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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, CHAPTER 11 TRUSTEE OF THE DEBTORS, Plaintiff, v. RITA DOS SANTOS, INDIVIDUALLY AND AS PUTATIVE CLASS REPRESENTATIVE, AND MARIA MURDOCH, ANGELA BATISTA JIMINEZ, ELISANGELA OLIVEIRA and DIOGO DE ARAUGO, AS PUTATIVE CLASS REPRESENTATIVES, Defendants.	Adversary Proceeding No. 15–04055

BRIEF OF THE CLASS DEFENDANTS AS *AMICI CURIAE* RELATIVE TO CROSS-MOTIONS FOR SUMMARY JUDGMENT

Dated: February 21, 2017

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I. INTRODUCTION

Amici are alleged "net winners" who are accused of profiting from the operations of TelexFree. The Trustee estimates that there are more than 14,818 such net winners, and has named 105 as defendants in the Trustee's Adversary Proceeding 16–4006. A defendant class has been certified, and this brief is submitted on behalf of all Class Defendants.

Class Defendants' interest in this action derives in large part from the prospect of financial devastation that could arise from incurring legal fees to defend parallel litigation in two different federal courts. At least 40 of the Class Defendants have already been named in nearly identical litigation pending in the District of Massachusetts *sub nom Da Silva & Dos Santos v. TelexElectric, LLLP*, MDL No. 4:14-md-2566-TSH and *Murdoch & Batista v. TelexElectric, LLLP*, MDL No. 4:16-cv-40018-TSH and Class Defendants believe that Plaintiffs' Interim Executive Committee (the "PIEC") will eventually add successive waves of additional defendants.

Class Defendants also possess unique knowledge of the operations of TelexFree that they believe may assist the Court and provide additional insight into the disputed issues currently pending. In so doing, Class Defendants do not intend to duplicate prior arguments or analysis, though some overlap may be inevitable. Nor do Class Defendants seek to catalogue every statement or assertion with which they disagree. Rather, the purpose of this brief is to advise the Court of the key points that Class Defendants believe tip the jurisdictional argument in favor of the Trustee.

II. FACTUAL BACKGROUND

All parties agree that net winners and net losers were promoters of TelexFree's phone and advertising service. *See* Trustee's Statement of Undisputed Material Facts in Support of His Cross-Motion for Summary Judgment, at ¶¶ 20, 35, 48 (Document No. 48) ("Trustee's Statement of Facts"). *See also* Local Bankruptcy Rule 7056-1 Statement of Undisputed Material Facts In Support of PIEC'S Motion for Summary Judgment, at ¶¶ 7, 9, 16, 20 (Document No. 40) ("PIEC's Statement of Facts").

And at least the Trustee will agree that all promoters were entitled to and almost all did in fact earn commissions and bonuses for their efforts. *See* Trustee's Statement of Facts, at ¶¶ 6, 8, 14–15, 24. PIEC does not deny the existence of promoter commissions and bonuses; it merely denies that TelexFree itself made any payments and otherwise refuses to discuss the nature of any payments to net winners except to argue that they were fraudulent. *See* PIEC'S Response to Trustee's Statement of Undisputed Material Facts in Support of His Cross-Motion for Summary Judgment, at ¶¶ 3, 6, 10–11, 14–15, 18, 24 (Document No. 77) ("PIEC's Response"). However, there is no evidence or allegation that any single net loser ever sought to invalidate the contracts they signed with TelexFree, sought rescission, or otherwise attempted to avoid any transfers.

Neither the Trustee nor PIEC discuss the exact relationship between promoters and TelexFree, although they must both acknowledge that the contract stated that they were considered independent contractors. *See* Exhibit C to Trustee's Statement of Facts, ¶ 2.4. Despite an attempt to disclaim "an employment relationship," the contract bore all the hallmarks of an employment relationship. Promoters engaged in the same business as

TelexFree, namely the advertising, promotion, operation, and new-member recruitment of a multilevel marketing ("MLM") network involving the sale of VoIP phone plans. *Compare Id.*, ¶ 2.1.1, *with* ¶ 2.2.1, *with* ¶ 2.2.2.1. The contract prohibited the supposedly independent contractors from working for another MLM network "whose activities are similar to TelexFree's." *Id.*, ¶ 2.4.4.1. Promoters also received "space on the site www.telexfree.com to promote the products/services" that they had acquired, and in addition to training received "access to materials also made available on the TelexFree website so that he can undertake to promote the latter and avail himself of the opportunity to be a PARTNER and PROMOTER to others in his circle of relationships." *Id.*, ¶ 2.2.1.

