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UNITED STATES BANKRUPTCY COURT DISTRICT OF MASSACHUSETTS

In re:)	Chapter 11
TELEXFREE LLC., et al., 1	Debtors.))))))	Case No. 14-40987 Jointly Administered

OBJECTION OF THE AD HOC COMMITTEE OF TELEXFREE GENERAL CREDITORS TO APPLICATIONS OF DEBTORS' PROFESSIONALS FOR ALLOWANCE OF COMPENSATION AND REIMBURSEMENT OF EXPENSES

The Ad Hoc Committee of TelexFree General Creditors, consisting entirely of victims of the TelexFree fraud who are accordingly holders of general unsecured claims in the above-captioned Chapter 11 cases and who are identified at Exhibit A hereto (the "Ad Hoc Committee"), through its undersigned counsel, respectfully objects (this "Objection") to the First and Final Application of Alvarez & Marsal North America, LLC ("A&M") for Allowance of Fees and Reimbursement of Expenses [Dkt. No. 383], the First and Final Application for Compensation and Reimbursement of Expenses of Greenberg Traurig, LLP ("Greenberg Traurig"), as Counsel for the Debtors, for the Period of April 13, 2014 Through June 30, 2014 [Dkt. No. 382] and the First and Final Application of Gordon Silver ("Gordon Silver", and with A&M and Greenberg Traurig, the "Applicants"), as Attorneys for Debtors, for the Allowance of Compensation for Professional Services Rendered and Reimbursement of Expenses [Dkt. No. 381] (collectively, the "Fee Applications"), and respectfully states as follows:

The Debtors in these cases (collectively, the "<u>Chapter 11 Cases</u>") are TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc.



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PRELIMINARY STATEMENT

- 1. Before this Court are matters that cry out for the input of a statutory fiduciary dedicated solely to protecting the interests of the hundreds of thousands of general unsecured creditors in these cases, primarily comprising the 1,000,000 or more victims of the fraud perpetrated by the Debtors and the many other persons and firms who aided and abetted the Debtors' wrongful conduct, and the additional wrongful conduct that they and others continue to perpetrate on these victims during the pendency. Those matters before the Court are the applications for payment of professional fees as administrative expenses of the estate. If these fee applications are allowed, millions of dollars otherwise available for creditor compensation would flow from the estate without the bases therefor having been reviewed or approved by an official creditor representative. As the only voice speaking solely for these victims and other unsecured creditors,² the Ad Hoc Committee respectfully objects to the fee applications and requests they be disallowed or that consideration thereof be postponed until an official committee of unsecured creditors is formed.
- 2. As this Court is aware, nearly five months have passed since these debtors (collectively, the "<u>Debtors</u>" or "<u>TelexFree</u>") filed for Chapter 11 relief because of the collapse of their Ponzi scheme that drew in cash reported to exceed \$1 billion or more, largely from individuals targeted from non-English speaking communities and for whom these losses often represented a major part of their life savings. During this five month period, the U.S. Securities

Primary counsel for each of the creditors who have formed the Ad Hoc Committee have represented to the undersigned that each creditor is a "net loser" with respect to the Ponzi scheme perpetrated by the debtors. In the informal discussions among the undersigned, the Chapter 11 Trustee and the Office of the United States Trustee, the Chapter 11 Trustee and the Office of the United States Trustee have emphasized the importance that the persons who are most clearly victims of this fraud are only those persons who have lost money invested, and who have not recovered anything from those "investments," and who do not have claims based on expectations of gains based on amounts that they hoped would be invested by others "further down" in the fraudulent pyramid scheme. Accordingly, the undersigned has worked closely with the primary counsel for each of the creditors listed at Exhibit A attached to assure to the greatest extent practicable adherence to this important criteria for participation in the Ad Hoc Committee.

