Docket #0051 Date Filed: 9/2/2016

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS

In re: TELEXFREE, LLC, TELEXFREE, INC. and TELEXFREE FINANCIAL, INC., Debtors.	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

MEMORANDUM OF LAW IN SUPPORT OF TRUSTEE'S OPPOSITION TO PIEC MOTION FOR SUMMARY JUDGMENT AND TRUSTEE'S CROSS-MOTION FOR SUMMARY JUDGMENT

Overview

The central issue presented in this case is who should prosecute claims against the Net Winners.[1] The Trustee is the appropriate party to prosecute actions against Net Winners to

[1] A "Net Winner" is defined as a Promoter who received a greater amount from the Debtors' scheme, including amounts received pursuant to Triangular Transactions, than the amount invested by the Promoter into the Debtors' scheme, including amounts paid pursuant to Triangular Transactions. *See Supplemental Order Respecting Motion by Chapter 11 Trustee for Entry of Order Finding that Debtors Engaged in a Ponzi and Pyramid Scheme and Related Relief* [docket entry 687].

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recover the payments the Net Winners received, whether from direct payments or through Triangular Transactions, for the benefit of all Net Losers. The Defendants assert that they should be permitted to prosecute claims against a subset of Net Winners, those that received membership fees paid pursuant to Triangular Transactions and then, only for the benefit of individuals who are Net Losers as a result of membership fees paid pursuant to Triangular Transactions. While the Defendants recognize that the Trustee is the only person able to pursue claims against Net Winners for direct transfers by TelexFree, they seek to compete with the Trustee by challenging his right to pursue recoveries based upon fraudulent transfers and preferential transfers to Net Winners arising out of Triangular Transactions.

In challenging the Trustee's right to recover membership fees paid pursuant to Triangular Transactions, the Defendants take a position which is at odds with the Court's finding that claims should be determined based upon the Net Equity formula, taking into consideration all payments made by a claimant, whether direct or indirect, to TelexFree and all distributions by TelexFree to that claimant, whether direct or indirect. The Defendants, while acknowledging the inherent fairness of such a claims allowance methodology, argue that the membership fees retained by Promoters[2] in Triangular Transactions did not involve transfers of property in which TelexFree had an interest and therefore are not subject to the Trustee's fraudulent conveyance and preference powers. By taking this inconsistent position, the Defendants are advocating for Net Winners to the detriment of the individuals the Defendants claim to be representing, e.g., Net Losers.

The Defendants' position is not only inconsistent and adverse to the interests of the individuals they purport to represent, but it ignores the economic reality of the transaction. The

[2] Promoters are those participants in the TelexFree scheme who furthered the fraud by recruiting on behalf of TelexFree other individuals into the scheme.

Triangular Transactions at issue were an integral and essential part of the pyramid aspect of the TelexFree fraud whereby Promotors were encouraged by TelexFree to recruit new individuals into the TelexFree program and acted as TelexFree's agent in collecting the membership fee on behalf of TelexFree and were rewarded for doing so. The substance of the transaction was that an individual who was being recruited into the program paid a membership fee to a Promoter who was acting on behalf of TelexFree. In return, TelexFree paid a commission to the Promoter who brought the individual into the program. In its financial statements, TelexFree recognized the membership fees collected through Triangular Transactions as revenue. TelexFree correspondingly recognized in its financial statements the retention of the membership fees by Promoters in Triangular Transactions as an expense. In its financial statements, TelexFree characterized payments to Promoters in Triangular Transactions as "agent commission." Consistent with the foregoing, TelexFree issued Form 1099's to the various Promoters in the TelexFree program, whose Form 1099's included the agent commissions paid as a result of Triangular Transactions.

Not only do the facts require a finding that the Trustee is the appropriate person to prosecute claims for recovery of membership fees paid arising out of Triangular Transactions, but to find otherwise would be to substantially undermine the Net Equity determination and allow Net Winners a windfall at the expense of all Net Losers.

I. Factual Statement

A. The Ponzi Scheme

On November 25, 2015, the Court, on motion by the Trustee and after notice and hearings, entered an Order, as amended on December 21, 2015, determining that each of the Debtors in these jointly administered cases perpetrated a fraud upon the public, primarily

targeting the immigrant community. The Debtors' fraud was premised upon the sale of membership plans to individuals, which the Debtors referred to as Promoters, and incorporated elements of both a Ponzi and pyramid scheme. *Trustee's Statement of Undisputed Material Facts in Support of His Cross-Motion for Summary Judgment* ("SUF"), at ¶1.

The Ponzi aspect of the fraud involved the promise of an astronomical return on the membership fee paid to join TelexFree, merely for posting meaningless internet advertisements. By posting these advertisements, among other things, Promoters would "earn" credits with TelexFree that were redeemable for cash. The more membership plans that a Promoter acquired, the faster that Promoter could acquire credits. SUF, at ¶2.

The pyramid aspect of the fraud was the compensation given to Promoters for recruiting individuals into TelexFree, unrelated to the sale of any product. Although the TelexFree program was structured as a multi-level marketing program, there was no need for Promoters to buy or sell the internet telephone product. As with most pyramid schemes, the more Promoters that one recruited, the more money that the recruiting Promoter could make.[3] The pyramid aspects of the TelexFree fraud featured prominently in TelexFree's website content, PowerPoint presentations, internet videos, and in-person recruitment meetings. All of these materials extolled the virtues of developing a Promoter's pyramid in order to maximize compensation. SUF, at ¶3, 4. Set forth below is illustrative of TelexFree's presentation materials to prospective Promoters:

[3] For example, for each new recruit, a Promoter would receive a "fast start" bonus, either of $20 or $100, depending upon the type of membership plan that he/she sold. Once an individual was recruited into another Promoter's pyramid, the Promoter would earn credits based upon membership plans sold by his/her 'downline' recruits. TelexFree encouraged this "team building" activity by offering "team builder bonus" compensation, which a Promoter could earn by, among other things, recruiting ten (10) additional Promoters into the Telexfree network. SUF, at ¶3.



B. The Triangular Transactions

One of the principal methods by which TelexFree encouraged and enabled the recruitment of new Promoters was by permitting existing Promoters to retain the membership fees paid by new recruits. Pursuant to this process (hereinafter, a "Triangular Transaction"), a new recruit solicited by an existing Promoter would be issued an invoice by TelexFree for the purchase of a membership plan. The Promoter collected the membership fee from the new recruit. TelexFree enabled the Promoter to retain the membership fee of the new recruit by redeeming the cost of the membership plan from the accumulated credits of the Promoter. The invoice was then marked satisfied by TelexFree, and the new recruit became a Promoter earning credits for posting meaningless advertisements and recruiting new Promoters. SUF, at ¶6, 7.

