Docket #0451 Date Filed: 9/15/2014

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
CENTRAL DIVISION

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**

OBJECTION BY STEPHEN B. DARR, CHAPTER 11 TRUSTEE, TO APPLICATION FOR ALLOWANCE OF ADMINISTRATIVE EXPENSE CLAIM (MACMILLAN)

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 files this opposition to The Application for Allowance of Administrative Expense Claim ("MacMillan Application") filed by Stuart MacMillan ("MacMillan"), the former chief executive officer of the Debtors. The fees and expenses sought by MacMillan should be disallowed in their entirety or substantially reduced because MacMillan has not demonstrated that his services provided any benefit to the estates or enhanced the estates in any manner.

In support of this opposition, the Trustee states as follows:

FACTUAL ALLEGATIONS[1]

I. Background of the Debtors and their Principals

1. TelexFree, Inc. is a Massachusetts corporation, formerly known as Common Cents Communications, Inc. ("Common Cents"). Common Cents was formed on or around 2003 by Carlos Wanzeler ("Wanzeler"), James Merrill ("Merrill" and, together with Wanzeler, the "Principals") and Steven Labriola.

2. TelexFree, LLC is a Nevada limited liability company formed by Wanzeler, Merrill, and Carlos Costa in July 2012.

3. TelexFree Financial, Inc. is a Florida corporation formed in December 2013 and owned by TelexFree, LLC.

4. After the Debtors' formation, Labriola and Costa allegedly transferred their interests in the Debtors to Wanzeler and Merrill.

5. In 2012, Costa and Wanzeler formed Ympactus Commercial Ltda ("Ympactus"), a Brazilian company that used the name "TelexFree" and marketed a voice over internet protocol ("VOIP") service.

6. In 2012, the Debtors commenced the sale of VOIP based upon what was purported to be a multi-level marketing ("MLM") structure that provided for the sale and resale of the Debtors' products through a group of individuals denominated as either members, partners, agents, or promoters. The most frequently used term for such individuals was "Promoters".

[1] The background information provided herein is based upon, among other things, documents produced to the Trustee pursuant to Rule 2004 examinations, interviews with interested parties, a review of pleadings filed in the bankruptcy court and other pending actions, and discussions with governmental representatives.

7. The terms of the Debtors' business plan provided that Promoters could receive several times their initial investment on an annual basis merely by placing internet advertisements and recruiting other Promoters, without regard to the sale of any product, a classic pyramid scheme.

8. In June 2013, Ympactus was seized by the Brazilian authorities and its operations shut down based upon the allegations that its operations constituted a pyramid scheme.

9. In August 2013, Jeffery Babener ("Babener") of Babener & Associates, an attorney retained by the Debtors who claimed to have extensive MLM experience, advised the Debtors that their business plan constituted a pyramid scheme.

10. In late summer or early fall of 2013, the Debtors retained The Sheffield Group ("Sheffield"), a consulting firm with extensive MLM experience, to ostensibly revise their business plan so that it would comply with applicable laws.

11. In late summer, early fall of 2013, the Debtors retained Robert Weaver ("Weaver"), an attorney with extensive white collar crime expertise, and the firm of Garvey, Schubert, Barer based in Seattle to provide, upon information and belief, legal advice respecting potential and/or ongoing violations of federal and state law.

12. Despite the shutdown of Ympactus on the basis that its business was a pyramid scheme, and being advised in the fall of 2013 that the Debtors' business plan was a pyramid scheme, the Principals continued to operate their business in accordance with that scheme throughout 2013 and into March 2014.

13. During the course of the Debtors' operations, the Principals paid themselves and Costa amounts substantially in excess of $10,000,000.[2]

[2] The Trustee is continuing his investigation and the exact amount of transfers made by the Debtors to or on behalf of the Principals and Costa has not yet been determined.

II. Governmental Investigations

14. On or about February 5, 2014, the Commonwealth of Massachusetts, Securities Division ("MSD") issued a subpoena to the Debtors in furtherance of an investigation into whether the Debtors' were operating in violation of applicable securities laws.

15. On or about February 7, 2014, the Debtors retained Greenberg Traurig LLP ("Greenberg") to represent the Debtors in connection with the MSD investigation.

16. Despite the fact that the Debtors' business plan was illegal, the Debtors' Brazilian affiliate, operating under a similar model, had been shut down by the Brazilian government, and investigations by the MSD and the Securities and Exchange Commission ("SEC") were ongoing, the Debtors continued to solicit and accept fees from new Promoters and, in fact, approximately $50,000,000 was taken from new and existing Promoters between early February 2104 and mid-March 2014.

