Docket #0046 Date Filed: 9/2/2016

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
CENTRAL DIVISION

In re: TELEXFREE, LLC, TELEXFREE, INC. and TELEXFREE FINANCIAL, INC., TelexFree.	Chapter 11 Cases 14-40987-MSH 14-40988-MSH 14-40989-MSH Jointly Administered
STEPHEN B. DARR AS TRUSTEE OF THE ESTATES OF TELEXFREE, LLC, TELEXFREE, INC. and TELEXFREE FINANCIAL, INC., Plaintiffs, v. RITA DOS SANTOS, INDIVIDUALLY AND AS PUTATIVE CLASS REPRESENTATIVE, AND MARIA MURDOCH, ANGELA BATISTA JIMENEZ, ELISANGELA OLIVEIRA AND DIOGO DE ARAUGO, AS PUTATIVE CLASS REPRESENTATIVES, Defendants.	Adversary Proceeding No. 15-04055

PLAINTIFFS' RESPONSE TO DEFENDANTS' LOCAL BANKRUPTCY RULE 7056-1 STATEMENT OF UNDISPUTED MATERIAL FACTS IN SUPPORT OF PIEC'S MOTION FOR SUMMARY JUDGMENT

1. The PIEC is the authorized representative of the victims of the TelexFree Ponzi and pyramid scheme, charged with prosecuting litigation on their behalf. See *MDL Case Management Order No. 3*, In re TelexFree Securities Litigation, MDL No. 14-02566 (D. Mass)(the "MDL Proceedings") [Docket No. 79], at 1-2.

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RESPONSE: Admitted in part. The Plaintiffs' Interim Executive Committee ("PIEC") has been appointed to coordinate and organize such Plaintiffs in the conduct of litigation pending before the United States District Court, MDL No. 4:14-md-2566-TSH. The Trustee disputes any suggestion that the PIEC's authority is any broader than as specifically set forth in MDL Case Management Order No. 3, Exhibit "A" to the Defendants' Local Bankruptcy Rule 56-1 Statement of Undisputed Material Facts in Support of PIEC's Motion for Summary Judgment ("Defendant Statement").

2. In June 2014, victims of TelexFree brought several actions against the perpetrators and co-conspirators of the Debtors' scheme. See *Complaint*, Guevara v. Merrill, et al., C.A. No. 14-22405 (S.D. Fla.) [Docket No. 1]; *Complaint*, Cook v. TelexElectric, LLLP, et al., C.A. No. 14-00134 (N.D. Ga.) [Docket No. 1]; *Complaint*, Githere, et al. v. TelexElectric, LLLP, et al., C.A. No. 14-12825 (D. Mass) [Docket No. 1]; *Complaint*, Ferguson, et al. v. TelexElectric, LLLP, et al., C.A. No. 14-40138 (D. Mass) [Docket No. 1].

RESPONSE: Admitted in part. The Plaintiffs admit that the actions attached as Exhibit B through E to the Defendant Statement were filed in connection with the TelexFree action. These actions, along with two adversary proceedings commenced in the Bankruptcy Court, were consolidated in the Transfer Order dated on or about October 22, 2014.

3. On October 22, 2014, the District Court for the District of Massachusetts transferred these actions to MDL No. 14-02566. See *Transfer Order*, MDL No. 14-02566 [Docket No. 1].

RESPONSE: Admitted that the actions set forth in paragraph 2 of the Defendant Statement, along with Martin v. TelexFree, Inc. et al (A.P. No. 14-4044) and Cellucci v.

TelexFree, Inc. et al (A.P. No. 14-4057) were transferred pursuant to the order dated October 22, 2014.

4. On April 30, 2015, the PIEC consolidated these prior actions in a single complaint naming over forty (40) defendants, including James Merrill and Wanzeler, the master-minds behind TelexFree, and certain other non-debtor promoters and co-conspirators for fraud, securities fraud, a variety of other torts, and for aiding and abetting these torts. See *Second Consolidated Amended Complaint*, MDL No. 14-02566 (the "SCAC") [Docket No. 141], at ¶¶ 39-100, 1004-1098. The SCAC includes a count of unjust enrichment against all defendants. See id. at ¶¶ 1037-1043.

RESPONSE: Admitted.