Because the Class Defendants are not a party to this adversary proceeding, they have not had the opportunity to add to the factual record. Accordingly, Class Defendants refer to—without necessarily conceding—facts compiled by the parties in their separate statements.

III. ARGUMENT

This is a case where one group of employees is suing another group of employees over the basic operation of their employer, TelexFree, whose intrinsic nature is alleged to have been a fraudulent Ponzi and pyramid scheme. Regardless of how the claims are captioned—fraudulent transfer or unjust enrichment—they all concern TelexFree's promoter compensation arrangements, which are alleged to have been unsustainably exorbitant—a classic Ponzi scheme—and which allegedly incentivized the recruitment of new members without the need to buy goods or services—a classic pyramid scheme.

The only thing that binds alleged net winners to claimed net losers is TelexFree itself and the contracts that all promoters signed when joining TelexFree. Out of this *milieu*, the Estate of TelexFree as the employer of both net winners and net losers has something more than a passing interest.

It goes without saying that Class Defendants dispute the methodology by which both Trustee Darr and the PIEC suggest that liability can be determined. But the Estate has at least *an interest* in any triangular transactions because any cash payments made by net losers were made pursuant to a contract that all promoters—net winners and net losers alike—entered into with TelexFree concerning membership fees and the wages that TelexFree owed its employees in the form of commissions and bonuses, all of which were recognized as an expense. Regardless of who initially possessed the money or why, the Debtor had at least a defeasible interest in all membership fees. The TelexFree contract that bound all members required new members to pay a membership fee in a "single installment." New members were presented with an equivalent choice of either paying the company or one of its agents. TelexFree remained entitled to that money, and indeed all "remuneration of the promoter," for example if there "legal issues" arose or administrative expenses were incurred. *See* Exhibit C to Trustee's Statement of Facts, ¶ 4.3.[1] The sponsoring promoters who received cash had a choice of keeping the funds or forwarding them to the company. This case, of course, only concerns the instances when the sponsoring promoter retained the membership fee

[1] It is unclear what "legal issue" was contemplated in subsection b) of ¶ 4.3 of the contract, as it is left blank.

in connection with earned commissions and bonuses. But there is no evidence—not even a suggestion—that the use of credits to satisfy a membership invoice in any way relieved a new member of his or her obligation to pay the fee in a "single installment." Thus, TelexFree at all times had at least a defeasible interest in the funds. Accordingly, the claims that spring from the retention of membership fees properly belong in Bankruptcy Court.

A. The Trustee Has Standing to Bring Fraudulent Transfer Claims, and PIEC's Claims Are Barred Because They Are Identical to and Derivative of the Trustee's Allegations Concerning the TelexFree Fraud

It cannot be disputed that a trustee has Article III standing to bring fraudulent transfer claims, no matter how disputed, against alleged net winners. *See Morley v. Ontos, Inc. (In re Ontos, Inc.)*, 478 F.3d 427, 431 (1st Cir. 2007). As the First Circuit has made clear, the Bankruptcy Code broadly defines property of the estate to include "all legal or equitable interests" of the debtor in property as of the commencement of the case," and it is "well established that a claim for fraudulent conveyance is included within this type of property." *See id.* (citing 11 U.S.C. § 541(a)(1)). This right belongs only to the trustee, and creditors cannot bring their own fraudulent transfer claims, unless the trustee "unjustifiably fails to pursue the claim." *Morley*, 478 F.3d at 431 (citing *Nat'l Tax Credit Partners* v. *Havlik*, 20 F.3d 705, 708–09 (7th Cir. 1994) ("right to recoup a fraudulent conveyance, which outside of bankruptcy may be invoked by a creditor, is the property of the estate that only a trustee or debtor in possession may pursue once a bankruptcy is under way.")); *Hatchett* v. *United States*, 330 F.3d 875, 886 (6th Cir. 2003) ("trustee has the exclusive right to bring an action for fraudulent conveyance during the

pendency of the bankruptcy proceedings…"); *Campana* v. *Pilavis* (*In re Pilavis*), 233 B.R. 1, 3 (Bankr. D. Mass. 1999)). It is thus "well-established that creditors may not 'vie with the bankruptcy trustee for the right to pursue fraudulent conveyance actions…'" *In re Pagnini*, No. 09-17144-WCH, 2010 Bankr. LEXIS 187, at *6 (Bankr. D. Mass. Jan. 26, 2010) (citing *Sears Petroleum & Transport Corp. v. Burgess Construction Serv., Inc.*, 417 F. Supp. 2d 212, 221 (D. Mass. 2006)).

