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UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

UNITED STATES OF AMERICA	]	
	]	No. 14-CR-40028-TSH
v.	]	
	]	
JAMES MERRILL	]	

GOVERNMENT'S TRIAL MEMORANDUM

The government hereby submits this trial memorandum to address certain issues that may arise at trial in this case.

INTRODUCTION

Between February 2012 and April 2014, James Merrill and Carlos Wanzeler, under the guise of a company providing phone service, ran a massive pyramid scheme that roped in about a million people worldwide and caused about a billion dollars in losses. That company, called TelexFree, paid participants a yearly return of over 200% without requiring them to sell anything. All they had to do was (a) pay TelexFree $1425 and then (b) spend a few minutes cutting and pasting tiny classified ads to a handful of web sites every day. The company paid participants to recruit others too, but never required significant sales of an actual product. Unsurprisingly, TelexFree collapsed; by April 2014 it owed its participants about $5,000,000,000.

So the issues for trial are essentially twofold: first, the government intends to prove that TelexFree was a Ponzi and pyramid scheme. Second, the government intends to prove that Merrill knew this almost from the beginning, and yet continued to actively promote the company and profited from its illegal proceeds.

At this point the government anticipates calling about 27 witnesses, and that trial should last three to four weeks.

FACTUAL BACKGROUND

I. Introduction

TelexFree, Inc., until its demise in April 2014, offered a product called "99TelexFree" that enabled customers to make unlimited phone calls using Voice over IP technology ("VOIP) for a monthly rate of $49.90. TelexFree, however, did not simply offer a phone service for retail sale.

TelexFree was a "network marketing company"[1] that offered its participants something more: according to James Merrill, the "opportunity of a lifetime"; according to co-defendant Carlos Wanzeler, a way to "change your life"; and, again according to Merrill, a chance to be part of something that Fortune 500 corporations (that "squeeze employees until there's nothing left") feared – "strength in numbers that network marketing produces."

TelexFree hosted events around the world, called "extravaganzas," to drum up interest in the company and reinforce to thousands of participants that TelexFree could change their lives and make them millionaires in a matter of months. Through a network of early, top promoters, in steady coordination with TelexFree's corporate officers, TelexFree promoted the company over social media and YouTube instructional/promotional videos. TelexFree targeted and marketed to members of the Brazilian and Latin America immigrant communities in Massachusetts, the United States, and around the world.

By the end, about 2,000,000 people around the world signed up to become promoters for TelexFree.[2] Between about February 2012 and April 2014, TelexFree participants bought about 6,500,000 promoter accounts with the company. But from its beginning, TelexFree was a fundamentally fraudulent business. Claiming to sell a retail product, TelexFree offered a complex, jargon-filled compensation plan that transformed the entire enterprise into a pyramid scheme and a Ponzi scheme (depending on which part of the compensation plan a participant used). And, like all such schemes, it collapsed.

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[1] Also called a "multi-level marketing company." Generically speaking, such companies rely on participants who sign up, receive training and product, and then tout and resell the product to acquaintances, who may also sign up to sell it themselves.

[2] About 930,000 people signed up with TelexFree in the United States. However, between both Ympactus/TelexFree in Brazil and TelexFree in the United States, the total number was about 2,000,000.

II. TelexFree in the United States

Before TelexFree, James Merrill and Carlos Wanzeler had worked together since about 1988. In about 2002, Merrill and Wanzeler joined their first network marketing business together, Common Cents Communications, Inc.[3] Through this business, the men were agents for a now-defunct telecom company called WorldxChange.

By the mid to late-2000's, Merrill and Wanzeler had started another company, called Diskavontade (also called Brazilian Help, Inc.).[4] Instead of acting as agents for WorldxChange, Merrill and Wanzeler bought their own telecom/VoIP switches and technology from a company in Washington State called Logitel Corporation. Diskavontade was a network marketing company that recruited agents for the company and marketed its VoIP product to the Brazilian community in Massachusetts over local television commercials. Diskavontade maintained an office in Shrewsbury but later moved to what became TelexFree's headquarters at 225 Cedar Street, Marlborough, Massachusetts.

