the Ponzi Motion, including the *Affidavit of Stephen B. Darr in support of Motion by Chapter 11 Trustee for Entry of Order Finding that Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* (“Darr Affidavit”), and notice of the Ponzi Motion having been given to all parties in interest in accordance with the order dated October 14, 2015; and supplemental notice of the Ponzi Motion and continued hearing having been given on or about December 7, 2015; and the Court having considered the oppositions filed, notice of the Ponzi Motion being sufficient; and after due deliberation and consideration of all of the foregoing, and sufficient cause appearing therefor, the Court hereby orders that:

- (i) In determining the amount of claims of Participants,¹ any claim or portion of claim based upon accumulated credits in a Participants' User Accounts as of the Petition Date shall be disallowed;
- (ii) The claims amounts of Participants shall be determined on a Net Equity basis, which shall be defined as follows: the amount invested by the Participant into the

¹ All terms not otherwise defined herein shall have the meaning ascribed to them in the Ponzi Motion.

Debtors' scheme, including amounts paid pursuant to Triangular Transactions, less amounts received by the Participant from the Debtors' scheme, including amounts received pursuant to Triangular Transactions.

- (iii) In determining the amount of a claim of a Participant who has more than one User Account, the activity in all of the Participants' User Accounts shall be aggregated and netted against one another;
- (iv) The calculation of a Participant's claim using the Net Equity basis is without prejudice to the Trustee's right to object to the claim of a Participant who had knowledge that the Debtors were engaging in a fraudulent scheme and is therefore not entitled to the claims afforded innocent Participants;
- (v) The relief granted herein is appropriately made by motion and does not require the institution of an adversary proceeding; and
- (vi) The foregoing findings and conclusions shall be applicable for all purposes in these proceedings.

Dated: January 26, 2016





Honorable Melvin S. Hoffman
Chief United States Bankruptcy Judge

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

In re:
TelexFree Securities Litigation

)
)
)
)
)

Case No. 14-MD-02566-TSH

BEFORE: The Honorable Timothy S. Hillman

Motion Hearing

United States District Court
Courtroom No. 2
595 Main Street
Worcester, Massachusetts
December 11, 2015

Marianne Kusa-Ryll, RDR, CRR
Official Court Reporter
United States District Court
595 Main Street, Room 514A
Worcester, MA 01608-2093
508-929-3399 justicehill@aol.com
Mechanical Steno - Transcript by Computer

1 MR. BENNETT: It would leave January 26th still on,
2 but the question then comes in as whether or not -- how do I
3 treat your allowance -- how does the Court treat your allowance
4 of the motion to amend? Are you making any substantive
09:28:54AM 5 findings with respect to their rights to proceed? Are you
6 making any substantive findings with respect to the claims by
7 the trustee that this violates the stay?

8 THE COURT: Why wouldn't I just -- well, all right.
9 Okay.

09:29:05AM 10 MR. BENNETT: And so, I mean, I would want to be heard
11 if the Court allowed me to intervene on that basis that they
12 should not be allowed to proceed on that -- on that action.

13 THE COURT: Actually, let's stay with intervention and
14 then we can talk about what goes after that.

09:29:17AM 15 MR. BENNETT: All right. So, your Honor, that is the
16 motion, the reason for requesting to intervene is to seek
17 basically a stay of your ruling on the motion to amend until
18 Judge Hoffman rules.

19 THE COURT: Thank you.

09:29:27AM 20 MR. BENNETT: Thank you, your Honor.

21 THE COURT: Who has got this for the plaintiffs?
22 Mr. Baldiga?

23 MR. BALDIGA: Thank you, your Honor. And good
24 morning. For the record, William Baldiga, Brown, Rudnick,
09:29:42AM 25 co-counsel for the plaintiff victims here.

1 Your Honor, this is one of those many instances where
2 the intersections between an ongoing MDL and bankruptcy
3 proceedings can have rough edges. This is admittedly one.
4 It's -- it is procedurally somewhat difficult, and
09:30:05AM 5 unfortunately here it will -- it does present to the federal
6 courts, and we'll -- we'll see in time which federal court
7 decides a very difficult issue because of one of first
8 impression as to the issue of property of the estate, which
9 does need to be decided.

09:30:26AM 10 Some things we don't disagree on with Mr. Bennett.
11 There should be a court that decides that issue. The trustee
12 has elected here to file papers both before Judge Hoffman and
13 here. It has caused some, we think, needless confusion and
14 expense. We -- we think we have -- we do agree that one court
09:30:55AM 15 should decide that issue. Whichever court -- and if -- if that
16 is Judge Hoffman, and it appears that Judge Hoffman is prepared
17 to take that issue on, we don't oppose Judge Hoffman deciding
18 that issue. We actually think that in the first instance at
19 least issue of what is property of the bankruptcy estate and
09:31:13AM 20 the extent of the bankruptcy stay is one that is well-suited
21 especially to a bankruptcy judge, not that this court couldn't
22 do it, and judges of a District Court do this, but much more
23 rarely than a bankruptcy judge.

24 And -- but we do oppose the intervention today, and
09:31:35AM 25 the trustee takes a view, of course, from the trustee's

1 perspective. He's one party, not even a party to this case,
2 but let's assume that he is a party of some sort. He's one of
3 only many, and the world doesn't revolve only around the
4 trustee. And I don't want to leak into right now the -- the
09:31:57AM 5 motion to amend, although these are obviously very much
6 related. It is important to us that Judge Hoffman, or this
7 court, if you decide that it should be you, it will be you,
8 resolves the issue of property of the estate. But we also want
9 to get on with a case that is already getting close to two
09:32:16AM 10 years old that has the positions of the other parties as to
11 this unjust enrichment also be heard. This -- a case this
12 complicated and with this many parties cannot proceed in
13 seriatim where we have to wait for one party to finish
14 everything they have to say before we get on to whatever any
09:32:39AM 15 other party wants to say and so forth.

16 These are victims for the most part who have lost
17 their life savings. We have about \$3 billion of transfers
18 among a million victims, and we hear and respect the bankruptcy
19 trustee wants to get some rulings that they hope will be
09:32:55AM 20 favorable to them before Judge Hoffman, but it's not a reason
21 to bring this proceeding to a halt.

22 And so just to review a little bit where we are, and
23 obviously we appreciate the coordination between you and Judge
24 Hoffman in terms of that's -- it's good for everyone for the
09:33:11AM 25 two courts to be coordinated.

1 The -- the trustee has filed a motion for a
2 determination that TelexFree engaged in a Ponzi scheme. We did
3 not oppose that. The trustee has also filed in the bankruptcy
4 case a -- a series of motions, the Ponzi scheme being one of
09:33:33AM 5 them, the bar date motion being another, seeking to have the
6 bankruptcy judge issue some guidance as to how proofs of claim
7 are going to be filed in the bankruptcy case and the mechanisms
8 that should guide the parties as to the allowance of those
9 claims. We've not opposed those.

09:33:53AM 10 And so the one thing that I would start with that I
11 would challenge Mr. Bennett on is that whatever you're being
12 asked to do here interferes with the administration of the
13 bankruptcy case. That's simply not the case. And that was
14 clarified at the hearing on November 24th where Judge Hoffman
09:34:10AM 15 asked me, "Do you oppose the bar date motion and the procedures
16 for the setting of the claims?" We do not. And I didn't think
17 there was really any confusion leading up to that hearing, but
18 certainly not since that hearing.

19 Secondly, we do not oppose in the bankruptcy case the
09:34:27AM 20 calculation that the trustee would use or the -- I'm sorry --
21 that the Bankruptcy Court would set for the determination of
22 what is an allowable claim and what is not an allowable claim
23 in the bankruptcy case. We do not oppose that. So there's no
24 interference here at all with the administration of the
09:34:46AM 25 bankruptcy case. That has to be overseen by Judge Hoffman, and

1 it will.

2 There are also a few other aspects for relief sought
3 by the bankruptcy trustee before Judge Hoffman that the
4 TelexFree defendants would have joint and several liability and
09:35:02AM 5 so forth. We also did not oppose those.

6 There was a motion filed -- or an adversary
7 proceeding -- the only person the trustee has sued in the
8 Bankruptcy Court is the victims' representative. That's the
9 only lawsuit that has been commenced by the bankruptcy trustee.
09:35:18AM 10 That's unfortunate, but that's for another day. That -- the
11 bankruptcy trustee has chosen for reasons known to him not to
12 set for a hearing. So that has not yet been set for a hearing
13 before Judge Hoffman, but we agree with Mr. Bennett that it
14 seems that Judge Hoffman has to take that up. We would ask --
09:35:38AM 15 we would have liked that to have been formally put before Judge
16 Hoffman. He seems to be getting there in his own way, and
17 there are further arguments at the end of January that would
18 seem to get there, but this could take a long time before it's
19 decided before Judge Hoffman.

09:35:55AM 20 Technically, the specific motion filed in the
21 bankruptcy case by the trustee on the very issue of what is
22 property of the estate has not even been set for a hearing.
23 And whatever -- and the issue has been briefed somewhat, and
24 Judge Hoffman may or may not advance the ball on that on
09:36:12AM 25 January 27th, but we don't know. And whatever is done in that

Murdoch - Direct

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1 next to the witness. I just want to make sure that we pick you
2 up.

3 THE INTERPRETER: Okay. You will. Thank you.

4 THE COURTROOM DEPUTY: Would you raise your right
5 hand?

6 MARIA MURDOCH, PIEC'S WITNESS, SWORN

7 THE COURTROOM DEPUTY: Could you spell her name,
8 please?

9 MS. TAYLOR: It's Maria, M-A-R-I-A --

10 THE COURTROOM DEPUTY: Yeah.

11 MS. TAYLOR: -- Murdoch, M-U-R-D-O-C-H.

12 THE COURTROOM DEPUTY: Thank you.

13 DIRECT EXAMINATION

14 BY MS. TAYLOR:

15 Q Afternoon, Ms. Murdoch. Thank you for joining us.

16 A Good afternoon.

17 Q Realizing that we're short on time, I will try to keep this
18 brief.

19 Do you speak -- do you speak English?

20 A Little bit.

21 Q But Portuguese is your primary language and you primarily
22 communicate in Portuguese, correct?

23 A Yes.

24 Q Have you ever testified in court before?

25 A No.

1 Q What is your occupation?

2 A I'm a house cleaning.

3 Q And where were you born?

4 A Brazil.

5 Q Are you a permanent resident now of the United States?

6 A Yes. I'm an LPR.

7 Q And how long have you lived here?

8 A Sixteen years.

9 Q And why did you move here?

10 A Because Brazil was very difficult at that time and I
11 brought my, my daughter here so she can study.

12 Q I'm going to ask a couple questions about your
13 participation in TelexFree.

14 When did you first hear about TelexFree?

15 A It was about August of 2013.

16 Q And how were you convinced to get involved?

17 A It was through some friends of mine.

18 Q And did you pay anyone any money to get involved in
19 TelexFree?

20 A Yes, I did.

21 Q Who?

22 A His name is Wagner.

23 Q How did you meet Mr. Wagner?

24 A It's through this group. They're doing some, having some
25 meetings.

1 Sam, Sam Rodriguez, that's the name of the person.

2 Q How many times did you attend a meeting with Mr. Rodriguez,
3 Sam Rodriguez?

4 A About three times.

5 Q Three times.

6 And how much money did you pay Mr. Wagner or Mr. Rodriguez
7 to get involved in TelexFree?

8 A \$25,000.

9 Q And that money was a large part or all of your savings,
10 correct?

11 A Yes. Everything I had.

12 Q And how did you pay that money?

13 A Cash.

14 Q Cash.

15 And you handed that cash directly to Mr. Wagner?

16 A To Wagner, yes.

17 Q Did you ever get any money back from TelexFree?

18 A No.

19 Q And have you filed a claim in the bankruptcy case?

20 A No. No.

21 Q Do you intend to file a claim?

22 A Yes.

23 Q I'm going to ask a couple questions about the motion that's
24 the subject of today's hearing.

25 Are you familiar with this motion?

1 A If I have the knowledge, you mean?

2 Q Do you know, generally, what it's about?

3 A Yeah, it's about TelexFree.

4 Q Okay. Did you receive by e-mail or by mail or by any other
5 means a copy of the motion?

6 A No.

7 Q And did you receive any notice of today's hearing in the
8 mail or by e-mail or by any other motion, or way?

9 A It was, yes.

10 Q It -- excuse me. I don't understand. It was.

11 A My daughter is the one who told me that I have to come here
12 today.

13 Q Okay. But prior to your daughter telling you, you
14 didn't -- did you get anything in the mail, you, saying that
15 there is a hearing today?

16 A No.

17 Q Okay.

18 So not having had a copy of the motion, did you know that
19 the motion, if it's granted today, would stop you or your
20 chosen lawyer from suing to get the money back that you gave to
21 Mr. Wagner?

22 A I didn't understand the question.

23 Q Okay. Let me try to rephrase.

24 Do you want to sue Mr. Wagner to get your money back?

25 A Yes, I do.

1 Q Did you know before today or yesterday that if the motion
2 is granted you won't be able to do that?

3 A No, I didn't.

4 Q Thank you.

5 MS. TAYLOR: I have nothing further.

6 THE COURT: Just a minute, please.

7 Mr. Bennett, anything?

8 MR. BENNETT: Very briefly, Your Honor.

9 THE COURT: Okay.

10 CROSS-EXAMINATION

11 BY MR. BENNETT:

12 Q When you paid the money to this individual did you get a
13 membership in TelexFree?

14 A No.

15 Q Did you get a user account with TelexFree?

16 A No.

17 Q Did -- does your daughter have a user account at TelexFree?

18 A No, she did not.

19 Q And how did your daughter find out about this hearing, if
20 you know?

21 A Through some friends that they were supposed to be here.
22 They told her that I, I was supposed to be here, too.

23 Q Thank you.

24 MR. BENNETT: No further questions on my part.

25 MS. TAYLOR: No further questions. Thank you.

**United States District Court
District of Massachusetts (Worcester)
CIVIL DOCKET FOR CASE #: 4:14-md-02566-TSH**

In Re: Telexfree Securities Litigation
Assigned to: District Judge Timothy S Hillman
Cause: 28:1332 - Diversity: Securities Fraud

Date Filed: 10/22/2014
Jury Demand: Both
Nature of Suit: 190 Contract: Other
Jurisdiction: Diversity

12/11/2015	367	Electronic Clerk's Notes for proceedings held before District Judge Timothy S Hillman: Motion Hearing held on 12/11/2015 re <u>310</u> MOTION (I) Modifying the Discovery Stay, <u>266</u> MOTION to Intervene filed by Stephen B. Darr as Trustee of the Chapter 11 Estates of TelexFree, Inc. and TelexFree, LLC, and <u>252</u> MOTION to Amend <i>Complaint and File Third Consolidated Amended Complaint</i> filed by Plaintiffs, Case called, Counsel appear for motion hearing, Court hears arguments of counsel, Court rules taking under advisement <u>252</u> Motion to Amend; granting <u>266</u> Motion to Intervene; taking under advisement <u>310</u> Motion Modifying the Discovery Stay, (Court Reporter: Marianne Kusa-Ryll at justicehill@aol.com.)(Attorneys present: Several) (Castles, Martin) (Entered: 12/11/2015)
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EXHIBIT 6

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS

In re:

TELEXFREE, LLC,
TELEXFREE, INC. and
TELEXFREE FINANCIAL, INC.,

TelexFree.

Chapter 11 Cases

14-40987-MSH
14-40988-MSH
14-40989-MSH

Jointly Administered

STEPHEN B. DARR AS TRUSTEE
OF THE ESTATES OF TELEXFREE, LLC,
TELEXFREE, INC. and TELEXFREE
FINANCIAL, INC.,

Plaintiffs,

Adversary Proceeding
No. 15-04055

v.

RITA DOS SANTOS, INDIVIDUALLY AND
AS PUTATIVE CLASS REPRESENTATIVE,
AND MARIA MURDOCH, ANGELA
BATISTA JIMENEZ, ELISANGELA
OLIVEIRA AND DIOGO DE ARAUGO, AS
PUTATIVE CLASS REPRESENTATIVES,

Defendants.

**AFFIDAVIT OF STEPHEN B. DARR IN OPPOSITION TO THE PIEC
MOTION FOR SUMMARY JUDGMENT AND IN SUPPORT OF THE
TRUSTEE'S CROSS-MOTION FOR SUMMARY JUDGMENT**

I, Stephen B. Darr, as the duly appointed Chapter 11 Trustee (the "Trustee") of the Estates of TelexFree, LLC, TelexFree, Inc. and TelexFree Financial, Inc. (collectively, "TelexFree"), having been duly appointed by Order of the Court dated June 6, 1014, and being duly sworn, depose and state that:

1. I am a Managing Director with the Business Advisory Practice of Huron Consulting Group. I have more than 35 years of experience providing accounting, auditing and financial consulting services to business organizations many of which are experiencing significant financial and operating difficulties. I am a Certified Public Accountant in Massachusetts and New Hampshire, a Certified Insolvency and Restructuring Advisor and hold certifications in both Financial Forensics and Distressed Business Valuation, as well as other professional qualifications.

2. The statements provided herein are based upon information and knowledge I have derived through my involvement in these Chapter 11 cases. During the course of my investigative duties in these cases, my colleagues and I have examined the Debtors' books and records, as well as documents produced by third parties in response to numerous motions for Federal Rule of Bankruptcy Procedure 2004 examinations. I and my professionals have conducted interviews of the Debtors' former employees and consultants, as well as professionals retained by the Debtors during the Chapter 11 cases. I have also reviewed the docket in these cases and related civil and criminal actions pending before the United States District Court for the District of Massachusetts.

3. I have previously filed affidavits in support of the *Motion by Chapter 11 Trustee for Entry of Order Finding that Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* (the "Ponzi Motion") and the *Verified Complaint* initiating the Darr v. Dos Santos Adversary Proceeding. I reaffirm each of the statements contained therein and those affidavits are incorporated by reference herein. [See Docket No. 623 and Adversary Proceeding No. 15-04055, Docket No. 3].

4. On November 25, 2015, the Court, on motion by the Trustee and after notice and hearing, entered an Order, as amended on December 21, 2015, determining TelexFree perpetrated a fraud upon the public, primarily targeting the immigrant community. TelexFree's fraud was premised upon the sale of membership plans to individuals and incorporated elements of both a Ponzi and pyramid scheme. [Docket No. 668].

5. The Ponzi aspect of the fraud involved the promise of astronomical returns to all Promoters who purchased a membership plan in TelexFree, merely for posting meaningless internet advertisements. By posting these advertisements, among other things, Promoters could "earn" credits with TelexFree that were redeemable for cash. The more membership plans that a Promoter acquired, the faster that Promoter could acquire credits. Each time a Promoter purchased a membership plan he/she was assigned a "User Account." Many Promoters had multiple User Accounts.

6. The pyramid aspect of the fraud was the promise to compensate Promoters for recruiting individuals into the TelexFree scheme. Although TelexFree was structured as a multi-level marketing company, there was no need for Promoters to buy or sell the internet telephone product it offered. As with most pyramid schemes, the more individuals that one recruited, the more money that the recruiting Promoter could make. For example, for each new recruit, a Promoter would receive a "fast start" bonus, either of \$20 or \$100, depending upon the type of membership plan that the Promoter sold. Further, once an individual was recruited into a Promoter's pyramid, the Promoter would earn credits as each of his/her 'downline' recruits became Promoters themselves by selling memberships to their own new recruits. TelexFree encouraged this "team building" activity by offering "team builder bonus" compensation, which

a Promoter could earn by, among other things, recruiting ten (10) additional Promoters into the scheme.

7. The pyramid aspects of the TelexFree fraud was prominently featured in TelexFree's website content, PowerPoint presentations, internet videos, and in-person recruitment meetings. All of these materials extolled the virtues of developing a Promoter's pyramid in order to maximize compensation. Examples of TelexFree's presentation materials to prospective Promoters are annexed as Exhibit A.

8. A Promoter's activity in recruiting individuals into the scheme and accounting for the membership fees collected and credits redeemed by Promoters was detailed in the Debtors' books and records (hereinafter referred to as "SIG") and reported in TelexFree's financial statements.

9. One of the principal methods by which TelexFree encouraged and enabled the recruitment of new Promoters was by permitting existing Promoters to earn credits by recruiting individuals into the program and redeeming those credits, referred to by TelexFree as "commissions" or "agent commission," from the fees paid by new recruits.

10. Pursuant to this, an individual could purchase a membership plan from TelexFree through a Promoter. TelexFree would then issue an invoice for the purchase of a membership plan being sold to that individual through a Promoter. The Promoter collected from the recruited individual the amount of membership fee set forth on the invoice as agent for TelexFree. The Promoter could redeem his earned credits from the membership fee the Promoter collected from the newly recruited individual. The Triangular Transaction was reflected on SIG, the invoice was marked satisfied, Promoter credits were reduced, and the new recruit became a member of the TelexFree program and could begin recruiting others.

13. The membership fee paid by an individual to a Promoter was income to TelexFree and treated by TelexFree on its financial statements as such. Annexed hereto as Exhibit B is the TelexFree Profit and Loss Statement for yearend 2013.

14. Similarly, any credits redeemed by the Promoter from the collected memberships in a Triangular Transaction was an expense of TelexFree and treated on TelexFree's financial records as such under the category of "Agent Commission."

15. TelexFree's Profit and Loss Statement for 2013 expressly separated TelexFree's revenue into 2 categories: (1) "payments through bank," which is a direct payment from the individual purchasing a membership program from TelexFree, and (2) "payments through system," which is a payment of a membership fee received by TelexFree through Triangular Transactions.

5

million in income “paid through system”. That entry reflects membership fees collected by Promoter from individuals through a Triangular Transaction.

17. The Profit and Loss Statement separately identifies expenses attributable to Triangular Transactions as commissions paid to Promoters in Triangular Transactions. The Income Statement reflects an expense of \$572 million for “Agent Commission – paid through system”, representing payments received by Promoters as part of a Triangular Transaction.

18. The treatment on the Profit and Loss Statement appropriately reflects the economic substance of the Triangular Transactions. The membership fees collected by a Promoter were revenue of TelexFree, e.g., property of TelexFree, and the corresponding distribution to Promoters was treated as an expense, e.g., payment by TelexFree of an “agent’s commission”.

19. TelexFree issued IRS Forms 1099 to Promoters in calendar year 2013 for income earned by Promoters from their involvement in TelexFree for that year.

20. The 1099 forms reported as income to Promoters both credits redeemed directly with TelexFree and income earned by Promoters for recruiting individuals into the scheme through Triangular Transactions.

21. The 1099 forms are further evidence of the economic substance of the Triangular Transaction, money paid by an individual to Promoters for a membership is treated as income to TelexFree, and the retention by the Promoters of those membership fees is treated as income to the Promoter and an expense of TelexFree.

22. In the Ponzi Motion, I described the mechanics of the TelexFree system, including the integral nature of the Triangular Transactions.

23. A central premise of the Ponzi Motion I filed that was approved by the Court was that claims should not be limited to payments made by individuals directly to TelexFree to join the program but needed to include fees collected from individuals and cash paid to promoters as part of the Triangular Transactions.

24. The Order entered by the Court directed the use of the Net Equity formula for determining allowance of claims includes both aspects of the Triangular Transactions [docket entry no. 687]. This formulation for allowance of claims provides that fees collected by Promoters from individuals would be deemed to have been paid to TelexFree and the amount retained by a Promoter was deemed a payment by TelexFree to the Promoter.

25. The Net Equity calculation recognizes that individuals recruited into the TelexFree program through a Triangular Transaction transferred money to TelexFree in exchange for the right to participate in the TelexFree program and the right to earn credits, thereby creating an obligation between TelexFree and that recruited individual which should be treated on the same basis as an individual who had paid the membership fee directly to TelexFree.

26. The “Net Losers” in the scheme are thereby treated equally under the Net Equity determination regardless of how their investment was made.

27. Similarly, it was important that the claims of Promoters who recruited the individuals into the program and collected a “commission” for doing so should be reduced to reflect amounts paid to, and retained by, them through Triangular Transactions in order to avoid a windfall.

28. The Ponzi Motion set forth the inequities that would result if Triangular Transactions were not included in the calculation of the amount of a Promoter’s claim.

29. First, the individual recruited by the Promoter would be denied a claim for amounts paid to the Promoter to purchase a membership plan from the Debtors.

30. This would have created an inequitable result since a substantial portion of Net Losers would be denied compensation because they were recruited into the scheme through a Triangular Transaction as opposed to having been recruited directly by TelexFree.

31. Second, the Promoter who recruited the individual into the scheme would profit by having redeemed credits through retaining the recruited individual's membership fee without a corresponding reduction in the Promoter's claim amount to reflect this payment.

32. These inequities are rectified by including the Triangular Transactions in the calculation of Net Winners and Net Losers.

33. The approval of the Net Equity formula for determining claims in the case appropriately addresses the equities of the case by recognizing the economic realities of the Triangular Transaction.

34. I have commenced two class actions seeking to recover from Net Winners, amounts they received through direct and Triangular Transactions in excess of amounts they contributed into the TelexFree program, under theories of both fraudulent transfer and preferential transfer.

35. The first class action adversary proceeding, Adv. Proc. No. 16-4006, was commenced against all Net Winners who are alleged to reside within the United States. I estimate that there are 14,818 Net Winners falling within this category. I named 105 participants as individual Defendants and proposed class representatives in the domestic class action, who are believed to be Net Winners in the aggregate amount of approximately \$109 million. A substantial portion of the \$109 million is attributable to the Triangular Transactions.

36. The second class action adversary proceeding, Adv. Proc. No. 16-4007, was commenced against all Net Winners who are alleged to reside outside of the United States. I estimate that there are 78,487 Net Winners falling within this category. I have named 96 participants as individual Defendants and proposed class representatives in the foreign class action, who are believed to be Net Winners in the aggregate amount of approximately \$76 million. A substantial portion of the \$76 million is attributable to the Triangular Transactions.

37. In these Adversary Proceedings, I seek recoveries on behalf of all Net Losers, including those who lost money through direct transactions, Triangular Transactions, or any combination thereof. A predicate to my pursuit of recoveries from Net Winners arising from Triangular Transactions is a finding that the membership fees paid to and retained by recruiting Promoters in Triangular Transactions comprised property in which TelexFree has an interest. Based upon my investigation, when the economic substance of the Triangular Transactions is considered, the payments received by the Promoters in Triangular Transactions constitutes property of the TelexFree estates and are recoverable by me as fraudulent transfers or preferential transfers.

38. Each of the Defendants named in this Adversary Proceeding were plaintiffs in actions pending before the United States District Court for the District of Massachusetts or United States District Court for the District of Arizona. Each represented in their pleadings that they were Net Losers. Each further represented they were representative of Net Losers who suffered losses as a result of Triangular Transactions.

39. An examination of the Defendants' account history reveals, however, that these representations are in some instances inaccurate.

40. In advancing these claims, the Defendants have also alleged at various times to have had no involvement or affiliation with the TelexFree operations.

41. A review of the facts, however, indicates that the Defendants have in each instance been intimately involved in the TelexFree scheme.

42. For example, Maria Murdoch testified in Court at an evidentiary hearing in October 2015 that she had invested approximately \$25,000 in the TelexFree scheme but that she had no contact with the Debtors, never became a member of TelexFree, and never received an invoice. *See Transcript of Hearing on Ponzi Motion*, attached as Exhibit G to Trustee's Statement of Undisputed Facts.

43. The Debtors' books and records reflect, however, that Ms. Murdock maintained *seventy-five* (75) accounts ("User Accounts") with the Debtors, with each User Account representing the purchase of a plan. Annexed as Exhibit C is Murdock's account statement with the Debtors.

44. In fact, all of the Defendants had multiple User Accounts with TelexFree as follows: Rita Dos Santos: 12; Angela Bautista Jiminez: 55; Elisangela Oliveira: 3; Diogio De Araugo: 65; and Celio Da Silva: 142. Each of the Defendants had the opportunity to earn credits and to recruit other individuals into the scheme. Annexed as Exhibit D are collectively Accounts for Defendants except Murdock.

45. In the case of Dos Santos, not only did she open multiple User Accounts with TelexFree but she received \$8,035.91 in payments directly from TelexFree. *See Excerpts from SIG and relevant bank statements* annexed hereto as Exhibit E.

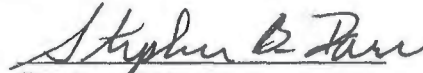
46. The evidence of these payments directly contradicts representations made by the Defendants in the multi-district litigation that Dos Santos never received any money from

TelexFree. *See In re TelexFree Securities Litigation*, MDL No. 4:14-md-2566 (D. Mass.) (the “MDL Action”), Docket No. 253-1, ¶ 38.

47. Indeed, some of the Defendants are actually Net Winners in the TelexFree scheme. The Debtors’ records indicate that Da Silva was a Net Winner in the amount of \$15,343 and Jiminez was a Net Winner in the amount of \$347.80. See Exhibit D.

I attest that, to the best of my knowledge, the foregoing is true and accurate based upon my personal knowledge, the investigation conducted on my behalf and the documents produced during the course of these proceedings and the public record.

Dated: September 2, 2016


Stephen B. Darr
Chapter 11 Trustee

714596





Place 1 Ad Per Day

TelexFREE™

*Upgrade
AD Central*

**Upgrade Cost
\$289.00**

CONTRACT

TelexFREE Optima

You Earn \$20.00 Week 52 Week \$20 x 52 = \$1040

19

Place 50 Ad Per Day

TelexFREE

*Purchase
AD Central*

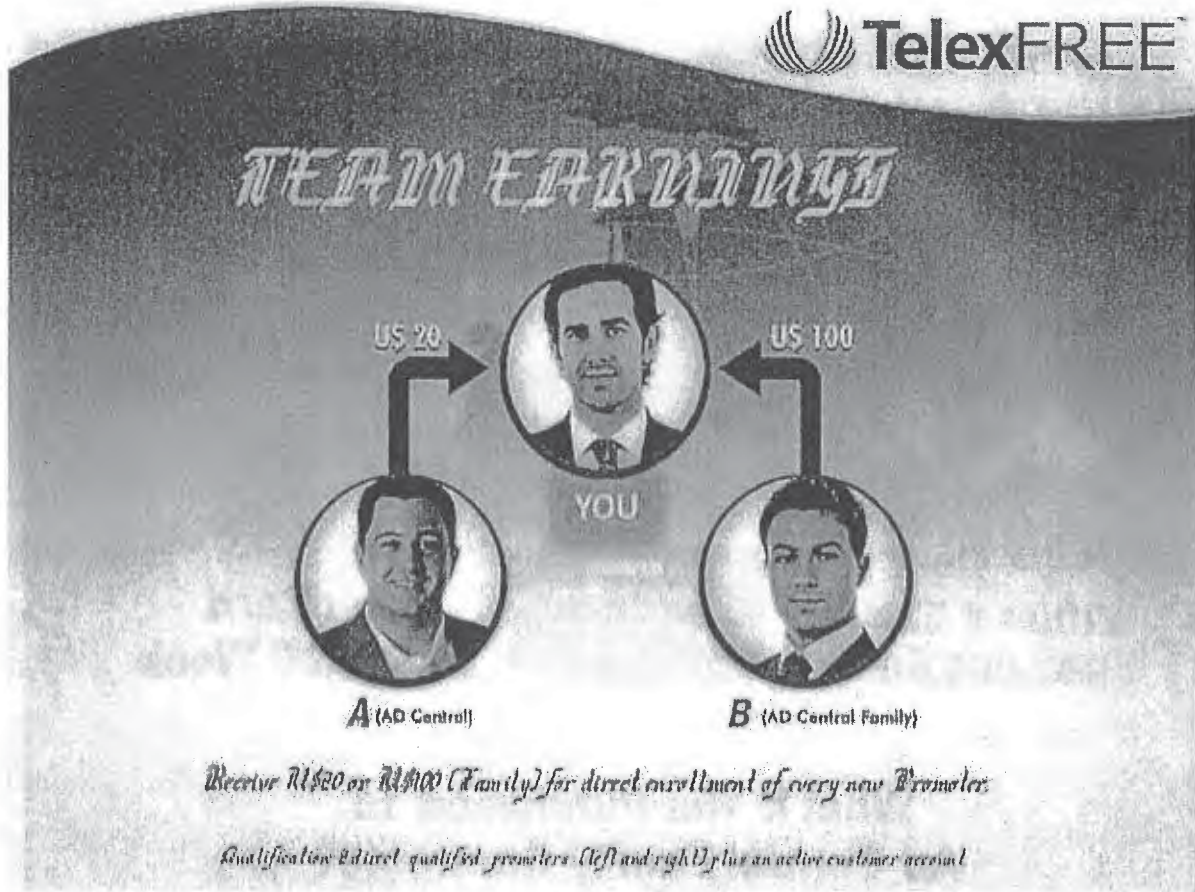
CONTRACT

**Upgrade Cost
\$1375.00 ea.**

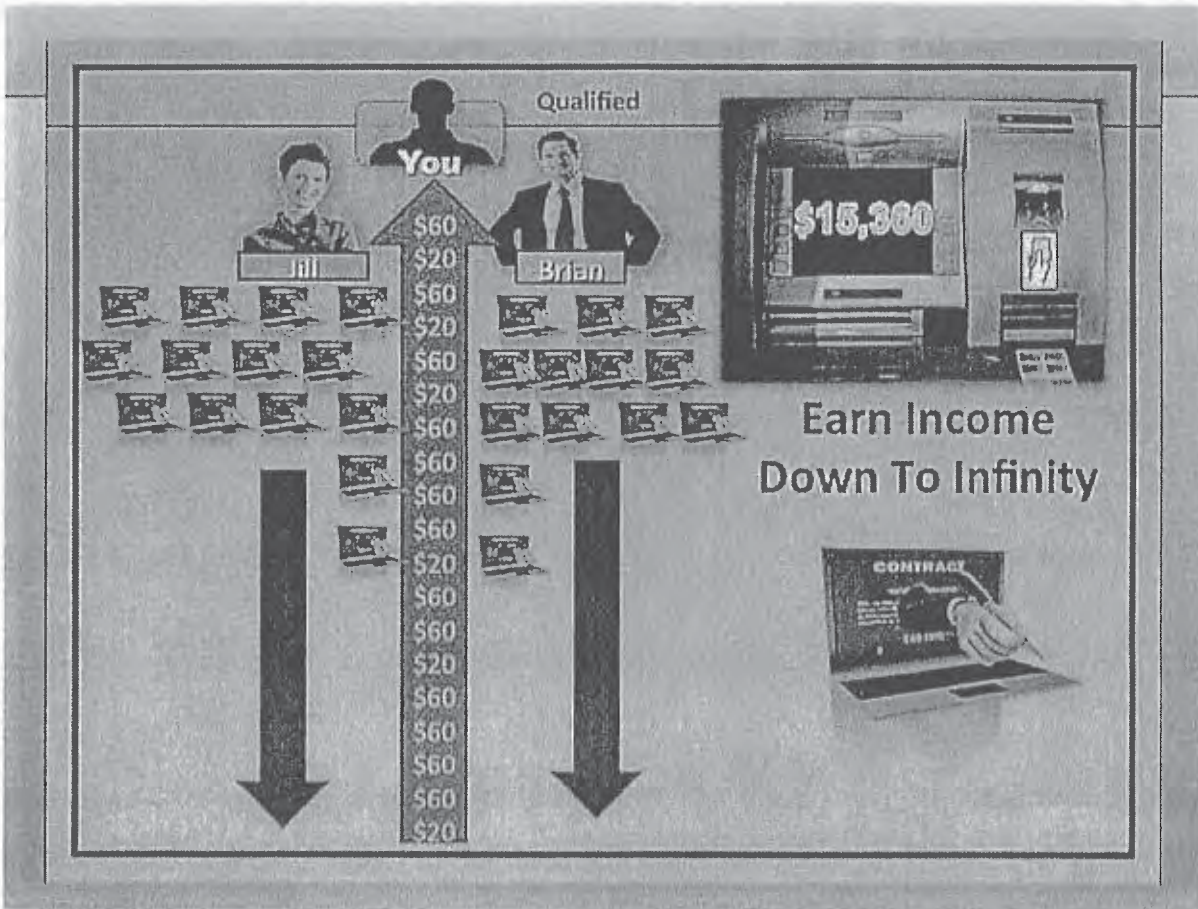
52 Week Contract
\$1000 x 52 =
\$52,000.00

You Earn
\$1,000.00 Week

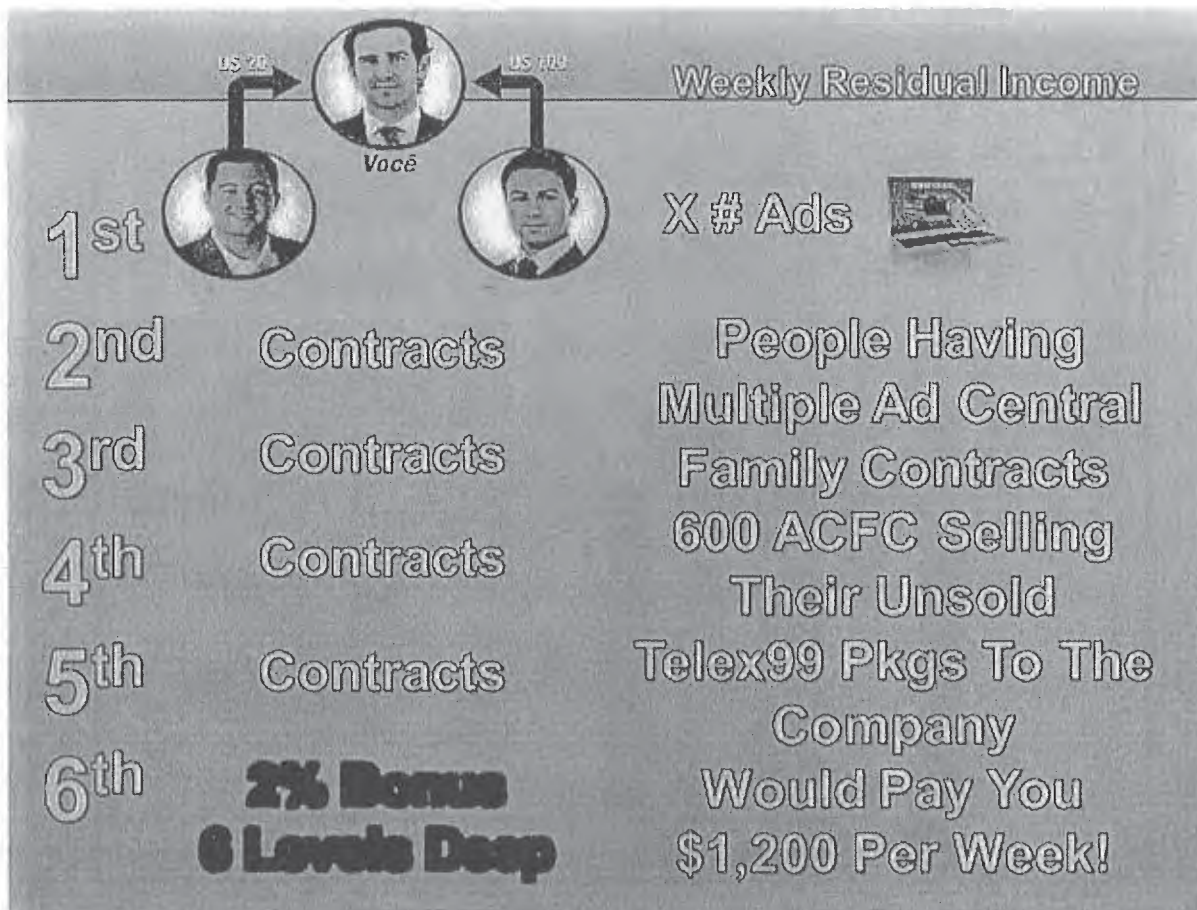
**What If You Purchased 10
Ad Central Family Contracts?**



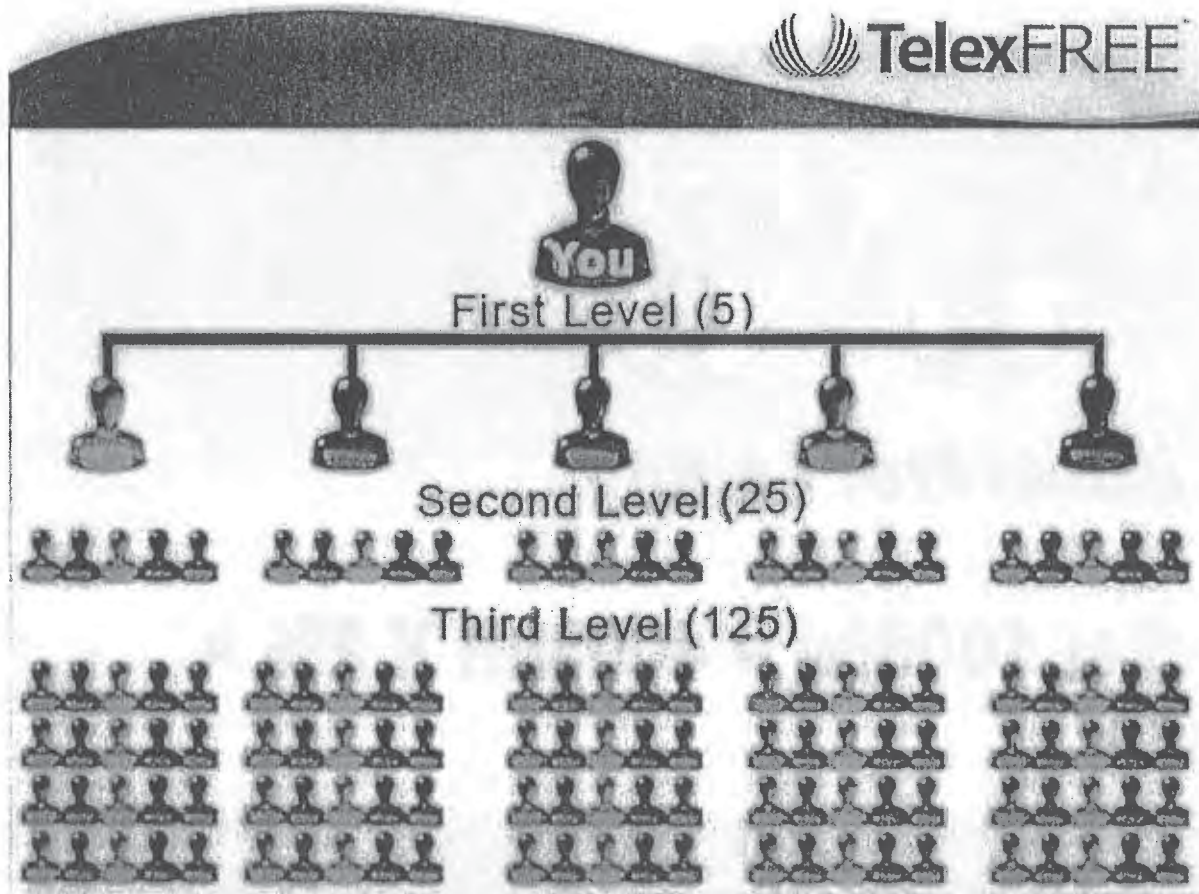
23




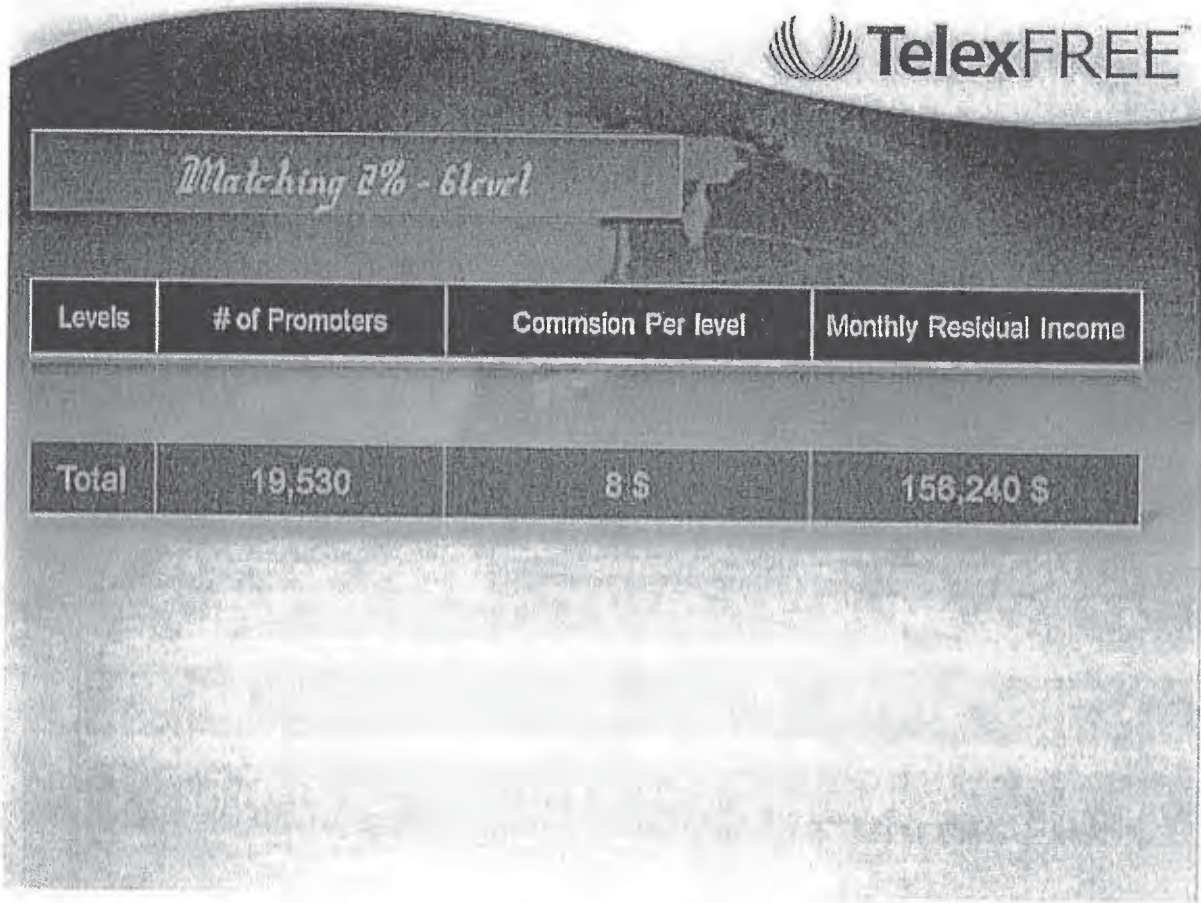
24




25



 TelexFREE™			
<i>Matching 2% - 6level</i>			
Levels	# of Promoters	Commision Per level	Monthly Residual Income
1	5	8 \$	40
2	25	8 \$	200
3	125	8 \$	1000
4	625	8 \$	5,000
5	3125	8 \$	25,000
6	15625	8 \$	125,000