Because the Trustee has asserted claims for fraudulent conveyance, there is no basis—either in law or policy—to launch a standing attack by "going behind" the pleadings. All that is required is "colorable" allegations of fraudulent transfer. *See Nisselson v. Lernout*, 469 F.3d 143, 150 (1st Cir. 2006) ("constitutional prerequisites for Article III standing are satisfied so long as a plaintiff colorably alleges an actual injury that is both traceable to the defendant's conduct and redressable by a favorable decision."). Where the statutory authority to bring claims is clear, courts should be wary of standing challenges that are merged with arguments on the merits. Objections based on "standing" must be addressed at the threshold if they implicate the authority to hear a case under Article III of the Constitution or introduce "endless complexities." *See Baena v. KPMG LLP*, 453 F.3d 1, 4 (1st Cir. 2006).

The present dispute concerns precisely such an attempt by PIEC, who attempts to invert two prudential considerations. First, PIEC attempts to merge standing with *in pari delicto*, despite criticism of such approach from the First Circuit. *See Nisselson v. Lernout*, 469 F.3d at 150 ("*in pari delicto* doctrine does not implicate a plaintiff's standing to sue but, rather, constitutes an affirmative defense"); *Baena v. KPMG LLP*, 453 F.3d at 6

("the doctrine of *in pari delicto* is sometimes described (dubiously) as one of standing."). *See also DeGiacomo v. Tobin & Assocs., P.C. (In re Inofin Inc.)*, Nos. 11-11010-JNF, 12-1091, 2012 WL 5457415, 2012 Bankr. LEXIS 5237, at *69–71 (Bankr. D. Mass. Nov. 8, 2012). Second, PIEC argues that the Trustee attempts to "disguise" common law creditor claims as fraudulent transfer claims, a reversal of the rule that prevents creditors from bringing "disguised" claims that belong to the Trustee.

As the *Picard* trilogy of cases demonstrate, these arguments fail. In the wake of the Madoff scandal, and similar investment scams, there is now a demarcated line between claims that the Trustee has standing to bring in Bankruptcy Court and claims that belong to individual creditors. PIEC argues that the *Picard* trilogy supports its position that Trustee Darr lacks standing, but a close inspection of these cases and the underlying law suggests the opposite conclusion. Thus, even if this Court were to "go behind" the pleadings and entertain the "endless complexities" offered by PIEC, it is clear that standing lies with the Trustee.

In *Picard I*, the trustee of Bernie Madoff's brokerage firm brought two dozen claims against a variety of banks and hedge funds, including JP Morgan, UBS, Access International, UniCredit, and HSBC. Crucially, there was no challenge to the Trustee's standing to pursue nineteen preference and fraudulent transfer claims against various banks totaling roughly $2 billion. The only attack was on the trustee's common law claims (as well as a state law contribution claim) asserted against these banks. Those common law claims were predicated on complicity and complacency: JP Morgan was "at the very center" of the fraud and presided over a checking account where no funds

were ever segregated by client and no securities were ever purchased. Instead funds went to pay other customers, all under a "well-known cloud" of suspicion; UBS created feeder funds and collected significant investments which were then plowed into Madoff's brokerage firm, despite serious misgivings; Access International continued recruiting investors, despite knowing that it was impossible for Madoff to have executed the volume of options or equities trades he reported; UniCredit continued to aggressively market its feeder funds, despite significant suspicions and an abject failure to conduct due diligence; and HSBC brought in roughly 40% of the funds Madoff held, and thus knew or should have known that Madoff was reporting more transactions than was possible given market volumes.

The Second Circuit held that these aiding and abetting claims were barred by the doctrine of *in pari delicto*.[2] *Picard v. JPMorgan Chase Bank & Co. (In re Bernard L. Madoff Inv. Sec. LLC)*, 721 F.3d 54, 63 (2d Cir. 2013) ("*Picard I*"). This holding was an application of the *Wagoner* rule,[3] in which a claim against a third party for defrauding a corporation with the cooperation of management "accrues to creditors, not to the guilty corporation." *Shearson Lehman Hutton, Inc. v. Wagoner,* 944 F.2d 114, 120 (2d Cir. 1991).