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and Exchange Commission (the "SEC") has filed an emergency civil enforcement action against the Debtors, these cases have been transferred from the District of Nevada to this Court, responsible persons have been criminally charged and others have fled or attempted to flee the country, and a Chapter 11 Trustee has been appointed. Upon information and belief, negotiations have been commenced among the Chapter 11 Trustee and the estate's largest apparent creditor -- the United States government -- on the division of property of the estate between assets surrendered to Federal authorities as criminal forfeitures, and assets administered in the Debtors' chapter 11 estate for the benefit of creditors. Notwithstanding these critical developments, no official committee of unsecured creditors has yet been formed, there is virtually no reliable information about these proceedings available to creditors, and creditors have no entity dedicated solely to representing their interests.³

3. As described herein, the dissemination of misinformation to and outright deception of persons already victims of the prepetition fraud have continued unabated without an official committee to perform the duties critically assigned by statute to the official committee, including the duty to provide trustworthy information to creditors during a case that protects the creditors from further abuse and misconceptions (see 11 U.S.C. § 1103(b)(3)) -- duties especially critical and time-sensitive in a case with 1,000,000 or more consumer creditors, many of whom do not speak English. To expedite the establishment of an organized source of information and advocacy for creditors, the Ad Hoc Committee has engaged the undersigned as special bankruptcy counsel and has respectfully requested that the Office of the United States Trustee

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The Chapter 11 Trustee, of course, acts in a fiduciary capacity as well, and the Ad Hoc Committee is appreciative that the U.S. Trustee has appointed such a capable person as the Trustee, and that Mr. Darr has engaged such highly capable firms as Murphy & King and Mesirow to represent him in these cases. However, the Chapter 11 Trustee must naturally represent the interests of many constituents, including the substantial positions of governmental claimants. However, only an official committee can speak solely for the Ponzi scheme victims and other general claimants.

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(the "<u>U.S. Trustee</u>") form an official committee of unsecured creditors soon.⁴ Since that request was made, special bankruptcy counsel has been in frequent communication with the U.S. Trustee, urging the prompt formation of the official committee. The Ad Hoc Committee fully appreciates this is a very difficult case in many respects, including because there is no apparent reliable report on the identity of the largest creditors of the Debtors and that, in Ponzi scheme cases, even if such report existed, the reported "largest" creditors are often later determined to have been early promoters of the scheme with claims based largely on anticipated profits, or whom have already recovered significant cash based on scheme distributions. The Ad Hoc Committee is appreciative that the U.S. Trustee is working diligently to gather information to form an official committee consisting only of "true" creditors, including trade creditors if there are any willing to serve. Nevertheless, it is an unfortunate fact these cases have been pending for over five months now without the participation of a statutory fiduciary charged solely with protecting creditors' interests.

4. In the absence such a fiduciary, the Ad Hoc Committee has taken it upon itself to review and analyze the Fee Applications which, if granted, would substantially diminish the already limited resources of the estate (and accordingly would diminish eventual recoveries to creditors). From the Ad Hoc Committee's initial review, no benefit of any type seems to have been conferred on the Debtors' estates by the Applicants' efforts to resist the rightful transfer of the Chapter 11 Cases to this Court and to oppose the plainly necessary appointment of a chapter 11 trustee. The Ad Hoc Committee objects to the allowance of the Fee Applications and

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Brown Rudnick LLP ("<u>Brown Rudnick</u>") has been engaged as special bankruptcy counsel to the Ad Hoc Committee, on a limited basis, at no charge to the Committee members, for the sole purpose of advocating the interests of general unsecured creditors until such time as an official committee of unsecured creditors is formed and can then succeed to that critical role, as required by the Bankruptcy Code. Brown Rudnick does not represent any of the individual members of the Ad Hoc Committee with respect to his or her individual claim, or for any other purpose in these cases.

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requests this Court disallow them in their entirety. Alternatively, the Ad Hoc Committee respectfully requests this Court postpone consideration of the Fee Applications until an official creditors' committee is formed and is granted sufficient time to more fully review the propriety of the requested fees.