17. In March 2014, the Debtors retained MacMillan as a consultant and later as interim chief executive officer.

18. In March 2014, more than six (6) months after it was advised that its business constituted a pyramid scheme, the Debtors introduced a modified plan to Promoters that ostensibly would take effect on March 13, 2014. The modified plan purportedly would remedy the illegality of the existing plan and address the trailing liabilities under the existing plan that exceeded $5,000,000,000.

19. Within days of the modified plan's attempted implementation, it became clear that it also was a pyramid scheme.

20. On or about April 3, 2014, Sheffield performed a stress test of the revised plan and concluded that it was unsustainable, in that promised payouts to Promoters substantially exceeded revenues from actual product sales.

21. Upon information and belief, the modified plan was rejected by Promoters who alleged, among other things, that the VOIP service was difficult or impossible to sell. In order to appease disgruntled Promoters, the Debtors apparently paid out $58,000,000 to Promoters and others as yet undetermined in late March/early April 2014 on account of obligations under the previous plan.

III. Preparation for Bankruptcy Filings

22. In the face of ongoing investigations by the MSD and SEC, Promoter unrest, and an estimated $5,000,000,000 in Promoter liability, the Debtors began to prepare for filing bankruptcy in early April 2014.

23. In early April 2014, Greenberg recommended that the Debtors retain Alvarez & Marsal ("A&M") to serve as financial advisors to the Debtors. A&M's engagement agreement was executed on April 10, 2014. William Runge ("Runge") of A&M was designated by the Debtors as chief restructuring advisor.

24. On April 12, 2014, Greenberg attended a board meeting for the Debtors, one purpose of which was to authorize the Chapter 11 filings. Also during that meeting, MacMillan was appointed as a director to serve with Wanzeler and Merrill.

25. At the April 12, 2014 board meeting, upon information and belief, Greenberg observed that the modified plan also appeared to violate applicable securities laws.

26. Gordon Silver ("Gordon"), which is based in Nevada, was retained just prior to the filings to serve as co-counsel to the Debtors.

IV. Activity During Chapter 11 Period

27. In April 2014, the Debtors' principal place of business was in Massachusetts.

28. On April 13, 2014 (the "Petition Date"), the Debtors filed their voluntary Chapter 11 petitions in the United States Bankruptcy Court for the District of Nevada (the "Nevada Bankruptcy Court"). The ostensible reason for the filing in Nevada was the choice of law provision in certain Promoter contracts and that one of the Debtors was established there. Upon information and belief, the real reason was to distance the Debtors from the pending governmental investigations in Massachusetts. The petitions were signed by MacMillan.

29. Prior to the bankruptcy filings, the Debtors paid the Debtors' Chapter 11 professionals in excess of $6,200,000, including $4,284,330.63 paid to Greenberg, $750,000 paid to Gordon, $1,000,000 paid to A&M, and $180,000 paid to MacMillan. Net of prepetition fees and expenses, the balance of the retainers held by each of the Debtors' professionals as of the Petition Date were as follows: Greenberg $3,726,604.89; Gordon $694,764.50; A&M $888,033.52, and MacMillan $177,576.81.

30. On April 15, 2014, the SEC and the Office of the United States Attorney (collectively, the "Federal Authorities") commenced civil and criminal actions against the Debtors, the Principals and others, alleging among other things that the Debtors were engaged in a pyramid scheme and were raising funds through the fraudulent and unregistered offering of securities.

31. On April 15, 2014, the MSD commenced an administrative proceeding against the Debtors and their Principals, alleging violation of state securities laws.

32. On or about April 15, 2014, on request of the SEC, the United States District Court for the District of Massachusetts ("District Court") entered a blanket temporary restraining

order (the "Restraining Order") that effectively shut down the Debtors' operations and froze all of their assets as follows:

> TelexFree and the Individual Defendants and each of their officers, agents, servants, employees, and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including via facsimile or email transmission, or overnight delivery service, shall hold and retain funds and other assets of defendants presently held by them, for their direct or indirect benefit, under their direct or indirect control or over which they exercise actual or apparent investment or other authority, in whatever form such assets may presently exist and wherever located, and are restrained from taking any actions to withdraw, sell, pay, transfer, dissipate, assign, pledge, alienate, encumber, dispose of, or diminish the value of in any way (including, but not limited to, making any charges on any credit card or draws on any other credit arrangement), any funds and other assets of TelexFree and the Individual Defendants presently held by them, for their direct or indirect benefit, under their direct or indirect control, or over which they exercise actual or apparent investment authority, in whatever from such assets may presently exist and wherever located. (Section IV(A), Restraining Order).