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[2] Any wrongdoing by TelexFree promoters was shared by *all* of them, regardless of whether they were net winners or net losers. Indeed, the net losers must concede that they were convinced to participate based on the same marketing pitches that convinced net winners to participate. And these marketing pitches described compensation plans that allegedly should have raised red flags. At bottom, net losers were attempting to and did in fact participate in the very same allegedly fraudulent enterprise and with precisely the same financial motives as the alleged net winners. For this reason, PIEC's claims that net winners were unjustly enriched at the expense of net losers are barred by *in pari delicto*.

[3] It should be noted that the First Circuit has not adopted the *Wagoner* rule and if anything is critical of it. *See Baena v. KPMG LLP*, 453 F.3d 1, 6 (1st Cir. 2006). Nevertheless, Class Defendants do not believe that adoption of the *Wagoner* rule affects the analysis here.

"[B]ecause a trustee stands in the shoes of the corporation, the *Wagoner* rule bars a trustee from suing to recover for a wrong that he himself essentially took part in." *Wight v. BankAmerica Corp.,* 219 F.3d 79, 87 (2d Cir. 2000). The Second Circuit noted that the trustee could have brought "derivative claims" against the banks, *i.e.* claims that "arise[] from harm done to the estate" and that "seek[] relief against third parties that pushed the debtor into bankruptcy." *Id*. But the trustee did not bring such derivative claims, however, and thus he lacked standing to assert them. *Id.* at 70–71 n.20.

In *Picard II*, two defrauded investors were enjoined from pursuing a putative class action in district court against one of Madoff's alleged co-conspirators and various related parties who were alleged to have knowingly profited from Madoff's scheme through fraudulent withdrawals that further depleted the available funds. The Second Circuit set forth the specific standard that a creditor must meet to wrest jurisdiction away from the trustee: "when creditors . . . have a claim for injury that is *particularized as to them*, they are exclusively entitled to pursue that claim, and the bankruptcy trustee is precluded from doing so." *Marshall v. Picard (In re Bernard L. Madoff Inv. Secs. LLC)*, 740 F.3d 81, 88 (2d Cir. 2014)("*Picard II*")(quoting *Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085, 1093 (2d Cir. 1995))(emphasis added). To be "particularized," an injury must be "directly traced to [the third party's] conduct." *Picard II*, 740 F.3d at 89 (quoting *St. Paul Fire & Marine Ins. Co. v. PepsiCo, Inc*., 884 F.2d 688, 704 (2d Cir. 1989)).

Using this framework, the Second Circuit found that the defrauded investors were properly enjoined because they had not alleged any such "particularized" actions by the defendants. *Id.* at 96. Most tellingly, the investors had not alleged that the defendants

had made any misrepresentations to them or that they had relied on any such misrepresentations. *Id.* at 93. In fact, there was no claim that defendants' actions were aimed at any particular customer of Madoff's brokerage firm. All that was alleged was that the defendants "knowingly reaped" the benefits of Madoff's scheme through fraudulent withdrawals using backdating trades to record fictional profits. The Second Circuit found that such an allegation "does not amount to a particularized claim that they directly participated in defrauding BLMIS customers by inducing them to invest." *Id*. In reaching the conclusion that the trustee had the authority to pursue such claims, the Second Circuit was not swayed by the fact that the defrauded investors had captioned their claims as conspiracy or conversion claims, or even that they sought damages that were unavailable to the trustee. Lacking a particularized injury, a creditor cannot "circumvent" the Bankruptcy Court's jurisdiction by "pleading around" the automatic stay, no matter how it captions the claims. *Id.* at 91–92.

In *Picard III*, the trustee attempted to block a settlement between a feeder fund and several of its clients, who brought claims against the fund for breach of fiduciary duty and misrepresentation. Consistent with its prior analyses, the Second Circuit found that the settlement did not violate the automatic stay because the clients had alleged a "particularized injury." *Picard v. Fairfield Greenwich Ltd.*, 762 F.3d 199, 211 (2d Cir. 2014)("*Picard III*"). The claims were not brought on the "same basis" as the trustee's fraudulent conveyance claims, despite the factual overlap. Key to its analysis was the finding that none of the plaintiffs' claims of liability against the feeder funds depended on "the wrongfulness of Madoff's conduct," or on the fact that Madoff transferred

funds to the feeder funds. *Id*. at 211. Rather, the Second Circuit found the defendants' "alleged knowledge of Madoff's fraud" relevant only to their liability for "breaches of duties they owed directly to the plaintiffs." *Id*. at 210. On that basis, the Second Circuit rejected the trustee's argument that the settled claims were an attempt to plead around the trustee's fraudulent conveyance claims, holding that the claims against the feeder funds were "particularized" and thus "outside the Trustee's purview." *Id.* at 211.

