Docket #0449 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 FIRST AND FINAL APPLICATION OF GORDON SILVER, AS ATTORNEYS FOR DEBTORS, FOR THE ALLOWANCE OF COMPENSATION FOR PROFESSIONAL SERVICES RENDERED AND REIMBURSEMENT OF EXPENSES

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 First and Final Application of Gordon Silver ("Gordon"), as Attorneys for Debtors, for the Allowance of Compensation for Professional Services Rendered and Reimbursement of Expenses (the "Gordon Application").

The fees and expenses sought by Gordon should be substantially disallowed because a substantial portion of the services rendered by Gordon was neither reasonable, necessary, nor reasonably likely to benefit the Debtors' estates at the time such services were rendered. Fees and expenses sought by Gordon for the period after the appointment of the Trustee should be disallowed in accordance with applicable law as set forth in Lamie v. United States Trustee, 540 U.S. 526 (2004), and its progeny.

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 services 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 or 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, upon information and belief, provide 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 August 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]

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. In order to respond to the pending MSD investigation and subpoena, Greenberg needed to conduct an investigation of the Debtors' business plan which by necessity would include reviewing and becoming familiar with the Debtors' sales program, preparing the Principals for examination and interviewing third parties. Through this process, it should have become apparent that the Debtors were operating a pyramid scheme.

17. In fact, shortly after its retention, Greenberg was informed by both Weaver and Babener that the Debtors were operating a pyramid scheme.

18. Angelo Alves, a former Promoter, informed his counsel (Foley Hoag) that Promoters were paid principally to place advertisements. This information was shared with the Debtors and Greenberg.

19. Despite the fact that the Debtors' Brazilian affiliate, operating under a similar model, had been shut down by the Brazilian government as a pyramid scheme, and investigations by the MSD and the Securities and Exchange Commission ("SEC") were ongoing, the Debtors

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

continued to solicit and accept fees from new Promoters and took approximately $50,000,000 from new and existing Promoters between early February 2104 and mid-March 2014.

20. In March 2014, the Debtors retained Stuart MacMillan ("MacMillan") as a consultant and later as interim chief executive officer.

21. In March 2014, more than six (6) months after it was advised that is business constituted a pyramid scheme, the Debtors introduced a modified business plan to Promoters to 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.

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

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

24. Upon information and belief, the modified plan was rejected by Promoters. They 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 the Promoters, and others as yet undetermined, in late March/early April 2014 on account of obligations under the original plan.

III. Preparation for Bankruptcy Filings

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

26. 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 entered into on April 10, 2014. William Runge ("Runge") of A&M was designated by the Debtors as chief restructuring advisor.

27. 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.

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

29. 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

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

31. 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 reasons filing in Nevada were that the choice of law provision in certain Promoter contracts pointed to Nevada and one of the Debtors was established there. Upon information and belief, the real reason for filing in Nevada was to

distance the Debtors from the pending governmental investigations in Massachusetts. The petitions were signed by MacMillan.

32. 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. After application of retainers to the payment of prepetition fees and expenses, the balance of the retainer held Gordon was $694,764.50.

33. 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.

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

35. On or about April 15, 2014, on request of the SEC, the United States District Court for the District of Massachusetts (the "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 form such assets may presently exist and wherever located. (Section IV(A), Restraining Order).

36. Also on April 15, 2014, various governmental agencies, including Homeland Security and the Federal Bureau of Investigation, executed a search warrant and seized virtually all of the Debtors' assets (the "Asset Seizure"). In connection with the Asset Seizure, the Federal Authorities seized, among other things, approximately $40,000,000 in cashier's 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.

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

38. After the Restraining Order was issued and the Asset Seizure 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.

39. Gordon participated in the preparation and filing on April 23, 2014 of the 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 and services rendered in connection therewith were not reasonable, necessary, nor reasonably likely to benefit the Debtors' estates at the time such services were rendered.

40. At about the same time, the Office of the United States Trustee ("UST") filed a motion for the appointment of a Chapter 11 trustee (the "Trustee Motion").

41. 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.

42. Gordon participated in the preparation and filing on April 29, 2014 of the opposition to the Venue Motion and, on April 30, 2014, to 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.

43. 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 modified plan had a commission payout of approximately eighty percent (80%), or double the amount that would be considered acceptable for an MLM program; and

iii. MacMillan and Runge were not VOIP specialists, and they 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 $1,000,000,000 in revenues in 2013 represented cash versus back office, non-cash bookkeeping entries.

44. 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.