5. On September 23, 2015, the PIEC filed a complaint in the United States District Court for the District of Arizona (the "Arizona Action"), which substantially mirrored the SCAC, except that the complaint was expanded to include a request for certification of a defendant class of "Net Winners" who received payments from other Participants in the TelexFree scheme. See *Complaint*, Dos Santos v. TelexElectric LLLP et al., C.A. No. 15-01906 (D. Ariz.) (the "Arizona Action Complaint") [Docket No. 1] at ¶¶ 1012-1021.[6]

RESPONSE: Admitted in part. The Trustee admits that the PIEC filed the Arizona Action on or about September 23, 2015. The Arizona Action did substantially mirror the PIEC's proposed Third Amended Complaint in the pending MDL action. The motion by the PIEC for authority to amend the SCAC and file the Third Amended Complaint was denied. The Trustee also states that the payments made in Triangular Transactions by the individual being recruited were made to the Debtors to satisfy the invoice issued by the Debtor to that recruited

individual. The money was collected by Promoters who recruited the individual on behalf of TelexFree. The Promoter was subsequently permitted by TelexFree to redeem earned credits against the member fee collected, thus constituting a payment to the Promoter by TelexFree.[1]

6. The Arizona Action was transferred to the United States District Court for the District of Massachusetts on October 21, 2015. See *Conditional Transfer Order (CTO-2)*, C.A. No. 15-01906 [Docket No. 12] at 1.

RESPONSE: Admitted.

7. On February 24, 2016, the PIEC commenced an action in the United States District Court for the District of Massachusetts, asserting an unjust enrichment claim against forty-seven "Net Winner" promoters (the "Oliveira Action" and together with the SCAC and the Arizona Action, the "Unjust Enrichment Claims"). See *Complaint*, Murdoch et al. v. TelexElectric LLLP et al., C.A. No. 16-40018 (D. Mass) [Docket No. 1].8

RESPONSE: Admitted in part. The Trustee further states that on March 2, 2016, the United States District Court entered an order, *sua sponte*, staying all further action in the Oliveira Action and finding that the institution of such action was an attempt to circumvent the denial of the motion to amend the SCAC.

8. On June 27, 2016, the PIEC filed an amended complaint in the Oliveira Action removing Maria Murdoch, Angela Batista Jiminez, and Diogo de Araugo as named plaintiffs. See *Amended Complaint*, C.A. No. 16-40018 (the "Amended Oliveira Complaint") [Docket

[1] Triangular Transactions are those transactions whereby a recruited Participant purchased a TelexFree membership plan, the Debtors issued an invoice to the recruited Participant, the recruited Participant delivered payment to the promoting Participant, and the promoting Participant retained the funds and used accumulated credits to satisfy the recruited Participant's invoice.

No. 7].

RESPONSE: Admitted.

9. On October 7, 2015, Stephen Darr, the Chapter 11 Trustee, initiated this Adversary Proceeding, seeking a declaratory judgment that the PIEC's actions violated the automatic stay and for an injunction prohibiting further prosecution of these actions insofar as they name TelexFree promoters as defendants. See *Verified Complaint* [Docket No. 1] at ¶¶ 39-48. On February 26, 2016, the Trustee filed an amended complaint. See *Amended Complaint* (the"Amended Complaint") [Docket No. 21].[11]

RESPONSE: Admitted.

10. The Trustee's proceeding is predicated on his allegation that all dollars paid by a Victim-Participant directly to a Promoter-Participant constitute a fraudulent transfer of TelexFree property for which the Trustee has the exclusive authority to recover. See id. at ¶¶ 33-43.

RESPONSE: Admitted in part. The Trustee asserts that payments made by an individual recruited by a Promoter to purchase a TelexFree membership plan were paid to TelexFree and should be treated as such, and the distribution to the Promoter resulting from that Triangular Transaction should be avoided to the extent it allowed the Promoter to recover more than he/she contributed to TelexFree.

11. The TelexFree scheme ostensibly revolved around the sale of membership plans and monthly voice over internet phone ("VoIP") packages. See Amended Complaint at ¶¶ 11, 14.

RESPONSE: Admitted.

12. Each time a person purchased a membership plan or VoIP package, they

became a participant ("Participant") in the scheme and the Debtors established a user account ("User Account") to track the Participant's activity. See id. at ¶¶ 9, 14.

RESPONSE: Admitted.

13. TelexFree had the basic features of both a Ponzi and a pyramid scheme. See Amended Complaint at ¶ 11, 14. Its Ponzi scheme features are the promise of significant returns on investment simply for paying money over to TelexFree (or an existing Participant) and generating credits for posting internet ads for a VoIP product. See id. at ¶ 11. The pyramid features of the scheme are found in the relationship between Participants, where an existing Participant could recruit new Participants and receive payments directly from those Participants. See id. at ¶ 11.

RESPONSE: Admitted in part. Pursuant to the Triangular Transactions, TelexFree delivered the invoice to the recruited individual in the amount of the membership fee. The membership fee was then collected by the Promoter, who recruited the individual into the TelexFree program as agent for the Debtors. TelexFree then redeemed the portion of the Promoter's earned credits with the membership fee.

14. A person could gain entry to the TelexFree scheme in one of two ways: (1) making a payment to TelexFree; or (2) making a payment to an existing Participant. See id. at ¶¶ 15-18.