Reading the *Picard* trilogy cases together, it is clear that the trustee has the statutory right to bring fraudulent transfer claims and creditors cannot plead around the automatic stay by bringing derivative claims. In not one of the decisions does the Second Circuit suggest that the existence of overlapping claims limits the trustee's standing to bring fraudulent transfer claims. The only limitation is when the trustee brings claims against third parties who are alleged to have caused a particularized injury that was not merely the debtor's fraud itself.

Here, it is clear that PIEC's claims are inseparable from the Trustee's fraudulent transfer claims. As in *Picard II*, the primary basis for liability is that Defendants knowingly profited from TelexFree's allegedly fraudulent scheme. Nowhere is it alleged that any Defendant made any specific misrepresentations or owed specific duties to any specific plaintiff. Indeed, neither of PIEC's amended complaints are able to pair the specific Defendants with the specific plaintiffs allegedly defrauded. This is a glaring omission that negates any claim of "particularized injury."

Unlike *Picard I* and *Picard III*, PIEC's complaints are "derivative claims" because they "arise [] from harm done to the estate" and "seek[] relief against third parties that

pushed the debtor into bankruptcy." *See Picard I,* 721 F.3d at 70. Not only do PIEC's claims depend on the "wrongfulness" of TelexFree's conduct, but the scheme that they alleged caused unjust enrichment is the *same* fraud that the Trustee alleges resulted in fraudulent transfers. *See Picard III*, 762 F.3d at 211. The "factual origins" of both sets of claims are one and the same—to wit the intrinsically fraudulent nature of TelexFree's operations, which allegedly paid excessive compensation to promoters and encouraged them to recruit additional members in a resulting pyramid structure. *See Picard II*, 740 F.3d at 89. PIEC does not allege a "secondary effect" or any "particularized injury…directly traced" to the Defendants' conduct. *Id*. Nor are any particularized misrepresentations alleged.

PIEC warns of an extraordinary power grab by the Trustee, but if anything the opposite is true. The unjust enrichment claims are identical to the fraudulent transfer claims; both involve the transfer of cash to promoters, and both rely on the same net equity model.[4] Accordingly, the Court must view PIEC's claims as fraudulent transfer claims "in disguise." *See Picard II*, 740 F.3d at 92 (citing *A & G Goldman Partnership v. Picard (In re Bernard L. Madoff Inv. Sec., LLC)*, No. 12 CIV. 6109 RJS, 2013 U.S. Dist. LEXIS 143956, 2013 WL 5511027, at *7 (S.D.N.Y. Sept. 30, 2013)("In other words, the Complaints plead nothing more than that the Picower Defendants fraudulently withdrew money from BLMIS."). There is no statutory or legal authority to support

[4] Nothing herein should be interpreted as an endorsement of the "net equity" model proposed by Trustee Darr. To the contrary, Class Defendants intend to demonstrate that the model is fatally flawed and should be rejected.

PIEC's claim that some fraudulent transfer claims confer legitimate standing while others do not. This would require the Court to look behind the pleadings to determine whether the Trustee's claims are valid, which undermines the Trustee's statutory authority and threatens to open any fraudulent transfer litigation to a standing challenge. This Court should reject this broadside attack on the statutory powers of trustees.

In the end, the necessary analysis is straightforward: "When Congress has specifically granted the trustee the power to *assert* the fraudulent transfer claim, *Wagoner* is inapplicable—standing has been statutorily conferred." *Ivey, Barnum & O'Mara, LLC v. Bear, Stearns & Co. (Stanwich Fin. Servs. Corp.)*, 488 B.R. 829, 834 (D. Conn. 2013) (emphasis added). Further, in the First Circuit, ". . .the in pari delicto doctrine does not implicate a plaintiff's standing to sue but, rather, constitutes an affirmative defense." *Nisselson v. Lernout*, 469 F.3d at 150; *see also Baena v. KPMG LLP*, 453 F.3d at 6 (1st Cir. 2006). Allowing parallel litigation against the same "net winners" to recover the same "net winnings" has more than a "conceivable effect" on the bankruptcy estate of TelexFree and thus the automatic stay should be used to bar the PIEC's claims. *See Picard II*, 740 F.3d at 88.