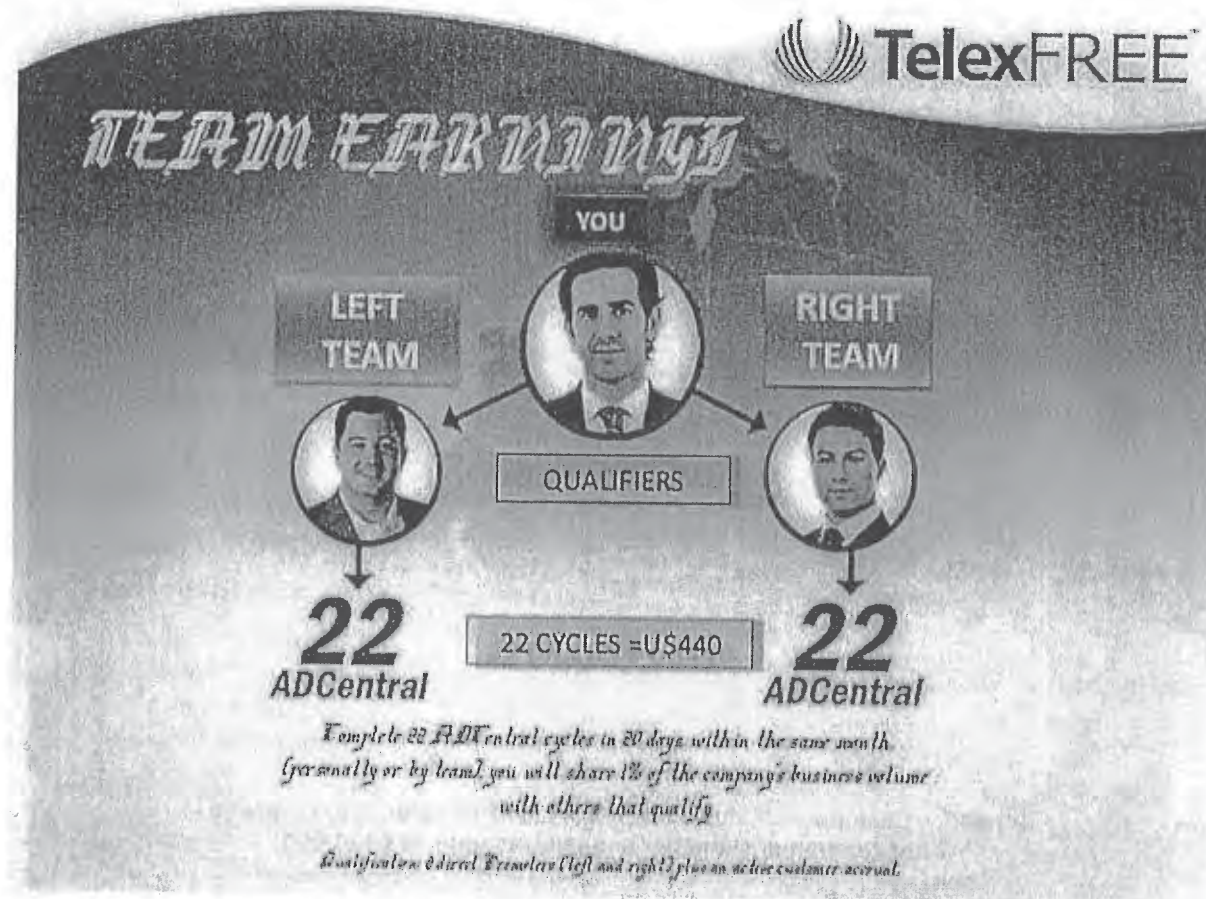

TelexFREE™

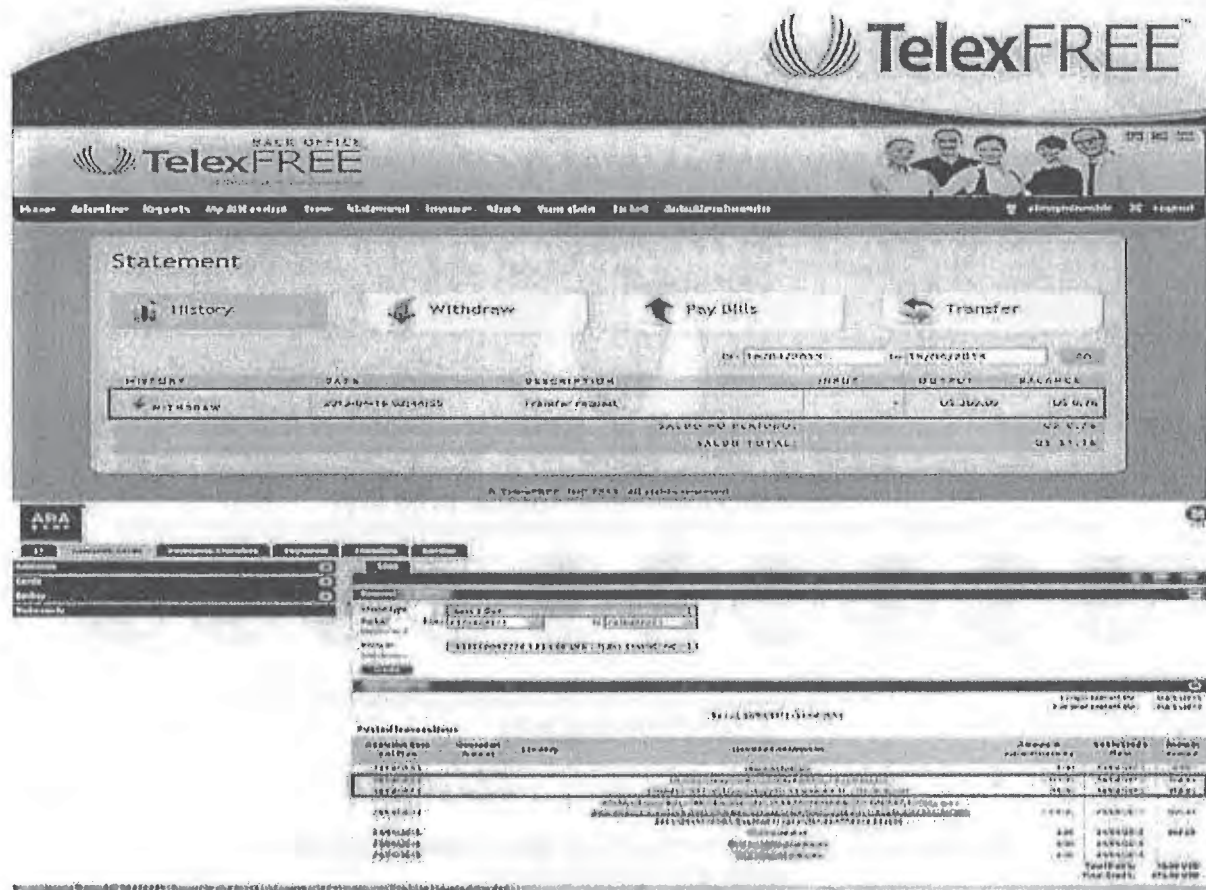
TEAM EARNINGS

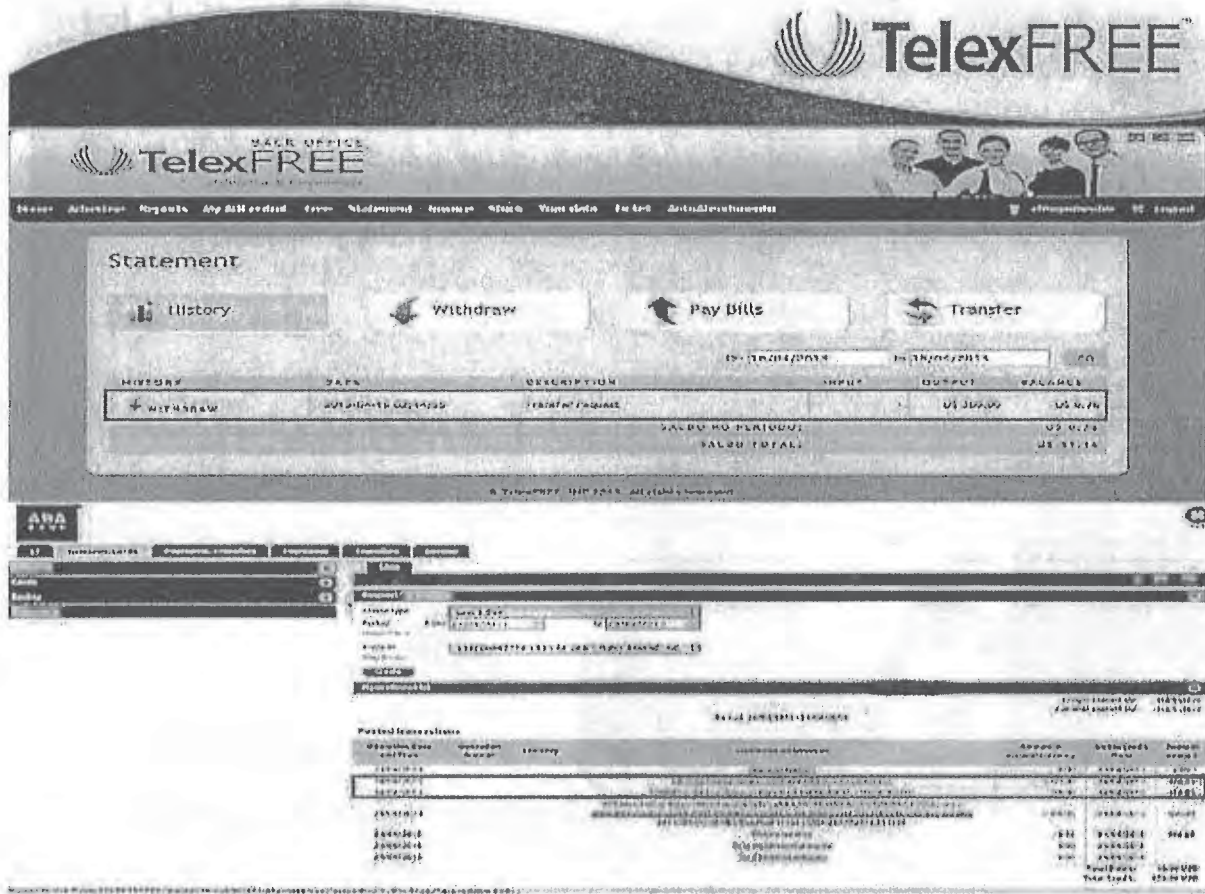
INDIRECT customer commission (Controlled by you)
and DIRECT customer commission (Controlled by your team)

Levels	# of Promoters	Commission Per level	Monthly Residual Income
-	You	Direct - 10%	US\$4.99
1	5	1 st Level - 2%	0.99 x (5) = US\$4.95
2	25	2 nd Level - 2%	US 0.99 x (25) = US\$24.75
3	125	3 rd Level - 2%	US 0.99 x (125) = US\$123.75
4	625	4 th Level - 2%	US 0.99 x (625) = US\$ 618.75
5	3125	5 th Level - 2%	US 0.99 x (3125) = US\$ 3,093.75
TOTAL	3905	TOTAL 20%	US \$3865.95 From Indirect customers alone

The above example assumes - 1 customer per Promoter. If the average is 3 customers per Promoter annually revenue is \$140,000
Classification: Promoter sends 1 customer per level. Promoter sends 3 direct customers for all 5 levels.







34

The advertisement is a grayscale image with a curved top. It depicts a man sitting at a desk with a laptop, looking up with his hands raised in a gesture of surprise or excitement. Numerous US dollar bills are shown falling from the top of the frame, creating a sense of wealth and success. The background is a light, textured surface.

TelexFREE
NEVER HAS IT BEEN
EASIER TO
REALIZE YOUR DREAMS
GET STARTED TODAY

TelexFREE
Advertise & Technology

www.telexfree.com/ad/kmeguilpe
www.facebook.com/telexfreeequipekm

35

Qualification: 2 direct promoters that have purchased an ADCentral (one on the left and one on the right) plus an active customer account.

To receive this bonus the promoter must be qualified:
2 direct qualified promoters (left and right) plus an active customer account.


*When Promoters Purchase additional ADCentral's
You earn 3 times as much per cycle*

Left Team ADDITIONAL AD CENTRAL	Right Team ADDITIONAL AD CENTRAL	Qualified AD CENTRAL Cycles	Value paid
3	3	3	US 60
768	768	768	US 15,360

Maximum daily earnings from ADDITIONAL AD CENTRAL bonus per level is
768 cycles (US\$15,360)

Additional AD Central's that grow in the strongest leg will always be accumulating, waiting for the formation of cycles with the ADCENTRAL in the weakest leg and will be paid when those cycles occur.

To receive this bonus the Promoter must be qualified:
2 direct qualified promoters (left and right) plus an active customer account.



TEAM EARNINGS

*DIRECT customer commission (Enrolled by you)
and INDIRECT customer commission (Enrolled by your team)*


Levels	# of Promoters	Commision Per level	Monthly Residual Income
-	You	Direct - 10%	U\$4.99
1	5	1 st Level - 2%	0.99 x(5) -- U\$4.95
2	25	2 nd Level - 2%	U\$ 0.99 x (25) -- U\$24.75
3	125	3 rd Level - 2%	U\$ 0.99 x (125) -- U\$123.75
4	625	4 th Level - 2%	U\$ 0.99 x (625) --U\$ 618.75
5	3125	5 th Level - 2%	U\$ 0.99 x (3125) --U\$ 3,093.75
TOTAL	3905	TOTAL 20%	U\$ 3,865.95 From Indirect customers alone

The above example assumes 1 customer per Promoter. If the average is
3 customers per Promoter annually revenue is **\$140,000**

Qualification: Promoter needs 1 customer per level. Promoter needs 5 direct customers for all 5 levels


15

<http://image.slidesharecdn.com/telexfreenpppdf-13111212...> 4/14/2014


 **TelexFREE**

TEAM EARNINGS

TEAM BUILDER POOL BONUS



Directly enroll 10 ADCentral families in 60 days



Receive 2% of the company's monthly business volume divided equally among all qualified TEAM BUILDERS.

The maximum TEAM BUILDER bonus is **U\$39,600**

Qualifications: 5 active customer account & 10 direct. Qualified ACD Families (each with 5 direct customers)

17



TelexFREE

Advertise & Technology

Group Earnings

Build your GROUP



=



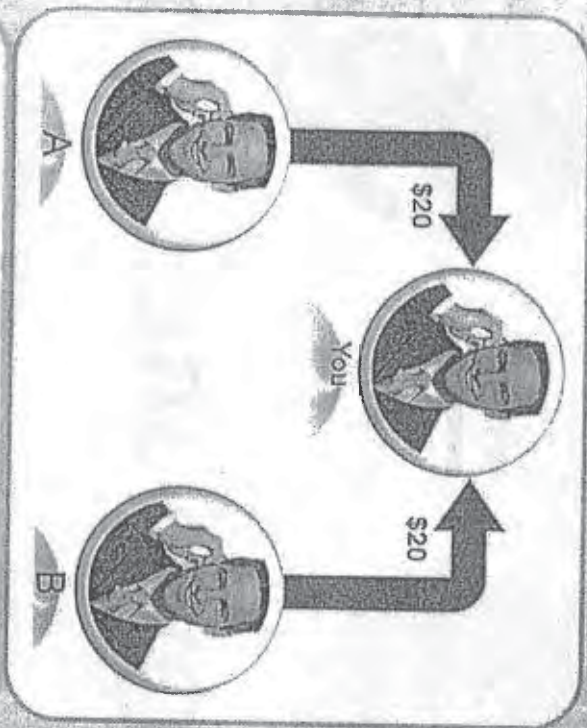
EARN MUCH MORE \$\$\$



TelexFREE™

Advertise & Technology

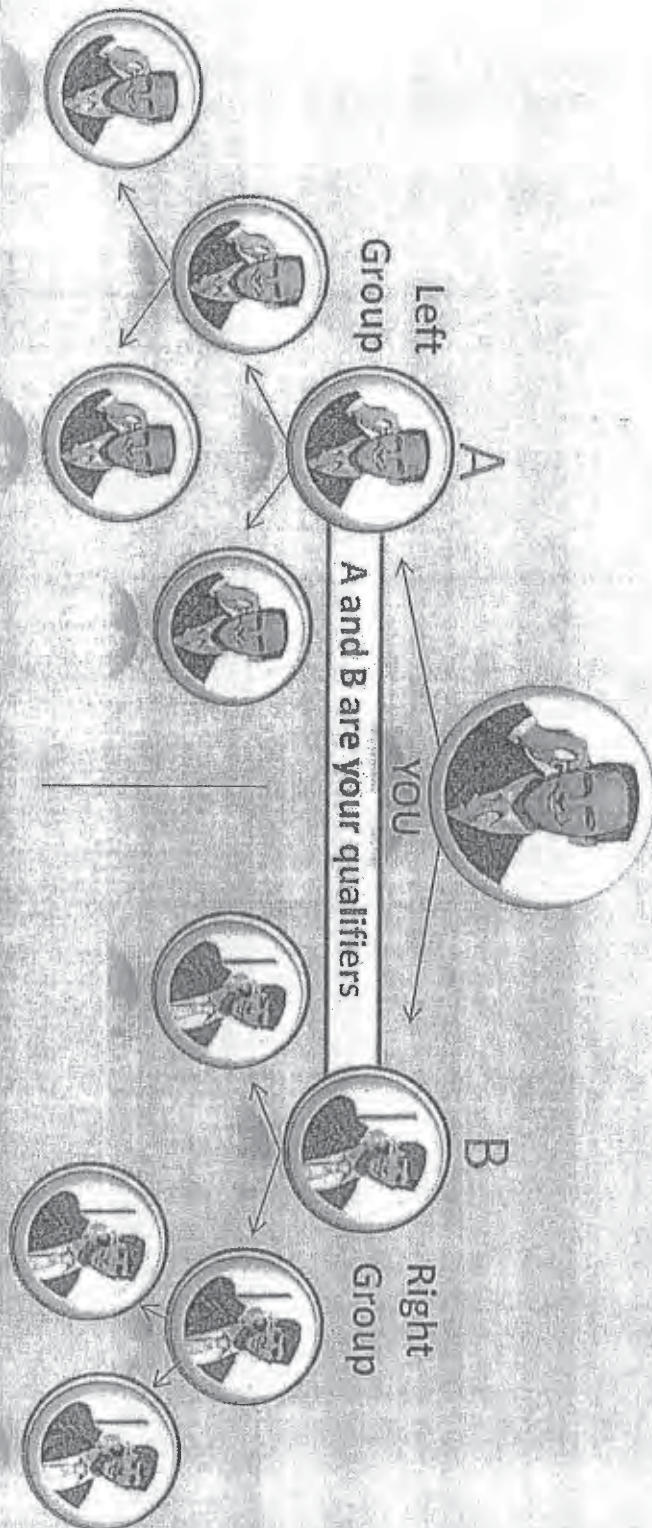
Group Earnings



Earn US\$20 for the direct registration of each new promoter. In this example, US\$40!
To have the right of receiving cycles, in binary, and residual up to the 6th level (for the ads), the promoter must be qualified, through the following way: 2 direct promoters, being 1 one on the left (A) and 1 on the right (B) + One account for personal use in your username.



Group Earnings Binary



Earn US\$20 per cycle each time you register 1 ADCentral in your left and 1 in your right, doesn't matter if they are direct, indirect, or gotten by transfer.

Maximum daily income for this earning: 22 ciclos (US\$440) leftovers remain for the following day



TelexFREE™

Advertise & Technology

Group Earnings

Earn US\$60 per each cycle of AdCentral additional, Following the table below:

Níveis de ganhos	Team Esq. ADCCENTRAL ADICIONAIS	Team Direito ADCCENTRAL ADICIONAIS	CICLOS DE ADCCENTRAL RECONHECIDOS	VALOR PAGO
1	3	3	3	US\$60
2	6	6	6	US\$120
3	12	12	12	US\$240
4	24	24	24	US\$480
5	48	48	48	US\$960
6	96	96	96	US\$1.920
7	192	192	192	US\$3.840
8	384	384	384	US\$7.680
9	768	768	768	US\$15.360

Maximum daily income for ADCCENTRAL additional by leveling is of 768 ciclos (US\$15,360) where the AdCentral additional that are left in the strongest side will always be accumulated waiting for cycles to form with the AdCentral Time from the other side and will be paid on the following days.



Group Earnings

Having DIRECT promoters (registered by you) and INDIRECT (registered by them)
See this SIMULATION with the revenue of 2%. (CAN INVITE HOW MANY DESIRED)

The promoter to have the right to receive for the 5 levels must have 5 direct clients

Qualification:

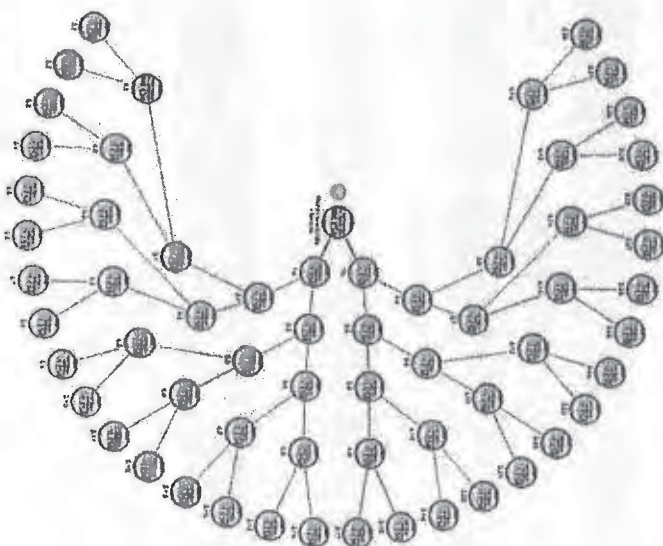
COM44-833105EAG11B061963 VoIP Textexfree service



Advertise & Technology

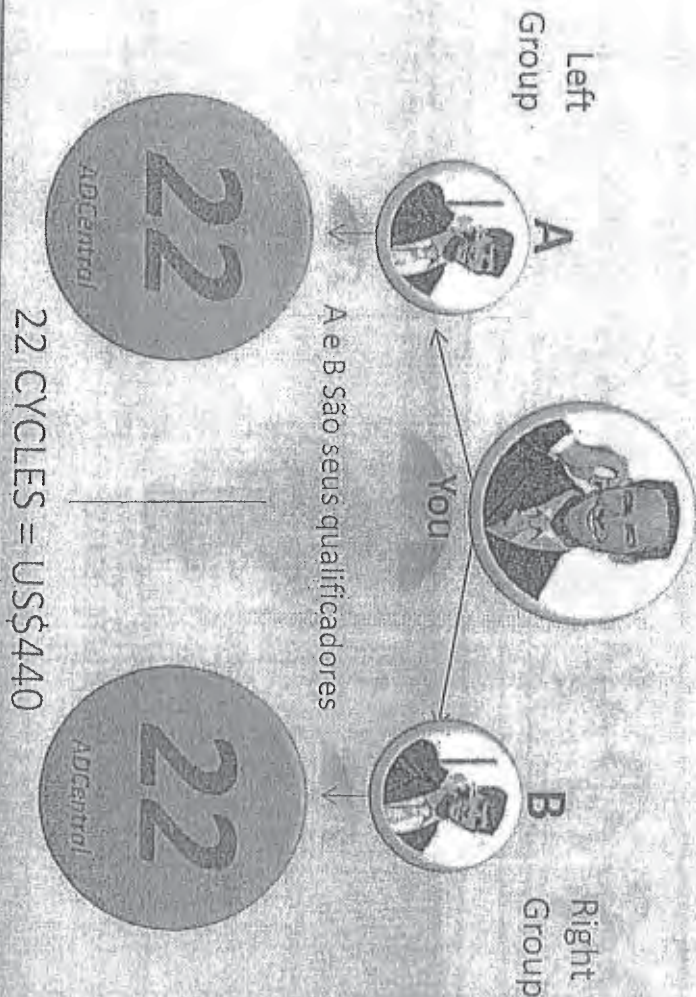
Group Earnings

Receive 2% over what your network, direct or indirect up to the 6th level, is receiving from Telexfree in money for the ads posting





Group Earnings



Everyone who reaches 22 ciclos of ADCENTRAL for 20 days, within the same month. Individually or by group will receive 1% of the business volume of the company, as extra bonus, will be divided equally among every one qualified.



Transfer

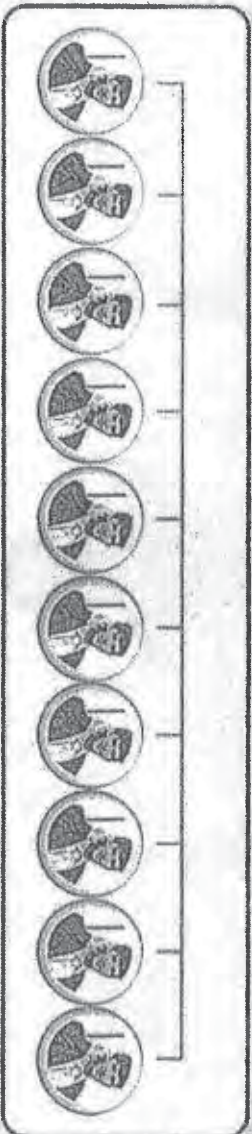
Advertise & Technology

Genoche Ltd

Team Builder



Have 10 direct ADCentral FAMILY in a period of 60 days from your activation date



Best formation: 5 on each side in the binary

Will receive the share of 2% from the revenue of monthly net sales for the company, divided equally among all the TEAM BUILDERS until receiving the maximum bonus for TEAM BUILDER which is of

US\$39.600

Or termination of the contract

Telexfree LLC
Profit and Loss
January - December 2013

	<u>Total</u>
Income	
Income	0.00
Income - paid through bank	119,468,920.12
Income - paid through system	572,240,960.21
Income from Ympactus	174,183,644.66
Total Income	<u>\$ 865,893,524.99</u>
Total Income	\$ 865,893,524.99
Cost of Goods Sold	
Direct Inbound Dial & Access Numbers	15,256.18
Telecom & Database Network Expense	397,322.12
Termination	1,850,898.35
Total Cost of Goods Sold	<u>\$ 2,263,476.65</u>
Gross Profit	\$ 863,630,048.34
Expenses	
Advertising	16,568.75
Agent Commission - paid through bank	50,670,290.64
Agent Commission - paid through system	571,917,743.23
Bad Debts	186,344,897.61
Bank Charges	255,369.15
Charitable Contributions	7,500.00
Credit Card Fees	16.10
Depreciation	9,575.10
Events	109,454.62
Filing and registered agent fees	1,579.00
Income tax expense	
Federal Income Tax Expense	16,025,349.00
State income and franchise taxes	2,969,510.80
Total Income tax expense	<u>\$ 18,994,859.80</u>
Interest Expense	14,127.09
Meals and Entertainment	2,861.52
Merchant Fees	1,038,788.45
Miscellaneous	33,151.36
Office Expenses	13,408.21
Office Rental	10,603.92
Office Supplies	1,956.33
Payroll Expenses	
Payroll Fees	545.10

Monday, Jun 16, 2014 12:57:50 PM PDT GMT-4 - Cash Basis

In re: TelexFree, LLC, et al.
 User Account Schedule - Net Equity
 Maria Murdock [1]

Name	Login	Date Created	Direct		Triangular		Manual Credits	Chargebacks	Net Equity
			Payment	Receipt	Payment	Receipt			
Maria docarmo kurdo cm	tyssa	8/29/2013	\$ -	\$ -	\$ -	\$ 2,113.90	\$ -	\$ -	\$ 688.90
maria do carmo murdock	mmurdock	10/27/2013	-	-	(1,425.00)	668.60	-	-	(756.40)
maria murdock	mmurdock100	12/11/2013	-	-	(149.70)	-	-	-	(149.70)
maria do carmo murdock	mmurdock1	12/28/2013	-	-	(1,425.00)	788.70	-	-	(636.30)
maria do carmo murdock	mmurdock200	2/3/2014	-	-	(99.80)	-	-	-	(99.80)
maria do carmo murdock	mmurdock2	3/9/2014	-	-	(1,425.00)	439.40	-	-	(985.60)
maria do carmo murdock	mmurdock3	3/9/2014	-	-	(1,425.00)	-	-	-	(1,425.00)
maria do carmo murdock	mmurdock4	3/9/2014	-	-	(1,425.00)	-	-	-	(1,425.00)
maria do carmo murdock	mmurdock5	3/13/2014	-	-	(359.50)	-	-	-	(359.50)
maria do carmo murdock	mcm00	3/14/2014	-	-	(99.80)	-	-	-	(99.80)
maria do carmo murdock	mdocm1	3/14/2014	-	-	(99.80)	-	-	-	(99.80)
maria do carmo murdock	mdocm2	3/14/2014	-	-	(99.80)	-	-	-	(99.80)
maria do carmo murdock	mdocm3	3/14/2014	-	-	(99.80)	-	-	-	(99.80)
maria do carmo murdock	mdocm4	3/14/2014	-	-	(99.80)	-	-	-	(99.80)
maria do carmo murdock	mdocm5	3/14/2014	-	-	(49.90)	-	-	-	(49.90)
maria do carmo murdock	mdocm6	3/14/2014	-	-	(49.90)	-	-	-	(49.90)
maria do carmo murdock	mdocm7	3/14/2014	-	-	(49.90)	-	-	-	(49.90)
maria do carmo murdock	mdocm8	3/14/2014	-	-	(49.90)	-	-	-	(49.90)
maria do carmo murdock	mdocm9	3/14/2014	-	-	(49.90)	-	-	-	(49.90)
Maria do Carmo Murdock	murdok10	3/19/2014	-	-	(339.60)	-	-	-	(339.60)
maria do carmo murdock	murdok11	3/21/2014	-	-	(339.60)	-	-	-	(339.60)
maria do carmo murdock	murdok12	3/21/2014	-	-	(339.60)	-	-	-	(339.60)
maria do carmo murdock	murdok12a	3/21/2014	-	-	(339.60)	-	-	-	(339.60)
maria murdock	murdok00	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok01	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok02	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok03	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok04	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok05	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok06	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok07	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok08	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok09	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok000	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok001	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok002	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok003	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok004	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok005	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok007	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok008	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok009	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok0	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok0001	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok0002	3/23/2014	-	-	(49.90)	-	-	-	(49.90)

In re: TelexFree, LLC, et al.

Name	Login	Date Created	Direct		Triangular		Manual Credits	Chargebacks	Net Equity
			Payment	Receipt	Payment	Receipt			
maria carmo	murdok0003	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok0004	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok0005	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok0006	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok0007	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok0008	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok0009	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok00061	3/23/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok100	3/24/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok101	3/24/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok102	3/24/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok103	3/24/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok104	3/24/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok105	3/24/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok106	3/24/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok107	3/24/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok108	3/24/2014	-	-	(49.90)	-	-	-	(49.90)
maria carmo	murdok109	3/24/2014	-	-	(49.90)	-	-	-	(49.90)
maria do carmo murdock	mmurdock6	4/7/2014	-	-	(339.60)	-	-	-	(339.60)
Maria do Carmo murdock	kkcv1u2grj3rle	4/7/2014	-	-	(49.90)	-	-	-	(49.90)
Maria do Carmo murdock	491w7my3bqil5ue	4/7/2014	-	-	(49.90)	-	-	-	(49.90)
Maria do Carmo murdock	8i285rbojv7k18d	4/7/2014	-	-	(49.90)	-	-	-	(49.90)
Maria do Carmo murdock	p34mjsdwdkfwkti	4/7/2014	-	-	(49.90)	-	-	-	(49.90)
Maria do Carmo murdock	fg3c76l9xmjqdpo	4/7/2014	-	-	(49.90)	-	-	-	(49.90)
Maria do Carmo murdock	o1xy8hka1bhddw	4/7/2014	-	-	(49.90)	-	-	-	(49.90)
Maria do Carmo murdock	tb270ncwhqftuuz	4/7/2014	-	-	(49.90)	-	-	-	(49.90)
Maria do Carmo murdock	gr1ohizfsdwj9i0	4/7/2014	-	-	(49.90)	-	-	-	(49.90)
Maria do Carmo murdock	x3dcefpnom8eut8	4/7/2014	-	-	(49.90)	-	-	-	(49.90)
Maria do Carmo murdock	z3t06bw82kh7mis	4/7/2014	-	-	(49.90)	-	-	-	(49.90)
maria do carmo murdock	murdok13	4/9/2014	\$	\$	(339.60)	\$	\$	\$	(339.60)
					(14,440.10)				(10,429.50)

Notes

[1] User Accounts aggregated with Participant based on a combination of information associated with each User Account, (e.g., name, email address, physical address, cell phone, etc...)

Source: Debors' SIG system

In re: TelexFree, LLC, et al
 Personal Information Associated with User Accounts
 Rita Dos Santos [1]

Name	Count	Address [2]	Count	Email Address	Count	Home Phone	Count	Cell Phone	Count	Birthday	Count
Rita d dos santos	11	330 park ave	11	luanusamaintenance@live.com	11	7814756833	11	7814756833	12	1962-05-14	10
Rita Santos	1	6247vijhjkdhakuhskha	1	gonhosa_bg@hotmail.com	1	7812197488	1			1962-03-14	1
	12		12		12		12		12	Blank	1
											12

Notes

- [1] User Accounts aggregated with Participant based on a combination of information associated with each User Account, (e.g., name, email address, physical address, cell phone, etc...)
 [2] All addresses give a Revere, MA address in the 02151 zip code.

Source: Debtors' SIG System

2 of 3

Prepared by HBA

[1] User Accounts aggregated with Participant based on a combination of information associated with each User Account, (e.g., name, email address, physical address, cell phone, etc...)

[1] User Accounts aggregated with Participant based on a combination of information associated with each User Account, (e.g., name, email address, physical address, cell phone, etc...)

Diogo de Araújo [1]

Name	Count	Address [2]	Count	Email Address	Count	Home Phone	Count	Cell Phone	Count	Birthday	Count
Diogo DeAraujo	14	Medford st	12	diogoraujo2007@gmail.com	31	7813508480	57	7813508480	57	1986-02-03	57
Diogo de Araujo	6	11 medford st unit 1	3	mariasudre@yahoo.com	32	Blank	5	Blank	5	Blank	7
Diogo Lima DeAraujo	11	11 Medford st. unit 1	1	diogoraujo2007@gmail.com	1	17813508480	3	17813508480	3	1986-03-02	1
diogo araujo	18	medford st	1	diogoraujo2007@yahoo.com	1						
Diogo de Araujo	11	11 medford st. Unit. 1	7								
Diogo .	3	11 Medford st unit. 1	4								
Diogo .	1	11 Medford st unit. 1	17								
diogo dearaujo	1		5								
		11 Medford	3								
		Medford st.	6								
		Medford st.	6								
	65		65		65		65		65		65

Notes

[1] User Accounts aggregated with Participant based on a combination of IP address and email address.

Source: Debtors' SIG System

Diogo de Araujo [1]

Direct

In re: TelexFree, LLC, et al

Triangular

Notes
[1] User Accounts aggregated with Participant based on a combination of information associated with each User Account, (e.g., name, email address, physical address, cell phone, etc.).

Source: Debors' SIG svstem

In re: TelexFree, LLC, et al.
 Personal Information Associated with User Accounts
 Elisangela Oliveira [1]

Name	Count	Address [2]	Count	Email Address	Count	Home Phone	Count	Cell Phone	Count	Birthday	Count
elisangela oliveira	2	48 magoun ave	3	vino-carla@hotmail.com	3	6178187460	3	6178187460	3	1975-07-26	1
elisangela oliveira	1									Blank	2
	3		3		3		3		3		3

Notes

- [1] User Accounts aggregated with Participant based on a combination of information associated with each User Account, (e.g., name, email address, physical address, cell phone, etc...)
 [2] All addresses give a Medford, MA address in the 02155 zip code.

Source: Debtors' SIG System

Notes

Source: Debors' SIG system

In re: TelexFree, LLC, et al.
Personal Information Associated with User Accounts
Celio Da Silva [1]

Name	Count	Address [2]	Count	Email Address	Count	Home Phone	Count	Cell Phone	Count	Birthdate	Count
celio da silva	69	pleasant st	3	celiodasilva0729@hotmail.com	17	16173940355	38	16176790083	1	Blank	128
celiodasilva	1	31, pleasant st #2	3	celiodasilva0729@hotmail.com	1	6173940355	71	16716970083	2	1960-07-29	13
celio silva	61	31 pleasant st	111	telexfreenamedida@gmail.com	12	16176970083	7	16176970083	33	1980-11-11	1
Celio Dasilva	3	31 pleasant st	2	1	1	1	1	6176970083	94		
celio dasilva	6	31 Pleasant St.	2	celiodasilva0729@hotmail	1	6176970083	23	16173940355	8		
celio da silva	2	1	1	1	8	16176790083	1	1	1		
		31 pleasant st.	1	reprofessionalserverinc@gmail.com	1	16176830083	1	16179040355	1		
		rua Diana	2	celiodasilva0729@hotmail.com	1			15088689347	2		
		31 Pleasant St. #2	2	oilcteam@gmail.com	99						
		.	15	oilcteam@gmail.com3	1						
	142		142		142		142		142		142

Notes

[1] User Accounts aggregated with Participant based on a combination of information associated with each User Account, (e.g., name, email address, physical address, cell phone, etc...)

[2] All Pleasant Street addresses give an Everett, MA address in the 02149 zip code. The Rua Diana address appears to be in Itabira, Brazil.

Source: Debtors' SIG System

Prepared by HBA

In re: TelexFree, LLC, et al
User Account Schedule - Net Equity
Celio Da Silva [1]

Name	Login	Date Created	Direct		Triangular		Manual Credits	Chargebacks	Net Equity
			Payment	Receipt	Payment	Receipt			
Celio Silva	oilecteamv3	3/22/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecteamv4	3/22/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecteamv5	3/22/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecteamv6	3/22/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecteamv7	3/22/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecteamv8	3/22/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecteamv9	3/22/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecteamv10	3/22/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecteam1	3/22/2014	-	-	(339.60)	-	-	-	(339.60)
Celio Silva	oilecplusc	4/3/2014	-	-	(339.60)	-	-	-	(339.60)
Celio Silva	oilecplusc1	4/10/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc2	4/10/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc3	4/10/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc4	4/10/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc5	4/10/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc6	4/10/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc7	4/10/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc8	4/10/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc9	4/10/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc10	4/10/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc1	4/12/2014	-	-	(339.60)	-	-	-	(339.60)
Celio Da Silva	oilecplusc2	4/12/2014	-	-	(339.60)	-	-	-	(339.60)
Celio Da Silva	oilecplusc3	4/12/2014	-	-	(339.60)	-	-	-	(339.60)
Celio Da Silva	oilecplusc4	4/12/2014	-	-	(339.60)	-	-	-	(339.60)
Celio Da Silva	oilecplusc5	4/12/2014	-	-	(339.60)	-	-	-	(339.60)
Celio Da Silva	oilecplusc6	4/12/2014	-	-	(339.60)	-	-	-	(339.60)
Celio Silva	oilecplusc1v1	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc2v1	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc1v2	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc2v2	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc7	4/12/2014	-	-	(339.60)	-	-	-	(339.60)
Celio Silva	oilecplusc2v3	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc1v3	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc2v4	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc1v4	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc3v1	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc2v5	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc3v2	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc3v3	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc3v4	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc3v5	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc3v6	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc3v7	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc3v8	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc3v9	4/12/2014	-	-	(49.90)	-	-	-	(49.90)

In re: TelexFree, LLC, et al
User Account Schedule - Net Equity
Celio Da Silva [1]

Name	Login	Date Created	Direct		Triangular		Manual Credits	Chargebacks	Net Equity
			Payment	Receipt	Payment	Receipt			
Celio Da Silva	oilecplusc3v10	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc1v5	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc1v6	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc1v7	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc4v1	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc4v2	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc1v8	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc4v3	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc2v6	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc4v4	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc1v9	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc4v5	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc4v6	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc1v10	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc4v7	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc4v8	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc4v9	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc4v10	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc6v1	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc6v2	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc5v1	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc6v3	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc6v4	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc5v2	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc6v5	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc6v6	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc6v7	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc6v8	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc5v3	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc2v7	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc6v9	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc6v10	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc5v4	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc7v1	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc5v5	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc7v2	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc5v6	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc7v3	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc7v4	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc5v7	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc7v4	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecplusc5v8	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc7v6	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecplusc7v7	4/12/2014	-	-	(49.90)	-	-	-	(49.90)

In re: TelexFree, LLC, et al
 User Account Schedule - Net Equity
 Celio Da Silva [1]

Name	Login	Date Created	Direct		Triangular		Manual Credits	Chargebacks	Net Equity
			Payment	Receipt	Payment	Receipt			
Celio Silva	oilecp\usc5v9	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecp\ussc7v8	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecp\ussc7v9	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecp\usc5v10	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Da Silva	oilecp\ussc7v10	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecp\usc2v9	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
Celio Silva	oilecp\usc2v10	4/12/2014	-	-	(49.90)	-	-	-	(49.90)
			\$ (49.90)	\$ -	\$ (21,808.60)	\$ 43,201.50	\$ -	\$ -	\$ 15,343.00

Notes

[1] User Accounts aggregated with Participant based on a combination of information associated with each User Account, (e.g., name, email address, physical address, cell phone, etc..)