BACKGROUND

A. The Debtors' Prepetition Operations

- 5. TelexFree claims to have previously operated a telecommunications business that used multi-level marketing to assist in distributing voice over internet protocol ("VoIP") telephone services. See *Omnibus Declaration of William H. Runge in Support of the Debtors' Chapter 11 Petitions and Requests for First Day Relief* [Dkt. No. 13] ¶ 9. Prior to filing these cases, the Debtors compensated individuals (referred to as "Promoters") for the sales of the VoIP product, the placing of advertisements and the recruitment of other Promoters. See id. at ¶ 11.
- 6. The Securities and Exchange Commission (the "SEC") adds additional color to this story: according to the complaint the SEC filed against the Debtors and others in the United States District Court for the District of Massachusetts on or about April 15, 2014, the Debtors' business was in reality an illegal pyramid scheme that raised as much as \$1 billion dollars over the course of eighteen (18) months through a fraudulent and unregistered offering of securities.
- 7. In response to subpoenas issued by the Secretary of the Commonwealth of Massachusetts, Securities Division in January and February, 2014, TelexFree changed its compensation plan so its Promoters would now be required to sell its VoIP product to qualify for the payments that TelexFree had previously promised to pay them. The rule change generated a storm of protests from Promoters who cannot recover their money, and also caused the precipitous decline in incoming revenue that pushed TelexFree into bankruptcy. In her motion seeking the appointment of Chapter 11 Trustee, the United States Trustee for Region 17

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(including Nevada) asserted that since mid-November 2013, TelexFree has transferred approximately \$30 million from its operating accounts to its principals and officers and to affiliated companies, and that millions of additional investor funds received by TelexFree are unaccounted for. See Motion of the United States Trustee for Order Directing the Appointment of a Chapter 11 Trustee Pursuant to §1104 (a) [Dkt. No. 65] at 3. According to the Chapter 11 Trustee, "the number of parties who may assert claims against the Debtors could exceed one million." Motion by Stephen B. Darr, Chapter 11 Trustee, to Conduct Rule 2004 Examinations of Global Payroll Gateway, Inc., International Payout Systems, Inc., Propay, Inc., Propay.Com, Argus Payments, and Allied Wallet [Dkt. No. 305] at ¶ 12.

B. The Commencement of These Chapter 11 Cases

- 8. On April 13, 2014 (the "<u>Petition Date</u>"), each of the Debtors filed voluntary petitions for Chapter 11 relief with the United States Bankruptcy Court for the District of Nevada. The Debtors initially operated as debtors-in-possession under Sections 1107 and 1108 of the Bankruptcy Code.
- 9. On April 22, 2014, the office of the U.S. Trustee moved for the appointment of a Chapter 11 Trustee. The Debtors opposed this motion. <u>See</u> Response and Objection by the Debtors to Motion of the United States Trustee for Order Directing the Appointment of a Chapter 11 Trustee Pursuant to §1104(a) [Dkt. No. 128].
- 10. On April 23, 2014, the SEC moved to transfer venue of the cases to the United States Bankruptcy Court for the District of Massachusetts, which was granted on May 6, 2014. The Debtors likewise opposed this motion. See *The Debtors' Opposition to U.S. Securities and Exchange Commission's Motion for Change of Venue* [Dkt. No. 120]. Notwithstanding, the cases were transferred to this Court on May 9, 2014.

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11. On May 30, 2014, this Court approved the U.S. Trustee's motion to appoint a Chapter 11 trustee. On June 6, 2014, the U.S. Trustee appointed a highly capable and experienced insolvency professional, Stephen B. Darr (the "Chapter 11 Trustee"), as Chapter 11 trustee for the Debtors.

C. The Debtors' General Unsecured Creditors

- 12. As this Court is aware, the vast majority of the Debtors' general unsecured creditors are the hundreds of thousands of Promoters unknowingly engaged to promote the Debtors' Ponzi scheme. Most are unfamiliar with the Chapter 11 process. As the scheme targeted immigrant communities, including the Brazilian, Dominican, Nigerian and Russian communities, many Promoters do not speak English fluently. The bulk of the Debtors' unsecured creditors cannot engage with these Chapter 11 Cases in any meaningful way.⁵
- 13. Also, there has been to date virtually no reliable information publicly provided to these creditors, in any language, leaving them vulnerable to expensive further abuse, excessive anxiety and loss. Many of the victim creditors have been approached by vulture investors seeking to use the present information vacuum to prey upon helpless consumer victims of this Ponzi scheme, including by offering to buy claims for pennies on the dollar. Even more egregiously, unscrupulous attorneys have been advising Promoters they *must* engage an attorney to file a proof of claim against the Debtor, and attempting to charge these individuals exorbitant fees to prepare those proofs of claim. Special bankruptcy counsel to the Ad Hoc Committee