The Triangular Transaction was the predominant method of entry into the TelexFree system. Invoices associated with the sale of membership plans or phone packages had a total value of $3,073,471,326. Of this amount, approximately $2,700,000,000 or nearly ninety percent (90%) of the membership fees sold by TelexFree, were effected through a Triangular Transaction. SUF, at ¶9.

The economic substance of the Triangular Transaction was, in fact, a payment by a new recruit of a membership fee to TelexFree and a payment by TelexFree to the Promoter in exchange for redemption of accumulated credits. The economic substance was treated as such by TelexFree on its financial statements. SUF, at ¶8.

The profit and loss statement for TelexFree for calendar year 2013 ("2013 Profit and Loss Statement") reflects $119 million in income "paid through bank". That entry reflects membership fees paid directly to TelexFree. SUF, at ¶13. There is a separate entry on the 2013 Profit and Loss Statement for an additional $572 million in income "paid through system". That entry reflects membership fees paid to the Promoter through a Triangular Transaction. Id. The most significant expense on the 2013 Profit and Loss Statement was commissions paid to Promoters in Triangular Transactions. The 2013 Profit and Loss Statement reflects an expense of $572 million for "Agent Commission – paid through system", representing membership fees paid to and retained by Promoters through Triangular Transactions. SUF, at ¶14. The treatment of the Triangular Transactions in the 2013 Profit and Loss Statement accurately reflects the economic substance of the Triangular Transactions. The membership fees were included as property of TelexFree and the fees retained by Promoters were treated as a payment by TelexFree. SUF, at ¶12, 13, 14.

The Debtors also issued Form 1099's consistent with the 2013 Profit and Loss Statement. SUF, at ¶16. The Debtors issued Form 1099's to Promoters in calendar year 2013 for income earned by Promoters from their involvement in TelexFree for that year. Id. The Form 1099's reported as income credits earned by Promoters and credits redeemed by Promoters in 2013. SUF, at ¶17. The income reported for redemption of credits included membership fees paid to, and retained by, Promoters from Triangular Transactions. Id. The Form 1099's evidence that TelexFree treated the membership fees paid in Triangular Transactions as income to TelexFree, and the payment to, or retention by, the Promoters of those membership fees as income to the Promoter and an expense of TelexFree. SUF, at ¶18.

C. The Net Equity Determination

The Court recognized the economic substance of the Triangular Transaction when it approved the *Motion by Chapter 11 Trustee for Entry of Order Finding that Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief* (the "Ponzi Motion"). In the Ponzi Motion, the Trustee described in detail the mechanics of the TelexFree system, including the pervasive use of the Triangular Transactions in the sale of membership plans. TelexFree's hybrid Ponzi/Pyramid scheme was unique, and the treatment of Promoter claims needed to be adapted to these circumstances. After notice and hearings, the Court approved the Ponzi Motion and, among other things, approved the Net Equity formula for determining claims in these cases. The order therefore provided that the use of the Net Equity formula in determining claims would include amounts paid and received pursuant to Triangular Transactions.[4] SUF, at ¶21.

[4] Net Equity is typically used in determining claims allowance in a Ponzi scheme, with the claim amount being equal to amounts that an investor paid into the program, less amounts that an investor received. *See, e.g., CFTC v. Topworth Int'l Ltd.*, 205 F.3d 1107, 1115-16 (9th Cir. 2000); *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229, 242 (2nd Cir. 2011); *Donell* v. Kowell, 533 F.3d 762, 772 (9th Cir. 2008); *In re Young*, 294 F. 1, 4 (4th Cir. 1923); *Janvey*, 2013 WL 2451738 at *9 (N.D. Tex. 2013); *In re Bayou*

The Net Equity formula was approved by the Court in recognition that an individual recruited in a Triangular Transaction transferred money to TelexFree in exchange for the right to participate in the TelexFree program and the right to earn credits, thereby creating an obligation between TelexFree and that individual on the same basis as if the individual had paid the membership fee directly to TelexFree. Individuals who became "Net Losers" through involvement in TelexFree were thereby treated equally under the Net Equity formula regardless of how they paid their membership fee. Similarly, it was important that the claims of Promoters be reduced to reflect amounts paid to, and retained by, them through Triangular Transactions in order to reflect the actual losses sustained from their involvement with TelexFree. SUF, at ¶22.

The Ponzi Motion set forth the inequities that would result if Triangular Transactions were not included in the calculation of the amount of a Promoter's claim. SUF, at ¶25. First, the individuals would be denied a claim for amounts paid to a Promoter to purchase a membership plan from the Debtors. SUF, at ¶26. This would have created an inequitable result since newly recruited individuals had the same rights and compensation opportunities, whether entry into the system occurred by a direct payment to TelexFree or through a Triangular Transaction. SUF, at ¶27. Second, the Promoter would profit further by retaining the recruit's membership fee without a corresponding reduction in his/her bankruptcy claim. SUF, at ¶28. This overarching inequity is rectified by the Net Equity formula. SUF, at ¶29. The approval of the Net Equity formula for determining claims in these cases appropriately addressed the losses sustained by individuals as a result of the Debtors' fraud regardless of whether the losses were incurred as a result of direct transactions or Triangular Transactions. SUF, at ¶30.

Grp., LLC, 439 B.R. 284 (S.D.N.Y. 2010); *In re Bernard L. Madoff Investment Securities, LLC*, 512 Fed. Appx. 18 (2nd Cir. 2013); *In re Old Naples Sec., Inc*., 311 B.R. 607, 616-17 (M.D. Fla. 2002).

The Defendants did not object to the allowance of claims based upon the Net Equity formula and recognized the inherent fairness of including the Triangular Transactions in it. However, the Defendants reserved their rights to argue that the membership fees paid to Promoters in Triangular Transactions did not constitute property in which TelexFree had an interest. SUF, at ¶31. This argument should be rejected because, among other reasons, the finding that TelexFree had an interest in any membership fees paid through a Triangular Transaction is a logical extension of the Net Equity formula. The same reasons that require the inclusion of the Triangular Transactions in the computation of allowed claims warrants a finding that the payment of membership fees to a Promoter constitutes a payment by TelexFree.

D. The Trustee's Class Action Litigation

The Trustee has commenced two class actions by which he has sought to recover from Net Winners based upon the Net Equity formula, under theories of both fraudulent transfer and preferential transfer, amounts they received through direct and Triangular Transactions in excess of amounts they contributed into the TelexFree program. SUF, at ¶32.

