Docket #0024 Date Filed: 3/17/2016

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

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| In re: | Chapter 11 |
| TELEXFREE LLC, et al.,[1] | Case No. 14-40987 |
| Debtors. | Jointly Administered |
| STEPHEN DARR, CHAPTER 11 TRUSTEE OF THE ESTATES OF TELEXFREE, LCC, TELEXFREE, INC. and TELEXFREE FINANCIAL, INC., | Adversary Proceeding No. 15-04055 |
| Plaintiff, | |
| v. | |
| RITA DOS SANTOS, INDIVIDUALLY AND AS PUTATIVE CLASS REPRESENTATIVE, | |
| Defendant. | |

**PLAINTIFFS' INTERIM EXECUTIVE COMMITTEE'S RESPONSE TO ORDER ON TRUSTEE'S MOTION FOR ORDER FOR SCHEDULING ORDER REGARDING TRUSTEE'S REQUEST FOR PRELIMINARY INJUNCTION**

The Plaintiffs' Interim Executive Committee (the "PIEC") appointed by the United States District Court in this District as the representative of the victims of the Debtors' pyramid scheme by orders entered in the multi-district litigation proceedings captioned *In re TelexFree Securities Litigation*, MDL No. 14-02566 (D. Mass.) (the "MDL Proceedings"), hereby submit this response to the *Order on Trustee's Motion for Order for Scheduling Order Regarding Trustee's Request for Preliminary Injunction* [Dkt. No. 22]. The PIEC believes that the *Motion for Scheduling Order Regarding Trustee's Request for Preliminary Injunction* (the "Scheduling

[1] The debtors ("TelexFree" or the "Debtors") in these cases (collectively, the "Chapter 11 Cases") are TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc.

Motion") [Dkt. No. 5] is not moot in certain respects, and respectfully states as follows as the basis for that belief:

**RESPONSE**

1. As this Court is aware, the Debtors formerly operated a pyramid scheme of nationwide and international scope. According to the Chapter 11 trustee (the "Trustee"), there are likely a million or more victims of the TelexFree scheme. See *Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* (the "Ponzi Scheme Motion"), Case No. 14-40987 [Dkt. No. 623] at ¶ 39. The vast majority of cash lost by victims, perhaps in excess of $1 billion, was paid by a victim directly to a recruiting participant or promoter already involved in the scheme (each payment, a "Direct Victim Payment"). See id. at ¶ 28.

2. On October 7, 2015, the Trustee filed this adversary proceeding (the "Adversary Proceeding"), seeking a determination that the Direct Victim Payments constitute property of the Debtors' estate and that the Trustee, and only the Trustee, has standing to pursue the recovery of those funds.[2]

3. Beginning with the first complaints, the PIEC has attempted to bring, in a responsible and legally correct manner, actions to recover the Direct Victim Payments on behalf of victims in the context of the MDL Proceedings. It has also sought and obtained attachments of significant assets belonging to recipients of Direct Victim Payments [Dkt. Nos. 40, 41, 42, 74, 138, 139, 342, 343, 375, 383, 389, 390, 405]. The PIEC has more recently attempted to bring claims to recover all Direct Victim Payments on behalf of all victims, including by the *Plaintiffs' Motion to Amend Complaint and File Third Consolidated Amended Complaint* (the "Motion to

[2] The Trustee filed the *Amended Complaint* [Dkt. No. 21] in the Adversary Proceeding on February 26, 2016.

Amend") [Dkt. No. 252], by which the PIEC attempted to bring a reverse class action to recover all Direct Victim Payments. By order dated January 15, 2016 [Dkt. No. 379], the District Court denied the Motion to Amend. The District Court did not state the reasons for the denial of the Motion to Amend but, given that most of the argument on that Motion to Amend was devoted to the reverse class action aspects of the intended action, the PIEC assumed and believed that the District Court's denial was based on the reverse class action nature of the relief sought. Attempting in good faith to address that perceived reason for denial, the PIEC then filed before Judge Hillman (in the context of the MDL Proceedings) an original action (Civ. Act. No. 16-40018-TSH) to recover the Direct Victim Payments from some individual recipients thereof, with no reverse class action request. This seemed reasonable as it appears tantamount to many of the same claims brought against the top level promoters named in the previous complaints. By order dated March 2, 2016 [Dkt. No. 414], the District Court stayed that new action until further notice.

4. No court has yet made any substantive ruling as to the gating legal question as to whether the Direct Victim Payments constitute property of the Debtors' estate (in which case only the Trustee may seek their recovery) or whether (as the PIEC believes) they do not, in which case the Trustee has no standing to do so.