B. Even if TelexFree Had No Possessory Interest in Transferred Funds, TelexFree's Estate Has an Interest in the Commissions and Bonuses[5] Paid to Its Promoters

Cases seeking to claw back a debtor's payment of commissions allegedly in furtherance of a Ponzi scheme are invariably litigated in Bankruptcy Court. *See e.g.*

[5] While the trustee and PIEC may assert that the work of TelexFree's promoters merely consisted of the completion of menial tasks and the transfer of "worthless" credits, the

Cuthill v. Kime (In re Evergreen Sec., Ltd.), 319 B.R. 245, 249 (Bankr. M.D. Fla. 2003) ("*In re Evergreen Sec.*"); *Cuthill v. Greenmark, LLC (In re World Vision Entm't, Inc.)*, 275 B.R. 641 (Bankr. M.D. Fla. 2002) ("*In re World Vision*"); *Balaber-Strauss v. Sixty-Five Brokers (In re Churchill Mortg. Inv. Corp.)*, 256 B.R. 664 (Bankr. S.D.N.Y. 2000) ("*In re Churchill Mortg.*"). Whether made to employees, brokers, or independent contractors, trustees generally have standing to assert the claim that the payment of *any* commission amount is constructively fraudulent because the debtor received no value for the services. The existence of standing, however, does not foreclose the availability of defenses or the ability of employees and independent contractors to assert them. *See In re World Vision*, 275 B.R. 641, 658 (Bankr. M.D. Fla. 2002); *Balaber-Strauss v. Sixty-Five Brokers (In re Churchill Mortg. Inv. Corp.)*, 256 B.R. 664, 681 n.12 (Bankr. S.D.N.Y. 2000) (noting that employees were entitled to a value defense and questioning why independent contractors should be "any less entitled to the 'value defense' than employees"). As such, these claims are properly and regularly addressed in bankruptcy court.

1. TelexFree Maintains an Interest in the Commissions and Bonuses Earned by Its Promoters

Trustee seeks to claw back payments made to promoters as fraudulent transfers. In determining whether a transfer was fraudulent, courts must assess value of the transfer on a case-by-case basis looking at the surrounding circumstances and focusing on the precise transfer in question and not on the value of the transfer to the debtor's overall

Defendant Class disputes such allegations and instead represents that for many members of the class, their work at TelexFree setting up meetings, recruiting new members, and placing ads was full-time employment. For many, it was also a primary source of income for their family.

fraudulent enterprise. *See In re World Vision,* 275 B.R. at 657. Simply because a debtor conducts its business fraudulently does not make *every single payment* by the debtor subject to avoidance:

> If so, every vendor supplying goods to the debtor would receive an avoidable fraudulent transfer when the debtor paid the vendor's invoice. Every employee, even lower-level custodial and clerical employees, would be required to return their wages, regardless of the work they performed.

Id. at 658. *See also DeGiacomo v. Sacred Heart Univ., Inc. (In re Palladino)*, 556 B.R. 10, 14 (Bankr. D. Mass. 2016) (finding that "a generalized intent to defraud," while certainly present in a Ponzi scheme case, "is not sufficient, by itself, to show that the transfers in question were made with fraudulent intent," and declining to extend the Ponzi scheme presumption so broadly that it would "ensnare transferees indiscriminately.").

The fact that commissions could loosely be painted as investment profits does not divest the Trustee of standing or this Court of jurisdiction. For example, in *In re Universal Clearing House,* the bankruptcy court had held that 127 sales agents who had received commission in furtherance of the Ponzi scheme "gave no value." *Merrill v. Allen (In re Universal Clearing House Co.)*, 60 B.R. 985, 997 (D. Utah 1986) ("*In re Universal Clearing House").* The district court reversed, finding that "a determination of whether value was given under section 548 should focus on the value of the goods and services provided rather than on the impact that the goods and services had on the bankrupt enterprise. *Id.* at 1000. The district court thus held "as a matter of law" that "the services provided by appellants did constitute value as that term is used in section 548," and remanded for further proceedings to determine whether such value was reasonably

equivalent. *Id.* Similarly, the Eleventh Circuit reversed a bankruptcy court ruling barring an employee of a Ponzi scheme from asserting an affirmative defense under Section 548(c) of "for value and in good faith" in response to a trustee's fraudulent transfer action seeking to recover over $1 million in commissions. *See Orlick v. Kozyak (In re Fin. Federated Title & Tr., Inc.)*, 309 F.3d 1325, 1331–33 (11th Cir. 2002).