The first class action adversary proceeding, Adv. Proc. No. 16-4006, was commenced against all Net Winners who are alleged to reside within the United States. The Trustee estimates that there are 14,818 Net Winners within this category. The Trustee has named 105 Participants as individual Defendants and proposed class representatives in the domestic class action, who are believed to be Net Winners in the aggregate amount of approximately $109 million. A substantial portion of the $109 million in net winnings of the individually named Defendants is attributable to the Triangular Transactions. SUF, at ¶33.

The second class action adversary proceeding, Adv. Proc. No. 16-4007, was commenced against all Net Winners who are alleged to reside outside of the United States. The Trustee

estimates that there are 78,487 Net Winners within this category. The Trustee has named 96 Participants as individual Defendants and proposed class representatives in the foreign class action, who are believed to be Net Winners in the aggregate amount of approximately $76 million. A substantial portion of the $76 million in net winnings of the individually named Defendants is attributable to the Triangular Transactions. SUF, at ¶34.

The Trustee seeks these recoveries on behalf of all Net Losers, including those who lost money through direct transactions, Triangular Transactions, or any combination thereof. SUF, at ¶35. The Trustee's right to do so is being challenged by the Defendants, who claim to be and represent a subset of Net Losers, being those individuals who claim to be Net Losers as a result of membership fees paid to a Promoter. For the reasons set forth herein, the Defendants' challenges should be overruled.

E. The Defendants' claims.

The named Defendants purport to be Net Losers who had little or no direct involvement or affiliation with TelexFree. An examination of the Defendants' account histories with TelexFree, however, reveals that this is not the case. For example, Maria Murdoch testified in Court at an evidentiary hearing in October 2015 that she had invested approximately $25,000 in TelexFree, but that she had no contact with the Debtors, never became a member of TelexFree, and never received an invoice. SUF, at ¶41. The Debtors' books and records reflect, however, that Ms. Murdock maintained *seventy-five* (75) accounts ("User Accounts") with the Debtors, with each User Account representing the purchase of a plan. SUF, at ¶42. In fact, all of the Defendants had multiple User Accounts with TelexFree including: Rita Dos Santos: 12; Angela Batista Jiminez: 55; Elisangela Oliveira: 3; Diogio De Araugo: 65; and Celio Da Silva: 142. Each of the Defendants was a Promoter and had the opportunity to earn credits and to recruit other Promoters. SUF, at ¶43.

In the case of Dos Santos, not only did she open multiple User Accounts with TelexFree but she received $8,035.91 in payments directly from TelexFree. SUF, at ¶44. The evidence of these payments directly contradicts representations made by the Defendants in the multi-district litigation that Dos Santos never received any money from TelexFree. SUF, at ¶45. Da Silva was a Net Winner in the amount of $15,343 and Jiminez was a Net Winner in the amount of $347.80. SUF, at ¶46. In recognition of the numerous problems associated with the Defendants' representations, on or about June 27, 2016, the PIEC amended their Complaint in one of the pending multi-district litigation matters to remove Murdock, Jiminez and De Araugo as named plaintiffs. The Defendants' extensive, multifacted involvement with TelexFree is indicative of how inextricably linked and tangled the different types of transactions were with one another in perpetuating the Debtors' fraud.

To date, the Defendants' attempts, on at least two occasions, to bring Unjust Enrichment Claims in District Court, on a class action basis, against Promoters who became Net Winners based upon the receipt of membership fees from other Promoters in Triangular Transactions, appropriately have been denied. SUF, at ¶48. In one instance, the District Court denied the Defendants' motion to amend their Complaint to sue the Net Winners in Triangular Transactions as a class. SUF, at ¶49. In the second instance, the Defendants' action was stayed because it was found to be an improper attempt to circumvent the order in the first case. SUF, at ¶50. For the reasons set forth herein, the Defendants should not be permitted to assert their Unjust Enrichment Claims.

II. STANDARDS FOR SUMMARY JUDGMENT

Summary judgment is appropriate when the record reveals "no genuine dispute as to any material fact and the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P.

56(a); Fed. R. Bank. P. 7056. "The role of summary judgment is to pierce the boilerplate of the pleadings and to provide a means for prompt disposition of cases where no trial-worthy issue exists." *Quinn v. City of Boston*, 325 F.3d 18, 28 (1st Cir. 2003) (citing *Suarez v. Pueblo Int'l, Inc.*, 229 F.3d 49, 53 (1st Cir. 2000)). "A 'genuine' issue is one that could be resolved in favor of either party, and a 'material fact' is one that has a potential of affecting the outcome of the case." *Calero-Cerezo v. U.S. Dept. of Justice*, 355 F.3d 6, 19 (1st Cir. 2004) (citing *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248-250 (1986)).

"To be considered 'genuine' for Rule 56 purposes a material issue must be established by 'sufficient evidence supporting the claimed factual dispute…to require a jury or judge to resolve the parties' differing versions of the truth at trial.'" *Hahn v. Sargent*, 523 F.2d 461, 464 (1st Cir. 1975) (quoting *First National Bank of Arizona v. Cities Service Co., Inc.*, 391 U.S. 253, 289 (1968)). "Once the movant has served a properly supported motion asserting entitlement to summary judgment, the burden is on the non-moving party to present evidence showing the existence of a trial worthy issue." *Gulf Coast Bank & Trust Co. v. Reder*, 355 F.3d 35, 39 (1st Cir. 2004) (citing *Anderson*, 477 U.S. at 248); *Garside v. Osco Drug, Inc.*, 895 F.2d 46, 48 (1st Cir. 1990). To meet that burden, the non-moving party may not rely on "bare allegations" but must come forward with substantive evidence to rebut the evidence that has been offered by the moving party. *Gulf Coast*, 355 F.3d at 39 (citing *Rogan v. City of Boston*, 267 F.3d. 24, 29 (1st Cir. 2001)).

The Trustee believes that the facts are uncontroverted and that he is entitled to a judgment as a matter of law.

III. ARGUMENT

As the Court recognized in its Net Equity decision: (i) only individuals who are Net Losers in accordance with the Net Equity formula qualify as creditors of the Debtors who may be entitled to allowed claims against the bankruptcy estates; (ii) the identity of Net Winners and Net Losers cannot be determined without taking into account membership fees paid, collected, and retained by Promoters through Triangular Transactions; and (iii) all Net Losers are entitled to equal treatment in the Debtors' cases, regardless of whether they paid their membership fees to TelexFree or to a Promoter.

