Docket #0149 Date Filed: 7/8/2022

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS

In re: TELEXFREE, LLC, TELEXFREE, INC. and TELEXFREE FINANCIAL, INC., Reorganized Debtors.	Chapter 11 Cases 14-40987-EDK 14-40988-EDK 14-40989-EDK Substantively Consolidated
STEPHEN B. DARR AS HE IS THE TRUSTEE OF THE CHAPTER 11 ESTATES OF EACH OF THE DEBTORS, Plaintiff, v. CARLOS WANZELER, et al., Defendants.	Adversary Proceeding No. 16-04032

TRUSTEE'S SUPPLEMENTAL MEMORANDUM IN OPPOSITION TO MOTION OF FABIO FARIA TO DISMISS

INTRODUCTION

Plaintiff Stephen Darr, as the duly appointed liquidating trustee (the "Trustee" or "Plaintiff") of the substantively consolidated, reorganized debtors TelexFree, Inc., TelexFree, LLC, and TelexFree Financial, Inc. (collectively, the "Debtors" or "TelexFree"), respectfully files this Reply to the *Supplemental Brief in Support of Defendant Fabio Faria's Motion to Dismiss* ("Faria Brief"). In summary:

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(i) The Trustee's claims against Faria are not subject to the heightened fraud standards of Rule 9 of the Federal Rules of Civil Procedure ("FRCP") and are adequately pled;

(ii) The TelexFree credits, while inherently having no value, were capable of being monetized and exploited during the existence of the scheme, and Faria's apparent large receipt of credits without payment is indicative of his special role within the TelexFree scheme;

(iii) The claims against Faria in the instant action are inherently distinct from the claims arising out of the net winner class action, and therefore the bar against duplicative litigation is inapplicable.

STANDARD OF REVIEW

In deciding a motion to dismiss under FRCP 12(b)(6), made applicable by Fed. R. Bankr. P. ("FRBP") 7012, a court must review the complaint and the documents attached to it to determine if the complaint contains "sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (*quoting Bell Atlantic v. Twombly*, 550 U.S. 544, 570 (2007)); *Rederford v. U.S. Airways, Inc.*, 589 F.3d 30, 35 (1st Cir. 2009). Accordingly, while the complaint must include more than a rote recital of the elements of a cause of action; it need only include "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.*

ARGUMENT

FRCP 9(b) IS NOT APPLICABLE TO THE CLAIMS AGAINST FARIA. EVEN IF SUCH RULE WERE APPLICABLE, IT HAS BEEN SATISFIED BY THE TRUSTEE.

Faria's motion is premised on the argument that the claim against him rests on an allegation that he engaged in fraudulent conduct and therefore is subject to the heightened standard of pleading set forth in FRCP 9(b), incorporated by Federal Rule of Bankruptcy Procedure 7009. This assumption misconstrues the claim asserted against Faria in the complaint and the law applicable to it. This Circuit has determined that Rule 9 (b) requires a party to plead

claims alleging fraud with particularity, only when the claim is alleging **actual fraud**. *N. Am. Catholic Educ. Programming Found., Inc. v. Cardinale*, 567 F.3d 8, 15 (1st Cir. 2009).

The only claim asserted against Faria is set forth in Count Eleven for aiding and abetting the TelexFree Principals in breaches of their fiduciary duty. While the Trustee has asserted numerous claims against the Principals for breaches of fiduciary duty, only Count Two asserts the Principals engaged in actual fraudulent conduct. Count Two asserts the Principals transferred assets with the actual intent to hinder, delay creditors subject to the heightened pleading standards of Rule 9(b). *N. Am. Catholic Educ. Programming Found., Inc. v. Cardinale*, 567 F.3d 8, 15 (1st Cir. 2009). Claims of constructive fraudulent transfer do not involve allegations of actual intent to defraud; therefore, Rule 9(b) is not applicable. *See Picard v. Cohmad Securities Corp. (In re Bernard L. Madoff Inv. Secs. LLC*), 454 B.R. 317 (Bankr. S.D.N.Y. 2011).

To the extent Count II is subject to Rule 9(b)'s heightened standard, the Trustee has satisfied that standard. TelexFree has been found to have engaged in a Ponzi scheme [Case No. 14-40987, docket no. 654]. As a result, there is a presumption that payments made in furtherance of the scheme are made with actual intent to defraud. *See Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 531 B.R. 439, 471 (Bankr. S.D.N.Y. 2015).[1] The Ponzi presumption satisfies the Rule 9(b) requirement of particularity, and there is no need for further factual allegations.