Source: Debors' SIG system

In re: TelexFree, LLC, et al.
 Personal Information Associated with User Accounts
 Angela Jimenez [1]

Name	Count	Address [2]	Count	Email Address	Count	Home Phone	Count	Cell Phone	Count	Birthday	Count
angela bautista-jimenez	49	1750 s rainbow blvd #15a	18	noahanthony2005@gmail.com	53	7022728049	55	7022728049	55	1975-01-04	22
angela bautista	5	1750 s rainbow blvd ste 15a	2	beatrizleal101@gmail.com	2					Blank	32
angela jimenez	1	1750 s rainbow blvd #15a	2							1977-01-04	1
		1750 s rainbow blvd #a	1								
		1750 s rainbow blvd 15a	2								
		1750s rainbow blvd 15a	1								
		1750 s rainbow #15a	23								
		1750 s rainbow 15a	2								
		1750 s rainbow15a	1								
		1750 s rainbow 15 a	1								
		1750 s rainbow 15 a	1								
		1750 s rainbow	1								
	55		55		55		55		55		55

Notes

[1] User Accounts aggregated with Participant based on a combination of information associated with each User Account, (e.g., name, email address, physical address, cell phone, etc...)

[2] All addresses give a Las Vegas, NV address in the 89146 zip code.

Source: Debtors' SIG System

In re: TelexFree, LLC, et al.
 User Account Schedule - Net Equity
 Angela Jimenez [1]

Name	Login	Date Created	Direct		Triangular		Manual Credits	Chargebacks	Net Equity
			Payment	Receipt	Payment	Receipt			
angela bautista-jimenez	jired4	7/13/2013	\$ (1,425.00)	\$ -	\$ -	\$ 6,698.00	\$ -	\$ -	\$ 5,273.00
angela bautista-jimenez	jired5	7/13/2013	\$ (1,425.00)	\$ -	\$ -	349.30	\$ -	\$ -	(1,075.70)
angela bautista-jimenez	jired6	7/13/2013	-	-	(1,425.00)	149.70	-	-	(1,275.30)
angela bautista-jimenez	jired123	7/14/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista	jired7	7/16/2013	-	-	(1,425.00)	-	-	-	(1,425.00)
angela bautista-jimenez	jired8	7/17/2013	(339.00)	-	(1,156.00)	339.60	-	-	(1,155.40)
angela bautista	jired9	7/18/2013	(1,495.00)	-	-	-	-	-	(1,495.00)
angela bautista-jimenez	jired10	7/18/2013	-	-	(1,495.00)	-	-	-	(1,495.00)
angela bautista-jimenez	jired11	7/20/2013	-	-	(1,495.00)	-	-	-	(1,495.00)
angela bautista-jimenez	jired12	7/20/2013	-	-	(1,495.00)	-	-	-	(1,495.00)
angela bautista-jimenez	jired13	7/21/2013	-	-	(1,495.00)	-	-	-	(1,495.00)
angela bautista-jimenez	jired14	7/21/2013	-	-	(1,495.00)	49.90	-	-	(1,445.10)
angela bautista-jimenez	noahanthony	7/22/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	skipy	7/22/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	noerodriguez	8/14/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	noerosas	8/22/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	noeflores	8/22/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista	jovencita123	9/14/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista	jiredjimenez	9/22/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista	noahnoe	9/22/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	jovencita1234	10/14/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	jovencita2013	10/22/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	ninabonita2013	10/22/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	floresitas	11/14/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	bomboni100	11/22/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	lamona10	11/22/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	100obejas	12/14/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	lapaloma110	12/22/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	lapaloma220	12/22/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	jired15	12/23/2013	-	-	(1,425.00)	11,699.40	-	-	10,274.40
angela bautista-jimenez	jired16	12/24/2013	-	-	(1,425.00)	-	-	-	(1,425.00)
angela bautista-jimenez	laestrellita	12/24/2013	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	jired17	12/29/2013	-	-	(1,425.00)	-	-	-	(1,425.00)
angela bautista-jimenez	jired18	12/29/2013	-	-	(1,425.00)	-	-	-	(1,425.00)
angela bautista-jimenez	lafloritaroke	12/29/2013	-	-	(99.80)	-	-	-	(99.80)
angela bautista-jimenez	floresitarokera	12/29/2013	-	-	(99.80)	-	-	-	(99.80)
angela bautista-jimenez	jired19	12/30/2013	-	-	(1,425.00)	-	-	-	(1,425.00)
angela bautista-jimenez	jired20	1/3/2014	-	-	(1,425.00)	-	-	-	(1,425.00)
angela bautista-jimenez	chanquito10	1/14/2014	-	-	(149.70)	-	-	-	(149.70)
angela bautista-jimenez	obejitas12	1/20/2014	-	-	(49.90)	-	-	-	(49.90)
angela bautista-jimenez	rokerita	1/22/2014	-	-	(99.80)	-	-	-	(99.80)
angela bautista-jimenez	rokerita1	1/22/2014	-	-	(99.80)	-	-	-	(99.80)
angela bautista-jimenez	palomita100	1/27/2014	-	-	(99.80)	-	-	-	(99.80)
angela bautista-jimenez	jired21	2/12/2014	-	-	(1,425.00)	-	-	-	(1,425.00)
angela bautista-jimenez	palomita1000	2/13/2014	-	-	(49.90)	-	-	-	(49.90)

Notes

Source: Debors' SIG system

DRAFT - Privileged and Confidential
Attorney Client Work Product

In re: TelexFree, LLC, et al.
Direct Receipt associated with Rita Dos Santos

Name	Login	Date	Amount	Description	Observation	Transaction Type
Rita D Dos Santos	rilu01	3/12/2013	\$ 1,204.91	Transfer request	aline: Confirmation Number: 96648590	2 - Direct Receipt
Rita D Dos Santos	rilu01	4/10/2013	3,021.00	Transfer request	quecia: 026 VEN 04/11/2013 11 Rita De Cassia Dos Santos Entered \$3,011.00 1 \$0.00 0 0 04/10/2013 08:49	2 - Direct Receipt
Rita D Dos Santos	rilu01	5/2/2013	3,810.00	Transfer request	janaina: 026 VEN 05/03/2013 2 Rita De Cassia Dos Santos Entered \$3,800.00 1 \$0.00 0 0 05/02/2013 08:16	2 - Direct Receipt

Source: Debtors' SIG System

Page 1 of 49
Statement Period
03/01/13 through 03/31/13
EO P PA 0A 43 0052415
Enclosures 0
Account Number 0046 3516 7408

Bus Platinum Privileges



01493 001 SCM999 0

TELEXFREE INC
225 CEDAR HILL ST STE 200
MARLBOROUGH, MA 01752-5900

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P.O. Box 25113
Tampa, FL 33622-5113

Deposit Accounts

Bus Platinum Privileges Relationship Business Economy Checking

TELEXFREE INC

Your Account at a Glance

Account Number	XXXX XXXX 7408
Statement Period	03/01/13 through 03/31/13
Number of Deposits/Credits	123
Number of Withdrawals/Debits	901
Number of Deposited Items	14
Number of Days in Cycle	31

Statement Beginning Balance	\$703,931.86
Amount of Deposits/Credits	\$2,286,020.37
Amount of Withdrawals/Debits	\$1,458,296.80
Statement Ending Balance	\$1,531,655.43
Average Ledger Balance	\$1,240,473.09



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TELEXFREE INC

Page 21 of 49
Statement Period
03/01/13 through 03/31/13
EO P PA OA 43 0052435
Enclosures 0
Account Number 0046 3516 7408

Withdrawals and Debits - Continued
Other Debits

Date Posted	Amount (\$)	Description	Bank Reference
03/12	2,090.00	Transfer Telexfree Inc:Drucila Felisberto	957103127507446
03/12	1,670.00	Confirmation# 2810442612	
03/12	1,574.91	Transfer Telexfree Inc:Nan Liu	957103127503054
03/12	1,470.00	Confirmation# 4011471123	
03/12	1,440.00	Transfer Telexfree Inc:Fabio Medeiros	957103127535167
03/12	1,400.13	Confirmation# 4011096173	
03/12	1,390.00	Transfer Telexfree Inc:Anderson Costa Campo	957103127539574
03/12	1,381.00	Confirmation# 4009585008	
03/12	1,218.63	Transfer Telexfree Inc:Vanessa R Goncalves	957103127529666
03/12	1,200.91	Confirmation# 4009529102	
03/12	1,194.91	Transfer Telexfree Inc:Lee A Williams	957103127565414
03/12	990.00	Confirmation# 4011828363	
03/12	990.00	Transfer Telexfree Inc:Marcio Santos Lima	957103127535296
03/12	954.91	Confirmation# 2811657208	
03/12	915.43	Transfer Telexfree Inc:leila brum ferrara	957103127584772
03/12	890.00	Confirmation# 4011940631	
03/12	848.83	Transfer Telexfree Inc:Santos Group Inc San	957103127589818
03/12	787.00	Confirmation# 4009857389	
03/12	690.00	Transfer Telexfree Inc:Alberto A De Jesus	957103127510314
03/12	675.00	Confirmation# 4009436073	
03/12	674.91	Transfer Telexfree Inc:Rita De Cassia Dos S	957103127569570
03/12	658.91	Confirmation# 4010754379	
03/12	610.00	Transfer Telexfree Inc:Deilton G Barbosa	957103127586253
03/12	590.00	Confirmation# 2810338667	
03/12	590.00	Transfer Telexfree Inc:Paul N Tharpe	957103127550263
03/12	530.00	Confirmation# 2811179128	
03/12		Transfer Telexfree Inc:Raul Serrano	957103127582006
03/12		Confirmation# 4010818337	
03/12		Transfer Telexfree Inc:Italo Magalhaes Azev	957103127596671
03/12		Confirmation# 4011434136	
03/12		Transfer Telexfree Inc:Carlos Contreras	957103127572946
03/12		Confirmation# 4009769832	
03/12		Transfer Telexfree Inc:valdinei de lima tei	957103127543826
03/12		Confirmation# 4009609456	
03/12		Transfer Telexfree Inc:Antonio G Oliveira	957103127559386
03/12		Confirmation# 4009696304	
03/12		Transfer Telexfree Inc:Marcio Santos Lima	957103127527214
03/12		Confirmation# 4011607246	
03/12		Transfer Telexfree Inc:Osmar P Millard Jr	957103127581149
03/12		Confirmation# 2811346985	
03/12		Transfer Telexfree Inc:Randy J Fiscus	957103127595980
03/12		Confirmation# 2810891512	
03/12		Transfer Telexfree Inc:Legacy Solutions	957103127575938
03/12		Confirmation# 4011890705	
03/12		Transfer Telexfree Inc:Jose R Lemus	957103127549448
03/12		Confirmation# 4011736819	
03/12		Transfer Telexfree Inc:warren standard	957103127506900
03/12		Confirmation# 4009415406	
03/12		Transfer Telexfree Inc:Amber J Santos	957103127532944
03/12		Confirmation# 4009547802	
03/12		Transfer Telexfree Inc:Bryan Juliatti	957103127566136
03/12		Confirmation# 4009733363	
03/12		Transfer Telexfree Inc:Rudolph Kremer	957103127531624
03/12		Confirmation# 4010563228	

TELEXFREE LLC
Business Checking
132421-802-6

TELEXFREE LLC
Business Checking
132421-802-6

EXHIBIT 7

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS**

In re:

TELEXFREE, LLC,
TELEXFREE, INC. and
TELEXFREE FINANCIAL, INC.,

Debtors.

Chapter 11 Cases

14-40987-MSH
14-40988-MSH
14-40989-MSH

Jointly Administered

STEPHEN B. DARR AS TRUSTEE
OF THE ESTATES OF TELEXFREE, LLC,
TELEXFREE, INC. and TELEXFREE
FINANCIAL, INC.,

Adversary Proceeding
No. 15-04055

Plaintiffs,

v.

RITA DOS SANTOS, INDIVIDUALLY AND
AS PUTATIVE CLASS REPRESENTATIVE,
AND MARIA MURDOCH, ANGELA
BATISTA JIMENEZ, ELISANGELA
OLIVEIRA AND DIOGO DE ARAUGO, AS
PUTATIVE CLASS REPRESENTATIVES,

Defendants.

**MEMORANDUM OF LAW IN SUPPORT OF TRUSTEE’S OPPOSITION TO PIEC
MOTION FOR SUMMARY JUDGMENT AND TRUSTEE’S
CROSS-MOTION FOR SUMMARY JUDGMENT**

Overview

The central issue presented in this case is who should prosecute claims against the Net Winners.¹ The Trustee is the appropriate party to prosecute actions against Net Winners to

¹ A “Net Winner” is defined as a Promoter who received a greater amount from the Debtors’ scheme, including amounts received pursuant to Triangular Transactions, than the amount invested by the Promoter into the Debtors’ scheme, including amounts paid pursuant to Triangular Transactions. *See Supplemental Order Respecting Motion by Chapter 11 Trustee for Entry of Order Finding that Debtors Engaged in a Ponzi and Pyramid Scheme and Related Relief* [docket entry 687].

recover the payments the Net Winners received, whether from direct payments or through Triangular Transactions, for the benefit of all Net Losers. The Defendants assert that they should be permitted to prosecute claims against a subset of Net Winners, those that received membership fees paid pursuant to Triangular Transactions and then, only for the benefit of individuals who are Net Losers as a result of membership fees paid pursuant to Triangular Transactions. While the Defendants recognize that the Trustee is the only person able to pursue claims against Net Winners for direct transfers by TelexFree, they seek to compete with the Trustee by challenging his right to pursue recoveries based upon fraudulent transfers and preferential transfers to Net Winners arising out of Triangular Transactions.

In challenging the Trustee's right to recover membership fees paid pursuant to Triangular Transactions, the Defendants take a position which is at odds with the Court's finding that claims should be determined based upon the Net Equity formula, taking into consideration all payments made by a claimant, whether direct or indirect, to TelexFree and all distributions by TelexFree to that claimant, whether direct or indirect. The Defendants, while acknowledging the inherent fairness of such a claims allowance methodology, argue that the membership fees retained by Promoters² in Triangular Transactions did not involve transfers of property in which TelexFree had an interest and therefore are not subject to the Trustee's fraudulent conveyance and preference powers. By taking this inconsistent position, the Defendants are advocating for Net Winners to the detriment of the individuals the Defendants claim to be representing, e.g., Net Losers.

The Defendants' position is not only inconsistent and adverse to the interests of the individuals they purport to represent, but it ignores the economic reality of the transaction. The

² Promoters are those participants in the TelexFree scheme who furthered the fraud by recruiting on behalf of TelexFree other individuals into the scheme.

Triangular Transactions at issue were an integral and essential part of the pyramid aspect of the TelexFree fraud whereby Promoters were encouraged by TelexFree to recruit new individuals into the TelexFree program and acted as TelexFree's agent in collecting the membership fee on behalf of TelexFree and were rewarded for doing so. The substance of the transaction was that an individual who was being recruited into the program paid a membership fee to a Promoter who was acting on behalf of TelexFree. In return, TelexFree paid a commission to the Promoter who brought the individual into the program. In its financial statements, TelexFree recognized the membership fees collected through Triangular Transactions as revenue. TelexFree correspondingly recognized in its financial statements the retention of the membership fees by Promoters in Triangular Transactions as an expense. In its financial statements, TelexFree characterized payments to Promoters in Triangular Transactions as "agent commission." Consistent with the foregoing, TelexFree issued Form 1099's to the various Promoters in the TelexFree program, whose Form 1099's included the agent commissions paid as a result of Triangular Transactions.

Not only do the facts require a finding that the Trustee is the appropriate person to prosecute claims for recovery of membership fees paid arising out of Triangular Transactions, but to find otherwise would be to substantially undermine the Net Equity determination and allow Net Winners a windfall at the expense of all Net Losers.

I. Factual Statement

A. The Ponzi Scheme

On November 25, 2015, the Court, on motion by the Trustee and after notice and hearings, entered an Order, as amended on December 21, 2015, determining that each of the Debtors in these jointly administered cases perpetrated a fraud upon the public, primarily

targeting the immigrant community. The Debtors' fraud was premised upon the sale of membership plans to individuals, which the Debtors referred to as Promoters, and incorporated elements of both a Ponzi and pyramid scheme. *Trustee's Statement of Undisputed Material Facts in Support of His Cross-Motion for Summary Judgment* ("SUF"), at ¶1.

The Ponzi aspect of the fraud involved the promise of an astronomical return on the membership fee paid to join TelexFree, merely for posting meaningless internet advertisements. By posting these advertisements, among other things, Promoters would "earn" credits with TelexFree that were redeemable for cash. The more membership plans that a Promoter acquired, the faster that Promoter could acquire credits. SUF, at ¶2.

The pyramid aspect of the fraud was the compensation given to Promoters for recruiting individuals into TelexFree, unrelated to the sale of any product. Although the TelexFree program was structured as a multi-level marketing program, there was no need for Promoters to buy or sell the internet telephone product. As with most pyramid schemes, the more Promoters that one recruited, the more money that the recruiting Promoter could make.³ The pyramid aspects of the TelexFree fraud featured prominently in TelexFree's website content, PowerPoint presentations, internet videos, and in-person recruitment meetings. All of these materials extolled the virtues of developing a Promoter's pyramid in order to maximize compensation. SUF, at ¶3, 4. Set forth below is illustrative of TelexFree's presentation materials to prospective Promoters:

³ For example, for each new recruit, a Promoter would receive a "fast start" bonus, either of \$20 or \$100, depending upon the type of membership plan that he/she sold. Once an individual was recruited into another Promoter's pyramid, the Promoter would earn credits based upon membership plans sold by his/her 'downline' recruits. TelexFree encouraged this "team building" activity by offering "team builder bonus" compensation, which a Promoter could earn by, among other things, recruiting ten (10) additional Promoters into the Telexfree network. SUF, at ¶3.



B. The Triangular Transactions

One of the principal methods by which TelexFree encouraged and enabled the recruitment of new Promoters was by permitting existing Promoters to retain the membership fees paid by new recruits. Pursuant to this process (hereinafter, a “Triangular Transaction”), a new recruit solicited by an existing Promoter would be issued an invoice by TelexFree for the purchase of a membership plan. The Promoter collected the membership fee from the new recruit. TelexFree enabled the Promoter to retain the membership fee of the new recruit by redeeming the cost of the membership plan from the accumulated credits of the Promoter. The invoice was then marked satisfied by TelexFree, and the new recruit became a Promoter earning credits for posting meaningless advertisements and recruiting new Promoters. SUF, at ¶¶6, 7.

The Triangular Transaction was the predominant method of entry into the TelexFree system. Invoices associated with the sale of membership plans or phone packages had a total value of \$3,073,471,326. Of this amount, approximately \$2,700,000,000 or nearly ninety percent (90%) of the membership fees sold by TelexFree, were effected through a Triangular Transaction. SUF, at ¶9.

The economic substance of the Triangular Transaction was, in fact, a payment by a new recruit of a membership fee to TelexFree and a payment by TelexFree to the Promoter in exchange for redemption of accumulated credits. The economic substance was treated as such by TelexFree on its financial statements. SUF, at ¶8.

The profit and loss statement for TelexFree for calendar year 2013 (“2013 Profit and Loss Statement”) reflects \$119 million in income “paid through bank”. That entry reflects membership fees paid directly to TelexFree. SUF, at ¶13. There is a separate entry on the 2013 Profit and Loss Statement for an additional \$572 million in income “paid through system”. That entry reflects membership fees paid to the Promoter through a Triangular Transaction. Id. The most significant expense on the 2013 Profit and Loss Statement was commissions paid to Promoters in Triangular Transactions. The 2013 Profit and Loss Statement reflects an expense of \$572 million for “Agent Commission – paid through system”, representing membership fees paid to and retained by Promoters through Triangular Transactions. SUF, at ¶14. The treatment of the Triangular Transactions in the 2013 Profit and Loss Statement accurately reflects the economic substance of the Triangular Transactions. The membership fees were included as property of TelexFree and the fees retained by Promoters were treated as a payment by TelexFree. SUF, at ¶12, 13, 14.

The Debtors also issued Form 1099's consistent with the 2013 Profit and Loss Statement. SUF, at ¶16. The Debtors issued Form 1099's to Promoters in calendar year 2013 for income earned by Promoters from their involvement in TelexFree for that year. *Id.* The Form 1099's reported as income credits earned by Promoters and credits redeemed by Promoters in 2013. SUF, at ¶17. The income reported for redemption of credits included membership fees paid to, and retained by, Promoters from Triangular Transactions. *Id.* The Form 1099's evidence that TelexFree treated the membership fees paid in Triangular Transactions as income to TelexFree, and the payment to, or retention by, the Promoters of those membership fees as income to the Promoter and an expense of TelexFree. SUF, at ¶18.

C. The Net Equity Determination

The Court recognized the economic substance of the Triangular Transaction when it approved the *Motion by Chapter 11 Trustee for Entry of Order Finding that Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* (the "Ponzi Motion"). In the Ponzi Motion, the Trustee described in detail the mechanics of the TelexFree system, including the pervasive use of the Triangular Transactions in the sale of membership plans. TelexFree's hybrid Ponzi/Pyramid scheme was unique, and the treatment of Promoter claims needed to be adapted to these circumstances. After notice and hearings, the Court approved the Ponzi Motion and, among other things, approved the Net Equity formula for determining claims in these cases. The order therefore provided that the use of the Net Equity formula in determining claims would include amounts paid and received pursuant to Triangular Transactions.⁴ SUF, at ¶21.

⁴ Net Equity is typically used in determining claims allowance in a Ponzi scheme, with the claim amount being equal to amounts that an investor paid into the program, less amounts that an investor received. *See, e.g., CFTC v. Topworth Int'l Ltd.*, 205 F.3d 1107, 1115-16 (9th Cir. 2000); *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229, 242 (2nd Cir. 2011); *Donell v. Kowell*, 533 F.3d 762, 772 (9th Cir. 2008); *In re Young*, 294 F. 1, 4 (4th Cir. 1923); *Janvey*, 2013 WL 2451738 at *9 (N.D. Tex. 2013); *In re Bayou*

The Net Equity formula was approved by the Court in recognition that an individual recruited in a Triangular Transaction transferred money to TelexFree in exchange for the right to participate in the TelexFree program and the right to earn credits, thereby creating an obligation between TelexFree and that individual on the same basis as if the individual had paid the membership fee directly to TelexFree. Individuals who became “Net Losers” through involvement in TelexFree were thereby treated equally under the Net Equity formula regardless of how they paid their membership fee. Similarly, it was important that the claims of Promoters be reduced to reflect amounts paid to, and retained by, them through Triangular Transactions in order to reflect the actual losses sustained from their involvement with TelexFree. SUF, at ¶22.

The Ponzi Motion set forth the inequities that would result if Triangular Transactions were not included in the calculation of the amount of a Promoter’s claim. SUF, at ¶25. First, the individuals would be denied a claim for amounts paid to a Promoter to purchase a membership plan from the Debtors. SUF, at ¶26. This would have created an inequitable result since newly recruited individuals had the same rights and compensation opportunities, whether entry into the system occurred by a direct payment to TelexFree or through a Triangular Transaction. SUF, at ¶27. Second, the Promoter would profit further by retaining the recruit’s membership fee without a corresponding reduction in his/her bankruptcy claim. SUF, at ¶28. This overarching inequity is rectified by the Net Equity formula. SUF, at ¶29. The approval of the Net Equity formula for determining claims in these cases appropriately addressed the losses sustained by individuals as a result of the Debtors’ fraud regardless of whether the losses were incurred as a result of direct transactions or Triangular Transactions. SUF, at ¶30.

Grp., LLC, 439 B.R. 284 (S.D.N.Y. 2010); *In re Bernard L. Madoff Investment Securities, LLC*, 512 Fed. Appx. 18 (2nd Cir. 2013); *In re Old Naples Sec., Inc.*, 311 B.R. 607, 616-17 (M.D. Fla. 2002).

The Defendants did not object to the allowance of claims based upon the Net Equity formula and recognized the inherent fairness of including the Triangular Transactions in it. However, the Defendants reserved their rights to argue that the membership fees paid to Promoters in Triangular Transactions did not constitute property in which TelexFree had an interest. SUF, at ¶31. This argument should be rejected because, among other reasons, the finding that TelexFree had an interest in any membership fees paid through a Triangular Transaction is a logical extension of the Net Equity formula. The same reasons that require the inclusion of the Triangular Transactions in the computation of allowed claims warrants a finding that the payment of membership fees to a Promoter constitutes a payment by TelexFree.

D. The Trustee's Class Action Litigation

The Trustee has commenced two class actions by which he has sought to recover from Net Winners based upon the Net Equity formula, under theories of both fraudulent transfer and preferential transfer, amounts they received through direct and Triangular Transactions in excess of amounts they contributed into the TelexFree program. SUF, at ¶32.

The first class action adversary proceeding, Adv. Proc. No. 16-4006, was commenced against all Net Winners who are alleged to reside within the United States. The Trustee estimates that there are 14,818 Net Winners within this category. The Trustee has named 105 Participants as individual Defendants and proposed class representatives in the domestic class action, who are believed to be Net Winners in the aggregate amount of approximately \$109 million. A substantial portion of the \$109 million in net winnings of the individually named Defendants is attributable to the Triangular Transactions. SUF, at ¶33.

The second class action adversary proceeding, Adv. Proc. No. 16-4007, was commenced against all Net Winners who are alleged to reside outside of the United States. The Trustee

estimates that there are 78,487 Net Winners within this category. The Trustee has named 96 Participants as individual Defendants and proposed class representatives in the foreign class action, who are believed to be Net Winners in the aggregate amount of approximately \$76 million. A substantial portion of the \$76 million in net winnings of the individually named Defendants is attributable to the Triangular Transactions. SUF, at ¶34.

The Trustee seeks these recoveries on behalf of all Net Losers, including those who lost money through direct transactions, Triangular Transactions, or any combination thereof. SUF, at ¶35. The Trustee's right to do so is being challenged by the Defendants, who claim to be and represent a subset of Net Losers, being those individuals who claim to be Net Losers as a result of membership fees paid to a Promoter. For the reasons set forth herein, the Defendants' challenges should be overruled.

E. The Defendants' claims.

The named Defendants purport to be Net Losers who had little or no direct involvement or affiliation with TelexFree. An examination of the Defendants' account histories with TelexFree, however, reveals that this is not the case. For example, Maria Murdoch testified in Court at an evidentiary hearing in October 2015 that she had invested approximately \$25,000 in TelexFree, but that she had no contact with the Debtors, never became a member of TelexFree, and never received an invoice. SUF, at ¶41. The Debtors' books and records reflect, however, that Ms. Murdock maintained *seventy-five* (75) accounts ("User Accounts") with the Debtors, with each User Account representing the purchase of a plan. SUF, at ¶42. In fact, all of the Defendants had multiple User Accounts with TelexFree including: Rita Dos Santos: 12; Angela Batista Jiminez: 55; Elisangela Oliveira: 3; Diogio De Araugo: 65; and Celio Da Silva: 142. Each of the Defendants was a Promoter and had the opportunity to earn credits and to recruit other Promoters. SUF, at ¶43.

In the case of Dos Santos, not only did she open multiple User Accounts with TelexFree but she received \$8,035.91 in payments directly from TelexFree. SUF, at ¶44. The evidence of these payments directly contradicts representations made by the Defendants in the multi-district litigation that Dos Santos never received any money from TelexFree. SUF, at ¶45. Da Silva was a Net Winner in the amount of \$15,343 and Jiminez was a Net Winner in the amount of \$347.80. SUF, at ¶46. In recognition of the numerous problems associated with the Defendants' representations, on or about June 27, 2016, the PIEC amended their Complaint in one of the pending multi-district litigation matters to remove Murdock, Jiminez and De Araugo as named plaintiffs. The Defendants' extensive, multifaceted involvement with TelexFree is indicative of how inextricably linked and tangled the different types of transactions were with one another in perpetuating the Debtors' fraud.

To date, the Defendants' attempts, on at least two occasions, to bring Unjust Enrichment Claims in District Court, on a class action basis, against Promoters who became Net Winners based upon the receipt of membership fees from other Promoters in Triangular Transactions, appropriately have been denied. SUF, at ¶48. In one instance, the District Court denied the Defendants' motion to amend their Complaint to sue the Net Winners in Triangular Transactions as a class. SUF, at ¶49. In the second instance, the Defendants' action was stayed because it was found to be an improper attempt to circumvent the order in the first case. SUF, at ¶50. For the reasons set forth herein, the Defendants should not be permitted to assert their Unjust Enrichment Claims.

II. STANDARDS FOR SUMMARY JUDGMENT

Summary judgment is appropriate when the record reveals "no genuine dispute as to any material fact and the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P.

56(a); Fed. R. Bank. P. 7056. “The role of summary judgment is to pierce the boilerplate of the pleadings and to provide a means for prompt disposition of cases where no trial-worthy issue exists.” *Quinn v. City of Boston*, 325 F.3d 18, 28 (1st Cir. 2003) (citing *Suarez v. Pueblo Int’l, Inc.*, 229 F.3d 49, 53 (1st Cir. 2000)). “A ‘genuine’ issue is one that could be resolved in favor of either party, and a ‘material fact’ is one that has a potential of affecting the outcome of the case.” *Calero-Cerezo v. U.S. Dept. of Justice*, 355 F.3d 6, 19 (1st Cir. 2004) (citing *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248-250 (1986)).

“To be considered ‘genuine’ for Rule 56 purposes a material issue must be established by ‘sufficient evidence supporting the claimed factual dispute...to require a jury or judge to resolve the parties’ differing versions of the truth at trial.’” *Hahn v. Sargent*, 523 F.2d 461, 464 (1st Cir. 1975) (quoting *First National Bank of Arizona v. Cities Service Co., Inc.*, 391 U.S. 253, 289 (1968)). “Once the movant has served a properly supported motion asserting entitlement to summary judgment, the burden is on the non-moving party to present evidence showing the existence of a trial worthy issue.” *Gulf Coast Bank & Trust Co. v. Reder*, 355 F.3d 35, 39 (1st Cir. 2004) (citing *Anderson*, 477 U.S. at 248); *Garside v. Osco Drug, Inc.*, 895 F.2d 46, 48 (1st Cir. 1990). To meet that burden, the non-moving party may not rely on “bare allegations” but must come forward with substantive evidence to rebut the evidence that has been offered by the moving party. *Gulf Coast*, 355 F.3d at 39 (citing *Rogan v. City of Boston*, 267 F.3d. 24, 29 (1st Cir. 2001)).

The Trustee believes that the facts are uncontroverted and that he is entitled to a judgment as a matter of law.

III. ARGUMENT

As the Court recognized in its Net Equity decision: (i) only individuals who are Net Losers in accordance with the Net Equity formula qualify as creditors of the Debtors who may be entitled to allowed claims against the bankruptcy estates; (ii) the identity of Net Winners and Net Losers cannot be determined without taking into account membership fees paid, collected, and retained by Promoters through Triangular Transactions; and (iii) all Net Losers are entitled to equal treatment in the Debtors' cases, regardless of whether they paid their membership fees to TelexFree or to a Promoter.

Recovery from those Promoters who profited as a result of the retention of membership fees paid through a Triangular Transaction is essential to achieving an equitable distribution for all creditors in these cases. To accomplish that result, the Trustee has filed two proposed class actions asserting claims of both fraudulent transfer and preferential transfer against Promoters who are Net Winners, largely as a result of membership fees paid to them pursuant to Triangular Transactions. The Trustee's right to pursue this recovery is supported by the unique facts of the case and applicable law, including theories of agency and economic substance. If the Trustee were unable to bring these actions, certain Net Losers (those who paid membership fees to Promoters in Triangular Transactions) would be unfairly advantaged over other Net Losers. Additionally, recovery actions against Net Winners would become more complicated, expensive, and protracted with collection efforts being undertaken in multiple forums by both the Trustee and certain Promoters.

The causes of action asserted by the Trustee constitute estate property. The Trustee is the sole party with authority to pursue such claims on behalf of all Net Losers, not a select few. The Defendants' attempt to characterize the Triangular Transactions as transactions solely

between Participants, in which the estate has no interest, is simply inaccurate and self-serving. The Defendants' attempt to pursue recovery of membership fees paid pursuant to Triangular Transactions constitutes a violation of the automatic stay and should otherwise be enjoined pursuant to Section 105(a) of the Bankruptcy Code as undermining the Net Equity decision and interfering with the Trustee's successful administration of the Debtors' estates to effect an equitable distribution to all creditors.

A. The economic substance doctrine and agency law require a finding that the membership fees paid pursuant to Triangular Transactions constitute property in which TelexFree has an interest.

A Triangular Transaction represents TelexFree's sale of a membership plan to a new recruit. Although the Promoter helped to facilitate the sale, TelexFree was the seller. Defendants' attempt to diminish TelexFree's interest in these sales by describing them as transactions between two third parties (or, in their words, "Participant-to-Participant Payments") is entirely inaccurate and self-serving. The Debtors designed the Triangular Transaction as an efficient mechanism for diverting the cash collected from new recruits' membership fees to compensate earlier Promoters. The effect was simultaneously to preserve the illusion of a profitable enterprise and to secure new Promoters to market it, perpetuating the fraud. The economic substance of the Triangular Transactions and application of blackletter agency law principles compel the conclusion that membership fees paid by new recruits as part of a Triangular Transaction constituted property in which TelexFree had an interest.

Property of the estate includes all legal or equitable interests of the Debtors in property as of the commencement of the cases, "wherever located and by whomever held." 11 U.S.C. § 541(a)(1). The United States Supreme Court has held that Congress intended the statutory definition of estate property to be interpreted broadly to include, among many other things, "property made available to the estate by other provisions of the Bankruptcy Code . . . [which

may] bring into the estate property in which the debtor did not have a possessory interest at the time the bankruptcy proceedings commenced.” *United States v. Whiting Pools*, 462 U.S. 198, 204-05 (1983). Such interests include all kinds of property, tangible and intangible, as well as causes of action. *Id.*; **H.R.Rep. No. 595**, 95th Cong., 1st Sess. 367-68 (1977), reprinted in 1978 **U.S.C.C.A.N.** at 5963, 6323 (1978).

The Promoters served as the Debtors’ agents in recruiting new members through Triangular Transactions. A principal-agent relationship exists where “there is mutual consent, express or implied, that the agent is to act on behalf and for the benefit of the principal, and subject to the principal’s control.” *Theos & Sons, Inc. v. Mack Trucks, Inc.*, 431 Mass. 736 (Mass. 2000). All Promoters acted as sales agents of TelexFree, and very specific rules were in place governing the manner of sales “with a view to protecting the image of TelexFree.”

The Promoters’ activity was ostensibly governed by a contract between the Promoter and TelexFree. SUF, at ¶3. While the contract ostensibly disavows an employment relationship, it clearly establishes an agency relationship between TelexFree and the Promoter. In fact, the contract refers to the Promoter as a Partner. The contract expressly authorized the use of a Promoter’s credits to satisfy the invoice of the new recruits. The contract prescribed the Promoter’s compensation and governed the activity of the Promoter in the recruitment of other Promoters and sale of product. For example, the contract provided that: “in making presentations to groups of people invited to join the TELEXFREE Multilevel network and use its products and services, [Promoters] must restrict themselves to the material made available in the video provided for the occasion, and may not express their own views in public. . . No other material may be used at presentations.” SUF, at ¶3. This level of control dictated by TelexFree over the Promoter’s activity is indicative of an agency relationship. *See, e.g. Cooper v. First*

International Bank (In re Cooper), 2 B.R. 188, 194 (Bankr. S.D. Tex. 1980) (ticket-sellers were agents of debtor where debtor had not only the power to order sale of tickets but also direct the time, place, and manner in which the sales were to take place) (applying Texas law).

In the context of Triangular Transactions, with the authority of TelexFree, Promoters also served as TelexFree's collection agents. TelexFree approved and encouraged the use of the Triangular Transaction in the recruitment of new individuals. It was TelexFree who controlled the implementation of each Triangular Transaction by (1) authorizing Promoters to collect membership fees from new recruits on its behalf, and then (2) accepting redemption of the Promoter's credits in settlement of the new recruit's invoice and allowing the Promoter to retain the cash collected. Without the participation, consent, and control of the Debtor, no Triangular Transaction could be consummated.

All participants in the Triangular Transaction understood both that the Promoter acted on behalf of and at the behest of TelexFree in facilitating the new recruit's purchase of a TelexFree membership plan, and that it was TelexFree that ultimately conferred the membership on the new recruit. An individual purchasing a membership plan could not begin to accumulate credits in the TelexFree network until TelexFree marked the associated invoice as paid and activated the new User Account. But for the expectation that TelexFree would deliver its membership plan, the new recruit had no reason to make payment to the Promoter.

Once an agent collects funds on behalf of its principal, the agent holds the funds in trust for the benefit of the principal. *Deep Blue Ventures, Inc. v. Manfra, Tordella & Brookes, Inc.*, 791 N.Y.S.2d 298, 301 (N.Y. Sup. Ct. 2004) ("[I]t is apparent that an agent who has received money for the principal has a duty to use care to keep it safely until it is delivered to the principal"). The agent further has a duty to remit the funds to the principal in accordance with

the terms of the agency. *See, e.g. Tidewater Designs, Inc. v. Evergreen America Corp. (In re Tidewater Designs, Inc.)*, 276 B.R. 733, 736 (Bankr. E.D.N.C. 2002) (as [creditor's] agent, Evergreen has a fiduciary obligation to transmit the debtor's payments to [creditor]"); *Gold v. Rowland*, 296 Conn. 186, 201 n. 15 (2010) ("Generally, an agent is under a duty to repay or deliver to the principal money or property belonging to the principal which comes into the agent's hands while conducting the business of the agency") (*citing* 3 Am.Jur.2d 689–90, Agency § 322 (2002)). The membership fees paid to Promoters in Triangular Transactions constituted property in which TelexFree had an interest. The Promoters collected the membership fees as agent for TelexFree and had a duty to remit the funds to TelexFree until otherwise instructed. In a Triangular Transaction, the Debtors opted to accept the redemption of accumulate credits by the Promoter, rather than delivery of the cash collected on its behalf, in satisfaction of the recruit's invoice.

Because the Debtors had an interest in the membership fees paid in a Triangular Transactions, both the new recruit's payment of membership fees to a Promoter and the Promoter's retention of those collected fees as permitted by TelexFree, constituted a transfer of property in which TelexFree had an interest. The TelexFree estate was depleted as TelexFree did not collect the revenue arising out of the Triangular Transaction but did become responsible to pay all of the compensation to which the new recruit would otherwise be entitled under the program. According to principles of agency law, the Triangular Transactions implicated property of the estate and the Trustee may pursue avoidance actions to recover it.

The same conclusion flows from application of the economic substance or "collapsing" doctrine, which requires consideration of the Triangular Transaction as the totality of its component transfers. As a court of equity, a bankruptcy court "may look through form to

substance when determining the true nature of a transaction as it relates to the rights of parties against a [Debtor's] estate.” *In re PCH Assocs.*, 949 F.2d 585, 597 (2d Cir. 1991) (citing *Pepper v. Litton*, 308 U.S. 295, 304 (1939)). See also *In re Adelphia Communications Corp.*, 512 B.R. 447 (Bankr. S.D.N.Y. 2014)(series of transactions may be treated as one when it appears that, despite formal structure erected and labels attached, segments comprise a single integrated scheme when considering knowledge and intent of parties involved in transaction); *Orr v. Kinderhill Corp.*, 991 F.2d 31, 35 (2d Cir. 1993) (“[w]here a transfer is only a step in a general plan, the plan must be viewed as a whole with all its composite implications.”). Here, a focus solely on the cash payment from the new recruit to the Promoter, as Defendants urge, eclipses the broader economic import of that transfer, and the proper scope of analysis is the Triangular Transaction as a whole.

The collapsing of transactions into an integrated transaction to recognize the true nature of a transaction has been employed by the courts in varying contexts and is required here to promote the equitable treatment of all similarly situated creditors. In the case of leveraged buyouts, payments made by an acquirer to selling shareholders are considered to be transfers of estate property even though the funds were paid by the stock purchaser and not the debtor. See, e.g., *In re Chas P. Young Company*, 145 B.R. 131 (Bankr. S.D.N.Y. 1992)(regardless of number of steps taken to complete a transfer of debtor's property, if they reasonably collapse into a single integrated plan and either defraud creditors or leave the debtor with less than reasonably equivalent value post-exchange, the transaction may be avoided as fraudulent transfer of debtor property); *In re OODC, LLC*, 321 B.R. 128 (Bankr. D. Del. 2005)(in deciding whether to collapse a leveraged buyout into one integrated transaction, the issue is whether there was an overall scheme to defraud the estate and its creditors by depleting the estate's assets); *United*

States v. Tabor Court, 803 F.2d 1288 (3rd Cir. 1986), *cert. den.* *McClellan Realty Co. v. United States*, 483 U.S. 1005, 107 S. Ct. 3229 (1987)(debtor merely served as conduit for transfer of funds to shareholders and did not receive funds as any form of consideration); *Wieboldt Stores v. Schottenstein*, 94 B.R. 488 (N.D. Ill. 1988)(leveraged buyout transfers would be integrated into one transaction and parties would be treated as having received transfers of debtor's property; focus is not on formal structure of transaction but knowledge or intent of parties involved in the transaction); *In re O'Day Corporation*, 126 B.R. 370 (Bankr. D. Mass. 1991); *In re Jevic Holding Corp.*, No. 08-11006, 2011 WL 4345204 (Bankr. D. Del. 2011)(leveraged buyout may be collapsed if transactions are interdependent and all parties had knowledge of the transactions).

Similarly, payments made by a purchaser of a debtor's assets to certain of the debtor's creditors are considered to be transfers of estate property for avoidance action purposes, even though the funds were paid by the asset purchaser to the creditor and not the debtor. *See, e.g., Warsco v. Preferred Technical Group*, 258 F.3d 557, 568-69 (7th Cir. 2001) (debtor sold its assets prepetition, and the asset purchaser used a portion of the sale proceeds to satisfy the claims of debtor's creditors. Court treated purchaser's payments to creditors as if debtor made them directly to creditors because there was a direct relationship between the consideration given for the debtor's assets and the funds used to pay the creditors, and funds would have otherwise been estate property); *In re Food Catering & Housing, Inc.*, 971 F.2d 396 (9th Cir. 1992) (prepetition payment made by purchaser of debtor's assets to creditor was avoidable preference; payment treated as if made by debtor).

Contrary to Defendants' arguments, the same rationale applies for collapsing the components of the Triangular Transaction to reflect the economic realities of the Debtors' fraudulent enterprise. In substance, the recruited individual paid the Debtors for the purchase of

a membership plan. The Debtors paid the Promoter by the Promoter retaining the collected membership fee and the Debtor making a corresponding reduction in the Promoter's accumulated credits. It is of no moment that the Debtors did not collect the cash directly from the recruited individual, since the Promoter collected it on TelexFree's behalf.

The fact that TelexFree was operating a Ponzi and Pyramid scheme does not prevent the recovery of membership fees from Net Winners. Funds obtained from investors in a Ponzi/Pyramid scheme are property of debtor, and are thus susceptible to preferential and fraudulent disposition by debtor. *See, e.g., In re Ramirez Rodriguez*, 209 B.R. 424 (Bankr. S.D. Tex. 1997); *In re Universal Clearing House Co.*, 62 B.R. 118 (D. Utah 1986); *In re Hedged-Investments Assoc., Inc.*, 163 B.R. 841, 850-51 (Bankr. D. Colo. 1994), *aff'd* 84 F.3d 1286 (10th Cir. 1996); *In re Int'l Loan Network*, 160 B.R. 1 (Bankr. D. Dist. Col. 1993); *In re Taubman*, 160 B.R. 964, 980 (Bankr. S.D. Ohio 1993); *In re Baker & Getty Financial Services, Inc.*, 98 B.R. 300 (Bankr. N.D. Ohio 1989); *In re Geltzer*, 502 B.R. 760 (Bankr. S.D.N.Y. 2013). The "net winnings" represent fictitious profits that are avoidable as fraudulent transfers because "[a]ny dollar paid to reimburse a fictitious profit is a dollar no longer available to pay claims for money actually invested." *Geltzer*, 502 B.R. at 770.