Recovery from those Promoters who profited as a result of the retention of membership fees paid through a Triangular Transaction is essential to achieving an equitable distribution for all creditors in these cases. To accomplish that result, the Trustee has filed two proposed class actions asserting claims of both fraudulent transfer and preferential transfer against Promoters who are Net Winners, largely as a result of membership fees paid to them pursuant to Triangular Transactions. The Trustee's right to pursue this recovery is supported by the unique facts of the case and applicable law, including theories of agency and economic substance. If the Trustee were unable to bring these actions, certain Net Losers (those who paid membership fees to Promoters in Triangular Transactions) would be unfairly advantaged over other Net Losers. Additionally, recovery actions against Net Winners would become more complicated, expensive, and protracted with collection efforts being undertaken in multiple forums by both the Trustee and certain Promoters.

The causes of action asserted by the Trustee constitute estate property. The Trustee is the sole party with authority to pursue such claims on behalf of all Net Losers, not a select few. The Defendants' attempt to characterize the Triangular Transactions as transactions solely

between Participants, in which the estate has no interest, is simply inaccurate and self-serving. The Defendants' attempt to pursue recovery of membership fees paid pursuant to Triangular Transactions constitutes a violation of the automatic stay and should otherwise be enjoined pursuant to Section 105(a) of the Bankruptcy Code as undermining the Net Equity decision and interfering with the Trustee's successful administration of the Debtors' estates to effect an equitable distribution to all creditors.

A. The economic substance doctrine and agency law require a finding that the membership fees paid pursuant to Triangular Transactions constitute property in which TelexFree has an interest.

A Triangular Transaction represents TelexFree's sale of a membership plan to a new recruit. Although the Promoter helped to facilitate the sale, TelexFree was the seller. Defendants' attempt to diminish TelexFree's interest in these sales by describing them as transactions between two third parties (or, in their words, "Participant-to-Participant Payments") is entirely inaccurate and self-serving. The Debtors designed the Triangular Transaction as an efficient mechanism for diverting the cash collected from new recruits' membership fees to compensate earlier Promoters. The effect was simultaneously to preserve the illusion of a profitable enterprise and to secure new Promoters to market it, perpetuating the fraud. The economic substance of the Triangular Transactions and application of blackletter agency law principles compel the conclusion that membership fees paid by new recruits as part of a Triangular Transaction constituted property in which TelexFree had an interest.

Property of the estate includes all legal or equitable interests of the Debtors in property as of the commencement of the cases, "wherever located and by whomever held." 11 U.S.C. § 541(a)(1). The United States Supreme Court has held that Congress intended the statutory definition of estate property to be interpreted broadly to include, among many other things, "property made available to the estate by other provisions of the Bankruptcy Code . . . [which

may] bring into the estate property in which the debtor did not have a possessory interest at the time the bankruptcy proceedings commenced." *United States v. Whiting Pools*, 462 U.S. 198, 204-05 (1983). Such interests include all kinds of property, tangible and intangible, as well as causes of action. Id.; **H.R.Rep. No**. 595, 95th Cong., 1st Sess. 367-68 (1977), reprinted in 1978 **U.S.C.C.A.N**. at 5963, 6323 (1978).

The Promoters served as the Debtors' agents in recruiting new members through Triangular Transactions. A principal-agent relationship exists where "there is mutual consent, express or implied, that the agent is to act on behalf and for the benefit of the principal, and subject to the principal's control." *Theos & Sons, Inc. v. Mack Trucks, Inc.*, 431 Mass. 736 (Mass. 2000). All Promoters acted as sales agents of TelexFree, and very specific rules were in place governing the manner of sales "with a view to protecting the image of TelexFree."

The Promoters' activity was ostensibly governed by a contact between the Promoter and TelexFree. SUF, at ¶3. While the contract ostensibly disavows an employment relationship, it clearly establishes an agency relationship between TelexFree and the Promoter. In fact, the contract refers to the Promoter as a Partner. The contract expressly authorized the use of a Promoter's credits to satisfy the invoice of the new recruits. The contract prescribed the Promoter's compensation and governed the activity of the Promoter in the recruitment of other Promoters and sale of product. For example, the contract provided that: "in making presentations to groups of people invited to join the TELEXFREE Multilevel network and use its products and services, [Promoters] must restrict themselves to the material made available in the video provided for the occasion, and may not express their own views in public. . . No other material may be used at presentations." SUF, at ¶3. This level of control dictated by TelexFree over the Promoter's activity is indicative of an agency relationship. *See, e.g. Cooper v. First*

International Bank (In re Cooper), 2 B.R. 188, 194 (Bankr. S.D. Tex. 1980) (ticket-sellers were agents of debtor where debtor had not only the power to order sale of tickets but also direct the time, place, and manner in which the sales were to take place) (applying Texas law).

In the context of Triangular Transactions, with the authority of TelexFree, Promoters also served as TelexFree's collection agents. TelexFree approved and encouraged the use of the Triangular Transaction in the recruitment of new individuals. It was TelexFree who controlled the implementation of each Triangular Transaction by (1) authorizing Promoters to collect membership fees from new recruits on its behalf, and then (2) accepting redemption of the Promoter's credits in settlement of the new recruit's invoice and allowing the Promoter to retain the cash collected. Without the participation, consent, and control of the Debtor, no Triangular Transaction could be consummated.

All participants in the Triangular Transaction understood both that the Promoter acted on behalf of and at the behest of TelexFree in facilitating the new recruit's purchase of a TelexFree membership plan, and that it was TelexFree that ultimately conferred the membership on the new recruit. An individual purchasing a membership plan could not begin to accumulate credits in the TelexFree network until TelexFree marked the associated invoice as paid and activated the new User Account. But for the expectation that TelexFree would deliver its membership plan, the new recruit had no reason to make payment to the Promoter.

Once an agent collects funds on behalf of its principal, the agent holds the funds in trust for the benefit of the principal. *Deep Blue Ventures, Inc. v. Manfra, Tordella & Brookes, Inc.*, 791 N.Y.S.2d 298, 301 (N.Y. Sup. Ct. 2004) ("[I]t is apparent that an agent who has received money for the principal has a duty to use care to keep it safely until it is delivered to the principal"). The agent further has a duty to remit the funds to the principal in accordance with

the terms of the agency. *See, e.g. Tidewater Designs, Inc. v. Evergreen America Corp. (In re Tidewater Designs, Inc.)*, 276 B.R. 733, 736 (Bankr. E.D.N.C. 2002) (as [creditor's] agent, Evergreen has a fiduciary obligation to transmit the debtor's payments to [creditor]"); *Gold v. Rowland*, 296 Conn. 186, 201 n. 15 (2010) ("Generally, an agent is under a duty to repay or deliver to the principal money or property belonging to the principal which comes into the agent's hands while conducting the business of the agency") (*citing* 3 Am.Jur.2d 689–90, Agency § 322 (2002)). The membership fees paid to Promoters in Triangular Transactions constituted property in which TelexFree had an interest. The Promoters collected the membership fees as agent for TelexFree and had a duty to remit the funds to TelexFree until otherwise instructed. In a Triangular Transaction, the Debtors opted to accept the redemption of accumulate credits by the Promoter, rather than delivery of the cash collected on its behalf, in satisfaction of the recruit's invoice.