Merrill and Wanzeler's next business venture, TelexFree, was formed in February 2012, when Common Cents Communications changed its name. TelexFree then opened bank accounts in Massachusetts and set up a website accessible anywhere in the world, www.telexfree.com.

III. TelexFree in Brazil

The idea for TelexFree actually originated in Brazil with a man named Carlos Roberto Costa ("Costa"). In 2010, Costa established a company called Ympactus Comercial Ltda ("Ympactus"), in the Brazilian state of Acre, to sell cosmetics, perfume and personal hygiene

[3] Common Cents Communication, Inc. was incorporated in Massachusetts in December 2002.

[4] Brazilian Help Inc., was incorporated in Massachusetts in October 2007. There are no corporate filings for any legal entity in Massachusetts or the United States called Diskavontade.

products. Costa, a friend of Wanzeler, was well-known in the world of network marketing in Brazil. Costa came to Merrill and Wanzeler with the idea of marrying Costa's network marketing strategy with TelexFree's VoIP product, and a partnership was formed.[5] By later in 2012, the relationship became more official: Merrill and Wanzeler became part owners in Ympactus (Merrill 20 percent, Wanzeler 30 percent, Costa 50 percent), and Ympactus signed a licensing agreement to market and promote TelexFree in Brazil.[6] While residing in Brazil, Costa also became a part owner of TelexFree in the United States[7] though he did not speak English and spoke mostly with Wanzeler.

Ympactus in Brazil and TelexFree in Massachusetts, though separate on paper as corporate entities, were both TelexFree – they both marketed the same compensation plan, and the same product, from the same web site, backed by the same set of servers. The only difference was that customers of TelexFree in Brazil paid the company in local currency (Brazilian Reals) while everyone else outside Brazil paid TelexFree in U.S. dollars, a difference tracked and reflected in TelexFree's business data.

During the charged wire fraud conspiracy, Merrill received substantial compensation from Ympactus/TelexFree in Brazil. Based on bank records from Brazil and the United States, in February 2013, the equivalent of about $1,500,000 was transferred from an Ymapactus account in

[5] Merrill, under oath, described the beginnings of TelexFree as follows: "In 2012, Carlos Wanzeler had a friend that was very well known in the network marketing business which was Carlos Costa, came to us with the idea to marry this advertising marketing program that he wanted to develop to our existing $49.90 unlimited plan and that's how Telexfree evolved." *Testimony of James Merrill, Massachusetts Securities Division*, 3/25/2014 ("Merrill MSD Testimony"), at 47; 65.

[6] *See* Merrill MSD Testimony at 171; GEX 133 (amendment to Ympactus Articles of Incorporation); GEX 129 (licensing agreement).

[7] During his MSD testimony, Merrill said that Costa was member of TelexFree LLC from August 2012 until sometime in 2013, when he left due to "legal reason on his part." Merrill MSD Testimony at 34-35; 40.

Brazil to an account held by Wanzeler in that country. The funds were then transferred from that account to an account belonging to Wanzeler in the United States. From there, on February 4, 2013, Wanzeler wrote a check to Merrill from that account, for $865,000. The memo line read, "$1,000,000 x 13.5% taxes" (that is, the $865,000 was $1,000,000 net of taxes due). Merrill then deposited the check into his personal account at Bank of America. Similarly, on or about June 11, 2013, Wanzeler wrote Merrill another check for $290,000. The memo line for that check said, "Cash 50.00 + 290 = 340" indicating that there was a further payment of $50,000 to Merrill from Wanzeler.