It appears that many of the creditor victims here are also undocumented immigrants residing in the United States, and may be thus extremely reluctant to directly participate in any formal proceedings, and also extremely reluctant to deal with a bankruptcy trustee or other official representative with duties other than solely to creditors. An official committee, of course, is neither a governmental agency or a chapter 11 trustee that has some duties to the United States government, as a creditor or otherwise. This is one of those rare and unfortunate situations, accordingly, where one of the most critical roles of an official committee will be to act as a conduit between those acting in official positions (such as governmental authorities and the chapter 11 trustee) and victim representatives, to ensure that victims who have valid claims are encouraged to file all valid claims and thus be able to fully participate in distributions from the estate.

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Assisted in shuttering one of the most glaring examples of Promoter abuse: a widely-viewed YouTube video in which an attorney claimed that proofs of claim were immediately due (though no bar date has yet been set), that defective claims would be invalidated without notice to the claimant (contrary to standard bankruptcy practice), and that proofs of claim must be accompanied by a "declaration re: electronic filing" (which is also patently untrue).⁶

14. Recognizing the danger that the lack of reliable information and the proliferation of misinformation posed and poses to the interests of all general unsecured creditors, the Ad Hoc Committee has formally requested that the U.S. Trustee appoint an official committee of unsecured creditors. Since that request was made, the Ad Hoc Committee, through special bankruptcy counsel, have engaged in constructive dialogue with the office of the U.S. Trustee, and the Ad Hoc Committee understands that the U.S. Trustee continues to gather additional information for the formation of an official committee. No official committee has yet been formed, making it necessary, in the opinion of the Ad Hoc Committee, for the Ad Hoc Committee to take action on an *ad hoc* basis to protect creditor interests, in full cooperation with the U.S. Trustee and the Chapter 11 Trustee, pending the formation of the official committee.

OBJECTION

15. On August 1, 2014, A&M, Greenberg Traurig, and Gordon Silver each filed a Fee Application. A&M seeks authority to apply a \$1 million pre-petition retainer to \$876,463.72 in fees and expenses. Greenberg Traurig seeks authority to apply a \$3,726,604.89 retainer to

The video, formerly accessible at http://youtu.be/GyW0Iru3wq8, is now marked as private and is at least presently inaccessible to the public, after the undersigned called the author of that video, challenged the "advice" given to victims, declined to enlist as a further "victim referral attorney" to be paid to file "corrected" creditor claims, and insisted that the site be disabled.

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\$1,044,813.95 in fees and expenses. Finally, Gordon Silver requests allowance of compensation and reimbursement of expenses in a total amount of \$229,712.85.⁷

efforts to form a creditors' committee soon, it believes that the upcoming hearing on the Fee Applications is a major case event that cannot pass without direct and formal creditor input. Unfortunately, without the presence of an official committee, empowered by the Bankruptcy Code with the ability and resources to investigate "any . . . matter relevant to the case," no one body can speak authoritatively for all creditors. Notwithstanding, the Ad Hoc Committee, populated solely by what it believes to be a representative sample of all general unsecured creditors, has taken it upon itself to review the Fee Applications, and respectfully submits that the tasks for which compensation and reimbursement is sought benefited neither the Debtors' estate nor its creditors. The Ad Hoc Committee respectfully requests this Court (i) enter an order disallowing the Fee Applications in their entirety, or (ii) postpone consideration of the Fee Applications until an official committee of unsecured creditors is appointed.