Because the Debtors had an interest in the membership fees paid in a Triangular Transactions, both the new recruit's payment of membership fees to a Promoter and the Promoter's retention of those collected fees as permitted by TelexFree, constituted a transfer of property in which TelexFree had an interest. The TelexFree estate was depleted as TelexFree did not collect the revenue arising out of the Triangular Transaction but did become responsible to pay all of the compensation to which the new recruit would otherwise be entitled under the program. According to principles of agency law, the Triangular Transactions implicated property of the estate and the Trustee may pursue avoidance actions to recover it.

The same conclusion flows from application of the economic substance or "collapsing" doctrine, which requires consideration of the Triangular Transaction as the totality of its component transfers. As a court of equity, a bankruptcy court "may look through form to

substance when determining the true nature of a transaction as it relates to the rights of parties against a [Debtor's] estate." *In re PCH Assocs*., 949 F.2d 585, 597 (2d Cir. 1991) (*citing Pepper v. Litton*, 308 U.S. 295, 304 (1939)). *See also In re Adelphia Communications Corp.*, 512 B.R. 447 (Bankr. S.D.N.Y. 2014)(series of transactions may be treated as one when it appears that, despite formal structure erected and labels attached, segments comprise a single integrated scheme when considering knowledge and intent of parties involved in transaction); *Orr v. Kinderhill Corp.*, 991 F.2d 31, 35 (2d Cir. 1993) ("[w]here a transfer is only a step in a general plan, the plan must be viewed as a whole with all its composite implications."). Here, a focus solely on the cash payment from the new recruit to the Promoter, as Defendants urge, eclipses the broader economic import of that transfer, and the proper scope of analysis is the Triangular Transaction as a whole.

The collapsing of transactions into an integrated transaction to recognize the true nature of a transaction has been employed by the courts in varying contexts and is required here to promote the equitable treatment of all similarly situated creditors. In the case of leveraged buyouts, payments made by an acquirer to selling shareholders are considered to be transfers of estate property even though the funds were paid by the stock purchaser and not the debtor. *See, e.g, In re Chas P. Young Company*, 145 B.R. 131 (Bankr. S.D.N.Y. 1992)(regardless of number of steps taken to complete a transfer of debtor's property, if they reasonably collapse into a single integrated plan and either defraud creditors or leave the debtor with less than reasonably equivalent value post-exchange, the transaction may be avoided as fraudulent transfer of debtor property); *In re OODC, LLC,* 321 B.R. 128 (Bankr. D. Del. 2005)(in deciding whether to collapse a leveraged buyout into one integrated transaction, the issue is whether there was an overall scheme to defraud the estate and its creditors by depleting the estate's assets); *United*

States v. Tabor Court, 803 F.2d 1288 (3rd Cir. 1986), *cert. den. McClellan Realty Co. v. United States*, 483 U.S. 1005, 107 S. Ct. 3229 (1987)(debtor merely served as conduit for transfer of funds to shareholders and did not receive funds as any form of consideration); *Wieboldt Stores v. Schottenstein*, 94 B.R. 488 (N.D. Ill. 1988)(leveraged buyout transfers would be integrated into one transaction and parties would be treated as having received transfers of debtor's property; focus is not on formal structure of transaction but knowledge or intent of parties involved in the transaction); *In re O'Day Corporation*, 126 B.R. 370 (Bankr. D. Mass. 1991); *In re Jevic Holding Corp.*, No. 08-11006, 2011 WL 4345204 (Bankr. D. Del. 2011)(leveraged buyout may be collapsed if transactions are interdependent and all parties had knowledge of the transactions).

Similarly, payments made by a purchaser of a debtor's assets to certain of the debtor's creditors are considered to be transfers of estate property for avoidance action purposes, even though the funds were paid by the asset purchaser to the creditor and not the debtor. *See, e.g., Warsco v. Preferred Technical Group*, 258 F.3d 557, 568-69 (7th Cir. 2001) (debtor sold its assets prepetition, and the asset purchaser used a portion of the sale proceeds to satisfy the claims of debtor's creditors. Court treated purchaser's payments to creditors as if debtor made them directly to creditors because there was a direct relationship between the consideration given for the debtor's assets and the funds used to pay the creditors, and funds would have otherwise been estate property); *In re Food Catering & Housing, Inc.,* 971 F.2d 396 (9th Cir. 1992) (prepetition payment made by purchaser of debtor's assets to creditor was avoidable preference; payment treated as if made by debtor).

Contrary to Defendants' arguments, the same rationale applies for collapsing the components of the Triangular Transaction to reflect the economic realities of the Debtors' fraudulent enterprise. In substance, the recruited individual paid the Debtors for the purchase of

a membership plan. The Debtors paid the Promoter by the Promoter retaining the collected membership fee and the Debtor making a corresponding reduction in the Promoter's accumulated credits. It is of no moment that the Debtors did not collect the cash directly from the recruited individual, since the Promoter collected it on TelexFree's behalf.

The fact that TelexFree was operating a Ponzi and Pyramid scheme does not prevent the recovery of membership fees from Net Winners. Funds obtained from investors in a Ponzi/Pyramid scheme are property of debtor, and are thus susceptible to preferential and fraudulent disposition by debtor. *See, e.g., In re Ramirez Rodriguez*, 209 B.R. 424 (Bankr. S.D. Tex. 1997); *In re Universal Clearing House Co.*, 62 B.R. 118 (D. Utah 1986); *In re Hedged-Investments Assoc., Inc.*, 163 B.R. 841, 850-51 (Bankr. D. Colo. 1994), *aff'd* 84 F.3d 1286 (10th Cir. 1996); *In re Int'l Loan Network*, 160 B.R. 1 (Bankr. D. Dist. Col. 1993); *In re Taubman*, 160 B.R. 964, 980 (Bankr. S.D. Ohio 1993); *In re Baker & Getty Financial Services, Inc.*, 98 B.R. 300 (Bankr. N.D. Ohio 1989); *In re Geltzer*, 502 B.R. 760 (Bankr. S.D.N.Y. 2013). The "net winnings" represent fictitious profits that are avoidable as fraudulent transfers because "[a]ny dollar paid to reimburse a fictitious profit is a dollar no longer available to pay claims for money actually invested." *Geltzer*, 502 B.R. at 770.