33. Also on April 15, 2014, various governmental agencies including Homeland Security and the Federal Bureau of Investigation executed upon a search warrant and seized virtually all of the Debtors' locatable assets (the "Asset Seizure"). In connection with the Asset Seizure, the Federal Authorities seized, among other things, approximately $40,000,000 in cashiers' checks from the briefcase of Joseph Craft, the Debtors' chief financial officer, and an undetermined amount from Wanzeler's wife while she was attempting to leave the country. Ultimately, on information and belief, the Federal Authorities seized more than $100,000,000 of the Debtors' assets.

34. Shortly after the entry of the Restraining Order and the Asset Seizure, Wanzeler fled the country, and Merrill was arrested.

35. After the Restraining Order was issued and the Asset Seizure was conducted, the Debtors had no cash or access to cash, no operations, and no employees. Most of the time spent after April 15, 2014 related to futile litigation with governmental authorities.

36. On or about April 23, 2014, Greenberg and Gordon prepared and filed a motion (the "Stay Motion") requesting that the Nevada Bankruptcy Court, among other things, modify or vacate the Restraining Order issued by the District Court. The Stay Motion had no merit as the Nevada Bankruptcy Court had no jurisdiction to modify the Restraining Order.

37. On or about April 22, 2014, the Office of the United States Trustee ("UST") filed a motion for the appointment of a Chapter 11 Trustee (the "Trustee Motion") and 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 "Venue Motion") where its action and that of the MSD were pending and where the Debtors' principal place of business was located.

38. On or about April 29, 2014 and April 30, 2014, respectively, Greenberg and Gordon prepared and filed oppositions to the Venue Motion and the Trustee Motion. The oppositions had little merit and the services rendered in connection therewith were not reasonable, necessary, nor reasonably likely to benefit the Debtors' estates at the time such services were rendered.

39. The Nevada Bankruptcy Court held a hearing on the Trustee Motion and the Venue Motion on May 2, 2014 (the "Evidentiary Hearing"). Runge and MacMillan testified to the following at the Evidentiary Hearing:

(i) Runge and MacMillan were working to secure a new compensation consultant to rewrite the Debtors' business plan because the modified plan, which was six months in the making and had just been introduced, was unsustainable;

(ii) The commissions payable under the modified plan (approximating eighty percent of revenues) were double that which would be considered acceptable for an MLM program; and

(iii) Neither MacMillan nor Runge were VOIP specialists, could not identify any of the Debtors' competitors or whether the Debtors' product was competitive and did not know how much of the Debtors' stated revenue was actually cash versus back office non-cash bookkeeping entries.

40. On May 6, 2014, the Nevada Bankruptcy Court ruled in favor of the SEC and entered an order directing the transfer of venue to Massachusetts. While it made no ruling on the Trustee Motion, the Nevada Bankruptcy Court observed that the Debtors' business plan was unsustainable, that MacMillan and Runge had little knowledge of the Debtors' business, and that Wanzeler, a fugitive, remained on the Debtors' board.

41. On or about May 27, 2014, the Court held a status conference, at which time the Debtors consented to the appointment of a trustee.

42. On June 10, 2014, the Court entered an order authorizing the retention of MacMillan as interim chief executive officer *nunc pro tunc* to the Petition Date.

43. During the period in which the Debtors were debtors-in-possession, no schedules and statement of financial affairs were filed, nor was a matrix of creditors filed.

44. On or about August 1, 2014, the Debtors' professionals filed their applications for compensation.

THE MACMILLAN APPLICATION

45. The MacMillan Application seeks allowance and payment of fees in the amount of $88,333.51 and expenses in the amount of $18,755.94 for the period from the Petition Date to the date of appointment of the Trustee.

46. MacMillan held a retainer of $177,576.81. Despite multiple requests by the Trustee, MacMillan has not turned over the amount of the retainer he holds in excess of fees and expenses sought in his application.

47. MacMillan also filed, through his firm Impact This Day, Inc. a Request for Administrative Expense Claim (the "Fee Request") which appears to be duplicative of the MacMillan Application.

LEGAL ANALYSIS

I. Standards for Allowance of Administrative Expense Claim

48. Section 503(b)(1) provides for the allowance of administrative expenses for "the actual, necessary costs and expenses of preserving the estate." 11 U.S.C. §503(b)(1)(A). "The traditional presumption favoring distribution among all holders of unsecured claims counsels strict construction of the Bankruptcy Code provisions governing requests for priority payment of administrative expenses." Woburn Assoc. v. Kahn (In re Hemingway Trans., Inc.), 954 F.2d 1, 4-5 (1st Cir. 1992). MacMillan bears the burden of proving an entitlement to administrative expense priority of his claim. See Hemingway, 954 F.2d at 5. In order to satisfy this burden, MacMillan must demonstrate that the consideration supporting his claim to payment was beneficial to the Debtors' estates and that his services preserved or enhanced the estates. See In re F.A. Potts & Co., Inc., 137 B.R. 13 (E.D. Pa. 1992); In re Pyxsys Corp., 288 B.R. 309, 318 (Bankr. D. Mass. 2003).

