

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS

In re:

TELEXFREE, LLC,
TELEXFREE, INC. and
TELEXFREE FINANCIAL, INC.,

Debtors.

STEPHEN DARR, LIQUIDATING TRUSTEE
OF THE CHAPTER 11 ESTATES OF EACH
OF THE DEBTORS,

Plaintiff,

v.

CARLOS WANZELER, et al
Defendants.

Chapter 11 Cases

14-40987-MSH
14-40988-MSH
14-40989-MSH

Substantively Consolidated

Adversary Proceeding
No. 16-4032

**MOTION BY TRUSTEE TO APPROVE STIPULATION OF SETTLEMENT BETWEEN
THE LIQUIDATING TRUSTEE AND JAMES MERRILL**

Stephen B. Darr, the duly appointed Liquidating Trustee (the “Trustee”) of the substantively consolidated bankruptcy estates (“Estates”) of TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc. (collectively, the “Debtors” or “TelexFree”), respectfully requests that the Court approve the attached Stipulation of Settlement (“Stipulation”) by and between the Trustee and James Merrill (“Merrill”), in accordance with Federal Rule of Bankruptcy Procedure 9019. The Stipulation will resolve the estate’s claims against Merrill, a principal of TelexFree, for an agreed judgment in the amount of \$3,000,000. In further support of this motion, the Trustee states as follows:



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BACKGROUND

1. On April 13, 2014 (the "Petition Date"), the Debtors filed voluntary Chapter 11 petitions with the United States Bankruptcy Court for the District of Nevada.
2. By order dated May 6, 2014, the Nevada Bankruptcy Court approved a motion to change venue filed by the Securities and Exchange Commission ("SEC"). The cases were transferred to this Court on May 9, 2014.
3. On May 30, 2014, the Court approved the motion of the Office of the United States Trustee to appoint a Chapter 11 trustee, and Stephen Darr was appointed Chapter 11 Trustee on June 6, 2014.
4. The principals of TelexFree were initially Merrill, Carlos Wanzeler ("Wanzeler") and Carlos Costa ("Costa" and, collectively, the "Principals").
5. The Debtors ostensibly operated a "multi-level marketing" company with its headquarters in Marlborough, Massachusetts. It represented itself as being in the business of selling telephone service plans that use "voice over internet protocol" ("VoIP") technology. The Trustee asserted that the sale of VoIP, however, constituted only a minor portion of their business, and that the Debtors' actual business was the recruitment of participants ("Participants"). The Debtors operated a massive Ponzi and pyramid scheme which involved more than a million Participants from multiple countries.
6. On November 25, 2015, the Court, on motion by the Trustee and after notice, 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.

7. On July 9, 2020, the Court entered an order confirming the *First Amended Liquidating Plan of Reorganization of Stephen Darr, Chapter 11 Trustee of TelexFree LLC, TelexFree Inc., and TelexFree Financial, Inc.* The plan became effective on July 14, 2020. Stephen Darr was appointed liquidating trustee under the confirmed plan. The plan resulted in the substantive consolidation of the Debtors.

8. On or about April 1, 2016, the Trustee commenced this adversary proceeding against the Principals and certain individuals who were related to the Principals or who the Trustee alleged facilitated the implementation of the scheme.

9. In December 2013, TelexFree paid the Principals approximately \$10,000,000, including \$3,000,000 to Merrill, \$3,500,000 to Wanzeler, and \$3,500,000 to Costa (collectively, the “Transfers”). The Trustee sought to recover the Transfers, as well as certain other payments made to the Principals within two years of the Petition Date, as being actual and/or constructively fraudulent transfers under the Bankruptcy Code. The Trustee asserted additional claims against the Principals for breach of fiduciary duty, looting, and civil conspiracy.

10. The United States of America commenced a criminal action against Merrill and Wanzeler (action no. 14-CR-40028, the “Criminal Action”). Merrill pled guilty on one count and was sentenced to a six-year prison term.