Contrary to Defendants' assertions, there is also no need for the Trustee to demonstrate that the fees paid by Promoters were "commingled" while in the Debtors' possession to justify recovery by the estate. In the aftermath of a Ponzi scheme, the paramount concern for ratable distribution of funds to creditors consistently takes priority over the rights of individual participants to seek imposition of a constructive trust on identifiable funds paid into the scheme. *See, e.g., United States v. Ramunno*, 599 F.3d 1269, 1275 (11th Cir. 2010)(declining imposition of constructive trust even if victim could trace funds, as it would elevate his position over that of

similarly situated victims and diminish the pool of funds available to be distributed to all victims); *United States v. Andrews*, 530 F.3d 1232, 1238 (10th Cir. 2008)(relief denied to victim who could trace Ponzi funds; other victims would not be unjustly enriched by receiving an appropriate share of the traced funds); *SEC v. Infinity Group Co.*, 226 F. Appx. 217, 219 (3rd Cir. 2007)(no equitable basis to distinguish between early investors and those who invested shortly before the debtor's account was frozen such that their assets were traceable. All investors should be treated the same); *SEC v. George*, 426 F.3d 786, 799 (6th Cir. 2005)(same); *United States v. Durham*, 86 F.3d 70, 73 (5th Cir. 1996)(even where tracing permissible and objecting creditor had right to seek constructive trust and return of identifiable property, the court may exercise its equitable discretion to deny such relief where it determined that the result would be inequitable. All victims of the fraud were in an equal position and should be treated as such).

Whether the Triangular Transactions are viewed in the context of agency law or the "collapsing" doctrine, the result is the same. The membership fees paid to the Promoter through the Triangular Transactions were property in which the Debtors had an interest, because the Promoter was acting on behalf of TelexFree when he/she sold the membership plan. The Debtors authorized the Promoter to collect the money from the recruited individual on its behalf. TelexFree authorized the Promoter to retain the membership fees in exchange for a redemption of credits in satisfaction of the invoice due from the new recruit. The retention of the membership fee and the reduction of the accumulated credits constitute a distribution to the Promoter by TelexFree, no different than if the recruit had paid the collected membership fee to TelexFree and TelexFree then redeemed the Promoter's accumulated credits for a corresponding amount of cash. This transaction constituted the transfer of the Debtors' interest in property that the Trustee seeks to recover. The Trustee is the proper party to pursue recovery of the

membership fees paid to Net Winners through Triangular Transactions, and the prosecution of these claims will promote the fair and equitable distribution to all Promoters.

B. The Defendants should not be permitted to prosecute the Unjust Enrichment Claims.

The Defendants' prosecution of the Unjust Enrichment Claims should be enjoined, both as a violation of the automatic stay, since they seek to recover estate property, and because it is warranted under Bankruptcy Code Section 105(a). The Unjust Enrichment Claims target some of the same defendants and funds that the Trustee is pursuing as fraudulent and preferential transfers, arise from the same transactions, and are so irreversibly intertwined with the Trustee's claims that failure to enjoin Defendants' suit will incontrovertibly interfere with the Trustee's effective administration of the Debtors' estates in furtherance of equitable distribution to all creditors.

As established, the membership fees paid to the Promoters in Triangular Transactions involve property in which TelexFree had an interest, and on that basis the Defendants' pursuit of Unjust Enrichment Claims to recover these funds would violate the automatic stay. Section 362 of the Bankruptcy Code provides fundamental, broad, and necessary protection to a trustee to administer the bankrupt's estate. *See Midatlantic Nat'l Bank v. New Jersey Dept' of Envtl. Prot*., 474 U.S. 494, 503, 106 S.Ct. 755, 760, 88 L.Ed.2d 859 (1986); *Soares v. Brockton Credit Union (In re Soares)*, 107 F.3d 969, 975 (1st Cir. 1997). The filing of a petition for relief operates as a stay, applicable to *all entities*, of, among other things: recovery against the debtor for pre-petition claims, and "any act to obtain possession of property of the estate or property from the estate or to exercise control over property of the estate." 11 U.S.C. §362(a)(3) (emphasis provided). "The automatic stay is 'extremely broad in scope' in that it prohibits almost all formal and informal acts taken against the debtor or the estate.'" *Knowles v. Bayview Loan*

Servicing, LLC, (In re Knowles), 442 B.R. 150, 160 (1st Cir. B.A.P., 2011). The actions taken by the Defendants in pursuing the Net Winners to recover payments received in Triangular Transactions constitute actions to obtain possession of estate property and/or to exercise control over estate property, namely the Trustee's fraudulent transfer and preference claims against the Net Winners.

It is well established that claims for fraudulent and preferential transfer are included within property of the estate, *In re Ontos, Inc.*, 478 F.3d 427, 431 (2007), and the Trustee has the exclusive standing to assert causes of action belonging to the Debtors' estates. *Id.* at 431; *Regan v. Vinick & Young (In re Rare Coin Galleries of America, Inc.)*, 862 F.2d 892, 901 (1st Cir. 1988) ("The trustee steps into the shoes of the debtor for the purposes of asserting or maintaining the debtor's causes of action, which become property of the estate."); *In re El San Juan Hotel Corp*., 841 F.2d 6, 9 (1st Cir. 1988) c*iting Matter of Milam*, 37 B.R. 865, 868-69 (Banrk. N.D.Ga. 1984); *In re Gunartt*, 355 Fed.Appx. 66, 68 (7th Cir. 2009); *In re Dziurgot Farnsworth*, 2008 WL 4833089 at *3 (Banrk. D. Mass. Oct. 28, 2008) ([F]raudulent conveyance causes of action are themselves interests in property of the estate, which 'the Trustee should at least be allowed the opportunity to recover the equity for creditors'") *quoting In re Ciccone*, 71 B.R. 4, 5 (Bankr. D.R.I. 1994); *Mi-Lor Corp. v. Gottsegen (In re Mi-Lor Corp.)*, 233 B.R. 608, 619 (Banrk. D. Mass. 1999) ("[N]o creditor has individual avoidance rights after the petition filing. Bankruptcy being a collective proceeding for the benefit of all creditors, avoidance rights belong only to the estate representative; upon their exercise the property recovered becomes part of the bankruptcy estate").

The imposition of the automatic stay against the Defendants is necessary to provide for equality of treatment among creditors and to avoid piecemeal litigation by individual creditors.

See e.g. Torres v. Santander Financial Services, Inc. d/b/a Island Finance, et al., 532 B.R. 195, 200-201 (Bankr. D.P.R., 2015). As stated in the House Report:

> The automatic stay…provides creditor protection. Without it, certain creditors would be able to pursue their own remedies against the debtor's property. Those who acted first would obtain payment of the claims in preference to and to the detriment of other creditors. Bankruptcy is designed to provide an orderly liquidation procedure under which all creditors are treated equally. A race of diligence by creditors for the debtor's assets prevents that.