Contrary to Defendants' assertions, there is also no need for the Trustee to demonstrate that the fees paid by Promoters were "commingled" while in the Debtors' possession to justify recovery by the estate. In the aftermath of a Ponzi scheme, the paramount concern for ratable distribution of funds to creditors consistently takes priority over the rights of individual participants to seek imposition of a constructive trust on identifiable funds paid into the scheme. *See, e.g., United States v. Ramunno*, 599 F.3d 1269, 1275 (11th Cir. 2010)(declining imposition of constructive trust even if victim could trace funds, as it would elevate his position over that of

similarly situated victims and diminish the pool of funds available to be distributed to all victims); *United States v. Andrews*, 530 F.3d 1232, 1238 (10th Cir. 2008)(relief denied to victim who could trace Ponzi funds; other victims would not be unjustly enriched by receiving an appropriate share of the traced funds); *SEC v. Infinity Group Co.*, 226 F. Appx. 217, 219 (3rd Cir. 2007)(no equitable basis to distinguish between early investors and those who invested shortly before the debtor’s account was frozen such that their assets were traceable. All investors should be treated the same); *SEC v. George*, 426 F.3d 786, 799 (6th Cir. 2005)(same); *United States v. Durham*, 86 F.3d 70, 73 (5th Cir. 1996)(even where tracing permissible and objecting creditor had right to seek constructive trust and return of identifiable property, the court may exercise its equitable discretion to deny such relief where it determined that the result would be inequitable. All victims of the fraud were in an equal position and should be treated as such).

Whether the Triangular Transactions are viewed in the context of agency law or the “collapsing” doctrine, the result is the same. The membership fees paid to the Promoter through the Triangular Transactions were property in which the Debtors had an interest, because the Promoter was acting on behalf of TelexFree when he/she sold the membership plan. The Debtors authorized the Promoter to collect the money from the recruited individual on its behalf. TelexFree authorized the Promoter to retain the membership fees in exchange for a redemption of credits in satisfaction of the invoice due from the new recruit. The retention of the membership fee and the reduction of the accumulated credits constitute a distribution to the Promoter by TelexFree, no different than if the recruit had paid the collected membership fee to TelexFree and TelexFree then redeemed the Promoter’s accumulated credits for a corresponding amount of cash. This transaction constituted the transfer of the Debtors’ interest in property that the Trustee seeks to recover. The Trustee is the proper party to pursue recovery of the

membership fees paid to Net Winners through Triangular Transactions, and the prosecution of these claims will promote the fair and equitable distribution to all Promoters.

B. The Defendants should not be permitted to prosecute the Unjust Enrichment Claims.

The Defendants' prosecution of the Unjust Enrichment Claims should be enjoined, both as a violation of the automatic stay, since they seek to recover estate property, and because it is warranted under Bankruptcy Code Section 105(a). The Unjust Enrichment Claims target some of the same defendants and funds that the Trustee is pursuing as fraudulent and preferential transfers, arise from the same transactions, and are so irreversibly intertwined with the Trustee's claims that failure to enjoin Defendants' suit will incontrovertibly interfere with the Trustee's effective administration of the Debtors' estates in furtherance of equitable distribution to all creditors.

As established, the membership fees paid to the Promoters in Triangular Transactions involve property in which TelexFree had an interest, and on that basis the Defendants' pursuit of Unjust Enrichment Claims to recover these funds would violate the automatic stay. Section 362 of the Bankruptcy Code provides fundamental, broad, and necessary protection to a trustee to administer the bankrupt's estate. *See Midatlantic Nat'l Bank v. New Jersey Dept' of Env'tl. Prot.*, 474 U.S. 494, 503, 106 S.Ct. 755, 760, 88 L.Ed.2d 859 (1986); *Soares v. Brockton Credit Union (In re Soares)*, 107 F.3d 969, 975 (1st Cir. 1997). The filing of a petition for relief operates as a stay, applicable to *all entities*, of, among other things: recovery against the debtor for pre-petition claims, and "any act to obtain possession of property of the estate or property from the estate or to exercise control over property of the estate." 11 U.S.C. §362(a)(3) (emphasis provided). "The automatic stay is 'extremely broad in scope' in that it prohibits almost all formal and informal acts taken against the debtor or the estate.'" *Knowles v. Bayview Loan*

Servicing, LLC, (*In re Knowles*), 442 B.R. 150, 160 (1st Cir. B.A.P., 2011). The actions taken by the Defendants in pursuing the Net Winners to recover payments received in Triangular Transactions constitute actions to obtain possession of estate property and/or to exercise control over estate property, namely the Trustee's fraudulent transfer and preference claims against the Net Winners.

It is well established that claims for fraudulent and preferential transfer are included within property of the estate, *In re Ontos, Inc.*, 478 F.3d 427, 431 (2007), and the Trustee has the exclusive standing to assert causes of action belonging to the Debtors' estates. *Id.* at 431; *Regan v. Vinick & Young (In re Rare Coin Galleries of America, Inc.)*, 862 F.2d 892, 901 (1st Cir. 1988) ("The trustee steps into the shoes of the debtor for the purposes of asserting or maintaining the debtor's causes of action, which become property of the estate."); *In re El San Juan Hotel Corp.*, 841 F.2d 6, 9 (1st Cir. 1988) citing *Matter of Milam*, 37 B.R. 865, 868-69 (Bankr. N.D.Ga. 1984); *In re Gunartt*, 355 Fed.Appx. 66, 68 (7th Cir. 2009); *In re Dziurgot Farnsworth*, 2008 WL 4833089 at *3 (Bankr. D. Mass. Oct. 28, 2008) ([F]raudulent conveyance causes of action are themselves interests in property of the estate, which 'the Trustee should at least be allowed the opportunity to recover the equity for creditors'") quoting *In re Ciccone*, 71 B.R. 4, 5 (Bankr. D.R.I. 1994); *Mi-Lor Corp. v. Gottsegen (In re Mi-Lor Corp.)*, 233 B.R. 608, 619 (Bankr. D. Mass. 1999) ("[N]o creditor has individual avoidance rights after the petition filing. Bankruptcy being a collective proceeding for the benefit of all creditors, avoidance rights belong only to the estate representative; upon their exercise the property recovered becomes part of the bankruptcy estate").

The imposition of the automatic stay against the Defendants is necessary to provide for equality of treatment among creditors and to avoid piecemeal litigation by individual creditors.

See e.g. *Torres v. Santander Financial Services, Inc. d/b/a Island Finance, et al.*, 532 B.R. 195, 200-201 (Bankr. D.P.R., 2015). As stated in the House Report:

The automatic stay...provides creditor protection. Without it, certain creditors would be able to pursue their own remedies against the debtor's property. Those who acted first would obtain payment of the claims in preference to and to the detriment of other creditors. Bankruptcy is designed to provide an orderly liquidation procedure under which all creditors are treated equally. A race of diligence by creditors for the debtor's assets prevents that.

H.R.Rep. No. 595, 95th Cong.2d Sess., *reprinted in* [1978] U.S.Code Cong. & Admin.News 5963, 6297 (emphasis added); S.Rep. No. 989, 95th Cong.2d Sess., *reprinted in* [1978] U.S.Code Cong. & Admin.News 5787, 5835. See also *Matter of Holkamp*, 669 F.2d 505, 508 (7th Cir. 1982) ("The purpose of the automatic stay is to...provide an equitable liquidation procedure for all creditors....")

Since payment of TelexFree membership fees to a Promoter constituted estate property, the Defendants' claim against the Net Winners for unjust enrichment must be derivative of the estate's claims, since it is the estate that has the right to recover the funds paid to the Promoter, not the new recruit. *In re Bernie L. Madoff Inv. Securities, LLC*, 740 F.3d 81, 89 (2nd Cir. 2014)("BLMIS I"). A claim asserted by a third party that is derivative of the estate's claim involves property of the estate and should be stayed. *Id.* at 88.

Because the Unjust Enrichment Claim seeks to recover property of the Debtors' estates in violation of Section 362(a)(3), the pursuit of such claims is subject to the automatic stay. See *Soares*, 107 F.3d at 969; *Interstate Commerce Comm'n v. Holmes Transp., Inc.*, 931 F.2d 984, 987 (1st Cir. 1991)("Judicial actions and proceedings...in violation of the automatic stay are void, are generally void and without legal effect..."); *In re Advent Corp.*, 24 B.R. 612, 614 (1st Cir. B.A.P. 1982); *FDIC v. Hirsch (In re Colonial Realty Co.)*, 980 F.ed 125, 137 (2d Cir. 1992).

Accordingly, the Trustee respectfully requests that the Court declare the attempted prosecution of the Unjust Enrichment Claim void and without effect as set forth in the Complaint.

Even if the Unjust Enrichment Claim is not derivative of the estates' claims and/or subject to the automatic stay provisions of Bankruptcy Code Section 362, the Defendants' should be stayed from pursuing those claim, pursuant to the powers set forth in Section 105 of the Bankruptcy Code, because failure to do so will undermine the application of the Net Equity formula and interfere with the Trustee's administration of the Debtors' estates for the benefit of all creditors.

Section 105(a) of the Bankruptcy Code provides that "[T]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." Actions that adversely affect the bankruptcy estate may be enjoined under Section 105. *See e.g. In re G.S.F. Corp.*, 938 F.2d 1467, 1474 (1st Cir. 1991)(under Section 105 there must be "some effect on the debtor's estate stemming from the action") *citing Matter of Energy Co-op., Inc.*, 886 F.2d 921, 929 (7th Cir. 1989) ("authority to enjoin actions which threaten the integrity of the bankrupt's estate"); *In re A.H. Robins Co.*, 880 F.2d 694, 701 (4th Cir. 1989) (may enjoin third party actions which "would affect the bankruptcy reorganization in one way or another"); *Menard-Sandofrd v. A.H. Robins Co.*, 493 U.S. 959, 110 S.Ct. 376, 107 FL.Ed.2d 362 (1989); *In re Bretanos's, Inc.*, 36 B.R. 90, 92 (S.D.N.Y. 1984)(stay "necessary to an orderly disposition of the debtor's estate"). *See also In re Crocker*, 362 B.R. 49, 57 (1st Cir. B.A.P. 2007).

The Unjust Enrichment Claim is not the type of "particularized" claim that courts have allowed to proceed in derogation of the rights of a trustee to pursue causes of action for the benefit of all creditors who suffered substantially the same injury, especially in the Ponzi scheme context. *See, e.g. In re Barkany*, 542 B.R. 662 (E.D.N.Y. 2015) (creditors barred from

prosecuting unjust enrichment claims, among others, where bankruptcy trustee’s fraudulent transfer claims against the same third parties arose from common facts—namely, “the third party defendants’ involvement in a fraudulent investment scheme perpetrated by the debtor with multiple victims”); *Meoli v. The Huntington Nat’l Bank (In re Teleservices Group, Inc.)*, 463 B.R. 28 (W.D. Mich. 2012) (despite the fact that creditors’ unjust enrichment claims against third parties did not belong to the bankruptcy estate, creditors barred from pursuing action where “the third party has been targeted only because his own dealings with the debtor have placed him in [that] unfortunate position”).

The prosecution of the Unjust Enrichment Claim would have a substantial adverse impact upon the estates in several respects. First, the Trustee would be engaged in a “race to the courthouse” with the Defendants, who would be pursuing the same Net Winners. The Trustee would be virtually incapable of settling any claims against these Net Winners, since they would be unlikely to settle without the participation of the Defendants in the settlement or the execution of a release by the Defendants. The result would be duplicative litigation and significant confusion amongst Net Winners, all to the detriment of the bankruptcy estates. Because of these adverse impacts, the further prosecution of the Unjust Enrichment Claim should be enjoined.

See In re Caesars Entertainment Operating Company, Inc., 808 F.3d 1186 (7th Cir. 2015)(controlling inquiry in determining whether injunction is warranted under Section 105 is whether the injunction is likely to enhance the prospects for a successful resolution of the disputes attending the bankruptcy); *Queenie, Ltd. v. Nygard Int’l*, 321 F.3d 282, 287 (2nd Cir. 2003); *Nevada Power Co. v. Calpine Corp., (In re Calpine Corp.)*, 365 B.R. 401, 409 n. 20 (S.D.N.Y. 2007) (“Courts consistently have found that section 105 may be used to stay actions against non-debtors even where Section 362 otherwise would not provide such relief”); *Fisher v.*

Apostolou, 155 F.3d 876, 882 (7th Cir. 1998) (“The jurisdiction of the bankruptcy court to stay actions in other courts extends beyond claims by and against the debtor, to include suits...which may affect the amount of property in the bankrupt estate, or the allocation of property among creditors.”)(citations omitted).

The Unjust Enrichment Claim arises out of the same set of facts and seeks to recover the same funds being pursued by the Trustee. The Second Circuit Court of Appeals, in two recent instances, entered permanent injunctions in favor of the Trustee under similar circumstances. *See BLMIS I; In re Bernard L. Madoff Investment Securities, LLC*, 512 Fed. Appx. 18 (2nd Cir. 2013)(“BLMIS II”).

In *BLMIS I*, the *Madoff* trustee brought claims against the “Picower” defendants for recovery of fraudulent and preferential transfers in connection with that well-documented Ponzi scheme. While settlement talks were pending, appellants Fox and Marshall filed complaints in federal court in Florida against the Picower defendants. Marshall, a net loser in the Ponzi scheme, purported to represent claimants who had not filed claims in the bankruptcy action or whose claims were disallowed. Fox asserted claims on behalf of net “winners”, who could not participate in the *Madoff* estate, for conspiracy and conversion against Picower, who were alleged co-conspirators of Madoff. The Second Circuit concluded that the Florida actions were based upon secondary harms to the debtor rather than particularized injuries and enjoined those actions as interfering with administration of the estate. *Id.* at 92 (injury was inseparable from, and predicated upon, a legal injury to the estate, namely the fraudulent withdrawals from the BLMIS accounts). Similarly, the Defendants’ claims are intertwined with the Trustee’s avoidance action claims against the Net Winners. Each set of claims is premised upon the membership fees paid to Promoters in Triangular Transactions.

As stated by the lower court whose decision was affirmed by the Second Circuit:

In order to assert such a claim independently of the administration of the bankruptcy case, a creditor must have suffered an injury significantly different from the injuries to creditors in general...Where the creditors' injury, while having some personal elements, overlaps with injury suffered by other creditors...the question to be answered is whether the injury to the creditor is "significantly different" from the injuries to other creditors in general."

Securities Investor Protection Corporation v. Bernard L. Madoff Investment Securities, LLC, 429

B.R. 423, 431 (Bankr. S.D.N.Y. 2010). The Net Losers in the Triangular Transactions

effectively suffered the same harm as all other Promoters who purchased TelexFree membership plans through either direct transactions with TelexFree or Triangular Transactions – they invested funds to purchase memberships in a Ponzi scheme and ultimately were unable to recoup their investment. This provides no basis for individual Net Losers to “jump the line” and recover funds invested to the detriment of other similarly situated Net Losers.⁵

A similar injunction issued in favor of the Trustee in *BLMIS II*. In that action, as in *BLMIS I*, the trustee was pursuing recovery of avoidance actions while a third party asserted tort claims against the debtor-affiliated defendant. In affirming the lower courts, the Second Circuit took a very expansive view of Section 105:

Section 105(a) is to be “construed liberally to enjoin suits that might impede the reorganization process or, as here, the process of liquidation...Liberal construction reflects ‘the underlying principle of preserving the debtor’s estate for the creditors and funneling claims to one proceeding in the bankruptcy court...105(a) is properly used to enjoin creditors’ lawsuits against third parties where ‘the injunction plays an important part in the reorganization plan’...or where the action to be enjoined will have an immediate adverse economic consequence for the debtor’s estate.

Id. at 20.

⁵ As discussed above, the Defendants have couched their claim as an “Unjust Enrichment Claim”, which is really just an equitable remedy and a repackaging of the fraudulent transfer claims asserted by the Trustee.

The District Court, whose decision was affirmed by the Second Circuit, noted that the court was dealing with “misrepresentations and lies that every creditor of the estate suffered” much like this case where the Defendants seek, on a class action basis, to recover from certain Net Winners for the harm that every Net Loser Promoter suffered. *In re Bernard L. Madoff Investment Securities, LLC*, 2011 WL 7975167 at *13 (S.D.N.Y. 2011).

The third *Madoff* action, cited with approval by the Defendants, supports the issuance of the Section 105 injunction in these cases. *Picard v. Fairfield Greenwich Limited et al*, 762 F.3d 199 (2nd Cir. 2014) (“BLMIS III”). In that case, the Second Circuit denied the trustee’s request for an injunction of a suit brought by investors in so-called “feeder funds” against the funds themselves, which the trustee was simultaneously pursuing. This case is completely distinguishable from the present case. The investors in *BLMIS III* dealt only with the feeder funds, had claims only against the feeder funds, and had no relationship with the *Madoff* estate. In the instant case, the new recruit had a direct and substantial relationship with the Debtors. TelexFree issued the invoices to the recruit, the recruited individuals became members of TelexFree, the recruited individuals began immediately earning credits that could be converted to cash, and the recruited individuals could themselves recruit others into the TelexFree network. The differences could not be more stark. The facts in this case are much more akin to the facts in *BLMIS I* and *II*, both of which favor imposition of an injunction.

Further support for an injunction in favor of the Trustee can be found in a recent decision in the Petters’ Ponzi scheme case. *See Ritchie Capital Management, LLC et al v. General Electric Capital Corp.*, 2016 WL 2731417 (2nd Cir. 2016). In *Ritchie*, the Second Circuit dismissed an action against General Electric Capital Corp. (“GECC”) for civil conspiracy and aiding and abetting fraud because the creditor lacked standing. The movants in *Ritchie* alleged

that GECC allowed misrepresentations to be made to recruit parties to invest in the debtor, causing a particularized harm. The trustee brought suit against GECC for fraudulent transfers rooted in the same conduct outlined in the plaintiffs' complaint. The plaintiffs' argument that their claims were particularized and that the estate's rights would be barred by the doctrine of *in pari delicto* did not prevail. Similarly, the Defendants claims against Net Winners for any benefits the Net Winners derived from their participation in TelexFree should be enjoined in favor of the Trustee's avoidance claims that will benefit all parties.

IV. CONCLUSION

The membership fees collected by Promoters pursuant to Triangular Transactions is property in which the Debtors had an interest. The membership fees in a Triangular Transaction were owed to TelexFree, but TelexFree authorized the Promoter to collect them on its behalf, and to then retain the payment in exchange for a redemption of his/her accumulated credits. The Promoter's retention of the membership fee for his/her own benefit constituted a transfer of property in which TelexFree had an interest, property that would have been would have been part of the bankruptcy estates had the Debtor not agreed to accept its payment in credits instead. The Trustee is the proper—and only—party authorized to pursue recovery of that property by prosecuting fraudulent and preferential transfer claims against “Net Winners” from the Triangular Transactions.

The Defendants' competing prosecution of the Unjust Enrichment Claims is a violation of the automatic stay in that it seeks to recover estate property. Even if the Unjust Enrichment Claims were a direct, particularized claim belonging to the Defendants, they target the same funds the Trustee is pursuing as fraudulent and preferential transfers, arise from the same

transactions, and are so irreversibly intertwined with the Trustee's claims as to warrant a permanent injunction pursuant to Bankruptcy Code section 105(a).

For all the reasons set forth herein and in the Motion, the Trustee is entitled to summary judgment as a matter of law.

Respectfully submitted,

STEPHEN B. DARR, CHAPTER 11
TRUSTEE,
By his counsel:

Dated: September 2, 2016

/s/ Andrew G. Lizotte
Harold B. Murphy (BBO #362610)
Charles R. Bennett, Jr. (BBO #037380)
Andrew G. Lizotte (BBO #559609)
MURPHY & KING,
Professional Corporation
One Beacon Street
Boston, MA 02108
Telephone: (617) 423-0400
ALizotte@murphyking.com

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EXHIBIT 8

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
CENTRAL DIVISION**

In re:	)	Chapter 11
)	
	)	Case No. 14-40987
TELEXFREE LLC., <u>et al.</u> , ¹)	
	)	Jointly Administered
Debtors.)	
)	
)	
STEPHEN B. DARR AS TRUSTEE OF THE ESTATES OF TELEXFREE, LLC, TELEXFREE, INC. and TELEXFREE FINANCIAL, INC.,)	
	)	Adversary Proceeding No. 15-04055
Plaintiffs,)	
)	
v.)	
)	
RITA DOS SANTOS, INDIVIDUALLY AND AS PUTATIVE CLASS REPRESENTATIVE, AND MARIA MURDOCH, ANGELA BATISTA JIMINEZ, ELISANGELA OLIVEIRA AND DIOGO DE ARAUGO, AS PUTATIVE CLASS REPRESENTATIVES,)	
)	
Defendants.)	

**PIEC’S RESPONSE TO MEMORANDUM OF LAW IN SUPPORT
OF TRUSTEE’S OPPOSITION TO PIEC MOTION FOR SUMMARY
JUDGMENT AND TRUSTEE’S CROSS-MOTION FOR SUMMARY JUDGMENT**

INTRODUCTION

As demonstrated in the *Memorandum in Support of PIEC’s Motion for Summary Judgment* [Docket No. 41] (the “PIEC Opening Brief”), and as admitted by the Trustee, TelexFree never acquired or held any legal title to the monies transferred as Participant-to-

¹ The debtors (the “Debtors”) in these cases (collectively, the “Chapter 11 Cases”) are TelexFree, LLC, TelexFree, Inc., and TelexFree Financial.

Participant Payments. Further, TelexFree never had actual possession of the Participant-to-Participant Payments and all of these Payments were the product of a fraud.² Accordingly, none of those Payments ever became property of the estate.

Conceding, finally, that TelexFree lacked possession of the Participant-to-Participant Payments, and that the absence of possession makes it impossible for the estate to have acquired legal title to these payments, the Trustee has now come up with a new theory: “agency.” Although the Trustee did not plead agency in his Complaint, he now argues that the Participant-to-Participant Payments were collected by the Promoter-Participants as “agents” of TelexFree, and that once these payments were collected by the Promoter-Participants it was *as if* the money had reached the hands of TelexFree. This new theory of the Trustee’s case is a last-ditch effort that does not withstand the slightest scrutiny.

The issue to be decided here is a serious one. It determines the rights of hundreds of thousands of individual victims, most of whom are of very modest means, to sue in their own names to recover for themselves the cash that they handed over to Promoter-Participants. In many instances, that cash was a major part of each victim’s life savings, the victim knows who they gave the cash to, and the victim wants desperately to sue to get it back from those who wrongfully and unjustly were enriched by the receipt.

The Trustee is trying to take to himself each victim’s right to do that, to settle out or otherwise do as he wishes with them, but not in accordance with the victims’ directions. The Supreme Court, in Caplin v. Marine Midland Grace Tr. Co. of N.Y., 406 U.S. 416 (1972), and its progeny, has dictated that a trustee must satisfy very specific and exacting requirements to have standing to sue Promoter-Participants to recover the monies transferred to them by individual

² Capitalized terms used but not defined herein shall have the meanings ascribed to them in PIEC Opening Brief.

Victim-Participants: (1) *possession* of the Participant-to-Participant Payments; and (ii) a *legal right* to the Participant-to-Participant Payments.

The Trustee's *Memorandum of Law in Support of Trustee's Opposition to PIEC Motion for Summary Judgment and Trustee's Cross-Motion for Summary Judgment* [Docket No. 51] makes plain that the Trustee cannot meet this standard. Instead, the Trustee now offers a novel and factually unsupported expansion of "agency" law in an attempt to circumvent the requirements of Caplin and manufacture standing. This attempt must fail. The Trustee has not demonstrated that TelexFree's contracts with Promoter-Participants (the "Promoter Contracts")³ created in TelexFree either possession of or a legal right to the Participant-to-Participant Payments. The Promoter Contracts were an integral part of TelexFree's fraud and accordingly were unenforceable and, moreover, unenforced. TelexFree could not have compelled the Promoter-Participants to turn over the Participant-to-Participant Payments to TelexFree under the fraudulent Promoter Contracts, and never so much as attempted to do so. Furthermore, even if one ignores the complete bar imposed on the Trustee by the doctrine of *in pari delicto*, the Promoter Contracts did not establish an agency relationship between the Promoter-Participants and TelexFree. Those Contracts demonstrate that the Promoter-Participants did not act for the benefit of TelexFree, were not subject to TelexFree's control, and had no authority to legally bind TelexFree.

As made clear in the PIEC Opening Brief, the Victim-Participants' claims against each Promoter-Participant are independent of their claims against TelexFree, because each Victim suffered a personal and particularized injury at the hands of the Promoter-Participants to whom he or she transferred money. The Trustee, however, now argues that the individual Victim-

³ A copy of a Promoter Contract is attached to the *Trustee's Statement of Undisputed Material Facts in Support of His Cross-Motion for Summary Judgment* [Docket No. 48] (the "Trustee SUF") as Exhibit C.

Participants suffered no particularized harm at the hands of Promoter-Participants and so lack standing to recover the money they lost. For that to be true, the Trustee would need to show that the funds were paid to the Debtors, rather than paid to or held by the Promoter-Participants individually, and thereafter transferred by the Debtors to third parties. But, the Trustee cannot overcome the uncontroverted facts that the individual Victim-Participants instead paid over the cash comprising the Participant-to-Participant Payments directly to individual Promoter-Participants and that TelexFree suffered no diminishment of its estate in connection with the Participant-to-Participant Payments. The Trustee simply cannot show here the critical fact necessary to eliminate particularized harm: possession by TelexFree of the Participant-to-Participant Payments, and the late development of a factually unsupported “agency” theory of the case does not supply that critically missing fact.

Finally, in a last-ditch effort to arrogate to himself the rights of a million individuals to assert direct claims on their own behalf, the Trustee finally argues that granting the Victim-Participants standing to recover the Participant-to-Participant Payments would be inconsistent with the Court’s *Supplemental Order Respecting Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* [Docket No. 687] (the “Ponzi Scheme Order”).⁴ As the Court no doubt remembers from the prior extensive presentations on this very issue, the Ponzi Scheme Order has no bearing on the issue in this case: it addresses only the *distribution* of funds, not which party has the right to *recover* funds.

In support of this Response, the PIEC incorporates the facts set forth in the *Memorandum in Support of PIEC’s Motion for Summary Judgment* [Docket No. 41] and *Local Bankruptcy*

⁴ The Ponzi Scheme Order is attached to the Trustee SUF as Exhibit E.

Rule 7056-11 Statement of Undisputed Material Facts in Support of PIEC's Motion for Summary Judgment [Docket No. 40] (the "PIEC SUF"). As there are no material facts in dispute, granting summary judgment in favor of the PIEC is appropriate.

ARGUMENT

The Trustee does not dispute that TelexFree never had actual possession of the Participant-to-Participant Payments, or that under Caplin the Trustee may not sue the non-debtor Promoter-Participants to recover Participant-to-Participant Payments on behalf of Victim-Participants in their capacity as TelexFree's creditors. Caplin, 406 U.S. at 428 (trustee under Chapter X of the Bankruptcy Act did not have standing to sue indenture trustee on behalf of holders of debentures issued by debtor); see In re Ozark Rest. Equip. Co., 816 F.2d 1222 (8th Cir. 1987) (Congress, in enacting the Bankruptcy Code in 1978, chose not to overrule Caplin); see also E.F. Hutton & Co. v. Hadley, 901 F.2d 979 (11th Cir. 1990); Williams v. California 1st Bank, 859 F.2d 664 (9th Cir. 1988) (trustee lacked authority to sue on behalf of debtor's creditors).

The Trustee seeks to side-step Caplin by arguing that the Promoter-Participants received the Participant-to-Participant Payments as agents of TelexFree, and that TelexFree therefore had possession of, and a legal right to, these payments, or at least something close enough to that to escape its reach. To the contrary, the Victim-Participants paid money directly to Promoter-Participants, this money was never transferred from the possession of the Promoter-Participants to the possession of TelexFree, and Victims received nothing of value from TelexFree. See PIEC SUF ¶ 16, Exhibit M ¶¶ 14-18; PIEC SUF ¶ 18, Exhibit N at 54:14-16, Exhibit O at ¶ 69. Granting the relief requested in this Adversary Proceeding would amount to an impermissible

expansion of agency law and a complete violation of the rights of individual Victim-Participants who suffered injury at the hands of the Promoter-Participants.

I. The Promoter-Participants Were Not Agents of TelexFree and Caplin Does Not Authorize the Trustee to Recover the Participant-to-Participant Payments.

The Trustee had neither *possession* of nor a *legal right* to the Participant-to-Participant Payments and is therefore not authorized to recover these payments on behalf of Victim-Participants under Caplin. Furthermore, the Promoter Contracts were unenforceable as part of TelexFree's fraudulent scheme, and did not give TelexFree a legal right to the Participant-to-Participant Payments. Further, and even if the Trustee could demonstrate the enforceability of the Promoter Contracts, these contracts by their terms do not create an agency relationship between TelexFree and the Promoters or imbue the Trustee with standing to recover the Participant-to-Participant Payments.

A. TelexFree, and therefore the Trustee, never had possession of or an enforceable legal right to the Participant-to-Participant Payments.

Conceding as he must that TelexFree never had actual possession of the Participant-to-Participants Payments which in fact were transferred directly from Victim-Participants to Promoter-Participants, the Trustee now attempts to generate possession by invoking the concept of "agency." He argues that the Promoter-Participants collected the Participant-to-Participant Payments on behalf of TelexFree, such that TelexFree had legal title to the money. In the Trustee's version of agency, the contract between TelexFree and the Promoter-Participants created "legal title" to the Participant-to-Participant Payments, which, he argues, is the equivalent of possession. However, the Trustee cites no support for this use of agency law and his belated agency arguments do not and cannot overcome the Trustee's lack of possession of the Participant-to-Participant Payments.

The Trustee argues that it was *as if* the Participant-to-Participant Payments were paid to TelexFree, based on the Promoter Contracts between TelexFree and the Promoter-Participants. The Promoter Contracts, however, were part and parcel of TelexFree’s fraudulent scheme and, therefore, unenforceable as a matter of law. See, e.g., Manta Mgmt. Corp. v. City of San Bernadino, 44 Cal. Rptr. 3d 35, 48 (Cal. Ct. App. 2006) (stating that company “is not entitled to recover any portion of its profits that were generated by illegal activity”), rev’d on other grounds, 181 P.3d 159 (Cal. 2008); Wilson v. HSBC Mortg. Servs., Inc., 744 F.3d 1, 9-10 (1st Cir. 2014) (agreements induced by fraudulent misrepresentation are voidable); Berwind Prop. Grp. Inc. v. Envtl. Mgmt. Grp., Inc., Civil Action No. 04-11411-NMG, 2007 WL 4707647, at *3 (D. Mass. Feb. 5, 2007) (same); see also W. Capital Partners, LLC v. Allegiance Tit. & Escrow, Inc., 520 F. Supp. 2d 777, 781 (E.D. Va. 2007) (“When a party’s assent to a contract is obtained by fraud, the contract is voidable.”). The Trustee cannot recast the illegal contracts with the Promoter-Participants, which could not create legal title, into a legitimate, legal relationship by arguing that there was an “agency” relationship between Promoters and TelexFree.

The Participant-to-Participant Payments were made by individual Victims to non-debtor third parties. TelexFree had no right to enforce these fraudulent contracts and compel the Promoters to turn over the Participant-to-Participant Payments. Therefore, even if the Promoter Contracts created an agency relationship, as the successor to TelexFree, the Trustee would still have no legal right to the cash transferred by Victims as Participant-to-Participant Payments. See Sender v. Buchanan (In re Hedged-Invs. Assocs., Inc.), 84 F.3d 1281, 1284-85 (10th Cir. 1996) (concluding that no exception in the Bankruptcy Code allowed chapter 7 trustee to take “greater rights than the debtor himself had” in a Ponzi scheme).

Furthermore, even assuming that each Promoter-Participant acted as an agent of TelexFree and was obligated to turn over money received from Victims, the doctrine of *in pari delicto* would nonetheless bar the Trustee from bringing a claim against those Promoter-Participants. See Shearman Lehman Hutton, Inc. v. Wagoner, 944 F.2d 114, 118 (2d Cir. 1991) (“[W]hen a bankrupt corporation has joined with a third party in defrauding its creditors, the trustee cannot recover against the third party for the damage to the creditors.”); Picard v. JPMorgan Chase & Co. (In re Bernard L. Madoff Invs. Secs. LLC), 721 F.3d 54, 63 (2d Cir. 2013) (“Picard I”) (trustee appointed in Madoff Ponzi scheme could not bring claims of creditors against third parties for unjust enrichment, breach of fiduciary duty, aiding and abetting fraud and negligence, among others, because, “the doctrine of *in pari delicto* bar[s] a debtor from suing third parties for a fraud in which he participated”). If the Promoter Contracts created an agency relationship, they did so only in the context of a fraudulent scheme. The Trustee therefore cannot now, and TelexFree never attempted to, enforce these Contracts to recover the Participant-to-Participant Payments.

Finally, even after a year of briefing and argument on these issues, the Trustee remains unable to cite to a single case in support of his analogy to leveraged buyouts (in which transfers of property are collapsed into a single transaction where the debtor *possessed* and had a *legal right* to the property). It also cannot escape the Court that the Trustee tellingly did not plead agency in his Complaint. Rather, still finding no case law support of any type, the Trustee now grasps at this “agency” argument solely because his original collapsing theory was exposed as untenable in the PIEC Opening Brief. It remains the case, simply but powerfully, that when a party defrauds another of his property, title acquired by the fraudster over that property is never more than “possessory title”; that is, because the transfer is the product of fraud, only actual

possession of the ill-gotten property can convey any sort of property interest. This fundamental principle of law continues to stand squarely in the path the Trustee tries to find to block victims from their proper exercise of their own rights of recovery.

B. The Promoter Contracts do not create an agency relationship between the Promoter-Participants and TelexFree.

Even if the Court ignores the complete bar imposed on the Trustee in this case by the doctrine of *in pari delicto*, the Promoter Contracts themselves make clear that there was no agency relationship between the Promoter-Participants and TelexFree in any event. Under agency law, an agent must: (i) act on behalf of and for the benefit of the principal; (ii) be subject to the principal's control; and (iii) have the authority to bind the principal. See Theos & Sons, Inc. v. Mack Trucks, Inc., 431 Mass. 736, 742 (Mass. 2000) (“[a]n agency relationship is created where there is mutual consent, express or implied, that the agent is to act on behalf of and for the benefit of the principal, and subject to the principal's control”); Motorsport Engineering, Inc. v. Maserati SPA, 316 F.3d 26, 29-30 (1st Cir. 2002) (“[a]n agent is simply someone who is authorized by the principal to act on the principal's behalf and bind the principal as if the latter were there himself”); Restatement (Second) of Agency § 14 (“A principal has the right to control the conduct of the agent with respect to matters entrusted to him.”).

The Promoter Contracts nowhere say, and the Trustee fails to cite to any provision, that the Participant-to-Participant Payments are being collected by Promoter-Participants “on behalf of” or “for the benefit of” TelexFree. The Trustee merely argues that the Promoter Contracts “expressly authorize the use of a Promoter's credits to satisfy the invoice of the new recruits.” [Docket No. 51] at 15. In fact, the Promoter Contracts explicitly state that the Promoters are not employees of TelexFree, not subject to the control of TelexFree, and not authorized to act in the name of TelexFree. For example, under Section 2.4.1, “PROMOTERS do not have employment

relationship, inasmuch as their working regimen is autonomous, free of any imposition of routines, goals or regulation, and there is no hierarchical relationship or geographic area, and must, however, diligently seek to preserve the good name, image and brand of TELEXFREE.” And, under Section 2.4.3, “[t]he PROMOTER is expressly notified that it is prohibited for him to present himself as acting in the name of TELEXFREE in relation to public or private institutions, nor is he authorized to make purchases or sign commitments or obligations on behalf of TELEXFREE, YMPACTUS.” Once again, the facts here provide no help to the Trustee.

These provisions do though make clear that the Promoter Contracts do not create an agency relationship between TelexFree and the Promoter-Participants. The Promoter-Participants were not “acting in the name of TELEXFREE.” TelexFree seemingly took pains to ensure that the Promoter-Participants were acting autonomously and unable to legally bind TelexFree to any obligations to third parties. In contrast to the facts here, an agency relationship requires the agent be subject to the principal’s control. This is not established by the Promoter Contracts.

Over the course of the TelexFree scheme, billions of dollars were transferred as Participant-to-Participant Payments. The great bulk of these dollars were never turned over to TelexFree. Nonetheless, the Trustee claims that these billions of dollars were collected by Promoter-Participants on behalf of and for the benefit of TelexFree. In reality, TelexFree never tried to enforce its “rights” to funds collected by Promoter-Participants and never received, possessed or controlled these funds. Given the billions of dollars at stake, it’s ludicrous to suggest that the Promoter-Participants collected these funds as agents of TelexFree.

II. The Trustee Has No Authority to Sue Third Parties on Behalf of Creditors Suffering Particularized Injury.

As noted above, and as mandated by the Supreme Court in Caplin, only the Victim-Participants have standing to recover the Participant-to-Participant Payments because each

Victim-Participant suffered direct harm at the hands of, and has an independent claim against, the one or more Promoter-Participants to whom he or she made payments. The Trustee next tries to escape the dictates of Caplin by arguing that the Victim-Participants do not have standing to recover those Payments because they did not suffer a particularized harm. In support of his argument, the Trustee cites to three decisions. However, and showing how far the Trustee has to reach here to find some way around Caplin, in EACH of those three cases all payments were made directly to fraudulent schemer. See Ritchie Capital Mgmt., LLC v. Gen. Elec. Capital Corp., 821 F.3d 349 (2d Cir. 2016) (no particularized harm where creditors made all payments directly to schemer, but sought to recover funds from third party based on third party's payment to schemer); In re Barkany, 542 B.R. 662 (E.D.N.Y. 2015) (no particularized harm where there were two related investment schemes and each had different victims, but the investment schemes were conducted by same individual and all payments were made to same individual); Meoli v. The Huntington Nat'l Bank (In re Teleservices Grp., Inc.), 463 B.R. 28 (W.D. Mich. 2012) (no particularized harm where only transfer at issue was direct transfer to debtor with respect to which trustee had standing to bring fraudulent transfer claim).

The facts of these cases stand in stark contrast to the facts here: Victims made payments directly to individual Promoter-Participants, the funds so transferred were never possessed by TelexFree or commingled with TelexFree's other funds, and the payment of these funds did not result in any diminishment of TelexFree's estate. See PIEC SUF ¶ 16, Exhibit M ¶¶ 14-18; PIEC SUF ¶ 18, Exhibit N at 54:14-16, Exhibit O at ¶ 69. In each of the cases cited by the Trustee, the court found that the individual creditors had not suffered particularized harm. But, in each of these cases, the creditors sought to recover money that had been paid directly to the schemer and

then transferred out to a third party. (Of course, the PIEC has never attempted to reach transfers of whatever cash was at some point in the possession of TelexFree.)

In another far reach, The Trustee next mischaracterizes the holdings of a trio of decisions coming out of the Madoff Ponzi scheme. The Trustee suggests that, under these decisions, payments made by creditors to non-debtor third parties somehow constitute harm to the debtor, such that the creditors suffered merely non-particularized, secondary harms. These decisions, however, make clear that non-particularized injuries are only those injuries that have some effect on the debtor's estate.

The Trustee first cites to Marshall v. Picard (In re Bernard L. Madoff Invs. Secs. LLC), 740 F.3d 81 (2d Cir. 2014) ("Picard II"). The creditors in Picard II sought to sue Madoff's co-conspirators to recover funds that those defendants had improperly withdrawn from the debtors' possession. Id. at 85. There, the court concluded that the creditors' claims against third party co-conspirators were not particularized because the claimed damages were "mere secondary harms flowing from the [] defendants' fraudulent withdrawals and the resulting depletion of BLMIS funds." Id. at 92. Here, in contrast, the Victim-Participants seek to recover funds paid directly to the Promoter-Participants in the form of Participant-to-Participant Payments that had no impact on TelexFree's estate. See PIEC SUF ¶ 16, Exhibit M at ¶¶ 17-18; PIEC SUF ¶ 18, Exhibit N at ¶ 54:14-16, Exhibit O at ¶ 69.

Second, the Trustee cites to The Lautenberg Foundation v. Picard (In re Bernard L. Madoff Inv. Secs., LLC), 512 Fed. Appx. 18 (2d Cir. 2013) ("Picard III"), in which the Second Circuit enjoined creditors' claims against employees of the Madoff scheme. As the lower court made clear, the creditors "assert[ed] violations of duties owed derivatively to all customers and creditors by virtue of the Madoff Defendants' positions generally at BLMIS, the breach of which

resulted in losses to all Madoff victims.” Secs. Inv. Protection Corp. v. Bernard L. Madoff Inv. Secs. LLC, 443 B.R. 295, 312 (S.D.N.Y. 2011), aff’d 512 Fed. Appx. 18 (2d Cir. 2013). Unlike the Picard III creditors, the harm suffered by the Victim-Participants did not result in a loss to all TelexFree Victims because TelexFree’s estate suffered no diminution in value as a result of the Participant-to-Participant Payments or the issuance of valueless “credits” to Victims or Promoters. See PIEC SUF ¶ 18, Exhibit N at 54:14-16, Exhibit O at ¶ 69.

Finally, the Trustee cites to Picard v. Fairfield Greenwich Ltd., 762 F.3d 199 (2d Cir. 2014) (“Picard IV”). In Picard IV, the Second Circuit addressed the right of the Madoff Ponzi scheme victims to bring breach of fiduciary duty and other claims against brokerage companies that invested the victims’ assets with Madoff. The court concluded that these victims had the right to bring their own claims, because:

- the victims’ complaints were not contingent on the debtors’ wrongful transfer of funds;
- the non-debtor third-party defendants owed independent duties to their customers;
- the defendants’ liability to the customer-victims was not dependent on Madoff’s liability to investors;
- the claims against the defendants were independent of claims against Madoff; and
- the claims were not dependent on funds wrongfully transferred by the debtors to the non-debtor third parties.

See id. at 209-10. Here, the Victims’ claims against TelexFree are likewise separate and distinct from their claims against the Promoter-Participants and do not depend on a determination of TelexFree’s liability to Victims. And, the Victims’ claims are not dependent on transfers of any property whatsoever from the Debtors to the Promoter-Participants. Like the creditors’ claims in Picard IV, the unjust enrichment claims brought by the Victim-Participants are grounded on a

particularized harm suffered by these claimants at the hands of third parties. It seems clear that the Madoff courts, including the Second Circuit, would have easily disposed of the Trustee's arguments here for all of the same reasons. And, there is no law, found by the PIEC or cited by the Trustee, to the contrary.

Based on the foregoing, the Trustee has failed to refute that the Victim-Participants' claims to recover Participant-to-Participant Payments are particularized as to them, the Victim-Participants are "exclusively entitled" to pursue these claims, and "the bankruptcy trustee is precluded from doing so." Picard IV at 211.

III. The Ponzi Scheme Order Does Not Grant the Trustee Authority to Sue to Recover Participant-to-Participant Payments.

The Trustee finally argues that the Court, through the Ponzi Scheme Order, has already in effect decided the critical questions at issue in this case: whether the Participant-to-Participant Payments constitute property of the Debtors' estate and, relatedly, whether the Trustee has authority to sue to recover Participant-to-Participant Payments. The Trustee suggests that the Ponzi Scheme Order creates standing where none otherwise exists. In reality, that Order has no bearing on this dispute. The Court in fact declined to enter a finding requested by the Trustee that the Participant-to-Participant Payments constituted property of the estate. On January 19, 2016, the Trustee filed the *Proposed Supplemental Order Respecting Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* (the "Proposed Supplemental Ponzi Order"). See Exhibit A to *Memorandum in Support of Proposed Supplemental Order Respecting Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* [Docket No. 677], Case No. 14-40987.⁵ In the Proposed Supplemental Ponzi Order, the Trustee requested a

⁵ A true and accurate copy is attached hereto as **Exhibit A**.

finding that “The payment made by a recruited Participant in a Triangular Transaction is a transfer of property of the Debtors’ Estates and should be included in the calculation of Net Equity.” Proposed Supplemental Ponzi Order, at ¶ 5(ii). The Court, however, declined to enter this finding as part of the Ponzi Scheme Order. The Ponzi Scheme Order only provides that claims in the Chapter 11 case shall be determined on a “Net Equity” basis. It does not address whether the Participant-to-Participant Payments are property of the estate or which party has the right to pursue which claims or to recover funds from “Net Winners” in the TelexFree scheme.