11. In connection with the Criminal Action, the United States froze all funds held by Merrill and his spouse, Kristin Merrill, at Waddell & Reed Financial Advisors and Middlesex Savings Bank. Pursuant to the plea agreement between Merrill and the United States entered into in October 2016 in the Criminal Action (the “Plea Agreement”), Merrill agreed to the forfeiture of all funds on deposit in the Waddell & Reed accounts. As of September 30, 2018, all of the foregoing funds on deposit at Waddell & Reed, totaling \$4,362,622.18, had been seized

and forfeited to the United States Treasury and on June 19, 2019 the United States Treasury turned over \$145,471,295.53 to the Trustee.

12. In the Plea Agreement, the Government expressly excluded from forfeiture retirement funds seized by the government from Middlesex Savings Bank totaling \$115,631.64. These funds were seized, in their entirety, by the Internal Revenue Service ("IRS") in July 2017.

13. The IRS has asserted the following claims against Merrill and Kristin Merrill:

- (i) Notice of Federal Tax Lien in the amount of \$1,796,52.58 against Merrill and Kristin Merrill relating to calendar year 2013 and recorded at the Registry of Deeds, Southern Middlesex County ("Registry") on August 19, 2015;
- (ii) Notice of Federal Tax Lien in the amount of \$1,224,639.56 against Merrill relating to calendar year 2014 and filed at the Registry;
- (iii) Notice of Federal Tax Lien in the amount of \$26,545.31 against Merrill relating to calendar year 2015 and filed at the United States District Court;
- (iv) Notice of Federal Tax Lien in the amount of \$91,727.01 against Kristin Merrill relating to calendar years 2016 and 2017 and filed at the Registry on October 18, 2018;
- (v) Notice of Federal Tax Lien in the amount of \$47,638.41 against Merrill relating to calendar years 2017 and 2018 and filed at the United States District Court.

14. The Massachusetts Department of Revenue ("DOR") has made an assessment against Merrill in the amount of \$22,766.01. Merrill has entered into a payment agreement with the DOR for the sum of \$100 per month with respect to such obligation.

15. The DOR has made an assessment against Kristin Merrill in the amount of \$16,275.05. Kristin Merrill has entered into a payment agreement with the DOR for the sum of \$100 per month with respect to such obligation.

16. The Plea Agreement excluded from forfeiture the residential real property owned by Merrill and Kristin Merrill, as tenants by the entirety, and located at One Coburn Drive, Ashland, Massachusetts (the "Residence"). The Residence has a Zillow assessment of \$815,000 and is subject to a first mortgage in the estimated amount of \$131,000 and the lien of the IRS in excess of \$1,000,000. The Merrills filed a declaration of homestead on or about January 15, 2002

17. Merrill has alleged that he has no assets available to satisfy a judgment in favor of the Trustee and that, in addition to the claims asserted by the IRS and DOR, Merrill has unpaid obligations for professional fees and loans made to him by private third parties.

18. The Trustee and Merrill have engaged in negotiations over the past several weeks in an effort to resolve the dispute. As a result of these negotiations, the parties have agreed to the terms of the Stipulation which is filed herewith. A summary of the terms of the Stipulation is provided below:

Stipulation of Settlement

A. Judgment shall enter in favor of the Trustee against Merrill on Count Four (breach of fiduciary duty) in the amount of \$3,000,000 (the "Judgment Amount"). All other Counts shall be deemed dismissed as against Merrill, with prejudice.

B. Any funds collected by the Trustee from either Wanzeler or Costa on account of claims by the Trustee against either or both of them shall reduce the Judgment Amount by an amount equal to fifty percent (50%) of any amounts so recovered. The Trustee shall from time

to time, upon reasonable request, advise Merrill of the status of collection efforts against Wanzeler and Costa.

C. Notwithstanding the provisions of paragraph B, the Trustee may recover the full amount of the then-outstanding Judgment Amount against Merrill and shall not be required to seek recovery, first, from either Wanzeler or Costa. In the event the Trustee shall recover the Judgment Amount from Merrill and subsequently recover amounts from either Wanzeler or Costa, Merrill shall not be entitled to any refund against amounts already paid to the Trustee.