H.R.Rep. No. 595, 95th Cong.2d Sess., *reprinted in* [1978] U.S.Code Cong. & Admin.News 5963, 6297 (emphasis added); S.Rep. No. 989, 95th Cong.2d Sess., *reprinted in* [1978] U.S.Code Cong. & Admin.News 5787, 5835. *See also Matter of Holkamp*, 669 F.2d 505, 508 (7th Cir. 1982) ("The purpose of the automatic stay is to…provide an equitable liquidation procedure for all creditors....")

Since payment of TelexFree membership fees to a Promoter constituted estate property, the Defendants' claim against the Net Winners for unjust enrichment must be derivative of the estate's claims, since it is the estate that has the right to recover the funds paid to the Promoter, not the new recruit. *In re Bernie L. Madoff Inv. Securities, LLC*, 740 F.3d 81, 89 (2nd Cir. 2014)("BLMIS I"). A claim asserted by a third party that is derivative of the estate's claim involves property of the estate and should be stayed. *Id.* at 88.

Because the Unjust Enrichment Claim seeks to recover property of the Debtors' estates in violation of Section 362(a)(3), the pursuit of such claims is subject to the automatic stay. *See Soares*, 107 F.3d at 969; *Interstate Commerce Comm'n v. Holmes Transp., Inc.*, 931 F.2d 984, 987 (1st Cir. 1991)("Judicial actions and proceedings…in violation of the automatic stay are void, are generally void and without legal effect…"); *In re Advent Corp.*, 24 B.R. 612, 614 (1st Cir. B.A.P. 1982); *FDIC v. Hirsch (In re Colonial Realty Co.)*, 980 F.ed 125, 137 (2d Cir. 1992).

Accordingly, the Trustee respectfully requests that the Court declare the attempted prosecution of the Unjust Enrichment Claim void and without effect as set forth in the Complaint.

Even if the Unjust Enrichment Claim is not derivative of the estates' claims and/or subject to the automatic stay provisions of Bankruptcy Code Section 362, the Defendants' should be stayed from pursuing those claim, pursuant to the powers set forth in Section 105 of the Bankruptcy Code, because failure to do so will undermine the application of the Net Equity formula and interfere with the Trustee's administration of the Debtors' estates for the benefit of all creditors.

Section 105(a) of the Bankruptcy Code provides that "[T]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." Actions that adversely affect the bankruptcy estate may be enjoined under Section 105. *See e.g. In re G.S.F. Corp*., 938 F.2d 1467, 1474 (1st Cir. 1991)(under Section 105 there must be "some effect on the debtor's estate stemming from the action") *citing Matter of Energy Co-op., Inc.*, 886 F.2d 921, 929 (7th Cir. 1989) ("authority to enjoin actions which threaten the integrity of the bankrupt's estate"); *In re A.H. Robins Co.*, 880 F.2d 694, 701 (4th Cir. 1989) (may enjoin third party actions which "would affect the bankruptcy reorganization in one way or another"); *Menard-Sandofrd v. A.H. Robins Co.*, 493 U.S. 959, 110 S.Ct. 376, 107 FL.Ed.2d 362 (1989); *In re Bretanos's, Inc*., 36 B.R. 90, 92 (S.D.N.Y. 1984)(stay "necessary to an orderly disposition of the debtor's estate"). *See also In re Crocker*, 362 B.R. 49, 57 (1st Cir. B.A.P. 2007).

The Unjust Enrichment Claim is not the type of "particularized" claim that courts have allowed to proceed in derogation of the rights of a trustee to pursue causes of action for the benefit of all creditors who suffered substantially the same injury, especially in the Ponzi scheme context. *See, e.g. In re Barkany*, 542 B.R. 662 (E.D.N.Y. 2015) (creditors barred from

prosecuting unjust enrichment claims, among others, where bankruptcy trustee's fraudulent transfer claims against the same third parties arose from common facts—namely, "the third party defendants' involvement in a fraudulent investment scheme perpetrated by the debtor with multiple victims"); *Meoli v. The Huntington Nat'l Bank (In re Teleservices Group, Inc.)*, 463 B.R. 28 (W.D. Mich. 2012) (despite the fact that creditors' unjust enrichment claims against third parties did not belong to the bankruptcy estate, creditors barred from pursuing action where "the third party has been targeted only because his own dealings with the debtor have placed him in [that] unfortunate position").

The prosecution of the Unjust Enrichment Claim would have a substantial adverse impact upon the estates in several respects. First, the Trustee would be engaged in a "race to the courthouse" with the Defendants, who would be pursuing the same Net Winners. The Trustee would be virtually incapable of settling any claims against these Net Winners, since they would be unlikely to settle without the participation of the Defendants in the settlement or the execution of a release by the Defendants. The result would be duplicative litigation and significant confusion amongst Net Winners, all to the detriment of the bankruptcy estates. Because of these adverse impacts, the further prosecution of the Unjust Enrichment Claim should be enjoined. *See In re Caesars Entertainment Operating Company, Inc.*, 808 F.3d 1186 (7th Cir. 2015)(controlling inquiry in determining whether injunction is warranted under Section 105 is whether the injunction is likely to enhance the prospects for a successful resolution of the disputes attending the bankruptcy); *Queenie, Ltd. v. Nygard Int'l*, 321 F.3d 282, 287 (2nd Cir. 2003); *Nevada Power Co. v. Calpine Corp., (In re Calpine Corp.)*, 365 B.R. 401, 409 n. 20 (S.D.N.Y. 2007) ("Courts consistently have found that section 105 may be used to stay actions against non-debtors even where Section 362 otherwise would not provide such relief"); *Fisher v.*

Apostolou, 155 F.3d 876, 882 (7th Cir. 1998) ("The jurisdiction of the bankruptcy court to stay actions in other courts extends beyond claims by and against the debtor, to include suits…which may affect the amount of property in the bankrupt estate, or the allocation of property among creditors.")(citations omitted).

The Unjust Enrichment Claim arises out of the same set of facts and seeks to recover the same funds being pursued by the Trustee. The Second Circuit Court of Appeals, in two recent instances, entered permanent injunctions in favor of the Trustee under similar circumstances. *See BLMIS I*; *In re Bernard L. Madoff Investment Securities, LLC*, 512 Fed. Appx. 18 (2nd Cir. 2013)("BLMIS II").