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

46. During the period in which the Debtors were debtors-in-possession, the Debtors did not file schedules or a statement of financial affairs, nor even a matrix of creditors.

47. On August 1, 2014, the Debtors' professionals filed their applications for compensation.

THE GORDON APPLICATION

48. The Gordon Application seeks allowance and payment of fees in the amount of $225,592.50 and expenses in the sum of $4,120.35 for services rendered and expenses incurred during the period from the Petition Date through July 31, 2014.

49. Of the amounts sought by Gordon, $159,135.50 in fees and a substantial portion of the expenses related to litigation with governmental entities, as follows:

(i) $44,949.00 in fees are sought for services in a category denominated "362 Stay Violation Matters" pursuant to which Gordon and Greenberg prepared, filed, and litigated the Stay Motion;

(ii) $74,546.50 in fees are sought for services in a category denominated "Litigation/Contested Matters" pursuant to which Gordon and Greenberg prepared, filed, and litigated the opposition to the Venue Motion and the Trustee Motion;

(iii) $39,640.00 in fees are sought for services in a category denominated "Regulatory/Securities" pursuant to which Gordon dealt with the MSD litigation, the SEC litigation, the Asset Seizure and related matters.

50. As discussed above, Gordon was paid a prepetition retainer of $750,000. It billed and was paid the sum of $55,235.0 for prepetition services, and reported a retainer of $694,764.50 as of the Petition Date. Despite multiple requests by the Trustee, Gordon has not turned over the amount of the retainer it holds in excess of fees and expenses sought in its application.

LEGAL ANALYSIS

I. Standards for Evaluating Requests for Professional Compensation

A. Reasonable and Necessary

51. Section 330 of the Bankruptcy Code governs compensation for professional persons employed under Section 327 and provides that the Court may award reasonable compensation only for actual, necessary services and reimbursement for actual, necessary expenses incurred in performing such services. 11 U.S.C. §330(a)(1).

52. Courts employ the "lodestar" approach to evaluate the reasonableness of compensation for professionals, establishing a threshold point, or lodestar, which is the number of hours reasonably spent multiplied by the professional's reasonable hourly rate, which may then be adjusted upward or downward. See In re Sullivan, 674 F.3d 65, 69 (1st Cir. 2012) (lodestar method appropriate measuring device for attorneys fees in bankruptcy cases); see also Boston & Maine Corp. v. Moore, 776 F.2d 2, 6 (1st Cir. 1985); Grendel's Den, Inc. v. Larkin, 749 F.2d 945, 950 (1st Cir. 1984); Furtado v. Bishop, 635 F.2d 915, 919-20 (1st Cir. 1980); McMullen v. Schultz, 428 B.R. 4, 11 (D. Mass. 2010).

53. In determining the reasonableness of the compensation to be awarded, a court considers the nature, extent, and value of the services rendered, taking into account all relevant factors including: A) the time expended, B) the rates charged, C) whether the services were necessary to the administration of the case, or beneficial at the time in which the service was rendered toward the completion of the case, D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed, E) whether the professional is board certified or has demonstrated skill and experience in bankruptcy, and F) whether the compensation is reasonable

based upon the customary compensation charged by comparably skilled practitioners in non-bankruptcy cases. 11 U.S.C. §330(a)(3). A court must disallow compensation for unnecessary duplication of services, or for services not reasonably likely to benefit the estate or not necessary to administration of the case. 11 U.S.C. §330(a)(4).

54. In assessing the reasonableness of fees, courts have considered, among other things, whether the services were necessary or beneficial, whether the services were adequately documented, whether the professional exercised proper billing judgment; and whether the fees were reasonable taking into account the statutory factors referenced above. See In re Wolverine, Proctor & Schwartz, LLC, 2012 WL 3930360, at *5 (Bankr. D. Mass. 2012); see also In re Puffer, 494 B.R. 1, 6 (D. Mass 2013) (in determining reasonableness, courts are directed to eliminate time unreasonably, unnecessarily, or inefficiently devoted to the case); In re Little, 484 B.R. 506, 511 (1st Cir. BAP 2013); In re Invent Resources, Inc., 2012 WL 5399616, at *6 (Bankr. D. Mass. 2012). The court may draw upon its own experience with professional fee charges to determine a reasonable fee. In re Young, 2012 WL 6091102, at*6 (Bankr. D.N.M. 2012). The burden of proof for demonstrating the reasonableness of fees is ultimately on the applicant. Berliner v. Pappalardo (In re Sullivan), 454 B.R. 1, 5 (D. Mass. 2011), aff'd 674 F.3d 65 (1st Cir. 2012); see also Garb v. Marshall (In re Narragansett Clothing Co.), 210 B.R. 493, 498 (1st Cir. BAP 1997), citing Woods v. City Nat'l Bank & Trust Co. of Chicago, 312 U.S. 262, 269 (1941).