In addition, the Trustee presupposes that all Victims will elect to file claims in the bankruptcy case. Yet, many Victims, for whatever reasons, may choose not to file claims in the bankruptcy court and to instead sue, individually or as part of a class, to recover the funds they lost on their own behalf. These Victims should not be denied their direct claims to recover on their personal losses because of their decision not to participate in the bankruptcy case.

The Trustee also incorrectly presupposes that all creditors in a bankruptcy case have the same rights as against third parties and will receive equal treatment. But bankruptcy law does not purport to “even out” distributions when some creditors have particularized relief against third parties, such as guarantors, third party tort-feasors, insurers or others. Not all victims of TelexFree’s fraud were in an “equal position” in connection with the fraud. Many Victims will have claims not only against TelexFree, but also against individual Promoter-Participants. See, e.g., Picard IV, 762 F.3d at 21 (“that plaintiffs in both [state court] Actions are creditors of the Madoff estate . . . [is irrelevant as] the plaintiff’s right to enforce duties owed to them in not qualified by the fact that they may also have claims against the Madoff estate”); Picard II, 740 F.3d at 91 (“[T]here is nothing illegal or contradictory about saying that [a third-party defendant] might have inflicted direct injuries on both the [estate’s creditors] and [the debtor estate] might

have inflicted direct injuries on both the [estate's creditors] and [the debtor estate] during the course of dealings that form the backdrop of both sets of claims"" (citation omitted)); United States v. Durham, 86 F.3d 70, 73 (5th Cir. 1996) (court denied return of traceable property where all victims of the fraud were in an equal position). Therefore, the Trustee's argument is without basis.

CONCLUSION

The Trustee has no property interest in the Participant-to-Participant Payments. He cannot demonstrate either *possession* of or a *legal right* to these payments. He has moreover failed to demonstrate that the Promoters acted for the benefit and under control of TelexFree, or were able to legally bind TelexFree, as is necessary to prove an agency relationship. Rather, each Victim-Participant suffered a personal and particularized injury at the hands of one or more Promoter-Participants, without entering into any financial transaction with TelexFree. For these reasons, and the other reasons set forth herein, and in the PIEC Opening Brief, the Victim-Participants are the only legally proper parties to pursue recovery of the Participant-to-Participant Payments. The Court should therefore deny the Trustee's request for summary judgment and grant summary judgment in favor of the PIEC.

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Dated: December 20, 2016

Boston, Massachusetts

BONSIGNORE, PLLC

/s/ Robert J. Bonsignore

Robert J. Bonsignore

NH Bar 21241

3771 Meadowcrest Drive

Las Vegas, Nevada 89121

Telephone: 781-856-7650

rbonsignore@classactions.us

Interim Lead Counsel

BROWN RUDNICK LLP

/s/ William R. Baldiga

William R. Baldiga (BBO #542125)

James W. Stoll (BBO # 544136)

Jill C. Wexler (BBO #691811)

One Financial Center

Boston, MA 02111

Telephone: (617) 856-8200

Facsimile: (617) 856-8201

wbaldiga@brownrudnick.com

jstoll@brownrudnick.com

jwexler@brownrudnick.com

For the Plaintiffs' Interim Executive Committee

CERTIFICATE OF SERVICE

The undersigned certifies that on December 20, 2016, the foregoing document was filed electronically, and therefore was sent by email to those receiving CM/ECF notices from the Court's electronic filing system. I further certify that I have caused to be sent by first class mail a copy to the following parties on this 20th day of December, 2016.

Charles R. Bennett, Jr., Esq.
Murphy & King, Professional Corporation
One Beacon Street
Boston, MA 02108

Richard King, Asst. United States Trustee
Office of the United States Trustee
446 Main Street
14th Floor
Worcester, MA 01608

/s/ William R. Baldiga
William R. Baldiga

EXHIBIT A

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS

In Re:

TELEXFREE, LLC ,
TELEXFREE, INC.,
TELEXFREE FINANCIAL, INC.,

Debtors.

Chapter 11

Case No. 14-40987-MSH

Case No. 14-40988-MSH

Case No. 14-40989-MSH

Jointly Administered

MEMORANDUM IN SUPPORT OF PROPOSED SUPPLEMENTAL ORDER
RESPECTING MOTION BY CHAPTER 11 TRUSTEE FOR ENTRY OF ORDER
FINDING THAT DEBTORS ENGAGED IN PONZI AND
PYRAMID SCHEME AND RELATED RELIEF

To the Honorable Melvin S. Hoffman, Chief United States Bankruptcy Judge:

Stephen B. Darr, the duly appointed Chapter 11 trustee (the "Trustee") of the bankruptcy estates of TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc. (collectively, the "Debtors"), respectfully submits this Memorandum in Support of the Proposed Supplemental Order (the "Supplemental Order") Respecting the *Motion by Chapter 11 Trustee for Entry of Order Finding that Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* (the "Ponzi Motion"). A copy of the proposed Supplemental Order is attached as Exhibit "A" hereto.

PROCEDURAL BACKGROUND

On April 13, 2014 (the "Petition Date"), each of the Debtors filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code ("Bankruptcy Code") with the United States Bankruptcy Court for the District of Nevada ("the Nevada Bankruptcy Court"). The Debtors initially operated as debtors-in-possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code. On the Petition Date, the Debtors filed a motion for joint administration



Prior to the filings, the Commonwealth of Massachusetts, Office of Secretary of State, Securities Division (the “MSD”) commenced an investigation into the Debtors’ business practices. On or about April 15, 2014, the MSD commenced an administrative proceeding against the Debtors. Also on April 15, 2014, the Securities and Exchange Commission (the “SEC”) commenced an action against the Debtors and others in the United States District Court for the District of Massachusetts. The foregoing actions alleged, among other things, that the Debtors were engaged in an illegal Ponzi and pyramid scheme and the fraudulent unregistered offering of securities. Contemporaneously with the commencement of the SEC action, Homeland Securities Investigation (“HSI”) seized the Debtors’ assets, books, and records. In connection therewith, the federal government seized more than \$107,000,000 in cash, including funds on deposit and checks payable to the Debtors, their principals, or their affiliates. Federal authorities have also made forfeiture claims against approximately forty (40) other items of real and personal property standing in the name of the Debtors’ principals and their affiliates, including automobiles, real properties, and notes secured by mortgages on real properties.

2

FACTUAL STATEMENT

The Debtors operated a massive Ponzi and pyramid scheme that involved the sale of membership plans and monthly voice over internet phone packages (“VoIP Package”). A person could become a “Participant” in the Debtors by purchasing a membership plan or VoIP Package. Each time that a Participant purchased a membership plan or VoIP Package, the Debtors established a “User Account” to track the activity of the Participant. There are approximately 11,000,000 User Accounts.

The Debtors provided Participants with two membership plan options, each of which allowed Participants to generate credits totaling up to 200% to 300% of their annual investment merely by posting meaningless internet advertisements. Participants could earn additional credits by selling membership plans. The Debtors also issued credits to Participants for the sale of VoIP Packages, but the revenue generated from the sale of VoIP Packages was insignificant. The overwhelming source of revenue for the Debtors was the membership fees paid by new Participants. Participants had various means to monetize credits; credits could be redeemed by the Participants for cash, or used by Participants to establish other User Accounts for the Participant or someone else.

When a membership plan or VoIP Package was purchased, the Debtor issued an invoice to the Participant. Invoices could be satisfied in one of two ways. A Participant could satisfy the invoice by payment in cash directly to the Debtors (a “Direct Transaction”), or a Participant could satisfy the Debtors’ invoice to them by payment to a recruiting Participant who in turn would pay the invoice by redeeming their accumulated credits, and the Debtors marked the invoice as paid and reduced the recruiting Participant’s credits by a corresponding amount (a

“Triangular Transaction”).¹ Essentially, Participants monetized their accumulated credits by recruiting new Participants through Triangular Transactions. In fact, it was a regular practice of the Debtors and Participants to engage in Triangular Transactions rather than by redeeming credits with the Debtors for cash.

The Ponzi Motion

The Trustee conducted an extensive investigation into the operations of the Debtors’ scheme and Participant involvement therein. As a result of the investigation, the Trustee concluded that the Debtors had engaged in a Ponzi and pyramid scheme.

On or about October 7, 2015, the Trustee filed the Ponzi Motion² and a motion to approve form of notice of the Ponzi Motion (the “Notice Motion”). Pursuant to the Ponzi Motion, the Trustee sought the following relief:

- (i) A finding that the Debtors operated a Ponzi and pyramid scheme;
- (ii) An order that any claim or portion of claim of Participants based upon accumulated credits in Participants’ User Accounts as of the Petition Date should be disallowed, and that the amount of claims should be determined on a "Net Equity" basis as described herein;

¹ A Participant could also open new User Accounts for himself/herself and engage in a Triangular Transaction where the Participant owned both the existing User Account and the new User Account. In these intra-Participant transactions, obviously no funds were exchanged, and the Participant was acquiring additional membership plans with accumulated credits in order to enhance opportunities for compensation.

² Simultaneously with the filing of the Ponzi Motion, the Trustee also filed his *Motion by Chapter 11 Trustee for Entry of Order Fixing Bar Date for Filing Proofs of Claim, Approving Form and Manner of Notice, Directing that Claims be Filed Electronically, and Approving Content of Electronic Proofs of Claim* (the “Bar Date Motion”). Pursuant thereto, the Trustee sought, among other things, approval for the electronic noticing of a Bar Date, the content of electronic proofs of claim, and the internet portal to be used in the claims process.

- (iii) An order that the Debtors should be held jointly and severally liable for the claims of Participants; and
- (iv) An order that the findings made pursuant to the Ponzi Motion should be applicable throughout these proceedings, for all purposes.

The Notice Motion was approved at a hearing held on October 14, 2015, and the Trustee provided notice of the Ponzi Motion on or about October 19, 2015. Objections to the Ponzi Motion were filed by the Plaintiffs' Interim Executive Committee (the "PIEC") in the class action complaint pending in the United States District Court and by the Debtors' principals. An evidentiary hearing on the Ponzi Motion was held on November 24, 2015. On November 25, 2015, the Court entered an order, as amended by order dated December 21, 2015, finding that the Debtors operated a Ponzi and pyramid scheme and that this finding was the law of the case. The Court also found that the Debtors were jointly and severally liable for the claims of the Participants and that this finding was also the law of the case. The Court continued until January 26, 2016 the hearing on the Trustee's request that the claims of Participants be determined based upon the "Net Equity" method and issues associated with such a ruling. The Court further directed that the Trustee provide supplemental notice to Participants of the relief requested and of the continued hearing, which was effected by the Trustee on or about December 7, 2015.

ARGUMENT

The Ponzi Motion and the PIEC's opposition raise the following issues: (i) whether credits earned by Participants should be disallowed in determining the amount of Participant claims; (ii) whether the Net Equity standard is the appropriate method for determining the amount of Participant claims, including whether the Triangular Transactions should be included

therein; and (iii) whether the additional relief sought in the Ponzi Motion may be granted without the commencement of an adversary proceeding.

I. Credits should be disallowed.

It is universally accepted that fictitious profits, or credits, “earned” during an investor’s involvement in a Ponzi and pyramid scheme are not components that should be considered in determining the amount of a participant’s claim. *See In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229, 241-42 (2d Cir. 2011); *Donell v. Kowell*, 533 F.3d 762, 772 (9th Cir. 2008); *SIPC v. BLMIS*, 499 B.R. 416, 424-29 (S.D.N.Y. 2013) (“*BLMIS I*”); compare *In re Churchill Mortgage Inv. Corp.*, 256 B.R. 664, 682 (Bankr. S.D.N.Y. 2000); *In re First Commercial Mgmt Grp.*, 279 B.R. 230, 232 (Bankr. N.D. Ill. 2002); with *In re Bayou Grp.*, 362 B.R. 624, 637-38 (Bankr. S.D.N.Y. 2007) (“*Bayou I*”); *In re Randy*, 189 B.R. 425, 441 (Bankr. N.D. Ill. 1995); *In re Int’l Loan Network, Inc.*, 160 B.R. 1, 12 (Bankr. D.D.C. 1993); see also *Janvey v. Golf Channel, Inc.*, 780 F.3d 641 (5th Cir. 2015) (vacated and certified to the Supreme Court of Texas on this issue, *Janvey v. Golf Channel, Inc.*, 792 F.3d 539 (5th Cir. 2015), *certified question accepted* (July 17, 2015)); *Janvey v. Alguire*, 2013 WL 2451738 at *9 (N.D. Tex. Jan. 22, 2013); *SEC v. Bernard L. Madoff Investment Securities, LLC (In re Madoff)*, 522 B.R. 41, 47 (Bankr. S.D.N.Y. 2014) (“*BLMIS II*”); *In re Taubman*, 160 B.R. 964, 980 (Bankr. S.D. Ohio 1993); *In re Bayou Grp., LLC*, 439 B.R. 284, 309 (S.D.N.Y. 2010) (“*Bayou II*”). Recovery based upon such amounts may be prejudicial to other investors in the scheme. *BLMIS I* at 427-29; *BLMIS II* at 47; *Scholes v. Lehmann*, 56 F.3d 750, 757 (7th Cir. 1995).

In the present cases, the accumulated credits issued to Participants for activities such as posting advertisements are equivalent to the fictitious profits promised in Ponzi schemes. The Participants were guaranteed an astronomical return by merely purchasing a membership plan

The accumulated credits based on the recruitment of later Participants should also be disallowed because the recruitment activity only contributed to and perpetuated the Debtors' scheme and provided no value to the Debtors' estates. 11 U.S.C. § 502(b)(1); *See In re Vaughan Co. Realtors*, 500 B.R. 778, 794 (Bankr. D.N.M. 2013); *Warfield v. Byron*, 436 F.3d 551, 560 (5th Cir. 2006); *In re Taubman*, 160 B.R. at 980; *Janvey*, 2013 WL 2451738 at *9; *Randy*, 189 B.R. at 441; *In re Independent Clearing House Co.*, 77 B.R. 843, 857 (Bankr. D. Utah 1987). Because the Debtors received no value for the accumulated credits, claims based on such credits should be disallowed. *See 11 U.S.C. §502(b)(1)*; *Independent Clearing House*, 77 B.R. at 857; *Warfield*, 436 F.3d at 560; *Johnson v. Home State Bank*, 501 U.S. 78, 86 (1991); *In re Muller*, 479 B.R. 508, 515 (Bankr. W.D. Ark. 2012).

7

To date, no objection has been filed to the proposed disallowance of credits in the determination of the amount of Participant claims.

II. The amount of claims should be determined on a Net Equity basis taking into consideration the Triangular Transactions.

The Ponzi Motion seeks approval of the use of the Net Equity method in determining the amount of Participant claims in these cases.³ The Net Equity calculation is as follows: the amount invested by a Participant into the Debtors, including amounts paid by the Participant pursuant to the Triangular Transactions, less amounts received by a Participant from the Debtors' scheme, including amounts received by the Participant pursuant to the Triangular Transactions.

In resolving claims and distribution issues in Ponzi and pyramid scheme cases, equitable considerations need to be taken into account to properly address the harms suffered by participants in the scheme. *See Cunningham v. Brown*, 265 U.S. 1, 13, 44 S. Ct. 424, 427, 68 L. Ed. 873 (1924) (all investors in a Ponzi scheme must be treated equally and that "equality is equity and this is the spirit of the bankrupt law"); *In re Young*, 294 F. at 4; *In re Taubman*, 160 B.R. at 980; *Int'l Loan Network*, 160 B.R. at 14; *BLMIS II* at 47. In order to fashion an equitable result, claims in such cases are determined upon a net equity basis, that is, the claim amount is equal to amounts that an investor paid into the scheme, reduced by amounts an investor received from the scheme. *See, e.g., CFTC v. Topworth Int'l Ltd.*, 205 F.3d 1107, 1115-16 (9th Cir. 2000); *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d at 242; *Donell*, 533 F.3d at 772; *In re Tedlock Cattle Co.*, 552 F.2d at 1353; *In re Young*, 294 F. at 4; *BLMIS I* at 427-29; *Janvey*, 2013 WL 2451738 at *9; *Bayou II* at 309; *BLMIS II* at 47; *In re Old Naples Sec., Inc.*, 311 B.R. 607,

³ The calculation of the amount of a Participant's claim using the Net Equity method is without prejudice to the Trustee's right to object to the claim of a Participant who may have had knowledge that the Debtors were engaging in a fraudulent scheme and is therefore not entitled to the claims afforded innocent Participants;

9

The sole objection filed to date to the adoption of the Net Equity methodology was by the PIEC, whereby the PIEC objected to the inclusion of the Triangular Transactions in the Net Equity calculation of a Participant's claims. As discussed above, the failure to include Triangular Transactions would skew the results. Net losers would have no claim, and net winners would further profit from the scheme. Apparently recognizing these inequities, the

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PIEC modified its blanket opposition to the inclusion of Triangular Transactions in the Net Equity calculation for purposes of claim determination. At the December 11, 2015 hearing before the District Court on the Trustee's *Motion to Intervene* to oppose the proposed third amended complaint whereby the PIEC sought to bring a class action against a subset of net winners, the PIEC stated as follows:

The Trustee has also filed in the bankruptcy case a – a series of motions, the Ponzi scheme being one of them, the bar date motion being another, seeking to have the bankruptcy judge issue some guidance as to how proofs of claim are going to be filed in the bankruptcy case and the mechanisms that should guide the parties as to the allowance of those claims. We've not opposed those.

...

Secondly, we do not oppose in the bankruptcy case the calculation that the trustee would use or the – I'm sorry – that the Bankruptcy Court would set for the determination of what is an allowable claim and what is not an allowable claim in the bankruptcy cases. We do not oppose that.

Transcript of hearing on Motion to Intervene, at p. 16:1-9; p. 16:19-23.

While recognizing that the Triangular Transactions should be included in Net Equity for the calculation of claims, the PIEC argued before the District Court that the Triangular Transactions do not involve the Estates or property of the Estates. Therefore, the PIEC asserted that it should be allowed to amend its complaint for the third time to include claims for unjust enrichment based upon the Triangular Transactions. The Trustee argued that the PIEC's position was wrong because the Triangular Transactions involved property of the Estates and the PIEC action would, among other things, constitute a violation of the automatic stay. On December 11, 2015, after a hearing, the District allowed the Trustee's *Motion to Intervene* and on January 15, 2016, the District Court denied the PIEC's motion to amend its existing complaint to add a proposed class action.

The PIEC's assertion that the Estates had no interest or involvement in the Triangular Transactions ignores the substance of the Triangular Transaction and the Debtors' essential role

therein. The recruited Participant purchased a membership plan from the Debtors, and the Debtors sent an invoice to the recruited Participant. The recruited Participant paid the membership fee to the recruiting Participant in exchange for the Debtors issuing a membership plan to the recruited Participant, with the promised guaranteed return for placement of advertisements. The Debtors permitted the recruiting Participant to retain the membership fee and to utilize his/her accumulated credits to satisfy the invoice due from the recruited Participant. If the Debtors had no interest in the funds, there would have been no basis to reduce the recruiting Participant's accumulated credits. Simply put, the Triangular Transactions would not have occurred without the Debtors' extensive involvement.

The substance of a transaction should prevail over its form when determining how the transaction relates to the rights of parties in a bankruptcy case. *See, e.g., In re PCH Assocs.*, 949 F.2d 585, 597 (2d Cir. 1991) (*citing Pepper v. Litton*, 308 U.S. 295, 304 (1939)); *In re Adelphia Communications Corp.*, 512 B.R. 447 (Bankr. S.D.N.Y. 2014)(series of transactions may be treated as single transaction when it appears that, despite formal structure erected and labels attached, the segments comprise a single integrated scheme when considering knowledge and intent of parties involved in transaction). A review of the substantive nature of the Triangular Transactions compels the conclusion that such transactions involved transfers of property of the bankruptcy estates.

The collapsing of transactions into an integrated transaction has been employed by the courts in varying contexts to reflect the substantive nature of a series of related transactions. In the case of leveraged buyouts, payments made by an acquirer to selling shareholders are considered to be transfers of estate property even though the funds were paid by the stock purchaser and not the debtor. *See, e.g., In re Chas P. Young Company*, 145 B.R. 131 (Bankr.

S.D.N.Y. 1992); *In re OODC, LLC*, 321 B.R. 128 (Bankr. D. Del. 2005); *United States v. Tabor Court*, 803 F.2d 1288 (3rd Cir. 1986) (*cert. den. McClellan Realty Co. v. United States*, 483 U.S. 1005 (1987)); *Wieboldt Stores v. Schottenstein*, 94 B.R. 488 (N.D. Ill. 1988); *In re O'Day Corporation*, 126 B.R. 370 (Bankr. D. Mass. 1991); *In re Jevic Holding Corp.*, 2011 WL 4345204 (Bankr. D. Del. Sept. 15, 2011). Similarly, payments made by a purchaser of a debtor's assets to certain of the debtor's creditors are considered to be transfers of estate property even though the funds were paid by the asset purchaser and not the debtor. *See, e.g., Warsco v. Preferred Technical Group*, 258 F.3d 557, 568-69 (7th Cir. 2001); *In re Food Catering & Housing, Inc.*, 971 F.2d 396 (9th Cir. 1992).

The same rationale applies for collapsing the components of the Triangular Transaction to reflect the economic realities of the Debtors' scheme. In effect, the recruited Participant paid the Debtors for the purchase of a membership plan or VoIP Package. The Debtors, in turn, distributed the invoice amount to the recruiting Participant in exchange for a reduction in the recruiting Participant's accumulated credits. Attached as Exhibit "B" is a schematic of the Triangular Transaction as it occurred; Exhibit "C" is a schematic of the Triangular Transaction after it has been characterized to reflect the economic substance of the transaction. The Net Equity formulation recognizes the claim of the paying Participant in the Triangular Transaction even though the funds were not directly received by the Debtors. The Debtors became obligated to the recruited Participant under the membership plan and issued credits and payments to that Participant. The PIEC acknowledges that the recruited Participant should have a claim against the Estates, a result which can only be justified if the payment made by the recruited Participant is considered a payment into the Debtors that is appropriately included under the classic Ponzi claim formulation.

III. There is no need for an adversary proceeding to determine the relief sought in the Ponzi Motion.

⁵ On January 15, 2016, the Trustee commenced two class action proceedings against net winners in the Debtors' Ponzi scheme, one action against net winners residing in the United States (A.P. no. 16-4006) and one against net winners residing outside of the United States (A.P. no. 16-4007).

notification forms filed with the Federal Bureau of Investigation through September 30, 2015. A copy of the Ponzi Motion was posted on the website operated by the Trustee's claims agent, Kurtzman Carson Consultants ("KCC"), in English immediately after it was filed. Spanish and Portuguese translations of the Ponzi Motion were posted on KCC's website on or about October 24, 2015.

At the conclusion of the evidentiary hearing, the Court directed the Trustee to provide supplemental notice of the remaining relief sought in the Ponzi Motion. The Trustee filed and served a supplemental notice detailing the additional relief respecting the use of the Net Equity method to determine claim amounts and the continued hearing date. The supplemental notice was served on or about December 7, 2015 in the same manner as the initial Ponzi Motion notice, as set forth in the preceding paragraph.

At this point, all parties-in-interest have been notified, twice, over a period of approximately 90 days, of the Ponzi Motion and the relief sought. Given the extent of notice already provided, no point would be served, and no notions of due process would be furthered, by requiring the Trustee to start again and institute an adversary proceeding for the balance of the relief sought, including providing notice yet again to Participants. An adversary proceeding would burden the Estates with substantial costs and delays and prevent the timely rollout of the electronic proof of claim ("ePOC") and claims filing and determination process. The design of the ePOC and the web portal require that there be a determination of the components of Participants' claims. For example, if credits are to be excluded from the computation of claim amounts, the ePOC and web portal need not contain or disclose this data. Similarly, if Triangular Transactions were to be excluded as components of a claim, this data would be unnecessary. Otherwise, the ePOC would serve as little more than a data dump, and the cost to

the Estates of having to sift through countless claims lacking any uniformity, and to potentially having to object afterwards to tens or hundreds of thousands of proofs of claim, would be a poor use of the Estates' limited resources. Both the Ponzi Motion and Bar Date Motion are scheduled for hearing on January 26, 2016 and are ripe for adjudication.

To require an adversary proceeding to obtain the relief requested in the Ponzi Motion, as suggested by the PIEC, would truly be an elevation of form over substance. All interested parties have had adequate notice of the requested relief, an opportunity to register objections and the right to be heard. The relief sought and the basis for such relief have been clearly articulated. There are no material facts in dispute. The relief is amply supported by the evidence, and the Trustee has provided evidentiary support for the Ponzi Motion.⁶

Under these circumstances, there is no need for an adversary proceeding, as there is no substantive difference in the process afforded. *See In re Reitter Corporation*, 449 B.R. 641 (Bankr. D. Puerto Rico 2011); *In re Sameer Lakhany*, 538 B.R. 555 (9th Cir. BAP 2015); *In re Ballard*, 502 B.R. 311 (Bankr. S.D. Ohio 2013); *In re Vance*, 120 B.R. 181, 192 (Bankr. N.D. Okla. 1990). In other Ponzi scheme bankruptcy cases, the Net Equity determination has been sought and obtained by motion. *See, e.g., BLMIS I*, 424-29; *In re Pearlman*, 484 B.R. 241 (Bankr. M.D. Fla. 2012).

Based upon the foregoing and the Ponzi Motion, the Trustee requests that the Court enter the order attached as Exhibit "A" hereto and that the Trustee be granted such other relief as is appropriate.

⁶ The PIEC also argued that a determination of the methodology for claims allowance is procedurally premature. This assertion is similarly without merit. The Court has the authority to make rulings in advance that will streamline or facilitate the claims filing and resolution process. *In re Young*, 294 F. at 4. This is particularly so in cases involving a complex Ponzi and pyramid scheme with as many as 1,900,000 Participants.

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EXHIBIT A

In Re:

Debtors.

Jointly Administered

ORDER

(i) In determining the amount of claims of Participants,¹ any claim or portion of claim based upon accumulated credits in a Participants' User Accounts as of the Petition Date shall be disallowed;

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- (ii) The payment made by a recruited Participant to a recruiting Participant in a Triangular Transaction is a transfer of property of the Debtors' Estates, and should be included in the calculation of Net Equity;
- (iii) The claims amounts of Participants shall be determined on a Net Equity basis, which shall be defined as follows: the amount invested by the Participant into the Debtors' scheme, including amounts paid pursuant to Triangular Transactions, less amounts received by the Participant from the Debtors' scheme, including amounts received pursuant to Triangular Transactions.
- (iv) In determining the amount of a claim of a Participant who has more than one User Account, the activity in all of the Participants' User Accounts shall be aggregated and netted against one another;
- (v) The calculation of a Participant's claim using the Net Equity basis is without prejudice to the Trustee's right to object to the claim of a Participant who had knowledge that the Debtors were engaging in a fraudulent scheme and is therefore not entitled to the claims afforded innocent Participants;
- (vi) The relief granted herein is appropriately made by motion and does not require the institution of an adversary proceeding; and
- (vii) The foregoing findings and conclusions shall be applicable for all purposes in these proceedings.

Dated: _____, 2016
695605

Honorable Melvin S. Hoffman
Chief United States Bankruptcy Judge

EXHIBIT B

STRUCTURE OF TRIANGULAR TRANSACTION

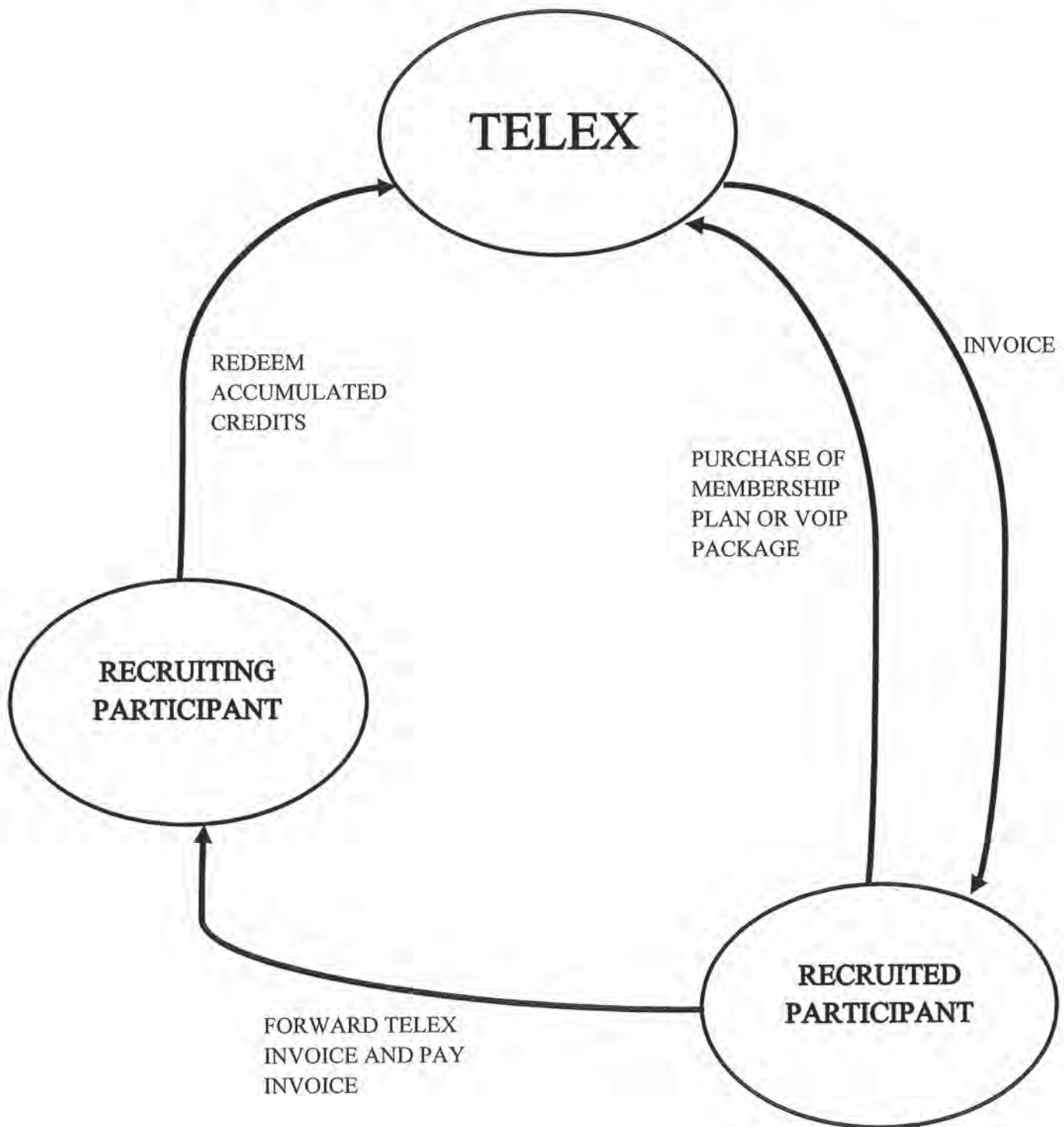


EXHIBIT C

SUBSTANTIVE CHARACTERIZATION OF TRIANGULAR TRANSACTION

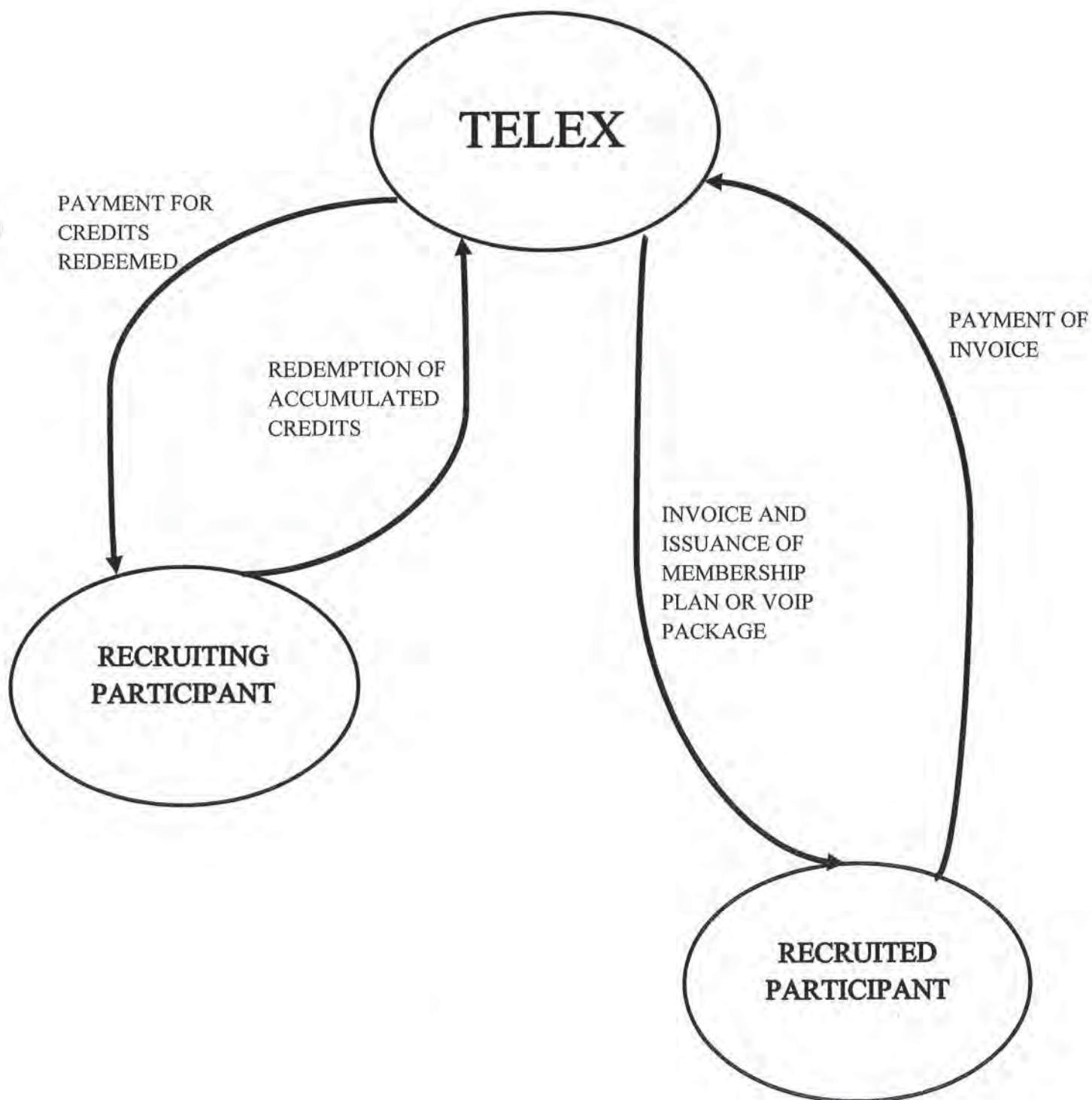


EXHIBIT 9

1 **APPEARANCES:**

2 For Stephen Darr,
3 Chapter 11 Trustee:

Murphy & King, P.C.
BY: CHARLES BENNETT, JR., ESQ.
ANDREW G. LIZOTTE, ESQ.
HAROLD B. MURPHY, ESQ.
One Beacon Street, 21st Floor
Boston, MA 02108

5 For the Plaintiffs'
6 Interim Executive Committee:

Brown Rudnick LLP
BY: WILLIAM R. BALDIGA, ESQ.
KELLIE W. FISHER, ESQ.
One Financial Center
Boston, MA 02111

8
9 **ALSO PRESENT:**

10 STEPHEN DARR
11 Chapter 11 Trustee
12 265 Franklin Street
13 Boston, MA 02210
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P R O C E E D I N G S

THE COURT: Morning, everyone. Be seated, please.

MR. BENNETT: Good morning.

MR. LIZOTTE: Morning, Your Honor.

THE COURTROOM DEPUTY: Calling Adversary Proceeding
15-4055, Darr v. Dos Santos, Individually and as Putative Class
Rep.

Will the parties please identify themselves for the
record?

MR. BALDIGA: Good morning, Your Honor. William
Baldiga. With me, my colleague, Kellie Fisher, Brown Rudnick,
for the PIEC in Dos Santos. Thank you.

MR. BENNETT: Morning, Your Honor. Charles Bennett on
behalf of Mr. Darr as the chapter 11 trustee of the debtors.
With me is Mr. Lizotte and Mr. Murphy. And Mr. Darr is also
present in the courtroom.

THE COURT: Okay. We have cross-motions for summary
judgment on for this morning. I will ask the parties if they
have a preference for an order of how to proceed?

(No response)

MR. BALDIGA: We agree on one thing, Your Honor.
That's good.

THE COURT: Well, let's see if we can agree on one
other thing, Mr. Baldiga. So you're going to present on the
defendants' motion for summary judgment?

1 MR. BALDIGA: Yes.

2 THE COURT: Before we start, tell me if I'm wrong.

3 This, this adversary -- the reference in this adversary
4 proceeding has been withdrawn by the District Court and then
5 sent back to me for determination of all pre-trial matters and
6 hearing dispositive motions and, which we are doing this
7 morning, and then my job is to render proposed findings and
8 rulings on the, on the dispositive motions to the District
9 Court?

10 MR. BALDIGA: That's the way I read Judge Hillman's
11 order, yes.

12 THE COURT: Mr. Bennett?

13 MR. BENNETT: I agree, Your Honor.

14 THE COURT: Okay, good.

15 Then let's proceed.

16 MR. BALDIGA: Thank you.

17 Again for the record, William Baldiga for Dos Santos
18 and the PIEC.

19 Your Honor, you've heard many of the arguments here
20 before in, in similar contexts not on motions for summary
21 judgment, but the, the issues here are not, are not newly
22 before you. But they have now been fully grieved. As you, as
23 you noted, there are cross-motions for summary judgment.

24 I'll start, Your Honor, to, to just say that what the
25 trustee is asking this Court to do in this context here is

1 something that would be completely without precedent and there
2 is no precedent cited. It would fly in the face of the Supreme
3 Court's Kaplan decision, which itself did not create new law,
4 but has been, certainly, the law throughout the country,
5 obviously, for more than 40 years, which is that creditors have
6 standing to bring their own lawsuits. It would be totally
7 inconsistent with the dozens of other decisions published in
8 all the Ponzi scheme cases, including, but not limited to,
9 Madoff, Madoff being important just because there have been
10 published decisions on so many aspects of Ponzi scheme law in
11 that one case.

12 But there are no -- I mean, there, there are,
13 unfortunately, a lot of Ponzi schemes out there, seems to be
14 more every year, and we've been litigating this issue now for a
15 long time and there hasn't been presented by the trustee any
16 case that's precedent for his reach here.

17 So this is an attempt by the trustee to have you
18 create new law that we think is flatly inconsistent with
19 Supreme Court precedent and I think, Your Honor, this --
20 this -- this type of dispute was, I thought, put to bed quite
21 elegantly in the, by the Second Circuit in the Madoff case,
22 obviously a Ponzi scheme case, when it said at Picard v.
23 Fairfield Sentry, 762 F.3d at 211, "When creditors" --

24 THE COURT: Is that -- is that -- is that No. II?

25 MR. BALDIGA: It is.

1 THE COURT: Okay.

2 MR. BALDIGA: Yeah.

3 "When creditors have a claim for injury that is
4 particularized as to them, they are exclusively entitled to
5 pursue that claim, and the bankruptcy trustee is precluded from
6 doing so."

7 So what are the undisputed facts here, Your Honor?
8 There are, you know, elaborate statements of facts. We each
9 agree with some of the facts from each other, but except most
10 of them. The debtors never possessed any of the monies paid by
11 a victim participant to a promoter participant that are the
12 subject of this lawsuit. The debtors never commingled any of
13 these monies with TelexFree's other assets.

14 THE COURT: But the, but the criteria for fraudulent
15 transfer is not possession. It's having an interest in. Did
16 not the debtor have an interest in these fees that paid back
17 and forth or, or credited back and forth?

18 MR. BALDIGA: The standard, Your Honor, is as to a
19 transfer of funds, that they be funds in possession under the
20 control of the debtor.

21 THE COURT: The standard for what, for, for making out
22 a fraudulent transfer?

23 MR. BALDIGA: Absolutely. And the cases are
24 absolutely uniform in that regard. There's not a single case
25 to the contrary. And I'll, we'll get to those.

1 The debtors experienced no diminishment of their
2 estate in connection with any of these payments. The debtors
3 had no legal right to the monies in question and the victims
4 do, did have and do have today a particularized injury on
5 account of each payment.

6 Your Honor, I do think we start with Kaplan. Kaplan,
7 Supreme Court 1972, said that a bankruptcy trustee has no
8 standing to sue on behalf of estate creditors, regardless of
9 the sense of fairness and so forth. And there's a recent Ponzi
10 scheme case, Your Honor, Ivey v. First Citizens Bank. This has
11 been decided since the briefing, but I think it's important.
12 The District Court decision was at 539 B.R. 77, decided late
13 last year, but affirmed just two weeks ago by the Fourth
14 Circuit, at 2017 WL 416964. Ivey, I-V-E-Y, v. First Citizens
15 Bank. It's a Ponzi scheme case, Your Honor, in the Fourth
16 Circuit and reading from that decision:

17 "A bankruptcy trustee can recover for the bankruptcy
18 estate transfers made by a debtor by demonstrating the
19 transferred property was of an interest of the debtor
20 in property. Any funds under the control of the
21 debtor, regardless of source, are properly deemed to
22 be the debtor's property, and transfers that diminish
23 the property are subject to avoidance. A debtor must
24 have exercised sufficient control over the funds to
25 warrant a finding that the funds were the debtor's

1 property," going right to your question.

2 This is the Fourth Circuit:

3 "The purpose of avoiding fraudulent transfer actions
4 is to prevent a debtor from diminishing property that
5 properly belongs to all creditors. That construction
6 simply recognizes that a transfer is not subject to
7 avoidance if it did not or could not diminish the
8 estate."

9 So that's the Ivey case, Your Honor. That's the most recent
10 Ponzi scheme decision of significance. That's reading from the
11 District Court opinion that was just affirmed by the Fourth
12 Circuit.

13 So that goes right to the heart of things, Your Honor.
14 Certainly, when in other contexts, not this context, "property
15 of the estate" has an expansive definition, but in terms of
16 being able to claw back as fraudulent conveyances payments
17 made, they have to be payments made by the debtor from funds
18 that it controlled and, and either had possession of and
19 commingled in every single case certainly controlled.

20 So let's talk about a couple of things that are in
21 some of the briefs that were --

22 THE COURT: So your, it's your position that -- that
23 it is -- that it is impossible to have a triangular fraudulent
24 transfer claim. Forget about Ponzi schemes.

25 MR. BALDIGA: I don't know if I need to prove the

1 totality of that conceivable universe. I'm very comfortable
2 that that's not what is the case here. Whether there was a
3 possibility that some other facts in some other case could give
4 rise to a triangular one, possibly, not in the context of a
5 criminal enterprise like this. I don't think there could be a
6 Ponzi scheme triangular case, which is why, Your Honor, there's
7 in the hundreds of Ponzi scheme cases not a single case that
8 has been brought to your attention to say, "Yeah, Judge,
9 another judge somewhere in the country has done that." It
10 never has been done, ever. And I'm -- I'm --

11 THE COURT: I, I'm assuming that's because there's
12 never been a case with these facts, not because there have been
13 cases like this that either the trustee threw up his hands and
14 decided not to prosecute or the court said you can't, right?
15 This is the first Ponzi scheme case with this particular
16 circumstance where there were these direct payments and credits
17 and so forth.

18 MR. BALDIGA: I don't think that's true.

19 THE COURT: Okay.

20 MR. BALDIGA: We haven't found cases where that issue
21 has been litigated, but in, in Madoff as an example, a lot of
22 funds went into the Madoff estate and then distributed by
23 Madoff as fictitious profits and those the trustee sued to
24 recover. But a lot of the litigation in that case are, is with
25 respect to payments that went to feeder funds, for example.

1 Some of those feeder funds went to pay third-party accountants
2 and other persons. The trustee was deemed not eligible to
3 recover anything that didn't go into Madoff. So --

4 THE COURT: Yeah, but the payments to the feeder funds
5 were not payments that were ordinarily to be made to Madoff.
6 Those were payments that the, that the customers owed to the
7 feeder funds.