17. Beyond debate, compensation paid under Bankruptcy Code Section 330 (as requested in the Fee Applications) must be for "necessary" services and expenses. 11 U.S.C. § 330(a)(1). In determining reasonable compensation for professionals, a court must consider "whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title." 11 U.S.C. § 330(a)(3)(C). The Fee Applications reflect charges for services that were neither necessary to the administration of, nor beneficial to the completion of, these Chapter 11 Cases. Rather, the

Notably, a significant percentage of Greenberg Traurig's and Gordon Silver's fees were generated in the Debtors' unsuccessful attempts to resist transfer of these cases to this Court and likewise to resist the appointment of a Chapter 11 Trustee.

⁸ 11 U.S.C. § 1103 (enumerating the powers and duties of official committees of unsecured creditors).

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Ad Hoc Committee respectfully submits that tasks performed resulted only in unnecessary delay and waste to the detriment of the interests of unsecured creditors.

18. A&M seeks authority to apply a \$1 million prepetition retainer to \$876,463.72 in fees and expenses. A review of A&M's Fee Application reveals that the bulk of its prepetition fees and expenses were incurred in advising the Debtors as to a "restructuring" of what was a fraudulent enterprise -- a restructuring which would be unrealistic and contrary to both public policy and applicable law. Postpetition fees and expenses were also incurred in responding to discovery requests served by the Trustee, in cooperating with governmental investigations by the Securities and Exchange Commission and the United States Department of Justice into the Debtors' affairs, and in preparing its Application. Not one has resulted in any demonstrable benefit to creditors.

19. Greenberg Traurig, which seeks authority to apply a \$3,726,604.89 retainer to \$1,044,813.95 in fees and expenses, spent inordinate time fighting both the rightful transfer of these Chapter 11 Cases from Nevada (where the Debtors had nothing but a sham "rent-a-space" office in Las Vegas) to Massachusetts (where the Debtors have their principal place of business) and the appointment of a Chapter 11 Trustee (patently necessary here, where key members of Debtors' management have been taken into criminal custody or fled the country). Gordon Silver, which requests allowance of compensation and reimbursement of expenses in a total amount of \$229,712.85, likewise incurred substantial fees and expenses contesting the motions to transfer these Chapter 11 Cases to Massachusetts and to appoint a Chapter 11 trustee. The Ad Hoc Committee is baffled how the delay and attendant expense resulting from these doomed efforts can be deemed "beneficial" to the estate.

Beth Healy, <u>TelexFree Money</u>, <u>Operatives Were on the Move</u>, Boston Globe (May 15, 2014).

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20. It is not the Ad Hoc Committee's intent to cast aspersions on the good faith of the Applicants or on the diligence of their efforts. However, the Ad Hoc Committee respectfully submits that the tasks performed by the Applicants, as reflected in the Fee Applications, meet no aspect of the standards set by the Bankruptcy Code for the payment of professional fees as an administrative expense of the Debtors' estate.

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CONCLUSION

WHEREFORE, the Ad Hoc Committee respectfully requests that the Court (i) enter an order disallowing the Fee Applications in their entirety, or (ii) postpone consideration of the Fee Applications until an official committee of unsecured creditors is appointed.

Dated: September 12, 2014 THE AD HOC COMMITTEE OF TELEXFREE GENERAL CREDITORS

By: /s/ William R. Baldiga

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Special Bankruptcy Counsel to the Ad Hoc Committee of TelexFree General Creditors

Exhibit A

Claim Holders

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UNITED STATES BANKRUPTCY COURT DISTRICT OF MASSACHUSETTS

In re:)	Chapter 11
TELEXFREE LLC., et al., 1)) Case No. 14-40987
· .—.—) Debtors.)	Jointly Administered
)))

CERTIFICATE OF SERVICE

I, Carol S. Ennis, hereby certify that on September 12, 2014, I caused a copy of the Objection of the Ad Hoc Committee of TelexFree General Creditors to Applications of Debtors' Professionals for Allowance of Compensation and Reimbursement of Expenses to be served via operation of this Court's CM/ECF System and/or by electronic mail on the parties listed on the attached service list:

/s/ Carol S. Ennis

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The Debtors in these cases (collectively, the "<u>Chapter 11 Cases</u>") are TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc.

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