5. However, the PIEC believes that this critical substantive question is ripe for decision, and should be decided without further delay, whether in the context of this Adversary Proceeding or otherwise.[3]

[3] In submitting this suggestion, the PIEC believes that such suggestion does not violate the stay imposed by Judge Hillman in Civ. Act. No. 16-40018. Indeed, in a colloquy before Judge Hillman in the MDL Proceedings on December 11, 2015, the parties (the PIEC and the Trustee) argued that this substantive gating issue be first decided by this Court, and Judge Hillman indicated that he was inclined to agree. However, that hearing pre-dated the most recent stay order, and if Judge Hillman instructs that his stay precludes even this suggestion that this Adversary Proceeding is not moot and that this Court should decide the legal issue as to who has proper standing to bring the claims in question, then the PIEC of course will immediately withdraw this request.

6. In connection with the Trustee's Ponzi Scheme Motion, the PIEC and the Trustee fully briefed and tried the issue of whether the Direct Victim Payments constitute property of the Debtors' estate. The record before the Court on this issue is, the PIEC believes, complete and includes:

- the Ponzi Scheme Motion;
- the *Opposition to Certain Aspects of the Relief Sought in the Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief*, Case No. 14-40987 [Dkt. No. 649];
- the *Omnibus Reply by Chapter 11 Trustee to: (1) Opposition to Certain Aspects of Relief Sought in Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief; and (2) Limited Opposition of Carlos Wanzeler and James Merrill to Motion of Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief*, Case No. 14-40987 [Dkt. No. 652];
- the November 24, 2015 Hearing Transcript;
- the *Post-Trial Brief Concerning Further Arguments With Respect to Certain Aspects of Relief Sought in the Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme*, Case No. 14-40987 [Dkt. No. 675]; and
- the *Memorandum in Support of Proposed Supplemental Order Respecting Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief*, Case No. 14-40987 [Dkt. No. 677].[4]

7. Furthermore, the PIEC believes that deciding whether the Direct Victim Payments constitute property of the Debtors' estate is crucial to the just administration of the Debtors' Chapter 11 Cases and the legal rights of perhaps a million individual victims, some of whom may be creditors of these estates, and perhaps hundreds of thousands of individuals who are not and likely never will be. The Direct Victim Payments represent at least hundreds of millions, and potentially billions, of dollars in harm to victims of the TelexFree scheme. The Trustee has

[4] On January 26, 2016, the Court held a further non-evidentiary hearing and granted certain of the relief requested in the Ponzi Scheme Motion. However, the Court did not decide whether the Direct Victim Payments constitute property of the Debtors' estate. See *Supplemental Order Respecting Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief*, Case No. 14-40987 [Dkt. No. 687].

brought two actions, against domestic and foreign promoters of the scheme, to recover Direct Victim Payments for the benefit of the Debtors' estate, seeking certification of reverse class action status virtually identical to the reverse class action status earlier sought by the PIEC and not permitted to proceed by Judge Hillman. See Adversary Proceedings Nos. 16-04006, 16-04007. These actions would forever foreclose the rights of a million or more victims, who are spread across the globe, to sue to recover the Direct Victim Payments in their own name, with no notice to them.[5] The PIEC respectfully believes that the property rights of these individual victims should not be foreclosed without this or some other Court entering an actual judgment on the merits as to the gating question as to whether they or the Trustee have standing to recover those payments.

8. Based on the foregoing, the PIEC believes that the Trustee's Scheduling Motion is not moot. The PIEC respectfully suggests that a status conference would be helpful to address these issues and direct the parties how to proceed. The PIEC will also file a copy of this paper in the MDL Proceedings so that Judge Hillman is directly and fully advised of its nature and contents, including to permit Judge Hillman to issue any instructions or other order he may deem appropriate, given the earlier stay order and the plainly inter-related nature of both proceedings and, respectfully, to avoid any misunderstanding that the PIEC is attempting to seek relief here that is in any way inconsistent with Judge Hillman's earlier orders.

*[Remainder of page intentionally blank]*

[5] The PIEC is the fiduciary for victims who directly paid the top promoters, and in that capacity has made every attempt under the circumstances to vigorously pursue the related available remedies against the top promoters. The PIEC has kept its clients informed and many victims have unequivocally advised the PIEC that they choose to represent themselves, do not choose to waive their related rights to seek economic damages from the Direct Victim Payment recipients, and have instructed the PIEC to oppose the efforts of the Trustee to enjoin them from doing so.

Dated: March 17, 2016
Boston, Massachusetts

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**CERTIFICATE OF SERVICE**

I, William R. Baldiga, hereby certify that on March 17, 2016, I caused a true and accurate copy of the foregoing Response to be served by operation of this Court's CM/ECF system and by first class mail, postage prepaid to the parties listed below.

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Dated: March 17, 2016
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