8 MR. BALDIGA: No. The customers paid to, for example,
9 Fairfield Sentry where we represent the liquidators, and the
10 only approved investment of Fairfield Sentry, as an example,
11 was to invest that money into Madoff.

12 So that's an example where monies were paid by one
13 third party to another third party and if it, if those monies
14 never got controlled by Madoff, the Madoff trustee could not
15 sue to recover them.

16 THE COURT: Hmm.

17 MR. BALDIGA: Because they were not under, first,
18 under the control of the Madoff entities and secondly, not
19 distributed by the Madoff entities.

20 So I think it's, it's not the case that every other
21 Ponzi scheme case has a hundred percent of the payments come
22 into their safe. I do admit that no one has ever tried to
23 recover all the other payments first and, and that's why we
24 have no decided decisions there because this is an
25 unprecedented effort by this trustee.

1 So it's not surprising that there's not a reported
2 decision denying a trustee to do this because I believe it's so
3 clearly contradicted by established law, including the cases --
4 every other Ponzi scheme case deals and sets narrow limits on
5 what the trustee can do.

6 So -- and we're not, obviously, Your Honor, litigating
7 here, from, from our perspective. TelexFree did get, according
8 to the trustee's accounting, something north of \$300 million
9 that went into TelexFree. We're not disputing whether the
10 trustee is solely authorized to recover that money. Of course
11 he is. We're also -- this has nothing to do anymore, as you
12 know, with -- when we started this dispute there were issues as
13 to how claims should be computed in the case. That now has,
14 issue has long come and gone and this is not that.

15 And every one, however, of the cases, Your Honor --
16 and we collect them at Pages 11 and 12 of our brief. And just
17 an example, the Universal Clearing House case, 62 B.R. 118,
18 holding that when a debtor obtains money by fraud and mingles
19 it so as to preclude tracing, it's property of the estate and a
20 transfer of that money can be -- those -- these are the cases
21 that the trustee cites, all of those.

22 But in the Madoff case, Your Honor, again very simply,
23 "In order to qualify as a disguised fraudulent transfer action
24 the complaints against the defendants would have to be
25 contingent on Madoff's wrongful transfer of the funds sought by

1 the actions. They are not." Trustee loses This is not a
2 novel situation. And, and so in Madoff there were efforts by
3 the trustee to go after defendants and monies other than on
4 account of the funds that were under control of Madoff. In
5 every single one, the trustee loses.

6 The trustee has three --

7 THE COURT: Tell me -- tell me how -- tell me how this
8 is going to work. If, if I were to rule in the favor, in the
9 defendants' favor here, that means that the, the class action,
10 presumably, would proceed whereby your, your class action
11 plaintiffs would pursue these net winners, these promoters.
12 And what kind of -- how does, how does the recovery work in, in
13 a class action context? Let's say you, you ultimately recover
14 a hundred million dollars on behalf of the class action
15 plaintiffs. What happens to the money? How does -- what --

16 MR. BALDIGA: Sure, Your Honor. And, and first, in
17 the first 18 months of this case that's exactly what was going
18 on. The first unjust enrichment action filed by victims
19 against promoters were filed in March 2014, about a month
20 before the bankruptcy case was commenced and certainly before
21 this Court's involvement or the Nevada court was involved.

22 So it's not like we're saying, "Oh, here's what we're
23 going to do. We're just going back to where we were 18 months
24 ago." And, in fact, during that time the trustee was
25 developing his database of all this information and said, "Oh,

1 you have some of these going. Here's the information so you
2 can sue the right people." The trustee has all that
3 information. The trustee decided, for reasons best known to
4 him, about a year ago to say, "You know what? I know it's
5 going to make it a lot easier for you to sue the right people."
6 Because these could be class actions. They don't need to be
7 class actions. We could sue in the name of -- if we bring a
8 suit on behalf of Joe Smith against Mary Jones, that would be
9 consolidated into the Multi-District Litigation and that suit
10 would proceed. It does not need to be class action.

11 THE COURT: Okay.

12 MR. BALDIGA: There -- there -- I think class actions
13 have some merit here, but I didn't want anybody to think that
14 this is caught up in class action law. That's convenient, but
15 not necessary.

16 So we would go back to doing exactly what was being
17 done before these were stayed. They were stayed about a year
18 ago so that you could make the decision that you now need to
19 make. That's where we've been. The trustee, if the trustee
20 loses today, I would think that it would not require an order
21 of this Court for the trustee to say, "Okay. Well, we finally,
22 you know, Bill, we've been litigating this. You won. We lost.
23 Here's the information." Because it's clear that victims would
24 be -- the, the worse thing for victims is that no one gets to
25 recover.

1 So if this issue were, you know -- and no one
2 challenged our standing for the first 18 months, including the
3 trustee. But if we just go back to where we were a year ago;
4 the trustee would, I think, say, "Here's the information." We
5 need -- you know, this is going to be public, anyway, if we're
6 going to allow claims. "Now you have names, addresses,
7 amounts. You have all the detail that you need to win." And
8 we'd sue in whatever way we thought was most efficient. And we
9 have lawyers waiting to pounce on all of these. And it would
10 be, I think, very efficient. They would all be consolidated in
11 the MDL. There would be common issues of fact, which is why --

12 THE COURT: But how does the recovery get distributed
13 in an MDL? I am not clear on that.

14 MR. BALDIGA: Well, it would be -- there is a -- it is
15 a consolidated class. We think at the end of the day it's
16 likely to be -- Judge Hillman would make this decision,
17 obviously. The Judge has all of these to dispose of. We do
18 think that Judge Hillman at the end of the day -- and we've
19 asked him to certify a class and for there to be a ratable
20 distribution within the class.

21 We have committed to this Court and to Judge Hillman
22 and I've committed to the trustee that we would like to have
23 those recoveries flow through the bankruptcy estate because it
24 would seem to be a tremendous waste to have a separate claims
25 allowance process. We have signed on to how you determine who

1 has a claim and it's the same formula that the trustee uses.
2 It's net winner. We would be able to do that ourselves if the
3 trustee shared that information with us. We would have thought
4 that that would be in the best interest of victims, but it's
5 certainly not in the best interest of the trustee trying to be
6 the gatekeeper on that. But in any event, we have time to
7 resolve that.

8 But with the trustee's information, which can be done
9 at the push of a button -- because it's a, it's a system and we
10 wouldn't want to pay for it twice, obviously -- victims who are
11 net losers would share in those recoveries and I think it would
12 look no different from how they would be distributed through
13 the bankruptcy estate. Certainly, our intention and I think,
14 as the Court knows, we have tried to get that done. We've
15 failed on our end to try to get the necessary parties to get
16 onboard with that. Doesn't mean that we'll stop trying.

17 But frankly, that's immediately done. If, if you were
18 to simply rule in our favor, I think that all comes together in
19 a heartbeat because it makes sense and the, the only reason why
20 it hasn't happened so far is because we haven't had that ruling
21 yet. But the ruling comes first. Mechanics come second. The
22 mechanics are not the difficult part. It's really the turf
23 issue that needs to be resolved.

24 So, given that in every single case the only type of
25 fraudulent transfer that can be had is from property under

1 control of the debtor, the trustee tries three or four ways to
2 try to argue here to get out from under that black letter law.
3 One is a novel expansion of this triangular preference
4 collapsing LBO case law.

5 Second, trustee argues that the victims suffered no
6 particularized harm in a situation where, for example, a
7 particular victim handed over a hundred thousand dollars of
8 particular cash to a particular promoter. The trustee argues
9 that that victim who had the hundred thousand dollars go from
10 their wallet to a promoter didn't suffer a particular harm.
11 We'll deal with that.

12 And more recently, just in the most recent brief, an
13 argument that you saw for the first time that, notwithstanding
14 all the other arguments on this, that there was somehow now an
15 agency scenario.

16 So those are the things that we have to talk about
17 here because those are the three ways that the trustee --

18 THE COURT: Or an employment scenario, never mind
19 agency. Now the *amicus* is describing this as an employee-
20 employer relationship.

21 MR. BALDIGA: Yeah. I, I don't think that's a serious
22 argument, but I can address that. I mean, if there's no
23 agency, there's no employment. And so we don't even think
24 agency is a close case, so. But that, that we'll, we'll get
25 to. The good thing is we have a document and the reason this

1 wasn't tried earlier is because the document so obviously on
2 its face contradicts the argument. But we'll, we'll get to
3 that.

4 First, on triangular preference.

5 THE COURT: How are the -- how are the -- if the end
6 result to the victims is going to be the same in terms of the
7 process, regardless of which of you moves ahead, which is
8 better for the victims financially?

9 MR. BALDIGA: Oh, that's -- it's -- I, I wasn't saying
10 the end result for the victims is the same. I think it's very,
11 very different, the end result. The formula for distribution
12 would be the same. That's what I meant to say.

13 THE COURT: Yeah.

14 MR. BALDIGA: We have incredibly motivated direct
15 victims with all the information saying, "I gave this money to
16 this person. You're my lawyer. Go get this money." I --- I'm
17 -- and we're telling them, "We've been stayed. We've been
18 stayed. We need to get a ruling here," the ruling that we're
19 seeking today. We have lawyers ready -- we're going to go
20 recover this. The trustee has had, I don't know, three years,
21 I guess, and a couple days to do this and they've recovered a
22 total of zero from these promoters.

23 So we know what's happening with the trustee in
24 charge. For the trustee, it's all about first hiring a, I
25 mean, unfortunately, paying victims' money that should go to

1 victims to pay another lawyer now to oppose those victims by
2 criticizing their own affirmative defense. I mean, it's a
3 cockamamie thing, if we ever saw it, but you get what you pay
4 for. The -- this is what the lawyers and the PIEC do and this
5 is what they signed up for, was to go chase the bad guys. The
6 trustee has a stay that's preventing us from doing that, which
7 we think is contrary to all law, and the trustee has said, "I
8 have all this information. Victims have paid us", I don't
9 know, "\$10 million," whatever it is, "approved by this Court to
10 develop this information and we're not sharing it."

11 So we can't force the trustee, again, to give us that
12 information, but you can. I mean, given that victims paid for
13 it, we would hope that it'd be available. But this is the
14 lawyers and the PIEC and other lawyers around the world that
15 we're ready to contract with to go get this money. This is
16 what we do. And they've done that in hundreds of other cases.
17 It's not that complicated and we will recover a lot of money
18 for victims. That's why Judge Hillman appointed the PIEC to
19 just go do it.

20 Now it's been stayed until you make this decision, but
21 the information is there. Standing is there. We just need to
22 have you unlock the door to allow us to do it.

23 But the result is much, much different. I didn't --
24 and I'm glad you asked that question because I didn't want
25 there to be any confusion that we thought the result would be

1 the same. The formula is the same. We don't want to redo
2 things that the trustee has done, such as developing the
3 information and developing the methodology for determining
4 who's a net winner and net loser. There's no need to spend
5 hundreds of thousands or millions of dollars to redo things
6 that have already been done. And I haven't been shy about
7 standing up here and saying I don't, I don't support the
8 trustee on this or that. But on that, we never had any problem
9 with it.

10 So let's talk about the triangular preference, Your
11 Honor, or fraud collapsing LBOs. There are eight cases. I
12 think the trustee has been looking at this for a long, long
13 time. If there were another case and there were nine, not
14 eight, I think the trustee would have brought the ninth to your
15 attention as well. We've looked and, and we agree that there's
16 eight cases, decided cases on this. Two of them are where the
17 debtor sold an asset. The debtor is entitled to cash for that
18 asset, but says, "You know what? Instead of paying me, pay a
19 creditor," and then the debtor files. And we agree completely.
20 That's the -- that's Food Catering and Warsau. They both start
21 critically, Your Honor, both of these -- that's the triangular
22 transaction, I mean, most classically. They start in both
23 cases, obviously, because this is what all the precedence says
24 with an asset of the debtor. The debtor sells an asset. They
25 sell a piece of equipment, I think, in both cases.

1 So that's not novel. We agree. If TelexFree started
2 with the asset that's the subject of the transfer here, we'd
3 lose. We wouldn't be here, in the first place. So those are
4 those two.

5 The other six, these are the collapsing LBO cases, and
6 there's -- this is the only two categories. There -- there are
7 -- there is no third category of these collapsing transactions
8 triangular. These where -- these -- these cases all involve
9 the debtor's assets being subject, becoming subject to a
10 lien --

11 THE COURT: Uh-huh (indicating an affirmative
12 response).

13 MR. BALDIGA: -- to support a leveraged buyout
14 transaction and the lien, the establishment of the lien is
15 subject to, in a collapsing analysis, subject to avoidance if
16 there was insolvency. We have no problem with any of those
17 things. Again, it starts with -- the Supreme Court points to
18 you have to start with property controlled of the debtor. All
19 six, okay, it's liens created on the property of the debtor.

20 So again, we don't, we don't argue that those cases
21 are somehow wrongly decided. They're exactly right decided,
22 but they have nothing to do with this case. But that's the
23 best the trustee has. So a couple of them, Your Honor, Baker &
24 Getty, 98 B.R. 306, I mean, these are the debtor's cases. "A
25 transfer is avoidable as a preference only if the transferred

1 property or interest in property diminished or depleted the
2 debtor's estate." If Mary Smith took a hundred dollars out of
3 her wallet and paid that promoter that hundred dollars and now
4 wants to sue to get it back, trustee is saying, "I don't -- you
5 can't do that." If she paid that hundred dollars to the
6 promoter or didn't pay the hundred dollars to the promoter,
7 there was not one whit of a difference to that estate. It made
8 a hell of a difference to Mary Smith. Excuse me. That hundred
9 dollars is the call we get every day saying, "How come I can't
10 get my hundred dollars?"

11 But it did not diminish the -- these are the trustee's
12 cases. Madoff and Picard III, Your Honor, exactly the same
13 rule, 762 F.3d 199 (2nd Cir. 2014). Diminishment of the estate
14 is the keystone to a fraudulent conveyance action in, in the
15 Ponzi scheme context. This is not new law and the trustee's
16 cases in the sale of an asset of the company or a creation of a
17 lien on the assets of a company have nothing to do in this
18 context.

19 Here, there was no diminishment of the estate. The
20 trustee argues now, "Well," and the *amicus* goes to the same
21 point, "Well, there were credits issued by TelexFree." Well,
22 you know, every Ponzi scheme case has something that dresses it
23 up to make it look like, I mean, you couldn't have a Ponzi
24 scheme that lasts more than a week without some sort of scam,
25 illegality, fictitious type of operation. These credits, of

1 course, were just, were just phony things printed up by
2 TelexFree. They had no value and Mr. Darr's affidavit, to his
3 credit, says that. I mean, this is just part of an illegal
4 scheme. These things were just printed. There is no value to
5 these. There is no diminishment to TelexFree by the issuance
6 of a credit when TelexFree could just start up the machine and
7 say, "How many do we need today? A thousand? A million?
8 They're all fictitious, anyway." There's no diminishment.

9 So when, when what is being issued is fictitious, it's
10 the opposite of diminishment. You can't have diminishment on a
11 fictitious thing because it was an unlimited amount of these,
12 obviously, in the hands of TelexFree. They made them up as
13 they went along.

14 THE COURT: Well, I've been thinking about that
15 argument and if that argument, following it to its logical
16 conclusion, then you can never have a preference claim in a
17 Ponzi scheme case because a preference claim is predicated on
18 an antecedent debt and if it's a phony debt, then you can't
19 have a preference. That's not what the cases say.

20 MR. BALDIGA: Well, you have -- so there are all sorts
21 of preferences --

22 THE COURT: Yeah.

23 MR. BALDIGA: -- in connection with trade -- I mean,
24 because even in a Ponzi scheme --

25 THE COURT: Forget those.

1 MR. BALDIGA: -- there are some things.

2 THE COURT: But there are preferences that involve
3 fictitious accountings and the predicate for a preference on,
4 like, a fraudulent transfer is the existence of an antecedent
5 debt. And no one takes the position that the fact that those,
6 that an antecedent debt is fictitious means there's no
7 preference --

8 MR. BALDIGA: Who --

9 THE COURT: -- as far as I can tell.

10 MR. BALDIGA: In your example, who is the debt owing
11 to? I'm sorry.

12 THE COURT: Well, it would be in a, an investment
13 scheme where, where there were investors or brokers or someone
14 who are ostensibly owed money and then were paid within 90 days
15 and that antecedent debt was as fictitious as everything else
16 in the Ponzi scheme --

17 MR. BALDIGA: Right.

18 THE COURT: -- right?

19 MR. BALDIGA: And so it is --

20 THE COURT: And you're saying that that's not a
21 preference?

22 MR. BALDIGA: A -- a -- an illegal enterprise.

23 THE COURT: In a?

24 MR. BALDIGA: An illegal enterprise cannot sue to
25 enforce an obligation to that enterprise. Yeah. That's,

1 that's, again, black letter law.

2 Here's another Ponzi scheme case, Your Honor, right on
3 point, Hedged-Investment Associates, 84 F.3d 1281, Tenth
4 Circuit. It's in our papers. The trustee tried to recover
5 excess distributions under the promoter contract, very similar
6 to here. And again, Your Honor, again, not, nothing here is --
7 there -- there -- we're not citing cases that are the outliers.
8 Every single case is, is of the same.

9 So the trustee tried to do essentially what this, this
10 trustee is doing in the sort of credit theory. Trustee tried
11 to recover excess distributions under the promoter contract and
12 the court, Tenth Circuit, held, "Enforcement of the partnership
13 contract would only serve to further the illegitimate Ponzi
14 scheme," and so rejected the trustee's efforts. There are no
15 successful efforts by a trustee to enforce the illegal
16 contract.

17 Now could, could there be a case out there where there
18 is a preference recovery because no one got up and challenged
19 standing? As you know, Your Honor, when parties are not
20 litigating a particular issue you can find a case that sort of
21 stands for anything, given, given that, but it doesn't mean
22 that the issue was litigated. But in every single case where
23 this is litigated, trustee loses without exception. There's
24 not a single case to the contrary, which is why these are
25 always litigated in the fraudulent conveyance arena and which

1 is why, again, without exception, with Charles Ponzi going back
2 to, what, he's now a, you know, Ponzi schemes are a hundred
3 years old. There's never been one that involves the recovery
4 by a trustee of monies that were not under the schemer's
5 control, not one. And the trustee's asking that you be the
6 first.

7 So let's get back to these credits. And this is, you
8 know, argued sometimes by trustees. We've collected the cases
9 at Page, Pages 14 to 15 of our primary brief. Mr. Darr himself
10 testifies, which is why, you know, we are here on
11 uncontroverted fact. "While some credits" -- and this is
12 Mr. Darr's affidavit, Docket 35 in the chapter 11 case, at Page
13 36:

14 "While some credits were issued by TelexFree
15 ostensibly for new memberships, 'a significant amount
16 of manual credits appeared to have been issued to
17 certain user accounts without any payment' or other
18 consideration or any other reason."

19 So, I mean, Mr. Darr confirms what we all kind of
20 suspected that they were just, they were just running a scam
21 and they, they made up as many of these do. There is no
22 diminishment of the estate. If there is any third leg to our
23 triangular theory, the cases uniformly hold diminishment is the
24 keystone. You must have diminishment.

25 Well, the trustee is saying when you boil it all the

1 way down, then there's some enforce, there's some enforceable
2 right here by the trustee to compel each -- what the trustee
3 really would have to say is, "If I'm going to have a theory
4 where this credit is of some legal significance where, Judge,
5 you should be enforcing this, this, this idea of a credit as
6 something that's not just part of an illegal scheme." Well,
7 that means that the trustee could legally compel each promoter
8 to, "Hey, give us this money. You received \$3 billion that we
9 didn't get." That's a lot of money. Some of these people are
10 local. There's a lot of them right here within ten miles of
11 Boston that we are so anxious to sue who are buying all sorts
12 of things, have all sorts of investments who are themselves
13 trying to insulate themselves from liability, which is why our
14 clients are so frustrated. How many of these -- if the trustee
15 really believed what he's now saying to you, how many of these
16 actions do you have before you by the trustee for that \$3
17 billion? Zero, because there is no legally enforceable right
18 of the trustee to enforce the thing that he's now trying to
19 construct just as a way to expand the standing here.

20 So just like a loan shark, Your Honor, cannot break --
21 I mean, a loan shark can break legs, but can't sue to collect
22 an illegally usurious loan. TelexFree, a criminal enterprise
23 that was promoting phony credits to just perpetuate the scam,
24 which is what Mr. Darr said, never did and could not sue
25 promoters. And it's black letter law. The trustee's rights

1 are no greater in that regard than TelexFree's, itself. That's
2 -- the Supreme Court said that in a hundred cases.

3 And again, Your Honor, going back to the Hedged-
4 Investment Associates case, that's exactly what -- the trustee
5 tried to enforce a partnership agreement. There, it was a
6 Ponzi scheme in a little bit different way, but there was a
7 partnership agreement under which the, the payments were made
8 and the trustee said, "For purposes of equitable distribution,
9 I should be able to enforce that because that partnership
10 agreement, it's a real agreement." And the Tenth Circuit said,
11 "No. It's an illegal scam. And the, the company couldn't have
12 enforced its illegal scam. And so, Trustee, of course you
13 can't." That's the Tenth Circuit. That's just two years ago.

14 So going to particularized harm, so we're talking
15 about payments here in cash, often in cash. Not always, but a
16 great majority in cash that victims gave to promoters in many,
17 many cases, maybe most cases. We'll find out. They know who
18 they gave the money to, but the good thing is the trustee, we
19 believe, has them listed chapter and verse who gave money to
20 who. So that -- all the information we need is available.

21 The trustee cites three cases, not more, for the
22 proposition that victims in a Ponzi scheme do not have
23 particularized harm, Ritchie, Archemy, and Meoli, but, Your
24 Honor, all three cases, when you actually read the decisions,
25 are exactly a, a victim of an unfortunate scheme suing to

1 recover for non-particularized harm. I mean, the primary case
2 cited by the trustee is Ritchie where a Madoff-duped investor
3 sued GECC. I'm sorry. It wasn't -- I'm sorry. It's in the
4 Fetter [sic] case, another pretty monstrous Ponzi scheme.
5 Fetter had a lending relationship with GECC and a duped
6 investor in the Fetters case, which is in bankruptcy court in
7 Minneapolis, sued to, sued GECC saying, "The Ponzi schemer used
8 your loan relationship in his advertising. And so people like
9 me looked at that loan relationship as evidence that they must
10 be pretty legit. So we're going to sue you, GECC." And the
11 court said, "No, 'cause you didn't have any relationship with
12 GECC. Fetters did and so your harm is not particularized."

13 That's the primary case cited for the trustee for the
14 proposition that, in support of his argument that victims in a
15 Ponzi scheme case don't have particularized harm. Well, those
16 cases prove the exact opposite. Sure, there are people who we
17 can't sue because we don't have particularized harm, but this
18 is -- we're here on a narrow issue. We, we just want to sue
19 the promoters to whom we handed the money. Nothing could be
20 more particular and, in fact, what could be more particular
21 than, literally, a physical in-cash transaction between two
22 natural persons? If that's not particular, nothing is.

23 The trustee then dives into the Madoff decisions and,
24 but, boy, they don't help. And yes, there are Picard I, II,
25 III, and IV, but they certainly don't help the trustee. In

1 Picard II, the victims were denied standing to sue the Ponzi
2 scheme's co-conspirators, but that, Your Honor, once you read
3 the decision, it's to recover the monies distributed by Madoff.
4 All right. Well, that's, that now is, again, black letter law.
5 We're not trying to sue to recover any monies distributed by
6 Madoff. And so the, the court said, well, those are, those
7 creditors in that case had, had non-particularized claims as to
8 the monies distributed by Madoff. Okay. Well, that's pretty
9 straightforward.

10 Picard III, 2013, same result because the creditors
11 there sued Madoff employees for helping to perpetrate the
12 fraud. That's, those victims didn't give those employees any
13 money. They were co-conspirators with Madoff. So there's no
14 particularized harm there.

15 Picard IV, no better. Here is where victims brought
16 suit against the brokerage firms that invested the victims'
17 assets with Madoff. And the victims said, unlike the other
18 cases, "We had some sort of" -- they didn't use the word
19 "privity" -- but, "We, we gave our money to these brokers. The
20 brokers violated our, whatever obligations they had to us by
21 letting the money be invested with Madoff." And the Second
22 Circuit -- good thing is all these cases do go up to the Second
23 Circuit, given how much money there is involved -- said, "You
24 know what? That's particularized harm. Trustee, you're out.
25 Victims, you have the right to sue."

1 That's, on its facts, the closest case we have here.
2 There's no case cited by the trustee or by us that has facts
3 closer to the ones here. When the victims give their money
4 first to someone else, you're a promoter, they're the brokerage
5 firm, and then the money -- there, the money did go up to
6 Madoff and the victims still had the right to bring their
7 direct claims. Here, the money didn't even go up to TelexFree.
8 It's much more attenuated here, but the victims won. Trustee
9 was denied. Victims won. They had the right to pursue those
10 claims directly.

11 So the very cases cited by the trustee are all in our
12 favor.

13 Now I, I'd move on to agency, if the Court's ready.

14 Your Honor, the three elements of agency are that the
15 agent must act on behalf of and for the benefit of the
16 principal, be subject to the principal's control, and have
17 authority to bind the principal. There's a reason this
18 argument was such a Johnny Come Lately. It's because, here,
19 the promoter contract is, actually, the exact opposite on all
20 of those things. The promoter contract says the promoters are
21 not employees, they're not subject to the control of TelexFree,
22 and they're not authorized to act in the name of TelexFree. I
23 believe you have that contract. It's, it's part of the papers
24 in, in the record here.

25 So just starting factually, Your Honor, these aren't

1 just throwaways that we're finding, you know, buried in a
2 hundred-page document. At Section 2.4, 2.4.1 --

3 And, Your Honor, do you have a copy of this? Could I
4 hand one up or --

5 THE COURT: If I have one, I haven't seen it.

6 MR. BALDIGA: Could, could I hand one up?

7 THE COURT: Does anybody have any objection?

8 MR. BALDIGA: I have one for the trustee as well.

9 MR. MURPHY: Is it filed in the record?

10 THE COURT: This is a copy of the promoters' contract?

11 MR. BALDIGA: Yeah.

12 THE COURT: Sure.

13 (Document handed to the Court)

14 MR. BALDIGA: It's in the record, Your Honor. So
15 we're not asking to admit something that the trustee hasn't
16 already provided, but it's, given, given the argument here.

17 So, Your Honor, on Page 3 -- and you can see up top
18 it's the, it's the docketing information in this case -- 2.4.1,
19 "Promoters do not have an employment relationship inasmuch as
20 their working regimen is autonomous" -- well, "autonomous." If
21 there's a word that's opposite of "agency," it's
22 "autonomous" -- "free of any imposition of routines, goals, or
23 regularity" -- okay. If it's, again, free of the things that
24 would create a -- and again, I don't even need to get to
25 employment because this doesn't even, you know, approach

1 that -- "and there is no hierarchal relationship since they can
2 establish on their own the pace, routine, or geographic area."
3 Okay.

4 2.4.3. This is -- this is -- if this were the only
5 sentence at all that I would cite to, it's, it's enough to be
6 fatal to the trustee's argument. "The promoter is expressly
7 notified that it is prohibited for him to present himself as
8 acting in the name of TelexFree." All right.

9 So nothing could be more clear. It's the opposite of
10 agency. And again, which is why this was never argued before.

11 And, and then, if you turn back, Your Honor, to the
12 prior page in the middle of Section 2.2.1 and the big carryover
13 paragraph, "All activities are performed by the partner
14 promoter without any employment relationship and they are able
15 individually to manage the team and the resources of their own
16 free will."

17 The -- so even before getting to the legal parts of
18 this, factually, there's--- there's nothing -- there's nothing
19 there. If there were a single use of the word "agency" in
20 anything, the trustee would have -- you, you have it, trustee,
21 so.

22 But let's talk about if there were an agency
23 relationship that is so belied by the facts. That wouldn't
24 help. *In pari delicto* then gets squarely in the way, which is
25 why no one ever makes this argument. It would require, then --

1 the reason the trustee makes this argument is that the trustee
2 says, "Well, this would enable us to enforce the promoter
3 contract." And I've just talked about a few of the cases where
4 courts have said uniformly, again without exception, "Wait a
5 minute. An illegal enterprise can't enforce anything," just
6 like why the trustee has not tried in the three years they've
7 been here to enforce anything. They've never tried to enforce
8 this promoter contract, even though there's been \$3 billion
9 kept under it.

10 But this comes up in the context of a Ponzi scheme.
11 Madoff, again 721 F.3d 54, "The Ponzi scheme trustee cannot sue
12 third parties to enforce contracts or for fraud in the context
13 of the illegal scheme." Second Circuit didn't have any problem
14 with this. I mean, they, they thought that was obvious.
15 Wagoner, a case that's often cited in *in pari delicto* context,
16 Second Circuit, 1991, "Trustee of a fraudster corporate debtor
17 cannot sue third parties on their so-called contracts."

18 So even if there were an agency here, the trustee
19 can't use that agency to bootstrap himself into standing. It
20 just, it doesn't work. So, Your Honor, on --

21 THE COURT: I understood the trustee's agency argument
22 to be raised for a different purpose, which was to strengthen
23 his triangular transaction claim, that -- that these -- the
24 victims' payments were being made to the promoters as agents of
25 TelexFree. They were essentially collecting the money on

1 behalf of TelexFree.

2 MR. BALDIGA: Yeah, except that they -- again, there
3 is no agency. So --

4 THE COURT: I, I understand that, but I'm just
5 suggesting that --

6 MR. BALDIGA: And they kept, they kept \$3 billion. So
7 that belies it a little bit. And again, we don't need to -- it
8 -- it's -- it's somewhat of an academic debate except the
9 trustee, I think, has settled it by his conduct. What would
10 have been the easiest -- we don't have the right to -- see, if
11 the trustee really thought this, he'd say, "Hey, Judge, you
12 know what? We've been arguing about this esoteric standing
13 issue for a long time. But you know what? I alone have the
14 ability to enforce contracts of the estate," just like they
15 brought the breach of contract action here against
16 Pricewaterhouse. Settled, no problem by us. They could come
17 in here -- they could end this debate in one minute and say,
18 "You know what? It's really about breach of contract. We're
19 just going to get the \$3 billion back on breach of contract."
20 It would lose in a heartbeat because they can't enforce that
21 contract.

22 It's an -- it's just part of a scam. It's fabricated.
23 There, there is nothing real here. It's a, it's an illegal
24 scheme. And agency, calling it agency doesn't elevate it to
25 something that's legally enforceable. It doesn't create

1 property of the estate. It doesn't create diminishment of the
2 estate. If there were \$4 billion collected or \$5 billion
3 collected, was the estate diminished? No. If, if there were
4 twice as many credits issued, would it affect the economics of
5 this case at all? No. It's fictitious. That's why not a
6 single court has given this any credence whatsoever in any
7 Ponzi scheme case that, well, let's just take and borrow and
8 accept as enforceable some part of the scheme and, and dress it
9 up with legal rights so the trustee has more rights than what
10 the TelexFree had. But the cases are uniformly to the
11 contrary.

12 There's, there's a sort of a, we hope, a last ditch
13 effort here. The trustee says, "Well, you've already made this
14 decision, Your Honor, in the context of the Ponzi scheme
15 motion." I -- we've all been here throughout the case. I
16 remember stomping my feet a few times here about a year ago on
17 that in a motion for partial reconsideration that the Court
18 allowed. I'm -- if you want me to spend more time on that, I
19 will, but I thought that was pretty well decided that you were
20 reserving this issue, which is why we're here today.

21 THE COURT: I agree.

22 MR. BALDIGA: On -- the trustee, then, as he should,
23 says, "All right, Judge. My final argument," even though he
24 didn't quite say it this way, "is any other result would be
25 unfair and in some way, only if I win as trustee, that would

1 ensure equality of distribution." That's really the trustee's,
2 I mean, the legal things here are so weak, that that's the
3 trustee's strongest argument, that, "Judge, get beyond the case
4 law, get beyond the fact that you'd be the first, and appeal to
5 some sense of fairness here." Well, there's still a huge fear
6 and today's political climate is not helping in terms of filing
7 claims in, in the bankruptcy case and that's just part of the
8 reality.

9 But in any event, as with most Ponzi scheme issues,
10 when the trustees have appealed to -- you're not the first
11 judge to have a sense of, you know, fairness be the final
12 appeal to get beyond standing issues. Same arguments were made
13 by Picard in the Madoff case. The Second Circuit dealt with
14 this right on point. It's Picard IV, 762 F.3d at 21. And I --

15 "That plaintiffs in both state court actions are
16 creditors of the Madoff estate is irrelevant as the
17 plaintiff's right to enforce duties owed to them is
18 not qualified by the fact that they may also have
19 claims against the Madoff estate. There is nothing
20 illegal or contradictory about saying that a third-
21 party defendant" -- here a victim -- "might have" --
22 I'm sorry. A promoter. I'm sorry -- "might have
23 inflicted direct injuries on both the estate's
24 creditors and the debtor estate during the course of
25 dealings that form the backdrop of both sets of

1 claims."

2 So a Madoff court and affirmed by the Second Circuit,
3 again at, at Picard IV, is saying that there's nothing
4 inherently wrong with a victim of a scheme, just like against
5 their brokerage firms, just like there are many other causes of
6 action that were allowed to proceed in the Madoff case, there's
7 nothing wrong with some victims having additional recourse,
8 that it's not the job of the bankruptcy court in that case or
9 here, I submit, to try to level people down. There's nothing
10 contradictory about this. And, and that's what the Second
11 Circuit was saying.

12 Your Honor, I, I want to close again --

13 THE COURT: But -- but -- but apart, apart from that,
14 what you're telling me is that that isn't even going to happen
15 here, that if -- if the -- if, if I let you proceed in the
16 District court, the money that you recover will go to the
17 trustee who will distribute the money in the same way that he
18 is going to distribute the money to every, any other money that
19 he recovers.

20 MR. BALDIGA: That -- that's --

21 THE COURT: The end result will be the same.

22 MR. BALDIGA: That's, that has been our goal from Day
23 1. I've said that in this court as often as I could. We need
24 the trustee's cooperation. We, we have failed in mediations
25 and other discussions that you don't need to hear about that

1 should not be part of the record, in every other way to get
2 that done. Indeed, we need information, but we're trying to do
3 that, but we've been frustrated in doing it. It is -- I
4 confirm on the record again -- our absolute goal to do it and
5 to do it because we think that's the most efficient way.

6 I'm going to close, Your Honor, again with the Tenth
7 Circuit in Hedged-Investments Associates, 84 F.3d 1281 (10th
8 Cir.), a Ponzi scheme case:

9 "The trustee articulates sound reasons why it might be
10 wise to allow an exception to this rule," the rule
11 that the trustee has no greater rights to the estate
12 and you have to start with commingled assets under the
13 control of the trustee, "especially in a case such as
14 this one, where the trustee's efforts stand to benefit
15 hundreds of innocent investors. However" -- and I'm
16 still reading the quote -- "to paraphrase the Supreme
17 Court, the issue is not whether such an exception
18 would make good policy but whether the exception can
19 be found in the Bankruptcy Code."

20 That's where we are, Your Honor. This is a legal
21 issue. We think, actually, the fairness and similar principles
22 are on our side, but this isn't a matter where we're making it
23 up as we go along. There is, there are rules. There's a
24 hundred years of uniform precedent on every single one of these
25 points that, without exception, lines up in front of us and if

1 the trustee's, if the trustee's allowed to usurp the rights of
2 a million, a million people to do their best with lawyers of
3 their choosing to get back \$3 billion of monies that they
4 handed over to people, that's the, the likely result of that,
5 Your Honor -- and it, it really never became as obvious as it
6 was, you know, made evident by the *amicus* brief.

7 So we have the estate, again, paying victims' money
8 for the, for the promoters' representative to say, "One of my,
9 one of my affirmative defenses against the trustee is awfully
10 weak, but you see that the, the win here by the promoters." I
11 mean, it's, it's now very obvious from the *amicus* brief. It
12 would have been nice to have it more than last night, but so be
13 it. "The *amicus* brief makes clear that we think we have
14 defenses to the trustee, but, oh, by the way, PIEC, we think we
15 have defenses to you guys, too. So what I need to do is,
16 first, knock out the trustee and then knock out you."

17 So the risk here, Your Honor, of an adverse ruling
18 against us, these promoters go free. There is going to be no
19 ability on a legal basis for the trustee to proceed and we
20 won't have the ability to proceed. We'll have to tell the
21 million people, "Sorry. We, we did everything we could. I
22 made the best arguments we could. We advanced all the case
23 law, but that's it. We lose with," you know, "whatever,
24 wherever that goes." And the promoters will get off, just like
25 they have so far, three years without a dime recovered because

1 we've been stayed.

2 So we think it's time to end the stay. We'd like to
3 get on with the important business at hand, which, again, we
4 did with the cooperation of the trustee for 18 months. We
5 started before the trustee was appointed. We did it 18 months
6 with the trustee's cooperation and, you know, unfortunately,
7 the case then broke down about turf. And that's, that's the
8 only reason why we're here. It's not about the law and,
9 because the law is clear.

10 So, Your Honor, I've said what I have to say.
11 Obviously, I'd like a couple minutes on rebuttal, but we'll see
12 what the trustee has to say and --

13 THE COURT: Yes, we will.

14 Thank you, Mr. Baldiga.

15 MR. BALDIGA: Thank you.

16 MR. BENNETT: Morning, Your Honor. Charles Bennett on
17 behalf of Mr. Darr, the trustee in the TelexFree cases.

18 One point I'd like to make at the outset, Your Honor,
19 is the trustee is not seeking to create any new law here. What
20 the trustee is seeking and what the trustee is arguing is to
21 take existing law, primarily the equitable powers of this
22 Court, to look through the form of a transaction to its
23 substance and recognize the, recognize the transaction for the
24 economic reality that it is, which is that the monies that were
25 collected by the promoters are monies that the trustee can

1 recover on behalf of all creditors in the same way that the
2 Madoff trustee could recover the fictitious profits that went
3 to the various feeder funds and other individuals.

4 So we're not here to create new law. We're here to
5 apply existing law.

6 The one, maybe, twist in this case that doesn't bring
7 it directly within the Madoff cases is the set of facts here
8 relating to a triangular transaction. The PIEC was, pointed
9 out on various parts of the argument that there is no case,
10 that the trustee cited no case to support the trustee's
11 position that this is property of the estate. And I'll agree,
12 Your Honor, that we cited no specific case that had the same
13 fact pattern as we find in this case because, as our research
14 will turn up, there is no case that has this type of unique
15 fact pattern. I would point out that the PIEC did not find any
16 cases, either, that had this, this type of specific fact
17 pattern and the cases cited by the PIEC were cases where you
18 have direct transfers coming up the line or a direct, or a
19 transfer from a investor to a feeder fund, commingled with the
20 feeder fund, and then the feeder fund investing money. But no
21 case that involved these types of triangular transactions.

22 So I think we have to begin, to some degree, at the
23 beginning, Your Honor, with what exactly was going on here.
24 There's no question that while TelexFree purported to be some
25 type of multi-layer marketing entity that was selling voiceover

1 Internet, what it really was doing was selling memberships into
2 a Ponzi scheme on the, on the representation that you would
3 earn these credits and then you could redeem these credits for
4 money and you would make a substantial return on your property.

5 One thing that's important to understand is the way
6 the transactions worked here. In order to become a member of
7 the Ponzi scheme, in order to participate and earn these
8 credits you had to make, you had to buy a membership interest
9 and you had to have TelexFree assign to you a user account. If
10 you didn't pay for the membership and if you didn't have a user
11 account, you wouldn't participate in the program, you wouldn't
12 earn the credits, you wouldn't have the rights to redeem the
13 credits for cash or to use the credits to buy more, more
14 membership interest or to use the credits to pay for other
15 membership interest. And that third part is a part of the
16 agreement. It is a part of the contract.

17 Under, under the agreement, once somebody became a
18 member of the, of the TelexFree membership program, once it
19 became a participant, it did earn these credits. It earned
20 them by placing these meaningless Internet ads, but it earned
21 these credits and they had, those credits allowed them to do,
22 among other things, to use those credits to pay invoices for
23 other parties.

24 And there were two ways, as the Court knows, that
25 somebody would come into the TelexFree scheme. One way was a

1 direct payment. You'd go to TelexFree, you'd pay some money,
2 you'd buy a membership. The other way was the triangular
3 transactions and you've had those described. There's no
4 dispute the way the triangular transactions worked. A promoter
5 would be contacted, a recruit or a recruit would contact a
6 promoter. Very often, they were people that knew each other or
7 people that were in the same community. The recruit, the new
8 individual coming into the scheme, would want to buy a
9 membership, would want to get into the program. They would go
10 to the promoter. The promoter, which is important to
11 understand, the promoter did not own memberships. The promoter
12 could not sell a membership. The promoter could not make a new
13 recruit a member of the Telex scheme. All the promoter could
14 do was to act on behalf of Telex, bring that new recruit in, go
15 to Telex and say, "Johnny Jone wants to join your, wants to
16 join TelexFree," then Telex, not the promoter, but Telex would
17 then issue an invoice and attached to the invoice would be a
18 membership right and a user, and once that invoice got paid,
19 there'd be a user account assigned. It was a triangular
20 transaction. All three parties needed to participate in the
21 transaction. Without Telex's participation, without them
22 authorizing the promoter to bring the recruiter in and without
23 Telex issuing the membership or issuing the user number, there
24 could be no transaction.

25 So unlike the cases cited by the PIEC where it was

1 solely a transaction between an investor and a feeder fund --
2 and Madoff was not involved in this case, in our case -- you
3 have direct involvement of Telex or direct involvement in that
4 case of Madoff. So you have the tri-party arrangement. It's
5 three essential parties. It's three legs of the same stool.

6 The accounting records and documents of TelexFree
7 reflect also the nature of this transaction and the fact that
8 the money was being earned and tracked as money being collected
9 on behalf of TelexFree. As we pointed out in the Statement of
10 Facts, all the money that was being collected by these various
11 promoters would get reflected in the financial statements of
12 Telex as revenues. Additionally, the monies, basically the
13 monies being retained by the promoters, were treated as
14 commissions or agent fees by Telex. So they were showed as an
15 expense on their balance sheet.

16 So on all the books and records of TelexFree, this
17 revenue that was coming in through triangular transactions was
18 reflected as revenue of Telex, was something that they were
19 technically responsible to pay a tax on, and the, the monies
20 going back down or the redemption of credits in exchange for
21 these transactions was treated as an expense.

22 THE COURT: But how -- how do you respond -- how do
23 you respond to PIEC's position that that doesn't constitute
24 diminishment of the estate? That's just paper transactions.
25 How was the estate diminished as a result of these triangular

1 transactions?

2 MR. BENNETT: Well, Your Honor, we do cite a number of
3 cases in our, in our brief dealing with the diminution of the
4 estate and those are on Pages 20. But in substance, Your
5 Honor, in all the Ponzi scheme cases what is being transferred
6 here and what is being paid is against fictitious profits.

7 So, in fact, the real money here was money, the
8 retention of the, of these funds that should have -- that would
9 have -- what was being diminished here was, the money for the
10 payment of the membership, was revenues to TelexFree that it
11 was then disbursing back to the promoters.

12 The transaction -- if, if we looked at the transaction
13 in a different format, if we slightly change the way the
14 transaction worked, if -- if -- if we looked at the transaction
15 as recruit goes to promoter to buy a membership plan. Promoter
16 contacts Telex and says, "I got Johnny Jones wants to buy a
17 plan," invoice issues down to the, to the recruit. The recruit
18 gives the money to the promoter, promoter pays the money back
19 to Telex, and Telex immediately gives the money back to the
20 promoter and redemption of credits. Under that situation,
21 there'd be no question that the money was property of the
22 estate and, therefore, clearly within the fraudulent conveyance
23 and that the transfer of that money back down to the promoter
24 was a fraudulent conveyance.