In *BLMIS I*, the *Madoff* trustee brought claims against the "Picower" defendants for recovery of fraudulent and preferential transfers in connection with that well-documented Ponzi scheme. While settlement talks were pending, appellants Fox and Marshall filed complaints in federal court in Florida against the Picower defendants. Marshall, a net loser in the Ponzi scheme, purported to represent claimants who had not filed claims in the bankruptcy action or whose claims were disallowed. Fox asserted claims on behalf of net "winners", who could not participate in the *Madoff* estate, for conspiracy and conversion against Picower, who were alleged co-conspirators of Madoff. The Second Circuit concluded that the Florida actions were based upon secondary harms to the debtor rather than particularized injuries and enjoined those actions as interfering with administration of the estate. *Id.* at 92 (injury was inseparable from, and predicated upon, a legal injury to the estate, namely the fraudulent withdrawals from the BLMIS accounts). Similarly, the Defendants' claims are intertwined with the Trustee's avoidance action claims against the Net Winners. Each set of claims is premised upon the membership fees paid to Promoters in Triangular Transactions.

> As stated by the lower court whose decision was affirmed by the Second Circuit:
>
> > In order to assert such a claim independently of the administration of the bankruptcy case, a creditor must have suffered an injury significantly different from the injuries to creditors in general…Where the creditors' injury, while having some personal elements, overlaps with injury suffered by other creditors…the question to be answered is whether the injury to the creditor is "significantly different" from the injuries to other creditors in general."

Securities Investor Protection Corporation v. Bernard L. Madoff Investment Securities, LLC, 429 B.R. 423, 431 (Bankr. S.D.N.Y. 2010). The Net Losers in the Triangular Transactions effectively suffered the same harm as all other Promoters who purchased TelexFree membership plans through either direct transactions with TelexFree or Triangular Transactions – they invested funds to purchase memberships in a Ponzi scheme and ultimately were unable to recoup their investment. This provides no basis for individual Net Losers to "jump the line" and recover funds invested to the detriment of other similarly situated Net Losers.[5]

A similar injunction issued in favor of the Trustee in *BLMIS II*. In that action, as in *BLMIS I*, the trustee was pursuing recovery of avoidance actions while a third party asserted tort claims against the debtor-affiliated defendant. In affirming the lower courts, the Second Circuit took a very expansive view of Section 105:

> > Section 105(a) is to be "construed liberally to enjoin suits that might impede the reorganization process or, as here, the process of liquidation…Liberal construction reflects 'the underlying principle of preserving the debtor's estate for the creditors and funneling claims to one proceeding in the bankruptcy court…105(a) is properly used to enjoin creditors' lawsuits against third parties where 'the injunction plays an important part in the reorganization plan'…or where the action to be enjoined will have an immediate adverse economic consequence for the debtor's estate.

Id. at 20.

[5] As discussed above, the Defendants have couched their claim as an "Unjust Enrichment Claim", which is really just an equitable remedy and a repackaging of the fraudulent transfer claims asserted by the Trustee.

The District Court, whose decision was affirmed by the Second Circuit, noted that the court was dealing with "misrepresentations and lies that every creditor of the estate suffered" much like this case where the Defendants seek, on a class action basis, to recover from certain Net Winners for the harm that every Net Loser Promoter suffered. *In re Bernard L. Madoff Investment Securities, LLC*, 2011 WL 7975167 at *13 (S.D.N.Y. 2011).

The third *Madoff* action, cited with approval by the Defendants, supports the issuance of the Section 105 injunction in these cases. *Picard v. Fairfield Greenwich Limited et al*, 762 F.3d 199 (2nd Cir. 2014) ("BLMIS III"). In that case, the Second Circuit denied the trustee's request for an injunction of a suit brought by investors in so-called "feeder funds" against the funds themselves, which the trustee was simultaneously pursuing. This case is completely distinguishable from the present case. The investors in *BLMIS III* dealt only with the feeder funds, had claims only against the feeder funds, and had no relationship with the *Madoff* estate. In the instant case, the new recruit had a direct and substantial relationship with the Debtors. TelexFree issued the invoices to the recruit, the recruited individuals became members of TelexFree, the recruited individuals began immediately earning credits that could be converted to cash, and the recruited individuals could themselves recruit others into the TelexFree network. The differences could not be more stark. The facts in this case are much more akin to the facts in *BLMIS I* and *II*, both of which favor imposition of an injunction.

Further support for an injunction in favor of the Trustee can be found in a recent decision in the Petters' Ponzi scheme case. *See Ritchie Capital Management, LLC et al v. General Electric Capital Corp.*, 2016 WL 2731417 (2nd Cir. 2016). In *Ritchie,* the Second Circuit dismissed an action against General Electric Capital Corp. ("GECC") for civil conspiracy and aiding and abetting fraud because the creditor lacked standing. The movants in *Ritchie* alleged

that GECC allowed misrepresentations to be made to recruit parties to invest in the debtor, causing a particularized harm. The trustee brought suit against GECC for fraudulent transfers rooted in the same conduct outlined in the plaintiffs' complaint. The plaintiffs' argument that their claims were particularized and that the estate's rights would be barred by the doctrine of *in pari delicto* did not prevail. Similarly, the Defendants claims against Net Winners for any benefits the Net Winners derived from their participation in TelexFree should be enjoined in favor of the Trustee's avoidance claims that will benefit all parties.

IV. CONCLUSION

The membership fees collected by Promoters pursuant to Triangular Transactions is property in which the Debtors had an interest. The membership fees in a Triangular Transaction were owed to TelexFree, but TelexFree authorized the Promoter to collect them on its behalf, and to then retain the payment in exchange for a redemption of his/her accumulated credits. The Promoter's retention of the membership fee for his/her own benefit constituted a transfer of property in which TelexFree had an interest, property that would have been would have been part of the bankruptcy estates had the Debtor not agreed to accept its payment in credits instead. The Trustee is the proper—and only—party authorized to pursue recovery of that property by prosecuting fraudulent and preferential transfer claims against "Net Winners" from the Triangular Transactions.

The Defendants' competing prosecution of the Unjust Enrichment Claims is a violation of the automatic stay in that it seeks to recover estate property. Even if the Unjust Enrichment Claims were a direct, particularized claim belonging to the Defendants, they target the same funds the Trustee is pursuing as fraudulent and preferential transfers, arise from the same

transactions, and are so irreversibly intertwined with the Trustee's claims as to warrant a permanent injunction pursuant to Bankruptcy Code section 105(a).

For all the reasons set forth herein and in the Motion, the Trustee is entitled to summary judgment as a matter of law.

Respectfully submitted,

STEPHEN B. DARR, CHAPTER 11 TRUSTEE,
By his counsel:

Dated: September 2, 2016

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