IV. Merrill's Position at TelexFree

Merrill was the president of TelexFree in the United States and a 50 percent co-owner of the company with co-defendant Carlos Wanzeler.[8] But his role was not quite as dry as the term "corporate president" might imply. TelexFree's public events – in Newport Beach, California; Orlando, Florida; Brazil; and Boston, Massachusetts – were arranged to generate excitement and to present Merrill to TelexFree's predominantly working class Latin American victims as a minor celebrity; a competent and experienced American businessman with serious credentials. At the Orlando conference in November 2013, TelexFree's "international marketing director" introduced Merrill to the crowd to the song "Eye of Tiger" (from the *Rocky* soundtrack).[9] A DVD TelexFree made available from its website for another event featured staged images of Merrill approaching a cruise ship with crowds running to greet him.[10]

[8] While there were several related corporate entities, *i.e.*, TelexFree, Inc., incorporated in Massachusetts, TelexFree LLC, in Nevada, TelexFree Financial in Florida, and TelexFree International, in Grand Cayman, TelexFree operated as a single business.

[9] *See* YouTube File "Extravaganza USA 2013 – James Merrill – President TelexFree."

[10] A preview of the video was featured on YouTube. *See* 1ª Convencion Internacional TelexFREE 1º DIA*, File No. n1r9SO-oBo4

By July 2012, the TelexFree website featured a photograph of Merrill and invited visitors to "Meet the founder and president of TelexFREE ads and technology, Mr. James Merrill." Clicking Merrill's photograph led visitors to a biography of Merrill which claimed that Merrill earned a degree in Economics from Westfield State University (which was false) and described Merrill as a "Man of great vision." The page included photographs of Merrill standing in front of a bright red Hummer (which he did not own, but which had the byline, "Arriving at the company for one more day of work"); and Merrill standing in front of the office building at 225 Cedar Street in Marlborough, presented as "the headquarters of Telexfree in the U.S" (even though TelexFree leased only a small portion of the building).

Merrill ran TelexFree on a daily basis. He handled "most of the admin and vendor relations and product development."[11] In an earlier filing with the Alabama Public Service Commission, Merrill said he was responsible for TelexFree's "technology platforms, the day-to-day operations, excluding sales and marketing, and for the company's ongoing profitability."[12]

While Merrill also later claimed to have little knowledge and a limited role in TelexFree's compensation plan,[13] he was in fact intimately involved in reviewing and developing it. Merrill also edited the PowerPoint presentations maintained on TelexFree's site that explained TelexFree's compensation plan and were intended for use by its promoters for recruiting purposes.

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[11] Merrill MSD Testimony at 28.

[12] GEX 1 (State of Alabama, Public Service Commission Filing).

[13] *See, e.g.*, Merrill MSD Testimony at 44 ("But that was a few years ago and I don't recall the compensation plan. I'm not ever really involved in the compensation plans."); 79 ("Direct, cycle, uni-level – again, guys, I'm sorry, but not my strong point.").

Based on advice from TelexFree's lawyers, from the very beginning Merrill was keenly aware that the compensation plan was not only fatally flawed, but illegal.

Merrill also opened and maintained the bank accounts for TelexFree. TelexFree needed U.S. financial institutions and third-party payment processors to facilitate the flow of U.S. dollars to TelexFree to fund its operations and pay commissions and bonuses to an ever growing number of participants. Merrill opened each of the bank accounts and signed each of the business contracts on behalf of the company, and did this repeatedly over a two-year period, as banks regularly forcibly closed TelexFree's accounts for fear that TelexFree was involved in money laundering or other illegal activity.

V. TelexFree's Compensation Plan

TelexFree advertised two methods of compensation: getting paid for posting classified ads on the Internet every day for a week, and getting paid for recruiting other people to join TelexFree. The first method required no product sales. The second method required a single product sale, a feat promoters routinely accomplished by simply selling a VOIP package to themselves and then never using it.

A. The Ad Posting Ponzi Scheme

TelexFree purported to be a company about "Advertising and Technology."[14] But TelexFree simply paid its participants to post classified ads on the internet. In a meaningless and repetitive task, TelexFree participants copied pre-made ads from TelexFree's website and pasted them to various free classified advertising sites, the addresses for which were provided by

[14] These words were typically featured on TelexFree's website and business presentations. One of the top promoters for TelexFree, in a presentation posted on YouTube, described TelexFree thus: "You know, the company is called TelexFree, they're an advertising and technology company, they're headquartered right here inside the United States. The founder and president of TelexFREE is Mr. James Merrill." GEX 388 (English Business Presentation Video).