55. The majority of circuits hold that court appointed professionals need to show that there was a reasonable likelihood of benefit to the estate at the time services were rendered. See, e.g., In re Smith, 317 F.3d 918 (9th Cir. 2002); In re Top Grade Sausage, Inc., 227 F.3d 123 (3d Cir. 2000); In re Ames Department Stores, Inc., 76 F.3d 66 (2d Cir. 1996); In re Taxman

Clothing Co., 49 F.3d 49 F.3d 310 (7th Cir. 1995). At least one circuit court has held, however, that a professional must demonstrate an actual benefit to the estate for services rendered in order to be compensated. See In re Pro-Snax Distributors, Inc., 157 F.2d 414 (5th Cir. 1998).

56. Professionals should not be compensated for services where it should have been clear to counsel from the outset that a debtor could not prevail in the litigation or succeed in a reorganization. See In re Hammond Computer, Inc., 1997 WL 33321089 (Bankr. D. Utah 1997) (counsel unsuccessfully defended a motion to appoint a Chapter 11 trustee; while counsel has an ethical duty to represent a debtor using all of his knowledge and skills, time expended on futile efforts should not be compensated); see also Wolverine, 2012 WL 3930360, at *5 (where it becomes reasonably obvious that litigation will cost more than it likely will benefit the estate, counsel has a duty to abandon such litigation); In re Vines, Inc., 159 B.R. 381 (Bankr. D. Mass. 1993) (no compensation to professionals where it was clear that no reorganization was feasible and counsel's efforts only worsened the position of creditors); In re Amstar Ambulance Service, Inc., 120 B.R. 391 (Bankr. N.D. W. Va. 1990) (reorganization counsel must make a seasoned determination of whether further rehabilitation efforts are warranted; fees incurred beyond the point where there is no likelihood of reorganization will be denied); In re L.D. Alderson, 114 B.R. 672 (Bankr. D.S.D. 1990) (fees incurred by counsel in Chapter 12 case after counsel knew or should have known that conversion was plainly in prospect should be denied; counsel has duty to ascertain the true financial condition of the debtor to determine if a reorganization is the proper course of action);.

57. Professionals have a heightened duty when representing clients that may be engaging in conduct that is fraudulent or illegal. See FDIC v. O'Melveny & Myers, 969 F.2d 744 (9th Cir. 1992) (counsel must act competently to avoid public harm after discovering that

client is dishonest and must protect the client from liability that flows from promulgating false or misleading offerings); In re Wilde Horse Enterprises, Inc., 136 B.R. 830 (Bankr. C.D. Cal. 1991) (counsel must ask probing questions and demand full response when concerns arise that debtor is being dishonest or neglecting fiduciary duties; unresolved concerns must be brought to the court's attention by way of motion to withdraw or some other vehicle).[3]

B. Compensation for Post-Trustee Services

58. Professionals retained by a Chapter 11 debtor may not be compensated for services rendered after the conversion of a case to Chapter 7 and the appointment of a trustee. Lamie v. United States Trustee, 540 U.S. 526 (2004). The holding in Lamie extends to services rendered after the appointment of a trustee in Chapter 11 cases as well. See In re International Gospel Party Boosting Jesus Group, Inc., 487 B.R. 12 (D. Mass. 2013); see also Morrison P.C. v. United States Trustees, 2010 WL 2653394 (E.D.N.Y. 2010) (same). Section 330 does not prohibit a debtor from engaging counsel prior to conversion and paying counsel reasonable compensation in advance to perform necessary post-conversion services. Lamie, 540 U.S. 526. The retainer exception referenced in Lamie, however, applies only to flat fee retainers that become property of counsel upon payment and is intended to refer to prepayment of services, not security retainers. In re CK Liquidation Corporation, 343 B.R. 376 (D. Mass. 2006); see also In re Anctil Plumbing & Mechanical Contractors, Inc., 416 B.R. 333 (Bankr. D. Mass. 2009)

[3] See also Comm. v. Jerome, 56 Mass. App. Ct. 726 (2002) (counsel has duty to withdraw if representation will result in violation of rules of professional conduct or other laws); Wilde Horse Enterprises, 136 B.R. 830 at 845 (violation of code of professional ethics or breaches of fiduciary duty can give rise to reduction, denial, or forfeiture or compensation); *Mass. R. Prof. C. 1.6(b)(*counsel must reveal client information if necessary to prevent commission of criminal or fraudulent act that counsel reasonably believes is likely to result in substantial injury to the financial interests or property of another).