25 What you have here is, in substance, the exact same

1 thing except that you didn't, you skipped one step. But it
2 wasn't an essential step. It's a form. The substance of the
3 transaction comes [sic] the same. And what's important here
4 to, to recognize with respect to the substance of the
5 transaction and why they were doing it was that in order to
6 perpetuate the Ponzi scheme and the typical and usual aspect of
7 a Ponzi scheme is some money that's being collected from the
8 victims or from the recruits have to be passed on to the older,
9 the earlier participants in the scheme. You have to keep
10 transferring that money. You have to feed the pool because if
11 you don't make payments and if you don't pay some of the older
12 participants, you're not going to perpetuate your scheme.

13 So the triangular transactions was the methodology by
14 which Telex could perpetuate its scheme by collecting money
15 from new recruits and paying a portion of that money back down
16 into the older recruit, the older participants and, therefore,
17 the participants/promoters could then hold themselves out as
18 having collected money and the scheme works and, therefore,
19 lure more people into the scheme and be used to continue to
20 perpetuate the scheme, collect money into the, into Telex.

21 The issue with respect to property of the estate, we
22 agree that in order to pursue a fraudulent conveyance action
23 there has to be property of the estate. We say that there are
24 three ways upon which the Court can find, can find that the
25 transactions constituted transfers of property of the estate.

1 And the first set of cases we cite into was the collapsing
2 cases and the triangular preference cases. Now we cite those
3 cases not because the facts are identical, but because of the
4 general principle of law that those cases stand for. The
5 general principle, Your Honor, is that the court, bankruptcy
6 court and all federal, and all courts, are courts of equity and
7 that they have to look at the substance of a transaction and
8 look through the form of the transaction in order to fashion a
9 remedy that gives effect to the substance and it recognizes the
10 economic reality of the transaction. That's the underlying
11 principle of law that the collapsing cases relied upon.

12 The court in those collapsing cases was faced with a
13 situation where they had no direct access for a fraudulent
14 conveyance. They had no direct right to go in and, and set
15 aside the transactions, but they looked at the transactions and
16 said, "Wait a minute. These are not a series of three
17 independent transactions. This was not a lien being granted to
18 the bank in exchange for a loan by the bank that benefited the
19 debtor. What this was was a three-step transaction that you
20 have to collapse. You have to integrate. You have to look
21 through the form of the transaction and what was the economic
22 reality." And when you looked at the economic reality of the
23 collapsing cases what you saw was the debtor conveying a lien
24 to the bank and the bank giving the money to a third person.
25 Therefore, the court looked at that, applied the equitable

1 principles, and recognized the economic reality and, therefore,
2 found a fraudulent conveyance basis.

3 That's the same thing we're asking the Court to do
4 here, look through the form, look to the substance, what
5 happened. Money was transferred into these various promoters
6 in the equivalent of fictitious profits that should be
7 recovered by the trustee in order to distribute it to all the
8 victims on an equality of distribution.

9 Now this, the collapsing case is not the only cases
10 where the courts have applied this concept of looking through
11 the form of the transaction to the substance. There are a
12 number of cases where the, where the court has looked at a
13 creditor coming into an estate and presenting itself as a
14 creditor on a loan or some type of other basis, primarily as a
15 loan, and the court looking at the circumstances, the
16 circumstances of the transaction and saying, "No, this is not a
17 loan. I don't care what the form of the transaction was. When
18 I look at the substance of the transaction, I'm going," the
19 court will recharacterize that as equity. Again, it's the
20 application of the general equitable principles of the court,
21 not to be misled by the form, but to get down to the economic
22 reality.

23 So there is a long line of cases for which the Court
24 can, can rely upon granting that there's equitable power and
25 its equitable principle, look through the form to the substance

1 and that's the principle that we're relying, one of the
2 principles we're relying upon here. So when we cite the
3 collapsing cases, when we cite the triangular preference cases,
4 what we are citing to is not the specific facts of the case,
5 but we're directing the Court to the equitable principles of
6 the theory of law, the principle of law that underlies those
7 cases and supports the recovery in those cases and should
8 support the recovery in this case. Because in each of those
9 cases there had to be a first court. There was a court that
10 was initially faced with this unique set of facts and the court
11 couldn't find another case that related to it, couldn't point
12 to another case, but could look to its equitable principles,
13 its general doctrine of law, and, therefore, rationalize
14 through it, reason through the facts, and come to the correct
15 conclusion that, in fact, property of the estate; in fact, the
16 right of the trustee to recover, and that's what the Court
17 should do in this situation here.

18 And in doing that, we will promote --

19 THE COURT: Your, your example of diminishment where
20 you say that had the, had the, the new member -- sorry -- had
21 the promoter taken the new member's membership payment, paid it
22 over to TelexFree within, immediately, turn around and pay it
23 back to the promoter for the credits, but TelexFree had no
24 legal obligation, enforceable legal obligation to pay that
25 money to the promoter. TelexFree could have taken that

1 membership fee and on its books cancel the, the promoter's
2 credit because they were all phony.

3 So it isn't, it isn't exactly the same, is it, as the
4 true triangular transactions where, like in a triangular
5 preference where the debtor actually, the debtor's assets are
6 reduced by a legitimate credit?

7 MR. BENNETT: No, Your Honor. I, I believe it is when
8 you look at the context of the case. It's -- it's -- in the --
9 in the -- as, as the scheme is being perpetuated, those credits
10 are, are worth money, are valuable. They're -- you could go to
11 Telex and you could get real money for those.

12 THE COURT: Hmm.

13 MR. BENNETT: Not only could you use those to pay an
14 invoice for a new recruit, but you could redeem that for cash.

15 THE COURT: And there were -- there were --

16 MR. BENNETT: So within the confines --

17 THE COURT: There were instances in the history of
18 TelexFree where there was cash redemption?

19 MR. BENNETT: Yes. I believe in the trustee's
20 affidavit he's gone through that and there are a number of
21 other promoters that are being sued directly on that basis
22 because they, in fact, cashed in their credits.

23 So yes, there are situations here where promoters or
24 just participants -- I won't call them promoters --
25 participants had their credits, cashed them in, and could get

1 cash back. There were a, there was numbers of checks. There's
2 a number of preference actions, there'd be a number of
3 preference actions within our class action where cash was
4 issued out within the 90-day period on the, for cashing in of
5 these credits.

6 THE COURT: Is that a factual matter that is in
7 dispute about the fact that there were credits, promoter
8 credits that were actually paid in cash?

9 MR. BENNETT: I don't believe there's any dispute to
10 that.

11 THE COURT: Okay.

12 MR. BENNETT: So, Your Honor, within the confines of
13 the case, yes, they had value. There was a diminution and when
14 you look through the form you can see the economic transaction.
15 And really, it was no different than in the Madoff case. If
16 you think about the Madoff case, the most part is the money
17 came up to, to Madoff. He then had it and then he distributed
18 that money back to other people, to earlier investors, in order
19 to keep the scheme going. That's no different than what's
20 happening here. The money's coming into Telex. It's then
21 distributing it back to certain of its, certain of the
22 participants in order to keep the scheme going.

23 And the trustee's right to look through this
24 transaction and recover this money is also, I think the Court
25 should view, as a corollary to the decision it's already made

1 with respect to the net equity determination of claims.
2 Because if you look at the net equity of claims, what we have
3 done is two things. First of all, under the Court's ruling and
4 under the formulation of net equity we -- we have -- the Court
5 has allowed and the trustee will accept claims from net losers
6 whose losses arrived as a result of triangular transactions.

7 So even though they didn't pay the money directly to
8 Telex, they paid the money to a promoter and they lost that
9 money. We're allowing -- those, those individuals are allowed
10 to file a claim, which is somewhat different than you'll find
11 in the, in the Madoff cases where you had a investor dealing
12 with a feeder fund and then the feeder fund going to Madoff.
13 The investor who dealt with the feeder fund was not going to
14 file a claim in the Madoff case. Didn't have standing 'cause
15 it didn't deal with Madoff. In this case, under our
16 formulation of the net equity, those individuals, even though
17 they dealt in the triangular transaction, they are being
18 permitted to have a claim in the case and recover from the
19 assets of the estate, just like anyone else who invested
20 directly with Telex.

21 Additionally, not only are we allowing those
22 individuals who lost money to, to participate in the estate,
23 but to the extent we are excluding individuals, we're excluding
24 individuals who became net winners and those individuals for
25 the calculation of net winners under the formulation approved

1 by the Court not only includes money directly paid down by
2 Telex when you cash in a credit, but also includes the money
3 that those individuals may have received as part of a
4 triangular transaction.

5 So in the overall formulation of the claims we have
6 recognized this triangular transaction as a, as a transaction
7 that involved the debtor and that involved the transfer of the
8 debtor's property. If you do not permit the trustee, then, to
9 proceed to recover against the net winners who, in fact, have
10 stopped the transaction halfway through and you -- the --
11 the -- and you will no longer be -- you won't allow the trustee
12 to recover back for the benefit of all the estates that amount
13 of money that the net winners received. In other words, you
14 have, in order to balance it, you need not only the sort of,
15 the credit coming in, the claim coming in, but to recover where
16 the money went that gave rise to the claim.

17 THE COURT: Right, which I -- which is -- what I
18 understand the PIEC to be saying, that's not a problem because
19 they're going to give you all the money they recover and so
20 that the, the claims process will be identical.

21 MR. BENNETT: They can't.

22 THE COURT: Why not?

23 MR. BENNETT: Well, two reasons. First of all, the,
24 what the PIEC has been arguing, somewhat later on in my
25 argument, but I'll pick it up now, is this issue of a

1 particularized claim. Now in order to have a particularized
2 claim it does have to be the individual claim. It can't be a
3 general claim, can't be a claim that all the creditors share.
4 It's got to be a specific claim. In other words, as
5 Mr. Baldiga repeats on various occasions, Mary Smith takes a
6 hundred dollars and pays it to Johnny Jones. Mary Smith should
7 have the right to recover that hundred dollars. Well, if
8 that's the case, then that's Mary Smith's recovery. There's no
9 basis upon which Mary Smith should have to share that recovery
10 with anyone else. It's her claim, just as Mr. Baldiga's
11 argued. It's the victim's claim. It's the victim's money.
12 They shouldn't be deprived of that right.

13 So what are we going to say? You can go and collect
14 that money, but you can't have it? It's your own money, but
15 you have to share it?

16 THE COURT: Well, that's what I'm trying to
17 understand, as to, as to what happens in the Multi-District
18 Litigation class action with the money that's collected and how
19 it gets distributed.

20 MR. BENNETT: I think there's two points. I'm sorry.
21 I didn't mean to interrupt.

22 THE COURT: Go ahead.

23 MR. BENNETT: There's two points in that. First of
24 all, if you look at what is pending up there now, which is,
25 primarily, the actions against the financial institutions and

1 certain other, other entities that dealt with the debtor
2 directly, if you look at those, those actions, that money would
3 come in, be collected by the PIEC, and then that money would be
4 distributed to the members of the PIEC's class, just like any
5 other class action. There'd be no obligation to transfer that
6 back to the estate 'cause it's their claims, their money. They
7 collect it, they distribute it. Now whether they come up with
8 some other arrangement is not a matter of law, may be a matter
9 of accommodation. But at least as a matter of class action it
10 would be up to them to collect it and distribute the money.

11 You can't bring, you cannot bring a class action with
12 respect to the other set of claims, the particularized claims.
13 Those claims have to be brought by each individual creditor.
14 They have to be brought by that creditor and since it's an
15 unjust enrichment claim, it has to be brought by that creditor
16 against the specific individual that received that, received
17 the money from the victim, as characterized by Mr. Baldiga.

18 So what you, what you are looking at is millions of
19 potential individual claims of an individual right to recover
20 the money and to retain the money for themselves.

21 THE COURT: You say you cannot bring a class action on
22 the, on these particularized claims, but that's what's
23 happening. That is the, the request in the District Court, is
24 to, is to have that litigation designated as a class action,
25 no?

1 MR. BENNETT: Well, they have brought a action in the
2 District Court, the Dos Santos action, separate from the, what
3 we call the MDL action. This is the -- this -- this was sort
4 of a second complaint that --

5 THE COURT: Yes.

6 MR. BENNETT: -- was stayed by Judge Hillman.

7 THE COURT: It's, it's been stayed, yes.

8 MR. BENNETT: And in that action they have asserted
9 this general claim of unjust enrichment, but they have not
10 identified the plaintiffs as being a specific victim of the
11 defendants. They have made it in a very general way.

12 So they have not asserted in any way particularized
13 claims in the class action, just the opposite. They have just
14 asserted some general claim on behalf of all creditors. I
15 think that fails. I think as a class action that would fail,
16 Your Honor.

17 In any event, by their own admission, that class, that
18 action does not assert particularized claims and, therefore,
19 one doesn't fall within the Mr. Baldiga's arguments now.
20 There's not an action that can be pursued in the District Court
21 on behalf of each separate individual. And again, I think
22 would fail as a class action because one of the things you have
23 to prove for unjust enrichment is that the person who received
24 the money knew that they were receiving a benefit for which
25 they weren't entitled to retain. I suspect in most of these

1 cases the promoters, most of the promoters, were accepting the
2 money as part of the triangular transactions and believed that
3 they had the absolute right to retain the money because they
4 were conferring a benefit upon the recruit because they were
5 getting the recruit to be brought into the TelexFree case and,
6 in fact, they were -- "they," the promoters -- were paying what
7 they thought was good consideration by redeeming their credits.

8 In any event, it's a, it's an individual, to the
9 extent you find it's an individualized claim as unjust
10 enrichment, you'd have to go through each individual element as
11 to whether it's equitable in each individual case and you can't
12 do it on general allegations that have been raised in their
13 pleading. In fact, if the Court looks, goes back and looks
14 back at the Dos Santos action, you will see that they don't in
15 any way assert that they as plaintiffs had any specific
16 dealings with the defendants they named. All they say is that
17 these defendants were top promoters and participated in the
18 TelexFree scheme and, therefore, were unjustly enriched by
19 their participation in the scheme, but they do not say they
20 were unjustly enriched because of any transfers made by Ms. Dos
21 Santos. And, in fact, they've withdrawn almost all the other
22 putative defend, putative plaintiffs in that case.

23 THE COURT: How do you respond to Mr. Baldiga's
24 assertion that he has a much stronger case and you're -- you're
25 -- you're -- it's not slam dunk that you're going to win this

1 case and in that case everybody loses?

2 MR. BENNETT: Well, I suppose to some degree, Your
3 Honor, I think Mr. Baldiga --

4 THE COURT: Well, to make it, to make it more
5 specific, if you were to bring individual claims against each
6 of the promoters by each of the victims, it's a slam dunk.
7 It's -- you -- "I paid you 'X.' You didn't give me what I,
8 what I bargained for. Give it back to me," right?

9 MR. BENNETT: I don't think it's that easy, Your
10 Honor. As again, I said if you look at the unjust enrichment
11 cases, you need to show that there's a transfer. You need to
12 show that at the time of the transfer the person who was trans,
13 the person receiving the money was knowing that they were
14 getting a benefit for which they weren't entitled to and you
15 have to apply the equitable, equities of each specific case.
16 What was the circumstances by which that money was given, you
17 know. What did each --

18 THE COURT: You have all that information, he says,
19 and you can make his case very easy.

20 MR. BENNETT: Well, no, Your Honor. We don't have the
21 information with respect to what did the two parties do. What
22 was the transaction between the two parties? What did the,
23 what did the defendant, the individual defendant know when he
24 took that money? When he -- when he sent that -- when he asked
25 for the credits to pay the invoice, what -- what was he

1 think -- what was his transaction, what benefits would he
2 receive? What was he giving up? And how does the equities
3 apply to each specific case? That, we don't have. That, that
4 would have to be litigated in each case 'cause each case would
5 be unique.

6 What we do have is generalized information for which
7 we can probably coordinate each time that somebody used credits
8 to pay an invoice for somebody else and get a user account. We
9 believe our system would do that, but it doesn't tell us what
10 the circumstances were of the situation as opposed to our case,
11 which is fairly straightforward, Your Honor. Our case is a
12 fraudulent conveyance case and under the Ponzi scheme -- and
13 you have already found that this is a Ponzi scheme -- --
14 there's a presumption and the presumption is that any transfers
15 were made with the actual intent to hinder, delay, and defraud.

16 So that's been ruled upon and that order that you
17 entered was an order that was binding not only in the context
18 of the particular motion, but the way that order was entered,
19 we sent service out to everybody and we notified every
20 potential member of the class action that that specific finding
21 is going to be applicable to these fraudulent conveyance cases.
22 So there is the -- there is the presumption. There is the
23 finding of actual intent to hinder, delay, and defraud with
24 respect to the transactions.

25 So our class is much simpler. Our case -- the only

1 issues that really complicate our case to any degree is the
2 application of the methodology for which we arrived at the
3 particular transfers. And the question with that will be is,
4 is (a) the Sieg (phonetic) system, which is the recording
5 system of TelexFree, was that -- is that -- can we establish
6 sufficient validity to establish that they, to use the
7 information that's contained there and (b) the methodology that
8 the trustee applied in order to aggregate user accounts to each
9 individual so as to determine whether an individual was a net
10 winner or a net loser, is that, was that methodology reasonable
11 and should that methodology be adopted to find that the, the
12 ultimate transfer, yes, is the actual fraudulent conveyance.

13 That's the same issue that they're going to have.
14 'Cause the PIEC, if they're going to rely upon our information,
15 then they're going to have to do the same thing: (a) establish
16 the reasonableness of the system and (b) establish the
17 reasonableness of the trustee's methodology to match user
18 accounts to individual and to show that the transactions
19 occurred within those user accounts.

20 So the cases are the same as far as the underlying
21 facts. Our case, once we establish the underlying facts, we
22 have the presumption of the actual intent. They still need to
23 prove each and every individual element as to each individual
24 case. And that's not a class action. They haven't brought
25 that action. They haven't brought any of those claims in a, in

1 their Dos Santos case or in the Murdoch case -- I'm sorry -- or
2 in the MDL case.

3 The second formulation upon which the trustee, or a
4 second reason upon which the trustee argues that these, that
5 the Court should find this is property of the estate is the
6 question with, is the argument that the promoters were acting
7 as agents on behalf of TelexFree. And in -- that -- with
8 respect to that particular argument, I would draw the Court's
9 attention to Paragraphs 5 through 18 of the trustee's factual
10 statement where we lay out all the basic facts to establish the
11 nature of the transaction. Now much of this I've already
12 stated, which is related to how the triangular transactions
13 operated. We know that the, on the financial records these --
14 these -- these collections or this money was being treated as
15 revenues. We know that the redemption of the credits is part
16 of the -- part of these transactions were being treated as a
17 commission or an agency pay, or an agency fee. We know that,
18 according to the records and the profit and loss statements,
19 that TelexFree would record payments in two different
20 methodologies. One would, it would have a reference of Paid
21 Thru Bank, in which case we knew that was a direct payment.
22 And then the other one was Paid Thru System, which we knew was
23 a paid through a triangular transaction. But in both
24 instances, those are reflections on the records of revenues to
25 TelexFree and then we know that they would similarly show the

1 offsetting expenses for commissions on triangular transactions
2 and we know that they issued 1099s out to the promoters for
3 these monies.

4 I would also point out that in the PIEC's own
5 complaint, the Dos Santos action that they filed, they make
6 allegations which would support a finding of agency. Paragraph
7 136 of the PIEC's complaint, they say that "Telex's top
8 promoters at all times acted according to the directions of
9 TelexFree." Now this is in the PIEC's own complaint. It's a
10 binding admission on their part and it's a statement that "the
11 top promoters at all times acted according to the direction of
12 TelexFree." It's an agency requirement.

13 They go in Paragraph 137, "Telex provided all the
14 promotional materials and coordinates and controls the
15 dissemination of such materials." Again, Telex controlling the
16 actions of the agents. This is not a statement by the trustee.
17 This is a statement by the PIEC in their complaint and it's a
18 binding admission on their part.

19 And then it goes on to say that, "TelexFree would
20 also" -- Paragraph 138 -- "would also provide to the promoters
21 marketing materials in order to promote the transactions."

22 So by their own admissions and their own pleadings,
23 Your Honor, they have established the requisite elements for
24 agency and certainly requisite facts from which the Court can
25 conclude that the promoters were acting for, acting as an agent

1 for TelexFree.

2 And I'd submit that under either one of those
3 formulations, either applying the equitable principles or
4 applying the facts to establish agency, we've established a
5 sufficient basis to conclude that TelexFree had, and I would
6 quote, "conceivable interest of the debtor," "of the debtor,
7 future, nonpossessory, contingent, speculative, and derivative,
8 is within the reach of the bankruptcy estate."

9 So every conceivable interest of the debtor, whether
10 it's a future interest, a non-possessory interest, contingent,
11 speculative, derivative, is within the reach of the bankruptcy
12 estate. That's a quote out of Madoff II, 740 F.3d 81 (2014).
13 So based --

14 THE COURT: Give me that quote, give me that cite
15 again.

16 MR. BENNETT: It's 740 F.3d 81. I think we refer to
17 it as Madoff II.

18 THE COURT: What about the, the promoter contract? It
19 specifically says it's not an agency relationship.

20 MR. BENNETT: It does say that, Your Honor, but then
21 it goes on to talk about what the, what the promoters have to
22 do, what representations they can make, and you also, and it
23 also provides for the specific types of transactions that we're
24 talking about here with respect to the redeeming of the credits
25 to pay invoices of others and you, you look at the contract,

1 but then you can step outside the contract and look at what did
2 the parties do. 'Cause you have two things. You have what the
3 contract says and then what, in reality, occurred. And
4 clearly, when you look at what, in reality, occurred you find
5 that they were acting on behalf of TelexFree and that there was
6 sufficient actions on the part of all the individuals from
7 which the Court can conclude that these individuals were
8 agents.

9 So the mere fact that they say there's no agency
10 agreement and then you go on and, in fact, act as agents,
11 promote yourself as an agent, you can find, you can conclude
12 there's an agent, notwithstanding the contract, itself.

13 Again, even on, even on that basis, Your Honor, it's
14 important to, to, to fit within the confines of the case that
15 the promoters, the agents, had nothing to sell. They couldn't
16 deliver a product to their recruits. That product could only
17 be delivered, that item, that, whatever they were, what they
18 were selling as part of the scheme, that could only be sold by
19 TelexFree and TelexFree had to be a participant in the
20 transaction and if it was not a participant in the transaction,
21 it couldn't have occurred. The recruit couldn't become a
22 member, wouldn't have got a user number, and couldn't have been
23 engaged in his own activity to earn credits and recruit other
24 individuals.

25 Now back slightly more or back again briefly on the

1 particularized claim, the first point on particularized claim
2 is that even if the Court finds that it's a particularized
3 claim that doesn't mean that the trustee's action is
4 prohibited. As Mr. Baldiga pointed out towards the end of his
5 argument and the cases he was referencing, there are cases
6 where the trustee would be permitted to pursue the fraudulent
7 conveyance action 'cause that's clearly property of the estate
8 and at the same time an individual could pursue an
9 individualized claim if it was separate and distinct from the
10 fraudulent conveyance. In other words, if the individual said,
11 "I" -- "I" -- "there was a specific misrepresentation to me by
12 the promoter and I'm suing on that misrepresentation," that
13 would be different than the trustee's claim and you could have
14 two claims pursuing it.

15 In that situation, Your Honor, though, we would, we
16 asked in our complaint that the Court use its 105 powers to
17 prohibit the individuals from pursuing those actions. Even if
18 the -- therefore, even if the Court was to find that it was a
19 particularized claim, they should not be permitted to proceed
20 and they should be prohibited under 105 from proceeding on the
21 basis of two, two bases. The first is that you would interfere
22 with and severely restrict the trustee's ability to make
23 recoveries on the fraudulent conveyance 'cause, clearly, no
24 promoter's going to want to make a settlement with the trustee
25 and at the same time be exposed to these third-party claims.

1 And more importantly is that if you allow these
2 millions of claims to be brought, you're now going to have a
3 completely unwieldy situation of thousands of individual
4 creditors out there pursuing thousands of other defendants,
5 some of which will be net losers, some will be net winners.
6 You could have net winners suing net winners. Net losers suing
7 net winners and net losers suing net losers. And at that point
8 the PIEC cannot, can no longer control who's bringing those
9 because the individuals -- it would be an individual claim who
10 could hire an individual attorney and bring the individual
11 claim against another individual winner.

12 The chaos that would ensue, Your Honor, does form a
13 basis for the Court to grant an injunction under 105 so that
14 all the litigation, all the recoveries are, are brought within
15 the bankruptcy case by the trustee in one coordinated action;
16 actually, two coordinated actions, one in the foreign class
17 action and one in the domestic and that would then allow for
18 and promote what should be the cardinal principle underlying
19 all of this, which is the equality of distribution. That
20 equality of distribution, that principle, is the underlying
21 principle of all the Ponzi scheme cases and in each instance
22 when the court fashions a remedy to allow the trustee to make a
23 recovery it wasn't ordered to obtain the result of equality of
24 distribution.

25 Initially, in the Madoff case and the Ponzi scheme

1 cases these so-called suits to recover the fictitious profits
2 were challenged under much of the basis that Mr. Baldiga cited,
3 which is that there was no real transfers here. And what the
4 court said was, is that, "We're going to allow those, the
5 trustee to pursue those claims because what we want to do is we
6 want to equalize the recoveries. We want an equality of
7 distribution. We want to recover the monies that came out of
8 the estate that were investors' monies that should come back
9 into the estate so that all the victims, investors, net losers
10 can be treated equally and receive an equal distribution."

11 That's what the trustee's trying to accomplish and
12 will accomplish by pursuing these two class actions to recover
13 against the net winners the amount of money that they received
14 over and above their initial investments. On that basis, Your
15 Honor, I'd ask you to deny the PIEC's motion for summary
16 judgment and allow the trustee's motion for summary judgment.

17 Thank you.

18 THE COURT: Before you sit down, can you respond to
19 Mr. Baldiga's observation that the trustee has not pursued
20 promoters just for recovery of the credits?

21 MR. BENNETT: I'm sorry? For the recovery of the
22 credits?

23 THE COURT: Yes. In other words --

24 MR. BENNETT: We have sued all of the -- the class
25 action is to recover all transfers of monies to the net

1 winners --

2 THE COURT: Right.

3 MR. BENNETT: -- either their direct payments or as
4 part of those triangular transactions.

5 So any money that went to a, to a individual that
6 resulted in that individual becoming a net winner --

7 THE COURT: Uh-huh (indicating an affirmative
8 response).

9 MR. BENNETT: -- the amount of the net winnings is
10 being pursued, both the direct payments and the triangular
11 transactions. We have not distinguished in the pleading
12 between those two. We haven't said that we're -- we haven't,
13 we haven't in any way distinguished it. We've, we've applied
14 the Court's formula for net equity, determined how much net
15 equity a particular defendant would have received, and that's
16 the amount, whether it's from direct or indirect payments.

17 THE COURT: All right. Thank you.

18 MR. BENNETT: Thank you, Your Honor.

19 THE COURT: Mr. Baldiga?

20 MR. BALDIGA: No. Do you want to --

21 MR. BENNETT: No, no. I'm fine.

22 MR. BALDIGA: Thank you, Your Honor. A few points in
23 reply.

24 Your Honor, I think -- your first question to
25 Mr. Bennett was, obviously, the key one. So I, I want to go

1 right to there. I mean, the cases do absolutely require
2 diminishment and as I said at the beginning of my presentation,
3 we think, actually, that's where this starts and, and ends. I
4 mean, if, if you don't have diminishment, you don't get into
5 any of this other stuff. And Mr. Bennett gave you a straight
6 answer to your straight question. He said, "Turn to Page 20 of
7 our response because we, on the answer to diminishment, Page
8 20, we collect the cases that respond to the diminishment
9 argument." So that's what I'm going to do.

10 THE COURT: Page 20 of whose response?

11 MR. BALDIGA: Page 20 of the trustee's brief at Docket
12 51.

13 THE COURT: Trustee's brief in support of its --

14 MR. BALDIGA: Yes.

15 THE COURT: -- motion for summary judgment?

16 MR. BALDIGA: Yes.

17 Okay. So that's his answer. That's the question
18 everybody knew that was coming. So that's his answer to your
19 question tell me why diminishment is not required. It also
20 goes to particularized harm. I mean, they're, they're really
21 the inverse parts of it. So let's go through each of the six
22 cases.

23 Ramirez Rodriguez, I'm not going to do the cite on the
24 record here, Your Honor, because the cites are right in the
25 brief. So I'm not going to go farther there. This was

1 entirely about cash in the debtor's estate. The, the case
2 concerned with the defendant's, defendant's belief that the
3 debtors were engaged not in a Ponzi scheme, but in an illegal
4 business and the court said, "Your belief is irrelevant. You
5 got money out of the debtor."

6 So the recipient of the transfer of debtor's money by
7 the debtor loses. Obviously, there was direct diminishment
8 there.

9 Next, Universal Clearing House, quoting from the
10 decision at Page 124 to 125:

11 "We therefore conclude that, where a debtor obtains
12 money by fraud and mingles it with other money so as
13 to preclude any tracing and where the defrauded party
14 does not timely avoid the transaction, the money is
15 'property' of the debtor within ... 548."

16 I agree with Mr. Bennett. This case is directly on
17 point and in that case it was squarely comminglement,
18 commingling. So the, the second case cited by Mr. Bennett for,
19 that there doesn't need to be diminishment is exactly to the
20 contrary.

21 Third, Hedged-Investments. I, I cited to this case
22 decision, Your Honor, several times in my opening comments.
23 Here, the trustee was trying to stand in the shoes of the
24 debtor. The victim wins, I mean, the, the trustee loses this
25 case cited by Mr. Bennett. (Reading):

1 "The estate's rights are no stronger than when they
2 were actually held by the debtor. Congress intended
3 the trustee to stand in the shoes of the debtor and
4 'take no greater rights than the debtor himself had.'
5 So the trustee for his standing in the case may not
6 use his status as trustee to insulate the partnership
7 from the wrongdoing of Mr. Donahue," the bad, the
8 schemers.

9 Trustee loses.

10 So there, diminishment doesn't come up, but the
11 trustee -- this is where the trustee intend, tried to recover
12 monies under the partnership agreement. That's why I cited
13 that. I'm not sure why Mr. Bennett cites that since it goes in
14 favor, goes in our favor, but it certainly doesn't stand for
15 commingling is not a requirement.

16 International Loan Network. Actually, I don't have
17 that one in front of me.

18 THE COURT: All right. So you're telling me that
19 these cases the trustee is bringing to bear are either, they
20 don't stand for the proposition that he's saying they do or
21 that they, they don't help him on the facts. I, I can read the
22 cases. I understand them.

23 MR. BALDIGA: Yeah, but I -- I just -- I, I want to go
24 to, to Baker & Getty. And this'll be the last one. But
25 without exception, Your Honor, Baker & Getty -- I'm reading

1 from the decision at 195. This is, again, Mr. Bennett's cite
2 for diminishment. (Reading):

3 "A transfer is avoidable as a preference only if the
4 transferred property or interest in property
5 diminished or depleted the debtor's estate."

6 And it cites like a handful of cases for that proposition.

7 It also has, just like Mr. Bennett said, the
8 definition of, of "property" is very broad.

9 But going on:

10 "There is also formidable judicial precedent by courts
11 reviewing transfers in a Ponzi scheme. The reviewing
12 courts have concluded that when a debtor obtains money
13 by fraud and mingles it with other money so as to
14 preclude any tracing and when the defrauded party
15 accepts benefits under the contract, the money is then
16 'property' of the debtor's estate."

17 So Todman (phonetic), Geltzer, they all go the same
18 way. They -- these cases are all either the trustee loses or
19 there was commingling and diminishment. And as you saw from, I
20 mean, it didn't take me that long to find the exact quotes.
21 They all stand for the proposition that commingling is, indeed,
22 required.

23 So, Your Honor, and, and again, I thought this
24 argument should, I mean, we've all got to cover all our bases
25 and so forth -- and 105 certainly comes up at the end of

1 anything -- but diminishment, in every other Ponzi scheme
2 case, diminishment starts and ends the argument. It doesn't --
3 we don't go beyond that.

4 You asked the question credits redeemed for cash, any
5 dispute. Yeah, that is one of the things we dispute. We don't
6 -- and remember, on the trustee here, first, we don't, we don't
7 accept that. The trustee is saying there were a hundred
8 thousand net winners. Those are the people who are targets of
9 this litigation. No one's going to sue a hundred thousand
10 people. We'll all take the biggest ones, obviously.

11 I guess it's conceivable that a couple of them got
12 cash, but that hasn't been pled and it certainly -- let's say
13 if Joe Smith redeemed his credits for cash. That doesn't mean
14 that Mary Smith was the subject of some sort of property of the
15 estate without commingling. The trustee is making a blanket
16 allegation that all of the promoters, that under Kaplan victims
17 have a right to sue. He's now saying for the first time,
18 "Well, every one of you victims can't sue the person that you
19 handed the money to because maybe a couple of them redeemed
20 their credits for cash." Well, if I'm Mary Smith, "What some
21 other promoter did has nothing to do with me. You're not
22 saying my promoter redeemed anything for cash. I have the
23 right to sue. Kaplan, the Supreme Court says I have the right
24 to sue."

25 But in any event, we dispute that, but the trustee,

1 the trustee's facts belie it, in any event, because you asked
2 before about --

3 I'm sorry?

4 -- about preferences. Well, if someone in the two
5 years prior to the commencement of the case did redeem a credit
6 for cash, that's a, that's clearly a preference. Hasn't been a
7 single preference case brought. You don't have to show any --
8 there's no standing issues. There's no competition with us.
9 If someone got -- and, and we tried to stress this, but it's --
10 we've tried to tell the trustee from the beginning, "If
11 something came out of TelexFree, it's all yours." That's --
12 it's a red herring, Your Honor. We're not here litigating
13 about anything that came out of the debtor and if someone got
14 cash on their credits, go for it, Trustee. You should have
15 sued for that and we cheer you on and we don't touch that with
16 a ten-foot pole. We don't have the right to. We know that.

17 But it's a, it's a clear preference action and,
18 hopefully, the trustee has brought whatever ones he thought
19 factually existed.

20 Third, the trustee criticizes, unfortunately, the
21 specificity in the District Court action in terms of our
22 allegations because after a year or 18 months the trustee
23 stopped sharing information that he has, that these victims
24 paid for, stopped sharing the information with us that we would
25 need to be more specific. I -- that's really unfortunate on

1 many levels, but we've accepted that that's, unfortunately,
2 where we are.

3 The trustee argues from that that, boy, there's no way
4 here and, and it's the particularized harm. I, I know of a
5 case, Your Honor, in which there were, there was an MDL and a
6 chapter 11 case and, and a criminal proceeding. The harm there
7 was not the payment of cash, but it was doctors all around the
8 country injecting tainted steroids into the spines of a
9 thousand people. I represented the Committee in that case, New
10 England Compounding. There, unfortunately, there was quite a
11 turf battle between the trustee and the, and the PIEC. Called
12 something different in that case, but we represented the
13 Committee and we brokered a deal.

14 What could be more particularized than a doctor taking
15 a needle and sticking it in someone's back and killing that
16 person? That's the particularized harm in that case. And the
17 trustee is arguing here that, "Well, geez, we just don't," you
18 know, "when there's particularized harm, Baldiga and his
19 cohorts in the PIEC could never do anything that produces a
20 just result for everyone." Well, we did. We did. In that
21 case, even though, unfortunately, the turf battle was allowed
22 to go longer than it should have, there was a --

23 THE COURT: In what, what case? You say --

24 MR. BALDIGA: New England Compounding.

25 THE COURT: Yeah.

1 MR. BALDIGA: There was a \$200 million in cash
2 assembled for victims -- and again, nothing is more
3 particularized than death at the hands of a particular doctor
4 who contributed into a pot -- and those monies are being
5 distributed to the class entirely through the bankruptcy estate.
6 Why? Because the parties got together and made that happen.
7 And issues that, unfortunately, create turf issues like who
8 gets paid out of what, the courts forced that not to be the
9 driver. That was a just result. Judge Boroff at the
10 confirmation hearing said, "This is what bankruptcy law is
11 supposed to be done at its finest."

12 And I brought that case up a couple times here and I
13 wasn't going to bring it up again, but I have to say --

14 THE COURT: But that was the result that was not
15 imposed by the court. That was a result that the parties
16 consensually presented to the court.

17 MR. BALDIGA: There were objections and they were
18 resolved, but that case was very contentious, initially. And
19 the point that Mr. Bennett was making, was trying to make here
20 was that when there's particularized harm it cannot be a, a
21 distribution, generally, on fair terms. And the point is that
22 there can be. And there, the PIEC distributed the entirety of
23 that money through the bankruptcy estate. And that's what you
24 can do in a case. So --

25 THE COURT: But is that -- but wait. What I'm trying

1 to understand is what is going on in the District Court
2 litigation in the stayed lawsuit, right? We know what we're
3 talking about. The second --

4 MR. BALDIGA: Right.

5 THE COURT: The lawsuit that was carved out and has
6 been stayed by Judge Hillman, right?

7 MR. BALDIGA: Yes.

8 THE COURT: It's the one that would go forward if, if
9 I went your way here. So --

10 MR. BALDIGA: Right.

11 THE COURT: -- that --

12 MR. BALDIGA: We're, we're stayed, altogether --

13 THE COURT: Right. That's a --

14 MR. BALDIGA: -- with every promoter action.

15 THE COURT: Is that a class action, or isn't it?

16 MR. BALDIGA: It's -- there are some class -- there,
17 there is a class action. There is also -- there -- and there
18 has been since 2014 -- particular actions.

19 Now in an MDL, they're all consolidated --

20 THE COURT: Okay.

21 MR. BALDIGA: -- and procedurally consolidated before
22 Judge Hillman. In 99 percent of the MDLs, there is at the end
23 of the day a class action order that governs distribution, not
24 too unlike a chapter 11 claim where if parties think -- I mean,
25 recently, the NFL head injury case, that was an MDL and there

1 was a matrix of harm and there was a -- and people fought like
2 crazy, but the court -- and it went up to the Circuit Court --
3 decided that that was, even notwithstanding some vociferous
4 objection by a lot of parties, that was a just and fair result
5 on the whole. Again, very particularized harm by people who
6 are suffering grievous injury.

7 Here, Judge Hillman has it within his power to do that
8 or he could at the end of the day say, "You know what? There
9 are common issues" -- and I'm going to get to unjust enrichment
10 in a minute -- "that on a class basis I'm going to resolve all
11 the common issues, then I'm going to send them back to the
12 originating courts. Because you know what, Mary Smith? You
13 have the right now. I've decided. This was unjust enrichment,
14 but you can go back to Seattle and sue the person there and
15 finish your lawsuit." That's okay. I mean, that happens
16 rarely because there's so much momentum built up for this.

17 But in every MDL, it's a, an amalgamation of
18 individual lawsuits that have been consolidated by the JPML,
19 the, whatever that is, because they thought there were common
20 issues and are most efficiently organized, dealt with,
21 administered by a single District Judge. And that's what we
22 have, but it doesn't dictate that you necessarily end with a
23 common fund.

24 But virtually always you have a so-called common fund.
25 Certainly our intention there and certainly as I've, again,

1 stressed many times it would be, as in New England Compounding,
2 it would be our intention to have the common fund flow through
3 the estate here. But we can create a common fund and there are
4 so, I mean, and because think about it. Mary Smith gave Joe
5 Jones her \$10,000. Joe Jones probably got \$10,000 from 500
6 people. The trustee has this information. We could have it if
7 they wanted us to have it.

8 So it's not as simple as Mary Smith versus Joe Jones,
9 but it's 500 Mary Smiths versus Joe Jones. There are very good
10 reasons for the common fund theory to apply. And we think
11 that's exactly what will happen. And that is, actually, what
12 happens in real life in these cases.

13 THE COURT: So, Mr. Baldiga, doesn't what you just
14 told me explain why you cannot have the argument of
15 particularized harm and also the kind of Multi-District
16 Litigation class action procedure, that that essentially
17 vitiates the particularized harm prong of your argument?

18 MR. BALDIGA: No.

19 THE COURT: Are there any cases --

20 MR. BALDIGA: It's, it's the exact opposite

21 THE COURT: Are there --

22 MR. BALDIGA: -- because Mary Smith has --

23 THE COURT: -- any of these cases, any of those cases
24 the Second Circuit, or anywhere else, where they, where they
25 find that there is particularized harm and they, and they

1 prevent the trustee from asserting the claims where that, where
2 those victims are part of a class action?

3 MR. BALDIGA: Standing on my feet like this, I, I
4 don't know, Your Honor, but the fact is there's been no class
5 certified. They may not be class actions. We have pending
6 matters that are not class actions. Judge Hillman has not even
7 gotten close to the class status. We intend to have victims
8 sue the people they handed the money to and even a class
9 action, Your Honor, the class action is only as to the common
10 elements of those claims. It wouldn't be as to particular
11 dollars from Mary Smith to Joe Jones.

12 So it's only as to the unjust enrichment aspect to it,
13 just as sort of what the trustee has asked here, but it doesn't
14 at all defeat the requirement that a trustee has rights only
15 where there is no particularized harm. Nothing is more
16 particular than money literally being taken out of a, a
17 person's wallet and given to someone. Mary Smith knows exactly
18 how much she wants. That's particular. And, and think about
19 it. The -- the type -- the trustee cites to the case of, well,
20 Madoff, I mean, the Fetters case seems to have been a big
21 fraud. "And GECC, if you hadn't lent to that company, the
22 fraud wouldn't have gone on so long. So I'm suing you, GECC."
23 And the court said, "Your harm is not particularized. All of
24 you victims" --

25 THE COURT: Hmm.

1 MR. BALDIGA: -- "were affected similarly by GECC.
2 Only the trustee can sue GECC." This is the exact opposite.
3 There's never been any question that we're suing specific
4 promoters.

5 On unjust enrichment Mr. Bennett misstates the
6 requirements. There is a transfer. Well, that's easy. I take
7 the money out. I give it to someone, a transfer. And then
8 Mr. Bennett said, wrongly, that we have to prove the knowledge
9 on the part of the recipient of some wrongful intent. No,
10 that's actually not the law in this context. And we briefed
11 this in the District Court. Never really came up here. We
12 only have to show that the recipient knew of a benefit. Well,
13 with cash, that's really easy.

14 So for unjust enrichment we have to show a transfer,
15 knowledge on the part of the recipient that it was receiving a
16 real benefit. There was something about this. And then, just
17 the unjust part of it, it would be unfair for that recipient to
18 keep it. We don't have to show bad intent on the part of the
19 recipients, but we'll get to that litigation later on.

20 But I didn't want the Court to be misled by a,
21 something that we had to prove. That just, the case law
22 doesn't bear that out.

23 THE COURT: Hmm.

24 MR. BALDIGA: On the agency, the trustee cherry picks
25 a couple of allegations. We do think that TelexFree controlled

1 the marketing materials. And the parts of the brief, of our
2 complaint cited there, we agree completely. The marketing
3 materials seemed to be controlled by TelexFree.

4 Finally, Your Honor, Section 105.

5 THE COURT: Well, you also say -- he says you say in
6 your complaint that the promoters acted according to the
7 direction of TelexFree.

8 MR. BALDIGA: Well, that's in connection with how they
9 marketed this thing, but it doesn't, I mean, we do have, again,
10 the facts in front of us. We have a contract and the contract
11 couldn't be more clear that --

12 THE COURT: Right. But you, you agree that, that the
13 contract isn't the end of the inquiry in terms of an agency
14 analysis, that what actually happened is relevant and, and can,
15 in fact, override the contract if the parties acted
16 differently.

17 MR. BALDIGA: Well, no, I would not agree that you
18 could have people who acted as to a certain part of a scam in
19 accordance with TelexFree's instructions to use only our
20 marketing materials, but in other ways did not. And when
21 TelexFree says, "You are not employees. You are not agents.
22 You are not under our control," and for reasons that were
23 important to TelexFree, which are the shoes the trustee has to
24 stand in, "You are free agents," for, in all I picked.
25 TelexFree didn't want to control them. They wanted them to go

1 out and get as much money as they could. And TelexFree wasn't
2 telling these people, "You go to this church basement and
3 collect this money from the Nigerian community," and so forth.
4 They did that. Promoters were doing this on their own.

5 So the facts do not belie the contract. The fact that
6 in one particular aspect of their relationship, TelexFree said,
7 "Use only these marketing materials," doesn't subvert the
8 entire situation. In fact, it'd be kind of amazing if agency
9 was established because of the ten aspects of a relationship
10 one was under control and nine weren't. And that's, that's
11 what happens when you cherry pick.