TelexFree. Each ad site contained, literally, thousands of identical ads spanning hundreds of pages. As an undercover HSI agent confirmed when she did it, ad posting took about five minutes.

In the "AdCentral" version of this plan, for $339 ($289 plus a $50 registration fee) a promoter "acquired" a "stock" of 10 VoIP packages to sell and was given an additional plan each week. If a promoter then posted 5 ads a day for 7 consecutive days, but no one actually responded to an ad and bought a VoIP plan, TelexFree would "buy back" the plans for $20 each. That's $1040 a year, a return of over 200%. In the "AdCentral Family" version, for $1,425 ($1,375 plus a $50 registration fee) a promoter acquired a stock of 50 VoIP packages and was given five additional plans a week. If a promoter then posted 5 ads a day for 7 consecutive days, but no one bought any of the promoter's VoIP packages, TelexFree would "buy back" the five plans for $100 ($20 each x five plans). That's $5,200 a year, a return of over 300%.

The promoter was not required to sell a single VoIP package – the company's only product – to get paid. The company openly advertised this fact. For example, in a PowerPoint presentation Merrill offered on the TelexFree site ("See our opportunity presented by our president Mr. James Merrill" (GEX 28)) TelexFree urged potential recruits to

> Earn money in a smart way! Without having to invite anyone, without selling anything in the comfort of your home. Build a great income – weekly – monthly – annual."

GEX 29. The PowerPoint then helpfully did the math on the impressive returns TelexFree was offering, showing charts demonstrating that if you invested $289 you would make $1040 a year ($20 x 52 weeks) and if you invested $1375 you would make $5200 a year ($100 x 52 weeks). *Id*. Later versions of the PowerPoint were a bit more discrete, removing the "make money without selling anything!" slide, but the plan was identical. TelexFree, including Merrill, at times insisted

that the "buy back" provision was a promotional step that could be rescinded at any time, but of course that never happened.

To maximize returns, a substantial majority of promoters bought multiple user accounts. For example, a promoter with two AdCentral Family accounts simply posted ads every day for both accounts, and made $200/week instead of $100. Many promoters maintained hundreds of user accounts. Some had thousands. As Merrill knew, promoters could even pay someone else to post ads for them, and simply collect a return each week.[15]

Unsurprisingly, because promoters had to pay to join, but did not have to sell a product, TelexFree had to compensate its promoters with the revenue generated from buy-in fees (the $339 or $1425) paid by newer promoters. That is, it was a Ponzi scheme. And, unsurprisingly, because hundreds of thousands of promoters joined, many of whom bought multiple plans generating greater returns, TelexFree eventually owed its promoters about $5,000,000,000, while it had about 2% of that amount in the bank.

B. Compensation for Recruiting Others to Sign Up

TelexFree also offered substantial rewards for recruiting others to join TelexFree. For example, for each new recruit who bought in at the AdCentral level, the recruiting promoter got a $20 "fast start" bonus. If the recruit bought in at the AdCentral Family level, the bonus was $100. The bonuses went on from there, including "cycle bonuses" for recruiting new people into the "right" and "left" sides of the promoter's "down line" (picture a growing pyramid) and "team builder" bonuses for recruiting ten people within a certain period. Of course, because nothing

[15] For example, in an email on October 1, 2013, Merrill acknowledged that promoters were having others post ads for them, noting that promoters were earning money doing "a little bit of ad placement work (they don't even do it they have a company do it for them)." GEX 163.

stopped one promoter from having more than one account, promoters would buy an AdCentral or AdCentral Family account and then recruit themselves by buying additional accounts with slightly different names. Combined with the weekly returns from ad posting and other recruitment incentives, it was quite an opportunity.