(Lamie retainer reference implicitly recognized that individual debtors may have exempt property that can be used to pay counsel in advance of conversion).

C. Compensation for Time Defending Fee Applications

59. Time expended by a professional defending an application for compensation is generally not compensable. In re Asarco, 751 F.3d 291 (5th Cir. 2014); Grant v. George Schumann Tire & Batt. Co., 908 F.2d 874 (11th Cir. 1990). See also In re Riverside-Linden Investment Co., 945 F.2d 320 (9th Cir. 1991) (no *per se* award of fees litigating applications for compensation; services must meet the requirements of Section 330(a)(4) and the case must exemplify a set of circumstances where the time and expense of defending the application was warranted); In re Jessee, 77 B.R. 59 (Bankr. W.D. Va. 1987) (fees expended defending previously allowed application for compensation at appellate level not compensable from the estate).

ARGUMENT

A. The Fees sought by Gordon were not reasonable or necessary, nor reasonably likely to benefit the Debtors' estates at the time such services were rendered.

60. Gordon was retained as local counsel shortly before the Chapter 11 petitions were filed in Nevada. Gordon seeks allowance and payment of fees in the amount of $225,592.50 and expenses in the sum of $4,120.35 for services rendered and expenses incurred during the period from the Petition Date through July 31, 2014 in defending a reorganization that was doomed to fail from its inception. Gordon's services were not reasonably likely to benefit the Debtors' estates at the time such services were rendered. See, e.g., In re Ames Department Stores, Inc., 76 F.3d 66 (2d Cir. 1996). Gordon is holding a retainer in the amount of $694,764.50.

61. Gordon advised the Debtors in preparing and filing the Chapter 11 petitions even though there was no prospect of reorganization. Whatever faint hopes may have existed were extinguished within two days of the filings by the issuance of the Restraining Order and the seizure of the Debtors' assets.

62. As a consequence of the foregoing, the Debtors had no access to cash or revenue, no employees, an interim chief executive officer with no independent authority, and a board that could not act without the approval of Wanzeler who, at the time, was a fugitive from justice.

63. Rather than recognizing that the reorganization was over and an independent trustee was required to take over the Debtors' affairs, Gordon participated in a futile effort to prolong it by: (i) opposing the Trustee Motion notwithstanding evidence of an ongoing fraud and a conflicted board; (ii) opposing the Venue Motion, clinging to the Nevada venue despite overwhelming evidence that Massachusetts was the more appropriate venue to administer the cases; and (iii) contesting the Restraining Order in the Nevada Bankruptcy Court via the Stay Motion, even though the Nevada Bankruptcy Court had no authority to modify or vacate orders entered by the District Court. These efforts served little purpose other than to consume legal fees and expenses and delay the inevitable.

i. The Venue and Trustee Motions

64. The Trustee objects to Gordon's request for compensation respecting $74,546.50 in fees sought for services in a category denominated "Litigation/Contested Matters" pursuant to which Gordon participated in the preparation, filing, and litigation of the opposition to the Venue Motion and the Trustee Motion.

65. The opposition to the Trustee Motion was filed on or about April 30, 2014, more than two weeks after the Restraining Order was entered and the Asset Seizure effected. At that

time, the evidence was compelling that the Debtors' management had engaged in fraud, dishonesty, and gross mismanagement, there was no business to reorganize, the Debtors did not have an independent board, and that an independent estate representative was required to take control of the Debtors' affairs. MacMillan could not be said to be independent, given his association with the Principals for at least a month prior to the filings, and his involvement in and/or knowledge of the payment of $58,000,000 to certain Promoters and others during his tenure. Gordon's services in this regard were not remotely reasonable, necessary, nor likely to benefit the Debtors' estates at the time the services were rendered.