Standards For Approval of Compromise

19. Bankruptcy Rule 9019(a) provides, in relevant part, that “On the motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement.” Settlements and compromises are normal parts of the process of reorganization. While the decision to approve a particular settlement lies within the sound discretion of the Bankruptcy Court, the Court should give deference to the business judgment of the estate representative. *Jeffrey v. Desmond*, 70 F.3d 183 (1st Cir. 1995).

20. The Court of Appeals has described the test to be used by Bankruptcy Courts called upon to approve or reject proposed compromises and settlements as follows:

bankruptcy judge has the authority to approve a compromise of a claim pursuant to Bankruptcy Rule 9019(a). The ultimate issue on appeal is whether the bankruptcy court abused its discretion when it approved the compromise, which is a process requiring the bankruptcy court to “assess and balance the value of the claim that is being compromised against the value to the estate of the acceptance of the compromise proposal.” *In re GHR Cos.*, 50 B.R. 925, 931 (Bankr. D. Mass. 1985) (quoting *In re Boston & Providence R.R.*, 673 F.2d 11, 12 (1st Cir. 1982)). The specific factors which a bankruptcy court considers when making this determination include: (i) the probability of success in the litigation being compromised; (ii) the difficulties, if any, to be encountered in the matter of collection; (iii) the complexity of the litigation involved, and the expense, inconvenience and delay attending it; and (iv) the paramount interest of the creditors and a proper deference to their reasonable views in the premise. *In re Anolik*, 107 B.R. 427, 429 (D. Mass. 1989).

Jeffrey v. Desmond, 70 F.3d 183, 185 (1st Cir. 1995).

21. The proposed settlement between the Trustee and Merrill fairly balances “the value of the claims being compromised against the value to the estates of the acceptance of the compromise proposal.” It is well within the bounds of this Court’s discretion to approve the proposed settlement. *Jeffrey v. Desmond*, 70 F.3d at 185.

22. The Trustee previously obtained judgments by default in this adversary proceeding against the other Principals, Carlos Wanzeler and Carlos Costa, in the amounts of \$3,785,192 and \$3,658,900, respectively. Merrill has agreed to entry of judgment in the amount of \$3,000,000, substantially equal to the amounts paid to Merrill by TelexFree in the two years prior to the Chapter 11 filings.

23. Merrill has alleged that he should have no liability because, unlike Wanzeler and Costa, the United States seized more than \$4,000,000 from Merrill and such funds were made available for distribution to claimants in this case. The Trustee has asserted that Merrill has joint and several liability under the counts asserted in the Complaint and the aggregate amount of Merrill’s liability likely exceed the amounts seized by the federal government. The Trustee further believes that, given the Ponzi scheme finding of the Court and the criminal conviction of Merrill, that he has a strong likelihood of success in the litigation.

24. Notwithstanding the strong likelihood of success on the merits, the collectability of any judgment against Merrill is in question. Merrill has alleged financial hardship, including difficulty paying ordinary expenses as they become due and the absence of any unencumbered assets. Merrill has asserted an inability to satisfy any judgment other than a nominal sum. Issues regarding collection were factored into the Trustee’s evaluation of settlement terms.

25. If the matter is not resolved consensually, the Trustee would at a minimum need to proceed with a motion for summary judgment. Given the complexity of the case, the filing of summary judgment pleadings could result in substantial administrative costs to the Estate, and the Trustee obtaining summary judgment is not a certainty.

26. Given all of these factors, and in order to avoid further costs and delays associated with litigation, the Trustee concluded that the terms of the settlement were fair and in the best interest of creditors.

27. Based upon the foregoing, good cause exists for approval of the Stipulation.

WHEREFORE, the Trustee respectfully requests that this Court enter an Order:

- (i) Approving the Settlement Agreement for the reasons set forth; and
- (ii) Granting such other relief as is just and proper.

STEPHEN DARR AS HE IS THE
LIQUIDATING TRUSTEE OF THE
CHAPTER 11 ESTATES OF EACH OF
THE DEBTORS

By his attorneys,

/s/ Andrew G. Lizotte
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