Promoters could also, of course, make a commission for actually selling the VoIP product. But TelexFree's own transactional data shows that this was a farce. First, to be allowed to collect recruitment bonuses, a promoter needed to have sold at least one VoIP plan in a given month, a task accomplished by simply selling it to himself under a slightly different name. The promoter would then get a *90%* commission on the sale (to himself). Of the – literally – millions of VoIP plans TelexFree "sold" this way in a two-year period, only about 3% of the plans were ever used to make calls. Of the millions of dollars of bonuses and commissions promoters earned from TelexFree in that period, about 4% was earned from selling VoIP; the other 96% was from ad-posting and recruiting. TelexFree never made a dime from selling VoIP, and neither did its participants.

C. The Back Office Credits System

TelexFree participants were not automatically paid the bonuses and commissions they accumulated. When each participant signed up, he was given a "back office" page on TelexFree's website, where he could keep track of his ad-posting and recruit efforts. When the participant earned bonuses or commissions, they were added, as "credits," to a running total presented on his back office page.

Once acquired, the participant could cash in the credits (one credit = one dollar) by making a request to TelexFree. The process took about 10 days. But participants did not need to cash out the credits – they could also use them to "buy" additional promoter accounts or VoIP accounts

within the TelexFree system. If, for example, a participant with an AdCentral Family account under the username "Andy1" wanted an additional account, he simply waited until he accumulated more than 1425 credits from posting ads weekly, and then used those credits to "buy" a second AdCentral account under username "Andy2." TelexFree would invoice the participant for the second account, and the participant would "pay" that invoice with credits, after which TelexFree would subtract the credits from the participant's back office page. The pernicious result of this system is that it encouraged participants not to withdraw their money from TelexFree, but instead to leave their money "in the system" and keep rolling it over to buy more accounts.

Participants could "buy" VoIP with credits as well, which led to the exponential growth of phantom revenue in the TelexFree system. If a participant used his own credits to buy a VoIP plan, he would "pay" about 50 credits for a month (the plan cost $49.90), meaning TelexFree would subtract 50 credits from the participant's back office page. But, as noted, participants were paid a 90% commission on all VoIP sales, so the participant would then get about 45 credits *back* from TelexFree. Moreover, the participant who recruited this participant, and additional participants farther up the chain, would all get commissions from TelexFree on this downstream VoIP "sale." This resulted in two things: first, that TelexFree's return on each sale – after paying commissions and whatever the cost was of providing the VoIP service – was infinitesimal and, second, that this infinitesimal return was in the form of "credits" TelexFree took back from the promoter. That is, it wasn't in *dollars* – TelexFree received no actual money from these transactions. Meanwhile, ignoring all of these problems, TelexFree listed each of these transactions as a "sale" of VoIP, and booked $49.90 in revenue from each one, resulting in some

impressive, though utterly bogus, revenue figures.[16] Out of the approximately 12,400,000 VoIP plans TelexFree sold, about 98% were purchased with back office credits, not with real money.

Furthermore, when a promoter recruited a new participant into TelexFree, that new participant would often pay cash *to the promoter* ($339 or $1425) – not to TelexFree – after which the promoter would use his accumulated credits to "pay" for the new recruit's AdCentral or AdCentral Family account. So, in many instances, TelexFree received no money even from new recruits joining the company – the *recruiting promoter* got the cash, while all TelexFree got was a reduction in the number of credits it owed that promoter.

As a result of this system, promoters at the top of the pyramid accumulated huge sums of cash, as hundreds of new participants paid them cash to sign up and as promoters even sold credits to each other when they ran low. Cash deposits flooded banks in New England and elsewhere. Top TelexFree promoters coached their members to make deposits in amounts under $10,000 to avoid federal reporting requirements for currency transactions.

D. TelexFree's Transactional Data

TelexFree maintained records of every transaction in every one of its participants' accounts, and of actual phone usage for every VoIP plan. This was accomplished with a network of databases spanning about 46 servers (the "TelexFree Database"). TelexFree employees in Brazil and the United States were able to access the TelexFree Database using a custom-designed web application called "SIG."[17]

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[16] *See, e.g.*, GEX 325 (TelexFree, Inc., profit and loss statement for 2013, as submitted to the MSD, listing $268,930,757.53 in income "paid through system" (that is, with credits).