66. The Debtors' opposition to the Venue Motion was similarly futile from the outset. The Debtors' connection with Nevada was tenuous at best. The rationale for filing in Nevada was questionable, in that the Debtors' only connection with Nevada was that one of the Debtors, which did not appear to have any substantial business operations at the time of the filing, was established in Nevada. On the other hand, the Debtors' connections to Massachusetts were substantial. The Debtors' physical office was in Massachusetts. The actions commenced by the Federal Authorities and the MSD were pending in Massachusetts. The Restraining Order, which the Debtors sought to overturn, was entered by a District Court in Massachusetts. Upon information and belief, the real basis for trying to keep the case in the Nevada Bankruptcy Court was to distance the Debtors and the Principals from the pending governmental litigation in Massachusetts. Once the Restraining Order had entered, the Debtors' assets seized, and the Principals incapacitated, no rational basis existed to contest the venue change. Gordon's services in opposing the Venue Motion were not necessary, reasonable, nor reasonably likely to benefit the Debtors' estates at the time the services were rendered.

ii. The Stay Motion

67. The Trustee objects to Gordon's request for compensation respecting $44,949.00 in fees sought for services in a category denominated "362 Stay Violation Matters" pursuant to which Gordon participated in the preparation, filing, and the litigation of the Stay Motion. The Stay Motion on its face could not be granted because the Nevada Bankruptcy Court had no jurisdiction to modify or vacate the orders entered by the District Court. In re Alberto, 199 B.R. 985 (Bankr. N.D. Ill 1990) ("The bankruptcy court is not the appropriate forum for an attempted effective collateral attack on the orders entered by [the District Court]."); see generally In re Chicago, Milwaukee, St. Paul and Pacific Railroad Co., 738 F.2d 209 (7th Cir. 1984) (judgment by a court of competent jurisdiction bears a presumption of regularity and is therefore not subject to collateral attack); In re Hammett, 42 B.R. 48 (Bankr. N.D. Miss. 1984) (the bankruptcy court cannot serve as an appellate forum to challenge the validity of orders entered by the district court).

68. Gordon's request for compensation in this category should be denied because the services were not necessary, reasonable, nor reasonably likely to benefit the Debtors' estates at the time the services were rendered.

iii. Services Rendered Opposing Efforts Of Governmental Authorities

69. The Trustee objects to Gordon's request for compensation respecting $39,640.00 in fees sought for services in a category denominated "Regulatory/Securities" relating to the MSD litigation, the SEC litigation, the Asset Seizure and related matters.

70. Gordon spent a considerable amount of time relating to the opposition to the motion for a preliminary injunction filed in the District Court. The opposition could not have provided a benefit to the Debtors' estates because, first, modification of the injunction would be

of no avail in light of the Asset Seizure and, secondly, the Debtors agreed to a consent order a week after the opposition was filed that effectively granted the Federal Authorities all of the requested relief. Gordon's services in this regard were not necessary, reasonable, nor reasonably likely to benefit the Debtors' estates at the time the services were rendered.

iv. **Services Rendered After The Appointment Of The Trustee And/Or In Defending Fee Applications**

71. Gordon has sought compensation in the Gordon Application for services rendered after the Debtors consented to the appointment of a Chapter 11 trustee. All such services are not compensable pursuant to Lamie v. United States Trustee, 540 U.S. 526 (2004). It makes no difference that Gordon may have rendered the services in preparing and defending the Gordon Application. Such services are of no benefit to the estate and are not compensable. See, e.g. In re Asarco, 751 F.3d 291 (5th Cir. 2014). The Trustee further objects to Gordon receiving payment from the retainer that it holds and has refused to turn over to the Trustee for any amounts for which it has not sought compensation from the bankruptcy estate pursuant to the Gordon Application. The Trustee reserves all of his rights and the rights of the estates in this regard.

CONCLUSION

72. All or substantially all of the fees sought by Gordon in connection with the Stay Motion should be denied because, among other reasons, the Nevada Bankruptcy Court had no jurisdiction to modify or vacate the Restraining Order entered by the District Court. All or substantially all of the fees sought by Gordon in opposing the Trustee Motion and the Venue Motion should be denied as the Debtors had no legitimate business to reorganize and Massachusetts was clearly the appropriate venue to administer the cases. All or substantially all of the fees sought by Gordon in litigating the preliminary injunction should be denied because

denial of the preliminary injunction would not have altered the Asset Seizure and the Debtors consented to the terms of the injunction merely one week after the Debtors' opposition was filed. All of the fees sought by Gordon for services performed after the Debtors' consented to the appointment of a Chapter 11 trustee should be disallowed.

73. The Trustee reserves all rights, claims, and defenses with respect to the services provided by Gordon 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) disallowing Gordon's fees and expenses as recommended herein; and

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

STEPHEN P. DARR,
CHAPTER 11 TRUSTEE,

By his attorneys,

/s/ Harold B. Murphy

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Dated: September 15, 2014
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