RESPONSE: Admitted in part. An individual did not "gain entry" to the TelexFree scheme merely by delivered funds to a promoting Participant. As part of a Triangular Transaction, the individual purchased a membership plan from TelexFree, and TelexFree issued an invoice to the individual. The Promoter then collected the membership fee and redeemed

earned credits from TelexFree in the amount of the collected fee. TelexFree then marked the invoice as satisfied and allowed the recruited individual into the scheme.

15. In the case of a Participant making a payment to TelexFree, the Participant paid the membership fee to TelexFree, TelexFree received the money from the Participant, and TelexFree opened a User Account that would track the Participant's activity. See id. at ¶ 16.

RESPONSE: Admitted.

16. In the case of a new Participant (a "Victim-Participant" or "Victim") making a payment (each, a "Participant-to-Participant Payment") to an existing Participant (a Promoter-Participant"), TelexFree issued an invoice to the Victim-Participant, the Promoter-Participant satisfied the invoice with credits previously accumulated by the Promoter-Participant, the Victim-Participant paid the invoice amount directly to TelexFree, and TelexFree opened a new User Account for the Victim-Participant. See Amended Complaint at ¶¶ 17-18. The Debtors never received or had possession of the money paid by the Victim-Participant to the Promoter Participant. See id. This alternative transaction is characterized by the Trustee as a "Triangular Transaction." See id. at ¶ 17.

RESPONSE: Admitted in part. The Trustee disputes that TelexFree never had possession of the payment for the invoice. See response to paragraph 14 above, which in incorporated herein.

17. The Victim-Participants themselves can be broken down into two categories: (1) new Participants who made one or more Participant-to-Participant Payments and did not thereafter recruit additional Participants; and (2) new Participants who made one or more Participant-to-Participant Payments and did thereafter recruit some new Participants but

nonetheless ended up on a net basis suffering damage (that is a Victim-Participant who originally paid in $X and received $X-Y later, with Y being less than X). See Amended Complaint at ¶¶ 14-18.

RESPONSE: Admitted in part. Participants could become net losers in the Ponzi scheme through several alternatives. A Participant could invest solely by direct transactions with TelexFree, solely by Triangular Transactions, or through some combination of the two. A Participant could also be a net loser overall, although he/she was a net winner in individual transactions.

18. The credits issued by TelexFree were part of an illegal scheme and in fact worthless. See Case No. 14-40987, November 24, 2015 Hr. Tr. (the "November 24th Hearing Transcript"), at 54:14-16; *Affidavit of Stephen B. Darr* (the "Darr Affidavit"), Exhibit A to *Motion by Chapter 11 Trustee for Entry of Order Finding That Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* [Docket No. 623], Case No. 14-40987, at ¶ 69.

RESPONSE: Admitted that the credits had no true economic value but while the Ponzi scheme was being perpetuated, the credits could be redeemed by a Participant for cash or in exchange for the purchase of additional membership plans.

19. Most of the monies extracted from the Victims were extracted by other individual, non-debtor, non-insider Participants. See Darr Affidavit at ¶ 35. While TelexFree issued invoices associated with the sale of both membership plans and VoIP packages that purported to show a face value of $3,073,461,326, only $359,792,242, or approximately twelve percent (11.7%) of that amount, was paid in cash to the Debtors by Victims. See id. The near 90% balance of these invoices, totaling over $2,713,679,084,

were actually Participant-to-Participant cash transactions, with the fictitious invoices and associated credits constituting the only aspects involving the Debtors. See id.

RESPONSE: Admitted in part. The Trustee disputes the PIEC's characterization of the Triangular Transactions as being a payment from one Participant to another Participant with no involvement of the Debtors. The Triangular Transaction would not have occurred but for the issuance by the Debtors of an invoice. The recruited individual was paying the membership fee to the Promoter as agent for the Debtors, for the invoice. Then, TelexFree redeemed the Promoter's earned credits through the membership fee. The Trustee admits that most of the plan purchases were made via Triangular Transactions.

20. The Unjust Enrichment Claims brought by the Victim-Participants are brought only against Promoter-Participants who received those Participant-to-Participant Payments. See SCAC at ¶¶ 51-62; Arizona Action Complaint at ¶¶ 1012-1021; Amended Oliveira Complaint at ¶¶ 18-72.

RESPONSE: Admitted in part. The Trustee admits that the actions brought by the PIEC purport to involve Triangular Transactions but disputes that all the "Promoter-Participants" and the Victim Participants only received money from Triangular Transactions.

STEPHEN B. DARR AS TRUSTEE
OF THE ESTATES OF TELEXFREE,
LLC, TELEXFREE, INC. and
TELEXFREE FINANCIAL, INC.

By his attorneys,

Dated: September 2, 2016

/s/ Andrew G. Lizotte

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