The remaining counts against the Principals are based on allegations of constructive fraudulent conduct, or breaches of fiduciary duty to TelexFree. As such, these claims are not subject to the heightened pleading standards of Rule 9(b). *See Miller v. Greenwich Capital Fin.*

[1] The Trustee does not intend to pursue Count III, which is a claim for recovery of preferential transfers.

Prods (In re Am. Bus. Fin. Servs.), 361 B.R. 747, 757 (Bankr. D. Del. 2007) (pleading requirements of Rule 9(b) do not generally apply to state law claims for breach of fiduciary duty and aiding and abetting breach of fiduciary duty claims).

Thus, the foregoing claims asserted by the Trustee against the Principals, except for Count Two, are exempt from the heightened pleading requirements of Rule 9(b) and the Trustee has met his burden as to Count Two. Accordingly, claims against Faria for aiding and abetting the TelexFree Principals is similarly outside of the reach of Rule 9(b).

Moreover, to the extent that Rule 9(b) has any applicability, "strict application of Rule 9(b) may be relaxed in certain circumstances." *United Air Lines, Inc. v. Gregory*, 716 F. Supp. 2d 79, 86 (D. Mass. 2010) ("For example, when the underlying facts are 'peculiarly within the defendants' control,' less specificity may be required pending discovery." (*quoting U.S. ex rel. Franklin v. Parke–Davis, Div. of Warner–Lambert Co.*, 147 F. Supp. 2d 39, 47 (D. Mass. 2001). Bankruptcy courts have applied a relaxed Rule 9(b) pleading standard "for bankruptcy trustees bringing claims of fraud on behalf of the debtor and its creditors." *In re: Liberty State Benefits of Delaware, Inc.*, 541 B.R. 219, 233 (Bankr. D. Del. 2015) (and cases cited). "The policy justification for reducing the burden is that as a third party outsider, a trustee must rely on secondhand knowledge for the benefit of the estate and all of its creditors." *Id*. (internal citations and quotations omitted).

FARIA'S RECEIPT OF NEARLY $1,000,000 IN MANUAL CREDITS SUPPORTS THE CLAIMS AGAINST HIM IN THIS CASE.

The credits issued by TelexFree during the implementation of the Ponzi scheme had no inherent value after the scheme collapsed. However, while the scheme was operating, the credits had value to participants, who could and did monetize for substantial dollars. During the life of the scheme, credits that were "earned" by Participants could be monetized by either redeeming

them for cash or using them to satisfy the invoice of a new Participant recruited through a Triangular Transaction. In addition, there was a market for credits, and participants could sell credits to another participant for cash. In each of these instances, the credit had real, tangible value. The Trustee and his advisors reviewed the records of TelexFree and determined credits were "manually" issued to a very limited and select group of individuals. These credits were not "earned" through advertising or commissions but, rather, were simply issued by TelexFree to a very select group of individuals through a manual computer entry. The Trustee then isolated the individuals who: (i) received a large amount of manual credits; (ii) for which the TelexFree books and records provided no evidence of payment and determined the recipients were related to the Principals or had a close relationship to the Principals. Once the manual credits were issued, they were freely tradeable and could be sold to other Participants, used in triangle transactions, or redeemed for cash. Clearly, these manual credits were a means for the Principals to profit from the scheme and transfer money paid into the scheme to themselves and their family and close associates, such as Faria. As noted, this was a very selective group of individuals who received the earned credits. The Trustee estimates that approximately 20 Participants out of up to 1,000,000 individuals investing in the TelexFree program received manual credits. Faria was one of these 20 individuals. It is reasonable to infer from these circumstances that Faria had a special relationship with the Principals, and he was part of this very small, select group of individuals who aided and abetted the Principals in defrauding the hundreds of thousands of individuals who were net losers as a result of their participation in the TelexFree Ponzi scheme.

The trustee has met his obligation to state a claim for relief that is plausible on its face, and the motion should be denied. *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (*quoting Bell*

Atlantic v. Twombly, 550 U.S. 544, 570 (2007)); *Rederford v. U.S. Airways, Inc.*, 589 F.3d 30, 35 (1st Cir. 2009)

THE BAR AGAINST DUPLICATIVE LITIGATION IS INAPPLICABLE.

