

First Circuit Affirms Summary Judgment Ruling in Trustee's Favor Barring PIEC from Asserting Competing Claims in TelexFree Proceedings

(Boston, MA) – November 7, 2019

The U.S. Court of Appeals for the First Circuit affirmed the decision of the Massachusetts District Court, which adopted the Massachusetts Bankruptcy Court's award of summary judgment in favor of Chapter 11 Trustee Stephen Darr, represented by Murphy & King, in an adversary proceeding arising out of the bankruptcies of TelexFree, LLC; TelexFree, Inc.; and TelexFree Financial, Inc. (collectively, "TelexFree").

TelexFree operated one of the largest Ponzi/pyramid schemes in U.S. history, in which TelexFree held itself out as a multi-level marketing company selling international phone subscription packages, whereas its true purpose was geared towards recruiting new participants into the scheme.

Upon signing up, new participants owed a membership fee to TelexFree, which they could pay directly to TelexFree ("direct transactions") or to existing participants. In the latter scenario ("triangular transactions"), which accounted for the majority of membership fee payments, the existing participants who received the membership fee payments would redeem their own accumulated "credits" to settle the new participants' obligations to TelexFree. New participants then themselves could recruit additional participants into the scheme.

Although some participants were able to make more money than they paid into the scheme, i.e. "net winners," many participants lost more money than they paid in, i.e. "net losers." In TelexFree's bankruptcy proceedings, the Bankruptcy Court approved the Trustee's "net equity formula" for distributing estate assets, which accounted for both direct transactions and triangular transactions in determining net winners and net losers, and provided that only net losers could receive distributions as creditors of the estates.

The Trustee filed two class action avoidance actions against net winners, one against those in the U.S. and the other against those outside the U.S., to recover the "profits" that net winners had obtained through the scheme for ultimate ratable distribution to all net losers. A prospective class of TelexFree participants, represented by a "Plaintiffs' Interim Executive Committee" ("PIEC"), filed its own putative class actions, asserting unjust enrichment claims, and seeking to recover some of the same amounts from the same net winners. The Trustee initiated the underlying adversary proceeding to enjoin the PIEC from pursuing its competing actions.

The First Circuit affirmed the Bankruptcy Court and District Court's finding that TelexFree had a property interest in the membership fees paid through triangular transactions because they were "functionally the same" as membership fees paid through direct transactions. Citing to prior precedent, the First Circuit held that TelexFree possessed such a property interest notwithstanding that the funds were transferred within a Ponzi scheme. The First Circuit additionally affirmed the lower courts' ruling that the Trustee had exclusive standing to bring the avoidance actions against net winners, and upheld the permanent injunction barring PIEC from pursuing their competing actions.

Mr. Darr, the Trustee, heralded the decision as an important confirmation that “fraudulent conveyance claims are exclusively the property of the estate.” He and Murphy & King will continue their efforts to maximize the recovery in the avoidance actions against net winners for the benefit of all net losers.

Harold B. Murphy, Charles R. Bennett, Jr., Andrew G. Lizotte, and Shawn Lu of Murphy & King represented the Trustee in the appeal.

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