12 Section 105, Your Honor, finally -- I won't go into
13 this much more -- but, I mean, you do go there when, you know,
14 the facts or the law don't give you what you need such as
15 diminishment here, again. But, you know, it's black letter law
16 that Section 105 of the Code doesn't enable a party to do what
17 the Code otherwise does not permit.

18 And we start here, again, and I'm going to conclude
19 with Kaplan. The Supreme Court found it appropriate to say in
20 this context in 1972 that individual victims have the right to
21 sue in their own name for harms caused to them. And as the
22 Madoff court said and the Hedged-Investments court said, if the
23 trustee is going to find an exception to that it has to be
24 based in the Code. And in the area of 548 it is -- in the
25 seven cases now cited to you by the trustee and even now asked

1 to be more specific, every single one of them had commingling
2 and diminishment of the estate, period. End of story, again, I
3 submit. There is no case without that.

4 Thank you.

5 THE COURT: Thank you.

6 MR. BENNETT: Could I briefly respond, Your Honor?

7 THE COURT: Briefly.

8 MR. BENNETT: It will be brief, Your Honor.

9 With respect to the diminution of the estate and the
10 section that I was quoting out of my brief, I would note that
11 Mr. Baldiga did not recite to the Court the last case that is
12 cited that has the quotation attached. That's In re Geltzer,
13 G-E-L-T-Z-E-R, 520 B.R. 720. (Reading):

14 "The net winnings represent fictitious profits that
15 are avoidable as fraudulent transfers because any
16 dollar paid to reimburse a fictitious profit is a
17 dollar no longer available to pay claims for money
18 actually invested."

19 That was the holding of the case to find that, in
20 fact, that's the basis for the diminution of, in the estate.
21 Any money paid out for fictitious profits diminishes the estate
22 because it reduces the money that would have been otherwise
23 available for payment to investors.

24 In our case, to the extent that these triangular
25 transactions monies were paid out from, to the promoters,

1 diminished the money that would be otherwise available for the
2 estate. It's the same argument that was raised in that case.
3 It's the same argument that under, underlines all of the Madoff
4 cases allowing for the recovery of fictitious profits. We cite
5 those cases on Page 20 for the diminution of property of the
6 estate. I would note that Mr. Baldiga was arguing about
7 commingling, which is a different argument and not related to
8 the diminution-of-the-estate argument.

9 With respect to the question of the redemption of
10 credits, I'd ask the Court to look at the various class actions
11 that we brought and you can see that they include a general
12 calculation for net winners. If you'd look at the same
13 complaints, which include actions for preferences for payments
14 within 90 days and for fraudulent conveyances within that time
15 period, and on that basis, Your Honor, I think you can
16 certainly conclude that there were two types of transactions
17 and that there was cash payments for which the trustee is
18 seeking to recover.

19 THE COURT: And these would be -- where, where did you
20 say these are asserted?

21 MR. BENNETT: They're in the complaint, Your Honor.
22 You'll also find the, if you look at the trustee's affidavit
23 that he submitted in connection with the Ponzi scheme motion,
24 if you look at the trustee's affidavit submitted in this case
25 and the U. S. Attorney's, the affidavit of the U. S. Government

1 that's annexed to exhibits in this case, you will find that
2 there was a, two-tier types of payment and that credits were
3 being redeemed for cash. I think it's set forth in numerous of
4 different pleadings here. I find it difficult to believe
5 that's really being disputed.

6 Thank you.

7 THE COURT: Thank you.

8 Okay. This was very helpful for me. I'm sure it was
9 difficult for you, but you did a great job on both sides. And
10 I will do the best I can to come up with a report and
11 recommendation for Judge Hillman on these cross-motions and
12 we'll go from there.

13 Anything else we need to talk about this morning?

14 MR. BENNETT: I don't believe so, Your Honor.

15 MR. BALDIGA: No. Thank you very much, Your Honor --

16 THE COURT: All right.

17 MR. BALDIGA: -- for hearing us out.

18 THE COURT: Just on, off the subject. You know,
19 somebody mentioned Charles Ponzi earlier today, that this is
20 the cradle of Ponzi schemes, Boston, Massachusetts.

21 Does anybody know where Charles Ponzi's office was?

22 Mr. Darr?

23 MR. DARR: Up on Milk Street.

24 THE COURT: Ahh.

25 MR. LIZOTTE: School Street.

1 THE COURT: School Street.

2 MR. DARR: School Street. Sorry.

3 THE COURT: And it's still there.

4 MR. DARR: Right.

5 THE COURT: People used to line up in Pi Alley behind
6 the building to wait for their --

7 MR. DARR: Right.

8 THE COURT: -- payments from him. And that, that's
9 still there to this day.

10 MR. DARR: Along those lines, Your Honor, Mr.,
11 Mr. Ponzi's former home in Lexington, Massachusetts just was
12 sold on the open market about two years ago. It's quite a nice
13 house.

14 THE COURT: Not for the first time, I assume.

15 MR. DARR: No, no. Not for the first time. Yeah.
16 It's been tied up in litigation ever since.

17 No. It's been -- it was -- but it was just sold about
18 two years ago.

19 THE COURT: It's, it's a sad story that that, that
20 that name has gotten to be so infamous, I mean, over the years.
21 When I -- when I -- when I first read the Ponzi biography
22 before -- this was before Madoff and the explosion -- and I
23 mentioned it to my kids at the time -- they were younger --
24 they had no idea what I was talking about and I thought it was
25 very funny. And then all of a sudden they kept hearing about

1 Ponzi schemes now for the last 10 or 15 years. It's quite
2 something.

3 MR. BALDIGA: It's not getting any better.

4 THE COURT: No.

5 Thank you all.

6 MR. BALDIGA: Thank you.

7 MR. BENNETT: Thank you, Your Honor.

8 MR. LIZOTTE: Thank you, Your Honor.

9 THE COURTROOM DEPUTY: The court is in recess. All
10 rise.

11 (Proceedings concluded at 12:23:10 p.m.)

12

13

14 CERTIFICATE

15 I, court approved transcriber, certify that the
16 foregoing is a correct transcript from the official electronic
17 sound recording of the proceedings in the above-entitled
18 matter.

19 /s/ Janice Russell

August 28, 2017

20 Janice Russell, Transcriber

Date

21

22

23

24

25

EXHIBIT 10

Adversary Proceeding
No. 15-4055

Before me are cross-motions for summary judgment filed by the plaintiff, Stephen B. Darr, the trustee in the jointly administered chapter 11 cases filed by Telexfree, LLC, Telexfree, Inc. and Telexfree Financial, Inc. (individually and collectively, “Telexfree”), and an interested party, the Plaintiffs’ Interim Executive Committee (“PIEC”), appointed by the United States

District Court to represent the victims of the Telexfree fraud.¹ In this adversary proceeding, Mr. Darr seeks to enjoin the defendants, individually and as putative class representatives of Telexfree's victims, from proceeding with claims for unjust enrichment in lawsuits filed in the district court against certain participants in the Telexfree Ponzi and pyramid schemes.²

The dispute before me is over who, as between Mr. Darr and the Ponzi scheme victims, is the proper party to pursue recovery from the class of Telexfree participants who profited from the scheme, the so-called "Net Winners." Mr. Darr requests summary judgment on counts I and III of his amended complaint. In count I he seeks a declaratory judgment that the defendants' unjust enrichment claims are property of the Telexfree bankruptcy estates, and in count III he asks for an injunction enjoining the defendants from prosecuting those claims directly. The PIEC seeks summary judgment dismissing Mr. Darr's complaint on the basis that he lacks standing to

¹ The PIEC was appointed to represent victims of the debtors' Ponzi/pyramid scheme by Judge Timothy Hillman of the United States District Court for the District of Massachusetts on December 23, 2014, in the multidistrict litigation pending in that court, *In re: Telexfree Securities Litigation*, MDL No. 14-02566 (the "MDL Proceeding"). See MDL Case Management Order No. 3 attached as Exhibit A to the PIEC's Statement of Undisputed Facts.

² The first action was commenced by Ms. Dos Santos and others in the district court and consolidated in the MDL Proceeding. A motion to amend the complaint to add a count for unjust enrichment precipitated the filing of this adversary proceeding. After the district court denied the motion to amend, a second action was filed in the district court by Elisangela Oliveira and others (CA No. 16-40018-TSH) (the "Oliveira Lawsuit"). Judge Hillman, finding that the second action was an attempt by the class action plaintiffs to circumvent his ruling denying their motion to amend, stayed the Oliveira Lawsuit. Both Ms. Dos Santos and Ms. Oliveira are defendants in this adversary proceeding. On May 26, 2017, Judge Hillman modified the stay to permit Ms. Dos Santos and Ms. Oliveira to amend their complaints to add additional parties and to assert additional counts in order to pre-empt the running of relevant statutes of limitation. See 14-02566-TSH, documents #495 and #503 and 16-40018-TSH, document #12, attachment 1.

prosecute claims against the Net Winners because neither the money he seeks to recover nor the claims by which a recovery may be effected qualifies as property of the Telexfree entities or their bankruptcy estates. An *amicus curiae* brief supporting Mr. Darr's cross-motion for summary judgment has been filed by a group of Net Winners who comprise a certified class of defendants in a separate adversary proceeding brought in the Telexfree chapter 11 cases.³

Procedural Posture

On January 15, 2016, the United States District Court for the District of Massachusetts withdrew the reference in this adversary proceeding but returned the proceeding to this court "to rule on any preliminary or pretrial matters, hear any dispositive motions, conduct a trial if necessary, and submit [to the district court] proposed findings of fact and conclusions of law with respect to any dispositive motions or trial."⁴ After the parties' unsuccessful attempts at mediation, and upon review and consideration of all the parties' submissions and their very able oral presentations, I now submit to the District Court the following proposed findings of fact and conclusions of law pursuant to its order withdrawing the reference.

Facts

The material facts necessary to support a ruling on the cross motions are not in dispute. They are taken from the admitted portions of the statements of uncontested facts filed by the

³ See *amicus* brief, document #89. See also *Darr v. Argueta et al.* Adv. Proc. No 16-4006. The class is represented by the law firm of Milligan Rona Duran & King LLC.

⁴ See 16-40004-TSH, document #2.

parties in support of their respective motions for summary judgment and from the uncontested statements in the Affidavit of Stephen B. Darr in Opposition to the PIEC Motion for Summary Judgment and in Support of the Trustee's Cross-Motion for Summary Judgment (the "Darr Summary Judgment Affidavit").⁵ I also take judicial notice of the dockets in the Telexfree chapter 11 cases, in this and other adversary proceedings filed in the Telexfree chapter 11 cases, and in the Telexfree cases pending in the District Court.

Telexfree's Scheme

Telexfree, LLC, the lead debtor in these cases, is a Nevada limited liability company with its headquarters in Marlboro, Massachusetts.⁶ Telexfree purported to sell cheap long distance telephone service to over 40 countries using Voice over Internet Protocol or "VoIP".⁷ It targeted immigrant communities in the U.S. as well as their countrymen and many others around the

⁵ Document #49.

⁶ U.S. Securities and Exchange Commission's Motion for Change of Venue, Memorandum of Points and Authorities and Declarations of Mark Albers and Scott Stanley (14-40987, document #67). Telexfree, Inc. is a Massachusetts corporation while Telexfree Financial, Inc. is a Florida corporation that is owned by Telexfree, LLC.

⁷ Trustee's Statement of Undisputed Facts, document #48, at ¶ 1. PIEC's Statement of Uncontested Facts, document #40, ¶ 11. *See also* the Affidavit of Stephen B. Darr filed in support of his motion for class certification in *Darr v. Alecci*, Adversary Proceeding No. 16-4007, document #2 ("Darr's Alecci Affidavit") and ¶¶ 21-35 of the Affidavit of Stephen B. Darr in Support of Chapter 11 Trustee's Motion for Entry of Order that Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief, (the "Ponzi Scheme Affidavit"), which is document #623 of Telexfree's main bankruptcy case (14-40987) and attached as part of Exhibit O in the PEIC's Statement of Uncontested Facts, document #40. The Ponzi Scheme Affidavit is also incorporated by reference in the Darr Summary Judgment Affidavit.

world.⁸ Telexfree's real business and the source of almost all its revenue, however, was the recruitment from these communities of members (also referred to as participants and promoters) to sell memberships and VoIP plan packages to others.⁹ Participants received financial incentives to recruit additional members thereby creating an ever-expanding pyramid with money flowing upstream in a gravity-defying process enriching the upper-level members.¹⁰ Telexfree's "products," the long distance calling plans themselves, were a mere pretext to create the appearance that Telexfree had a business.¹¹ It was the right to sell the products and memberships that generated widespread interest among the communities targeted by Telexfree, both domestic and foreign, who believed that participation in the Telexfree program was a fast track to easy street.¹²

Membership in Telexfree's program was ostensibly governed by a contract—an untitled, 16-page, single-spaced, small-print document.¹³ The contract gives the impression, especially to a layperson, of great formality, solemnity and weight, but in fact much of it is incomprehensible.

⁸ Trustee's Statement of Undisputed Facts, at ¶ 1.

⁹ *Id.* at ¶¶ 1-3.

¹⁰ *Id.*

¹¹ *Id.* See also *id.* at ¶¶ 8 and 9.

¹² *Id.* at ¶¶ 2-4.

¹³ Exhibit C to Trustee's Statement of Undisputed Facts. It is unclear whether and how participants executed the contract, if at all.

For example, section 2.2 entitled “Purpose of the Contract” is followed by subsection 2.2.1 entitled “Synthesis of the legal relationship” [sic] which provides:

The user, by accessing the website of TELEXFREE.com [,] can become a member through payment of the respective fee, which will provide access to the TelexFREE Multilevel Marketing network for the period of one year, without extension or renewal. At this stage, the member is called a PARTNER. The PARTNER will have the right to acquire, at an exclusive discount, products that are offered on the website www.telexfree.com, with the principal VOIP telephony accounts called 99TELEXFREE. The PARTNER, upon acquiring them in the form of a kit (ADCENTRAL or FAMILY kit) assumes the title of PROMOTER and, as such, receives a space on the site www.telexfree.com to promote the products/services that he has acquired. He also receives training and access to materials also made available on the TELEXFREE website so that he can undertake to promote the latter and avail himself of the opportunity to be a PARTNER and PROMOTER to others in his circle of relationships. All activities are performed by the PARTNER/PROMOTER without any employment relationship, and they are able individually to manage the team and the resources it seeks to make available for such purpose, of their own free will. For the promotion of products/services he will receive a bonus in direct proportion to his results, based on the levels explained in a separate section in these GENERAL REGULATIONS. He must obey all the clauses of the GENERAL REGULATIONS so that the name of TELEXFREE and juridical persons associated with it remain unblemished. [sic]

When a new member participant signed on to the Telexfree program, Telexfree opened a user account for the member participant.¹⁴ Each user account was registered to a specific email address, thus allowing Telexfree to track participant activity.¹⁵ Participants could have more than

¹⁴ PIEC’s Statement of Uncontested Facts at ¶ 12.

¹⁵ Exhibit O to PIEC’s Statement of Uncontested Facts at ¶ 39.

one user account and, indeed, many of them did.¹⁶ Based on the trustee's reconstruction of Telexfree's database, there are 10,987,617 identified user accounts.¹⁷

Participants would receive credits to their user accounts from Telexfree for selling memberships or VoIP packages or for posting internet advertisements hawking Telexfree's products.¹⁸ These internet advertisements were prepared by Telexfree and made available to members to post *anywhere* on the internet without regard to whether the ads led to a single sale.¹⁹ Indeed, Telexfree's sales pitch promised participants astronomical returns merely for posting these meaningless advertisements.²⁰ Those returns, mostly in the form of credits, like the credit for selling VoIP plans or memberships, were generally deposited into the participant's user account.²¹

When a participant recruited a new member, Telexfree would issue an invoice to the recruited participant for the fees due for the VoIP plan or membership purchase.²² The recruited

¹⁶ Ponzi Scheme Affidavit at ¶ 39.

¹⁷ *Id.* at ¶ 30 and ¶¶ 37-49.

¹⁸ PIEC's Statement of Uncontested Facts at ¶ 13, citing the amended complaint at ¶ 11.

¹⁹ Darr's Alecci Affidavit at ¶ 14. Trustee's Statement of Undisputed Facts at ¶ 2 and the PIEC's response thereto (document #77).

²⁰ Trustee's Statement of Undisputed Facts at ¶ 2.

²¹ Darr Summary Judgment Affidavit at ¶¶ 5 and 9-10.

²² See PIEC's Statement of Undisputed Facts at ¶ 15 and 16.

participant could pay the invoiced amount either directly to Telexfree or to the member who recruited him or her.²³ The recruiting participant could, and frequently did, retain the fees paid by the recruited participant.²⁴ When this occurred, Telexfree considered its obligation to pay the recruiting participant for outstanding credits in the same amount satisfied, treated the redemption of credits as income to the recruiting participant, issued an Internal Revenue Service (“IRS”) Form 1099 to the recruiting participant for credits redeemed and considered the recruited participant’s invoice paid in full.²⁵

The vast majority of fees paid by recruited participants were retained by the recruiting participants in redemption of their Telexfree credits. The face value of all the invoices associated with the sale of Telexfree membership plans or VoIP packages was \$3,073,461,326, but only \$359,792,242 (approximately 11.7%) of that amount was paid in cash directly to Telexfree.²⁶ Telexfree recorded the cash and credit redemption transactions as separate accounting items. When an invoice was satisfied by a cash payment, the revenue was categorized as “payments through bank” while the redemption of credits owed to a recruiting participant who held on to the recruited participant’s payment was reflected as “payment through system.”²⁷ Telexfree’s 2013

²³ *Id.*

²⁴ *Id.*

²⁵ Darr Summary Judgment Affidavit at ¶¶ 10, 19 and 20.

²⁶ See PIEC’s Statement of Undisputed Facts at ¶ 19.

²⁷ Darr Summary Judgment Affidavit at ¶ 15.

profit and loss statement referred to funds retained by a recruiting participant as “Agent Commissions.”²⁸ Telexfree booked “payments through the system” as income to the company and “agent commissions” as company expenses.²⁹

Telxfree’s scheme was predicated upon recruited participants becoming recruiting participants in their own right, thereby creating the pyramid. By the time the scheme collapsed as all such schemes inevitably do, the trustee estimates that Telexfree had a million participants,³⁰ making it perhaps the largest Ponzi scheme in history in terms of number of victims.

The Bankruptcies

On April 13, 2014, each of the debtors filed a voluntary petition for relief under chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Nevada. By orders dated May 6, 2014, the bankruptcy cases and associated adversary proceedings were transferred to this court. On June 6, 2014, Mr. Darr was appointed the chapter 11 trustee in each case upon the motion of the United States trustee.

Subsequent to his appointment, Mr. Darr filed a motion requesting court rulings, for all purposes in the chapter 11 cases, that Telexfree had engaged in a Ponzi and pyramid scheme, that

²⁸ Trustee’s Statement of Undisputed Facts at ¶ 11.

²⁹ *Id.* at ¶ 10.

³⁰ Mr. Darr has estimated that there are approximately 900,000 unique email addresses that are linked to approximately 11,000,000 user accounts. Ponzi Scheme Affidavit at ¶ 39.

the so-called “Ponzi scheme presumption” would apply,³¹ and that accumulated but unredeemed credits owed to a participant would not be included in the calculation of any participant’s proof of claim filed in the bankruptcy cases (the “Ponzi Motion”). Mr. Darr requested that a participant’s claim be calculated as the total amount of money paid by a participant to either Telexfree or another participant less all amounts received by the participant from Telexfree or another participant. This formula, the so-called “net equity formula,” has been adopted by other courts in calculating the claims of victims of Ponzi and pyramid schemes.³² Using the net equity formula, the total amount a participant paid, whether to Telexfree or to a recruiting participant, minus the amount of money that the participant received, whether from Telexfree or a recruited participant, results in the amount of the participant’s claim. Mr. Darr proposed that all user accounts of a participant be aggregated for this calculation. By applying the net equity formula, participants would fall into two categories—“Net Winners” and “Net Losers.” As these terms suggest, Net Winners are those who received more from Telexfree and other participants than they paid to Telexfree and other participants, while the opposite is true for Net Losers. Mr. Darr maintained that only Net Losers should be entitled to participate as creditors in the bankruptcy cases.

³¹ The Ponzi scheme presumption presumes that all transfers made in furtherance of a Ponzi scheme are made with fraudulent intent. *DeGiacomo v. Sacred Heart Univ. (In re Palladino)*, 556 B.R. 10, 14 (Bankr. D. Mass. 2016).

³² See, e.g., *Marshall v. Picard (Bernard L. Madoff Inv. Securities LLC)*, 740 F.3d 81, 85 (2d Cir. 2014) (“*Madoff II*”); *Donell v. Kowell*, 533 F.3d 762, 772 (9th Cir. 2008).

The PIEC opposed the Ponzi Motion out of a concern that its allowance would bind all parties to Mr. Darr's methodology for determining Net Winners and Losers in the bankruptcy cases, which would result in his competing with them in attempting to recover payments directly between participants.

After an evidentiary hearing on the Ponzi Motion on November 24, 2015, I determined that Telexfree had indeed operated a Ponzi and pyramid scheme, that the Ponzi scheme presumption would apply, and that each of the debtors would be jointly and severally liable for the claims of the victims of the scheme.³³ I reserved on the issues of whether the net equity formula was the appropriate method for calculating claims in the cases and whether the trustee or the PIEC was the appropriate party to bring claims against Net Winners who retained funds paid by recruited participants. After a further hearing on January 26, 2016, I entered an order adopting the net equity formula as the method to be used in calculating a participant's claim.³⁴

Mr. Darr commenced this adversary proceeding on October 7, 2015, with a two-count complaint seeking a declaratory judgment that the defendants' unjust enrichment claims asserted in the District Court violated the automatic stay in effect as a result of the Telexfree bankruptcies

³³ Order dated November 25, 2015, docketed in Telexfree's main bankruptcy case (14-40987) as document #654, subsequently amended by order dated December 21, 2015. See document #668. A transcript of the evidentiary hearing is attached to the PIEC's Statement of Undisputed Facts as Exhibit N and also on the docket in Telexfree's main bankruptcy case as document #658.

³⁴ Order of January 26, 2016, docketed in 14-40987 as document #687.

and seeking an injunction enjoining the defendants from prosecuting those claims. In an amended complaint, Mr. Darr added a third count for damages resulting from the stay violation.

The Dispute

Mr. Darr as trustee wishes to recover from Net Winners for the benefit of the bankruptcy estates payments they received from or on behalf of Telexfree in excess of what they paid in. He has in fact begun to do so by commencing two class action adversary proceedings against thousands of alleged Net Winners, both domestic (Adv. Pro. No. 16-4006) and foreign (Adv. Pro. No. 16-4007).³⁵ Mr. Darr's recovery effort includes preference and/or fraudulent transfer claims against Net Winners to recover monies paid to them directly by recruited participants. He views the defendants' efforts to assert unjust enrichment claims against these Net Winners as interfering with his efforts.

Mr. Darr maintains that a recruiting participant's right to retain the fees received from a recruited participant arose because the recruiting participant had accumulated credits in his or her Telexfree user account. As a result, by retaining the fees, a recruiting participant effectively redeemed a portion of her credits while Telexfree applied the redemption amount to pay the invoice issued to the recruited participant. This Mr. Darr characterizes as a "triangular transaction."³⁶

³⁵ The *amicus* here is the class of domestic Net Winner defendants in Adv. Pro. No. 16-4006.

³⁶ Mr. Darr analogizes this to a bankruptcy trustee's garden-variety recovery action for an indirect fraudulent or preferential transfer where debtor owes or wants A to receive \$100 and B owes \$100 to debtor. Debtor instructs B to pay the \$100 directly to A and considers B's indebtedness to debtor paid in full. Even though debtor never touched the \$100, a bankruptcy

The trustee views all monies paid by a recruited participant to a recruiting participant as property in which Telexfree had an interest and so any attempt by Net Losers to sue Net Winners directly on a theory of unjust enrichment would amount to interference with property of the bankruptcy estates, namely the estates' interest in recovering that property through avoidance actions. This would violate the automatic stay. Mr. Darr maintains that excluding payments by a recruited participant to a recruiting participant from the reach of his trustee avoidance powers would sabotage the net equity formula. He points out that the court has already approved the use of the net equity formula in calculating claim amounts and suggests that this reflects the court's recognition that triangular transaction payments involved Telexfree property.

Mr. Darr asserts that in the aftermath of a Ponzi scheme the overriding concern of the court must be for ratable distribution of funds to all victims. He stresses that victims' claims in the Telexfree fraud were not particularized or susceptible to remedies such as the imposition of a constructive trust. He notes that due to an overriding concern that all Ponzi scheme victims receive equal treatment, a number of courts of appeal, including most recently the Eleventh

trustee may sue A for recovery if the transfer otherwise qualifies for avoidance. *Warsco v. Preferred Technical Group*, 258 F.3d 557, 564 (7th Cir. 2001). "As the explicit language of the Bankruptcy Code makes clear. . . the transfer need not be made directly by the debtor; indirect transfers made by third parties to a creditor on behalf of the debtor may also be avoidable under the Code. *Id.* (quoting *Dean v. Davis*, 242 U.S. 438, 443, 37 S. Ct. 130, 61 L. Ed. 419 (1917) ("Mere circuitry of arrangement will not save a transfer which effects a preference action from being invalid as such"))).

Circuit in *United States v. Ramunno*, 599 F.3d 1269 (11th Cir. 2010), have refused to impose constructive trusts in favor of defrauded victims even when those victims could trace their investments.³⁷

The PIEC couldn't disagree more with Mr. Darr's view of the case. It characterizes the payments by recruited participants to recruiting participants not as triangular transactions but as "participant-to-participant payments." The PIEC argues that Telxfree had no interest whatsoever in those payments so their disposition did not in any way diminish the Telxfree bankruptcy estates, a critical predicate to a trustee's prevailing on avoidance action claims. It views the trustee's triangular transaction construct as absurd because Telxfree was essentially a criminal enterprise and thus all the so-called debits and credits in and out of user accounts and the participant invoices were phony. These phantom transactions, the PIEC declares, had no impact on Telxfree's property as Telxfree never had possession of any of the cash. According to the PIEC all of the reported decisions in which a trustee had standing to bring avoidance-type claims in a Ponzi case involved the debtors' having had physical possession of the property obtained by fraud. Since Telxfree never had physical possession of the participant-to-participant funds, notes the PIEC, Mr. Darr's pursuit of recruiting participants who were Net Winners using his strong arm powers under the Bankruptcy Code will be a waste of time and money.

³⁷ The *amicus* agrees with Mr. Darr's characterization of the claims against recruiting participants as fraudulent transfers. It urges that the causes of action which the PIEC asserts belong to the victims are identical to and derivative of the trustee's fraudulent transfer claims and thus should be enjoined.

The PIEC asserts that it was not Telexfree which suffered losses as a result of the participant-to-participant payments; it was each recruited participant who turned out to be a Net Loser. Thus the losses were particularized to the Net Losers. The PIEC cites, among other decisions, *Caplin v. Marine Midland Grace Tr. Co. of N.Y.*, 406 U.S. 416 (1972), and the third of the Second Circuit’s Madoff trilogy, *Picard v. Fairfield Greenwich Ltd.*, 762 F.3d 199, 211 (2d Cir. 2014) (“*Madoff III*”), for the proposition that Ponzi scheme investors who suffer particularized harm caused by third parties may pursue direct causes of action against those parties while a bankruptcy trustee lacks standing to do so.

The Summary Judgment Standard

A court “shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law.” Fed. R. Civ. P. 56, made applicable by Fed. R. Bankr. P. 7056.

A genuine issue is “one supported by such evidence that ‘a reasonable jury, drawing favorable inferences,’ could resolve [the issue] in favor of the nonmoving party.” *In re McCarthy*, 473 B.R. 485, 491 (Bankr. D. Mass. 2012) (quoting *Triangle Trading Co. v. Robroy Indus., Inc.*, 200 F.3d 1, 2 (1st Cir. 1999)). A material fact is one that might affect the outcome of the case under the governing law. *See id.* at 491.

The moving party in a summary judgment motion bears the initial burden of demonstrating that no genuine issue of material fact exists by pointing to materials of evidentiary quality such as affidavits or depositions that are so one-sided as to warrant judgment as a matter of law. *See Anderson v. Liberty Lobby*, 477 U.S. 242, 252 (1986); *In*

re Varrasso, 37 F.3d 760, 763 (1st Cir. 1994). “Only if the record, viewed in that manner and without regard to credibility determinations, reveals no genuine issue as to any material fact may the court enter summary judgment.” *Cadle Co. v. Hayes*, 116 F.3d 957, 959 (1st Cir. 1997).

Discussion

Whether Mr. Darr has standing to pursue recovery of funds paid by Net Losers directly to Net Winners as fraudulent or preferential transfers begins with determining whether Telexfree had an interest in those funds at the time of their transfer. *See Rine & Rine Auctioneers, Inc. v. Douglas County Bank & Trust Co. (In re Rine & Rine Auctioneers, Inc.)*, 74 F.3d 854, 857 (8th Cir. 1996).³⁸ Putting aside for the moment the

³⁸ Bankruptcy Code section 547 provides in relevant part:

- (b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any *transfer of an interest of the debtor in property*—
 - (1) to or for the benefit of a creditor;
 - (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
 - (3) made while the debtor was insolvent;
 - (4) made—
 - (A) on or within 90 days before the date of the filing of the petition; or
 - (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
 - (5) that enables such creditor to receive more than such creditor would receive if—
 - (A) the case were a case under chapter 7 of this title;
 - (B) the transfer had not been made; and
 - (C) such creditor received payment of such debt to the extent provided by the provisions of this title.
- (Emphasis added).

unique issue of fraud, if Telexfree had an interest in the funds retained by a recruiting participant, then Mr. Darr and only Mr. Darr would have standing to seek to recover those funds using his statutory avoidance powers. *Morley v. Ontos, Inc.* (*In re Ontes, Inc.*), 478 F.3d 427, 431 (1st Cir. 2007) (fraudulent transfer); *In re Bodenstein*, 248 B.R. 808, 817 and n. 39 (Bankr. W.D. Ark.) (collecting cases), *aff'd*, 253 B.R. 46 (B.A.P. 8th Cir. 2000) (preferential transfer).

While the term “interest in property” is not defined in the Bankruptcy Code, it is often equated with the term “property of the estate,” which is. *See Bergquist v. Anderson-Greenwood Aviation Corp. (In re Bellanca Aircraft Corp.)*, 850 F.2d 1275, 1279 and n. 8 (8th Cir. 1988). *See also Rine & Rine Auctioneers*, 74 F.3d at 857 (“The phrase ‘property of the debtor’ in the pre-1984 version of § 547(b), which was replaced by ‘an interest of the debtor in property,’ is equivalent to ‘property of the estate’ for purposes of determining whether the transfer of proceeds derived from the debtor’s sale of transferee’s assets constituted a voidable preference”).

Bankruptcy Code § 548(a)(1) provides in relevant part:

The trustee may avoid any *transfer . . . of an interest of the debtor in property . . .* that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

- (A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted.
- (Emphasis added).

Bankruptcy Code § 541(a) is clear that property of the estate includes, with exceptions not relevant here, all legal or equitable interests of the debtor in property as of the commencement of the case “wherever located and by whomever held.” 11 U.S.C. § 541(a). “The scope of this paragraph is broad. It includes all kinds of property, including tangible or intangible property . . .” S. Rep. No. 95–989, 95th Cong., 1st Sess. 82 (1978), reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5868. *See also United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204–05, 103 S. Ct. 2309, 76 L.Ed.2d 515 (1983). Its intended breadth enables the bankruptcy court to control a debtor’s property, wherever found, for equitable distribution to creditors. *Straton v. New*, 283 U.S. 318, 320–21 (1931).

In determining what is property of the estate, courts look to state law. *Butner v. United States*, 440 U.S. 48, 55 (1979). Neither party has opined as to which state’s law controls in this proceeding. To determine what state’s law applies, a federal court utilizes the choice of law provision of the forum state. *Crellin Technologies, Inc. v. Equipmentlease Corp.*, 18 F.3d 1, 4 (1st Cir. 1994). Massachusetts courts “give effect to the law reasonably chosen by the parties to govern their rights under contracts so long as there is no substantial conflict with Massachusetts public policy and the designated state has some substantial relation to the contract.” *N. Parent, Inc. v. Cotter & Co. (In re N. Parent, Inc.)*, 221 B.R. 609, 620 n. 11 (Bankr. D. Mass. 1998). Here, the Telexfree membership contract designates Nevada law as governing “issues arising from this instrument.” Under Nevada law, fraud in the inducement renders a contract voidable but

not void. *Bishop v. Stewart*, 13 Nev. 25, 42 (Nev. 1878). This principle is neither remarkable nor unique and is the law in many states including Massachusetts. *See Shaw's Supermarkets, Inc. v. Delgiacco*, 410 Mass. 840, 842 (Mass. 1991).

The parties agree that no participant ever took steps to repudiate his or her membership contract with Telexfree. Under the contract Telexfree had the right to collect member fees but allowed a recruiting participant to hold on to those fees in exchange for redemption of credits in his Telexfree user account. That Telexfree treated membership fees as its own is reflected in its financial records and practices. Telexfree recorded participant-to-participant payments as “payments through the system” and booked these payments as a company expense for agents’ commissions. It issued IRS Forms 1099 to recruiting participants who held on to the membership fees.

That the funds retained by a recruiting participant never physically passed through Telexfree’s bank accounts does not matter for purposes of determining whether Telexfree had an interest in the funds. Physical possession is not the foundation upon which a determination of property of the estate rests. Bankruptcy Code § 541 includes property “wherever located and by whomever held.” An entity may have constructive possession of property. Even in the arguably more stringent criminal context, courts hold that “[p]ossession implies ‘control and power,’ exclusive or joint ..., or, in the case of ‘constructive possession,’ knowledge coupled with the ability and intention to exercise dominion and control.” *Com. v. Arias*, 29 Mass. App. Ct. 613, 617, 563 N.E.2d 1379,

1382 (Mass. App. Ct. 1990), *aff'd*, 410 Mass. 1005, 572 N.E.2d 553 (Mass. 1991).

Bankruptcy Code § 101(54) is also instructive. It provides:

“The term ‘transfer’ means— . . .

(D) each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with—

- (i) property; or
- (ii) an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption.”

“This definition is broad and covers not only the everyday buying and selling of goods, but also the transfer of a partial interest or a transfer that is not accompanied by a change of possession.”

Lehtonen v. Time Warner, Inc. (In re PurchasePro.com, Inc.), 332 B.R. 417, 426–27 (Bankr. D. Nev. 2005).

The PIEC does not necessarily disagree with any of this so long as the analysis is applied narrowly to the mill-run debtor actually engaged in business. The PEIC notes, however, that Telexfree was a criminal enterprise, its entire business model was a scam and all the funds involved in the scam were fraudulently obtained. The PIEC argues that when it comes to Ponzi scheme cases, the debtor must have had actual physical possession of the fraudulently generated funds for a bankruptcy trustee to have standing to deploy his or her avoidance powers to recover them. Since payments made directly between participants never came into Telexfree’s possession the PIEC maintains that Mr. Darr has no standing to sue to recover them and further that those funds should be impressed with a constructive trust for the benefit of the defendants. The PIEC also argues that the harm to the recruited participants who were Net Losers was particularized to them and that Mr. Darr lacks standing to compete with them for the same recovery.

While it is indeed the case that all reported decisions in which courts have recognized a bankruptcy trustee's standing to bring avoidance actions to recover funds transferred by a Ponzi scheme debtor involved funds actually in the debtor's possession, there is nothing in the Bankruptcy Code requiring that such possession be physical as opposed to constructive or indirect. The underlying principle upon which a bankruptcy trustee's avoidance power is based is that even as to property fraudulently obtained by a debtor, while unassailable title to such property may not have passed to the debtor, the debtor nevertheless obtains a defeasible interest in the property. *Bailey v. Big Sky Motors, Ltd. (In re Ogden)*, 314 F.3d 1190, 1198 (10th Cir. 2002) (defeasible title held by debtor who obtained funds by fraud). This principle would seem to apply with equal force whether the property is obtained directly or merely remotely or derivatively. By its nature, every triangular transaction underlying a participant-to-participant payment began with the creation of a debt owed by the recruited participant to Telexfree which Telexfree allowed to be repaid by the recruited participant's forwarding money directly to a recruiting participant to whom Telexfree had an obligation. The mere fact that the money flowed directly from a recruited participant to a recruiting participant rather from the recruited participant to Telexfree and then to the recruiting participant should not be the determining factor in Mr. Darr's standing to bring avoidance actions to recover that money for the benefit of all Telexfree's creditors.

The PIEC's claim that the funds paid by recruited participants to recruiting participants are being held in constructive trust for the benefit of the defendants reflects a

common misunderstanding of the nature of such trusts. “Nearly all literature on constructive trusts makes the point that a constructive trust is a remedy, rather than a substantive property right. It is not a trust, but an analogy to a trust employed to correct unjust enrichment.” Emily L. Sherwin, *Constructive Trusts in Bankruptcy*, 1989 U. Ill. L.R. 297, 310 (1989). “A constructive trust is a legal fiction, a common-law remedy in equity that may only exist by the grace of judicial action.” *XL/Datacomp, Inc. v. Wilson*, 16 F. 3d 1443, 1449 (6th Cir. 1994). The fact that a defrauded party has available the remedy of a judicially imposed constructive trust as to certain property does not deprive the party against whom the constructive trust remedy may be imposed from having rights in that property until such time as the trust is imposed. And further, unless the defrauded party can identify the property specifically, the ability to obtain the judicial remedy of constructive trust will be lost once a bankruptcy petition is filed. These principles were laid out nearly a century ago by the United States Supreme Court in the eponymous Ponzi case, *Cunningham v. Brown*, 44 S. Ct. 424 (1924). The defendants in this adversary proceeding cannot trace the funds they paid to the recruiting participants, and so their ability to seek the imposition of a constructive trust at this point has been lost.

“Constructive trusts are anathema to the equities of bankruptcy since they take from the estate, and thus directly from competing creditors, not from the offending debtor.”

XL/Datacomp, Inc., 16 F.3d at 1452.

The very reasoning that mandates denying the constructive trust remedy to the Telexfree victims also explains why their claims are not particularized. While each of the

victims no doubt views his or her loss as unique, from the vantage of the Telexfree bankruptcy estates, the victims are indistinguishable. Allowing one victim to elevate her claim over the claims of others thwarts the policy of ratable distribution at the heart of our bankruptcy system. *Id.* at 1451.

As Mr. Darr emphasizes, many of the defendants who claim no involvement with Telexfree actually had extensive interaction with the company as reflected by their multiple user accounts. For example, defendant Maria Murdoch testified at a November 24, 2015 evidentiary hearing that while she had invested approximately \$25,000 in Telexfree, she never had contact with Telexfree, never became a member of Telexfree, and never received an invoice from Telexfree.³⁹ Telexfree's books and records, however, reflect that Ms. Murdoch maintained seventy-five user accounts.⁴⁰ In fact, all of the named parties in various actions had multiple user accounts with Telexfree. They include: Rita Dos Santos, who had twelve accounts; Angela Batista Jiminez, who had fifty-five; Elisangela Oliveira, who had three; Diogo De Araugo, who had sixty-five; and Celio Da

³⁹ Trustee's Statement of Uncontested Facts at ¶ 41.

⁴⁰ *Id.* at ¶ 42.

Silva, who had one-hundred forty-two.⁴¹ In addition Ms. Dos Santos received \$8,035.91 in payments directly from Telexfree.⁴²

The cases relied upon by the PIEC, such as *Caplin* and *Madoff III*, do not support a finding of particularized harm in this proceeding. This is not a case where the trustee is asserting claims that do not belong to the Telexfree estate as in *Caplin*, where the trustee sought to sue an indenture trustee based on claims belonging not to the debtor but to the debenture holders under the indenture. Nor is it the case that the defendants here seek to assert claims against the recruiting participants that are distinct from the claims of Mr. Darr as in *Madoff III*, where investors who were customers of so-called “feeder funds,” and not Madoff’s funds, sought to sue the feeder funds directly. On the contrary, the relationships here more closely resemble those in the second of the Second Circuit’s Madoff trilogy, *Madoff II*, where Madoff customer/victims sought to sue Jeffrey Picower and his affiliates, who were Madoff’s co-conspirators, for conversion and other non-bankruptcy causes of action. The Second Circuit upheld an injunction issued by the bankruptcy court barring suit. The court ruled that the victims’ suit was nothing more than an attempt to “plead around” claims already being asserted by the Madoff trustee

⁴¹ *Id.* at ¶ 43. Ms. Murdoch, Ms. Batista Jiminez and Mr. Da Silva are no longer plaintiffs in the Oliveira Lawsuit. PIEC’s Response to Trustee’s Statement of Uncontested Facts at ¶ 38.

⁴² Trustee’s Statement of Uncontested Facts at ¶ 44.

and that the claims, despite being framed in non-bankruptcy legal terms, were derivative of the trustee's fraudulent transfer claims.

We have defined so-called “derivative claims” in the context of bankruptcy as ones that “arise[] from harm done to the estate” and that “seek [] relief against third parties that pushed the debtor into bankruptcy.” *Picard v. JPMorgan Chase & Co. (In re Bernard L. Madoff Inv. Sec. LLC)* (“*JPMorgan Chase*”), 721 F.3d 54, 70 (2d Cir. 2013). In assessing whether a claim is derivative, we inquire into the factual origins of the injury and, more importantly, into the nature of the legal claims asserted. See *Johns–Manville Corp. v. Chubb Indem. Ins. Co. (In re Johns–Manville Corp.)* (“*Manville III*”), 517 F.3d 52, 67 (2d Cir. 2008). While a derivative injury is based upon “a secondary effect from harm done to [the debtor],” an injury is said to be “particularized” when it can be “directly traced to [the third party’s] conduct.” *St. Paul Fire & Marine Ins. Co. v. PepsiCo, Inc.*, 884 F.2d 688, 704 (2d Cir. 1989).

Madoff II, 740 F.3d at 89.

Here, Mr. Darr wishes to sue recruiting participant Net Winners on theories of fraudulent and preferential transfer to recover money for the benefit of all the Telexfree victims. The defendants, a class of victims, seek to recover the same monies arising out of the same transactions based on a theory of unjust enrichment. They are in direct competition with the trustee. Viewed through the prism of bankruptcy law and policy, their claims are derivative of those asserted by Mr. Darr.

Recommended Ruling

For the reasons set forth above, I recommend granting Mr. Darr's motion for summary judgment and denying the PIEC's.

At Boston, Massachusetts this 18th day of December, 2017.

By the Court,



Melvin S. Hoffman
U.S. Bankruptcy Judge

Counsel Appearing: Harold B. Murphy, Esq.
Charles R. Bennett, Jr., Esq.
Murphy & King, Professional Corporation
Boston, MA
for Stephen B. Darr, Chapter 11 trustee, plaintiff

William R. Baldiga, Esq.
Brown Rudnick LLP
Boston, MA, and
Robert J. Bonsignore, Esq.
Bonsignore, PLLC
Las Vegas, NV
for the PIEC

Ilyas J. Rona, Esq.
Milligan Rona Duran & King LLC
Boston, MA
for Frantz Balan, class representative
Amicus curiae

In re Telexfree, LLC

Debtor

Stephen Darr
Plaintiff

vs.

Rita Dos Santos, Individually and as Putative Class Representative
Defendant

Related Bankruptcy Case: 14-40987
Chapter 11
Judge Melvin S. Hoffman

Adversary Proceeding: 15-04055

Initial Transmittal

The following is being transmitted to your court:

- ☐ Notice of Appeal with Order
- ☐ Bankruptcy Docket
- ☐ Election to have appeal heard in District Court
- ☐ Direct Appeal to Court of Appeals
- ☐ Motion for Leave to Appeal With/Without Objections
- ☒ Other Proposed Findings of Fact and Conclusions of Law

Date: 1/16/18

By the Court,

Stefanie Landry
Deputy Clerk
617-748-5319

Receipt is acknowledged of the enclosures referred to above.

District/Appellate Court Docket Number: _____

Date: _____

By: _____
Deputy Clerk