The mere existence of two separate adversary proceedings in which Faria is a defendant does not create cause for dismissal of one of the actions. An action is not rendered moot by the mere existence of an action pending against the party. *ConnectU, LLC v. Zuckerberg*, 522 F.3d 82, 89 (1st Cir. 2008). Before determining that litigation is duplicative, the Court must establish that the two actions are "materially on all fours", that is, whether the doctrine of *res judicata* would preclude the second litigation based upon a judgment in the first litigation. *See Cong. Credit Corp. v. AJC Int'l, Inc*., 42. F.3d 686, 689 (1st Cir. 1994); *Elliott-Lewise v. Abbott Labs*, 378 F. Supp. 3d 67, 70 (D. Mass. 2019); *Cherelli v. Instore Group, LLC*, 513 F. Supp. 3d 187 (D. Mass. 2021). If litigation is found to be duplicative, the Court can dismiss the later-filed action, stay the action, or consolidate both actions. *Id*. at 193.

The initial action to which Faria refers is the defendant class actions commenced by the Trustee against the domestic net winners (Adv. Proc. No. 16-4006) and foreign net winners (Adv. Proc. No. 16-4007) in the TelexFree Ponzi scheme (the "Class Actions"). In addition to aiding and abetting the Principals to extract money from TelexFree, Faria benefited directly from his participation in the scheme and is a net winner. As a net winner, he is within the group of individuals who make up the members in the Defendant Class Actions. The nature of a defendant class action (as with any class action) is that the named parties are representative of a much larger class of individuals who share common facts and legal issues. As such, it is not necessary to have named Faria as a defendant to make him a party to the defendant class action. Once the Court determines the class issues, the Trustee can then pursue and recover from the

individuals who are determined to be members of the defendant class, whether named as a class representative or not. Faria's presumption to the contrary (see Faria Brief, at p. 12) is just wrong.

The Class Actions concern claims against putative defendants consisting of Participants who received more from the Ponzi scheme than they invested and are net winners. The claim against Faria in the Class Actions is essentially one of fraudulent transfer. Because TelexFree has been found to be a Ponzi scheme, the Court may presume that: (i) TelexFree was insolvent at all applicable times; and (ii) that TelexFree intended to engage with actual intent in fraudulent transfers as to net winners. *See Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec., LLC*, 603 B.R. 682, 688 (Bankr. S.D.N.Y. 2019); *Klein v. Michelle Tuprin & Assoc., P.C.*, 2016 U.S. Dist. LEXIS 86954 at *18 (D. Utah 2016). The only genuine issue of material fact in the Class Actions is whether Faria, and the other putative defendants, were net winners.

The claims against Faria in the instant action are entirely separate from the Class Actions involving claims for having aided and abetted TelexFree's Principals in the commission of various fraudulent transfers, breaches of fiduciary duties, and conspiracy. To establish these claims, the Trustee needs to demonstrate that Faria provided substantive assistance or encouragement to the Principals in the commission of their improper acts with knowledge that the Principals were breaching a duty and with intent to assist those actions. *Mansor v. JPMorgan Chase Bank, N.A.*, No. CV 12-10544-JGD, 2016 WL 1676482, at *8 (D. Mass. Apr. 26, 2016) Such claims are distinct from the Class Actions and, in fact, could not have been brought in the earlier filed Class Actions as the Trustee could not maintain these same claims against all class defendants. Although all of the defendants in the Class Actions are alleged to be

net winners, most are not subject to additional claims such as those asserted against Faria in this action.

Regardless of whether Faria can demonstrate that his receipt of nearly $1,000,000 in credits under unusual circumstances did not aid and abet the Principals in their implementation of the scheme, the claims against Faria in the Class Actions involve a separate set of facts and separate legal standards. Because the facts essential to this action need not be present in the Class Actions, and because the same proof is not required to support the claims in both cases, *res judicata* does not apply and the bar against duplicative litigation is not applicable. *Curtis v. Citibank, NA.* 226 F.3d 133 (2nd Cir. 2000). The Trustee's claims against Faria in the Class Action are unaffected by the instant case.

CONCLUSION

For the foregoing reasons, Plaintiff respectfully requests that the Court deny Defendant Faria's motion to dismiss in its entirety.

Respectfully submitted,
STEPHEN DARR, LIQUIDATING TRUSTEE,
By his attorneys,

/s/ Andrew G. Lizotte

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CERTIFICATE OF SERVICE

I, Andrew G. Lizotte, hereby certify that on July 8, 2022, I caused a copy of the foregoing document to be served electronically through the Court's ECF System upon the registered participants as identified on the Notice of Electronic Filing.

/s/ Andrew G. Lizotte
Andrew G. Lizotte

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