49. While there may be some question as to whether the standards for retention and compensation of professional persons under 11 U.S.C. §§327, 330 apply to officers retained by a debtor-in-possession, the Court, in any event, has the inherent authority to review, and alter, the terms of compensation for a debtor's corporate officers. See In re Blue Stone Real Estate,

Construction & Development Corporation, 392 B.R. 897 (Bankr. M.D. Fla. 2008); In re New York City Shoes, Inc., 89 B.R. 479, 482 (Bankr. E.D. Pa. 1988); In re Lyon & Reboli, Inc., 24 B.R. 152 (Bankr. E.D.N.Y. 1982); In re Zerodec Mega Corp., 39 B.R. 932 (Bankr. E.D. Pa. 1984).

ARGUMENT

I. MacMillan's services did not provide a benefit to the Debtors' estates and his fees and expenses should be disallowed in their entirety or substantially reduced.

50. As set forth herein, MacMillan was retained by the Debtors as a consultant in March 2014 and served with the Principals for at least one month prior to the bankruptcy filings. MacMillan appears to have been involved in the inexplicable decision to pay out more than $58,000,000 to Promoters and others in late March/early April 2014 on account of the prior business plan after the modified plan had supposedly been implemented. While professing that the Debtors had a viable business worth saving, MacMillan was unable, at the evidentiary hearing on the Venue Motion, to demonstrate any meaningful insight into the Debtors' business or the industry generally. MacMillan was not a VOIP specialist. He did not know who the Debtors' competitors were, nor their price points. He did not know how much of the Debtors' $1,000,000,000 in so-called revenues in 2013 were actual cash revenues as opposed to merely credits being exchanged between the Debtors and Promoters in the back office accounting system. The Nevada Bankruptcy Court found him, and Runge, to have little knowledge of the Debtors' affairs.

51. While MacMillan might have arguably been able to provide some benefit to the Debtors' estates as interim chief executive officer when the Debtors had assets and authority to operate, once the assets had been seized and the Restraining Order entered two days after the bankruptcy filings, MacMillan's role was reduced to little more than a figure head.

52. MacMillan seeks payment of more than $100,000 for presiding over a nonexistent business. MacMillan has not provided any detail or description of services that he allegedly provided or benefit ostensibly conferred upon the estates from these services. To the extent that MacMillan was involved or directed the Debtors in their opposition to the government's efforts, to the Trustee Motion, or to the Venue motion, then not only did MacMillan not confer a benefit upon the estates but indeed his actions harmed the estates through the additional costs incurred in litigation and the attendant delay in appointing an independent trustee to assume control of the Debtors' liquidation. Certainly, with respect to services rendered between the time venue was transferred on May 9, 2014 and the appointment of the Trustee on June 6, 2014, which fees totaled approximately $50,000, MacMillan's services provided no discernible benefit to the Debtors' estates.

53. It is unclear to whom MacMillan, as interim chief executive officer, was reporting to or whose services he was directing. With respect to his reporting obligations as chief executive officer, it seems unlikely that he had significant responsibilities because Merrill was incarcerated and Wanzeler was a fugitive from justice. With respect to MacMillan's responsibility to manage personnel, it does not appear that any employees remained after the Restraining Order entered and Asset Seizure was effected, nor does it appear that there were any business decisions to be made since there was no business.

54. Under these circumstances, MacMillan's request to be paid approximately $88,000 in fees and approximately $18,000 in expenses should be disallowed in their entirety or substantially reduced, as MacMillan has failed to satisfy his burden respecting allowance of his fees and expenses.

55. The Fee Request filed by Impact This Day, Inc. should be disallowed as duplicative of the MacMillan Application.

CONCLUSION

56. The fees and expenses sought by MacMillan should be disallowed or substantially reduced because MacMillan has failed to meet his burden of demonstrating that such costs are allowable administrative expense claims.

57. The Trustee reserves all rights, claims, and defenses with respect to the services provided by MacMillan prior to the Petition Date and amounts paid or unpaid on account thereof.

WHEREFORE, the Trustee respectfully requests that the Court enter an order:

(i) determining the allowable compensation and expense reimbursement to which MacMillan is entitled; and

(ii) granting such other relief as is just and proper.

STEPHEN P. DARR,
CHAPTER 11 TRUSTEE,

By his attorneys,

/s/ Harold B. Murphy

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
Facsimile: (617) 423-0498
Email: HMurphy@murphyking.com

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