2. TelexFree's Interest in Bonuses and Commissions is Heightened by its Failure to Properly Classify Promoters as Employees

TelexFree's interest in the bonuses and commissions earned by the promoters of TelexFree is elevated because the promoters were misclassified employees of the company. *See* Mass. Gen. Laws. Ch. 149, § 148B. Under Massachusetts law, there is a three-prong test that employers must meet to properly consider someone an independent contractor; the burden of proof is on the employer, and the inability of the employer to prove any one of the prongs makes the person an employee. *Id. See also Scalli v. Citizens Financial Group*, No. 03-12413-DPW, 2006 WL 1581625, *14, 2006 U.S. Dist. LEXIS 7717, at *48 (D. Mass. Feb. 28, 2006); *Rainbow Dev., LLC v. Comm. Dep't of Indus. Accidents*, 20 Mass. L. Rep. 277, 2005 Mass. Super. LEXIS 586, *5–6 (Mass. Super. Ct. Nov. 15, 2005). To overcome the employee presumption, the employer must prove that the individual is not under the control and direction of the employer, the service performed is one outside the "usual course of business of the employer," and the individual regularly engages in an independent trade that is of the same nature as the service rendered. Mass. Gen. Laws. Ch. 149, § 148B (a)(1-3); *Monell v. Boston Pads, LLC*, 31 N.E.3d 60, 64-65, 471 Mass. 566, 572 (2015); *Depianti v. Jan-Pro Franchising Int'l, Inc.*,

990 N.E.2d 1054, 1066-67, 465 Mass. 607, 621 (2013)("First, 'an individual performing any service' is presumed to be an employee.").

TelexFree claimed that all promoters were independent contractors, but these claims certainly fail two of the prongs and likely fail all three. Without a doubt, promoters were engaged in providing a service in the usual course of TelexFree's business—the sales and advertising of phone services through multilevel marketing. *See* Exhibit C to Trustee's Statement of Facts, ¶ 2.2. Moreover, the contract prohibited promoters from being "part of another Multilevel Marketing network whose activities are similar to TelexFree's," thus running afoul of the requirement that independent contractors be "customarily engaged in an independently established trade, occupation, profession or business of the same nature as that involved in the service performed." Mass. Gen. Laws Ch. 149, § 148B (a)(3); *see* TelexFree Contract. The fact that many if not most of the Class Defendants were out of state has no impact on this analysis because it is clear that the Massachusetts Wage Act is applicable to claims of out-of-state employees of a corporation headquartered in Massachusetts. *See Dow v. Casale*, 989 N.E.2d 909, 914-15, 83 Mass. App. Ct. 751, 758 (2013).

PIEC focuses solely on whether TelexFree ever had possession of payments made to net winners by net losers, but ignores the nature of these payments as earned commissions and bonuses. And while Class Defendants do not believe the Trustee can meet his burden of proving the occurrence of triangular transactions or that Class Defendants acted as "collection agents" for TelexFree in such transactions, the Trustee's position that the Estate had at least an interest in these transfers is the only sensible one.

Under Massachusetts law, TelexFree had an interest in the alleged transfers because they fell under the Massachusetts Wage Act. *See* Mass. Gen. Laws Ch. 149, § 148. Section 541(a)(1) of the Bankruptcy Code creates an estate upon the filing of a bankruptcy petition that broadly includes "all legal or equitable interests of the debtor in property as of the commencement of the case," language that would be superfluous if possession were all that mattered. 11 U.S.C. § 541(a)(1). The scope of Section 541(a)(1) is governed by state law. *See Abboud v. The Ground Round, Inc. (In re The Ground Round, Inc.),* 482 F.3d 15, 17 (1st Cir. 2007) (citing *Butner v. United States,* 440 U.S. 48, 54–55 (1979)). Here, state law creates a significant interest in the alleged transfers. Not only is TelexFree liable to promoters for misclassification and any wage claw back, but it is required to give priority to $12,850[6] in wages, salaries, or commissions earned within 180 days before its assets were frozen. 11 U.S.C. § 507(a)(4).[7] Because the Trustee has statutorily asserted that these payments were fraudulent transfers, and because the Defendant Class may be entitled to some of these payments as wages, the issues are properly within bankruptcy court. *See* 11 U.S.C. § 548; 11 U.S.C. § 507 (a)(4)(A).

3. The Existence of a Ponzi Scheme does not Itself Deprive Promoters of a Claim to Earned Bonuses and Commissions

Undoubtedly, PIEC will argue any claims to wages are void as the fruits of a Ponzi scheme. However, the persons allegedly defrauded out of the property the trustee seeks

[6] Revision of Certain Dollar Amounts in the Bankruptcy Code, 81 Fed. Reg. 8748 (Feb. 16, 2016).

[7] Even if promoters were found to be independent contractors, priority would still be required for any promoter who earned 75% of his or her independent contractor income during the 12-month period preceding the shuttering of TelexFree.

to recover did nothing to avoid the transactions. Just as in *In re Universal Clearing House*, the alleged net losers here "did not rescind their contracts but rather accepted or anticipated payments according to the contract provisions." *In re Universal Clearing House Co.*, 60 B.R. 985, 996 (D. Utah 1986). In fact, some net losers held numerous user accounts, which is inconsistent with the behavior of a defrauded party who is seeking to avoid fraudulent transactions:

> Unless the defrauded party takes affirmative action to avoid a contract induced by fraud, property transferred under the contract must belong to the defrauder. The defrauded party may have a claim against the defrauder for damages, but that claim makes him only a creditor.

In re Universal Clearing House Co., 60 B.R. at 996.

In similar cases, courts conclude that any money transferred as a result of an alleged Ponzi scheme and which is subsequently mingled with other money so as to preclude the ability to trace the funds is property of the debtor within the meaning of 11 U.S.C. § 548, where the defrauded party does not timely avoid the transaction. *See In re Universal Clearing House Co.*, 60 B.R. at 997.[8]

Here, there is no allegation that any plaintiff made an effort to avoid any transactions, timely or otherwise. Indeed, the eponymous net loser Rita Dos Santos claims she lost $350,000, which suggests an intense and sustained desire to repeat rather than avoid her transactions with TelexFree.[9] According to the Trustee, she had 12 user

[8] Class Defendants do not admit that they received any funds that were property of the estate. This brief only concerns whether the Trustee has standing to make such allegations.

[9] Jonny Bonner, *$1 Billion Cut-and-Paste Ponzi Claim*, Courthouse News Service (Sept. 25, 2015, 5:51 A.M.), http://www.courthousenews.com/2015/09/25/1-billion-cut-and-paste-ponzi-claim.htm (last visited February 16, 2017).

accounts. Other named plaintiffs, such Maria Murdoch, Angela Batista, Diogio De Araugo, and Celio Da Silva had even more. Amazingly, the Trustee suggests that Rita Dos Santos may not even be a net loser!

C. The Claims against Promoters Relate to the Restructuring of Debtor–Creditor Relationships

Because Class Defendants have claims under the Wage Act, at a minimum for misclassification, and perhaps on a priority basis for the claw-back of the wages earned within 180 days of the shutdown, they will be asserting class-wide claims for commissions, bonuses, and misclassification. Accordingly, the same issues will arise both in the allowance of claims and the claims against Class Defendants. When the same issue arises as part of the process of allowance and disallowance of claims, it is triable in equity. *Granfinanciera v. Nordberg*, 492 U.S. 33, 58 (1989). Where, as will be the case here, creditors assert a claim thoroughly intertwined with preference actions against them by a trustee, the trustee's actions are "integral to the restructuring of the debtor-creditor relationship through the bankruptcy court's equity jurisdiction." *Langenkamp v. Culp*, 498 U.S. 42, 44 (1990). *Stern v. Marshall* did not chip away at this principle. *See Stern v. Marshall*, 564 U.S. 462, 503 (2011). For this reason, the forthcoming filing of a class-wide proof of claim should be dispositive of the Trustee's standing to bring claims against the Class Defendants.

IV. CONCLUSION

Based on the foregoing, Class Defendants believe the Trustee, not the individual net losers, have standing to pursue claims against the Class Defendants arising out of the operations of TelexFree.

DEFENDANT CLASS
REPRESENTATIVE FRANTZ BALAN,
By his counsel,

Dated: February 21, 2017

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CERTIFICATE OF SERVICE

I, Ilyas J. Rona, hereby certify that I have caused a copy of the **Brief of the Class Defendants as *Amici Curiae* Relative to Cross-Motions for Summary Judgment** to be served on counsel for the Trustee by email as follows and all registered electronic filers appearing in this case via the Court's CM/ECF system:

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