[17] SIG was an acronym for the Portuguese term "*Sistema de Informação de Gestão,*" which translates as "Management Information System."

The "Diskavontade Database" (named for Merrill and Wanzeler's earlier VoIP company) contained information about the usage of the actual VoIP product, including the total number of individual VoIP packages each account had acquired and the total number of minutes (of phone calls) each VoIP package had used. The total number of minutes each VoIP plan used was automatically copied from a third database, the Logitel Database (also referred to as the "VXT1" database). The Logitel Database contained the actual VoIP technology itself that directed the internet phone calls to maximize speed and efficiency. Over the years, Ryan Mitchell, an engineer, helped Merrill and Wanzeler with the Logitel Database and was compensated based on the actual amount of phone traffic.

A detailed review reveals that, out of the approximately 12,400,000 VoIP plans TelexFree sold, only 402,161 of them were ever used to make phone calls (about 3%). Moreover, a review of TelexFree Database data in conjunction with bank and payment processor records shows that, unsurprisingly, less than 2% of TelexFree's revenue (meaning real money) came from the sale of VoIP plans.

VI. The Warning Signs

A. Early Stages

As early as December 2012, Merrill and Wanzeler knew that if they did not earn revenue from the actual sale of their product (that is, sale to a genuine retail customer who wanted to use the service) they would be in trouble. For example, during a trip to Brazil in December 2012, Ryan Mitchell listened to Merrill and Wanzeler's description of TelexFree's business plan and asked an obvious question: How does a company that takes in $1,425 (from selling an AdCentral Family plan) but then has to pay out $5,200 a year per plan, survive? Where does the money come from?

During a series of emails between December 7 and 9, 2012, Mitchell raised this issue of "customer acquisition cost." Mitchell wrote that he met with Carlos Costa (the president of Ympactus in Brazil) but "still ha[s] concerns about the finances." Mitchell asked how much revenue was coming from the sale of the VoIP and added, "If you can't answer these simple questions . . . everyone is eating BS!" Merrill acknowledged the obvious: "If all the Revenue is from agent start up fees and we pay agents without them acquiring customers, we would be in trouble." This admission comes 16 months before TelexFree's collapse.

By early January 2013, Gerald Nehra, TelexFree's first legal counsel and a specialist in the MLM industry, gave Merrill specific advice on the need for actual product sales.[18] For example, during a series of emails in January 2013, Merrill provided Nehra with a copy of a new PowerPoint for posting on TelexFree's site. Nehra wrote back various suggestions, including that, on slide 11, "we need to say somewhere that this bonus is paid when the enrolled person buy/sells the VoIP service."[19] Merrill resisted this change and acknowledged that there might be "a higher risk of regulatory scrutiny."[20]

By later in January 2013, Nehra began receiving emails from TelexFree promoters in Brazil about allegations that TelexFree in Brazil was "engaged in [an] illegal pyramid scheme or Ponzi scheme" there and that an investigation being conducted in the State of Acre in Brazil. Nehra

[18] Nehra began representing TelexFree in May 2012, but was not fully engaged in providing advice to Merrill and TelexFree until the following year. In an email dated November 15, 2012, Nehra reminded Merrill, "stuff needs to really get bought and sold – it cannot be just the movement of money[.]" In that same series of emails, Merrill acknowledged that product sales "are not going very well at this point."

[19] Nehra Email, 1/7/2013 at 11:08 am, titled "US Presentation translatejm1.pptx."

[20] Nehra Email, 1/10/2013 at 9:00 am, titled "US Presentation translatejm1.pptx."

forwarded the emails to Merrill, who assured Nehra that they had lawyers in Brazil and that, "As far as I know no other problems with that investigation."[21]

Between March 2013 and May 2013, Nehra fielded additional emails from TelexFree participants, this time in the United States, who questioned whether TelexFree was an illegal pyramid and Ponzi scheme. Nehra again forwarded this emails to Merrill and discussed with Merrill, in detail, the critical issue of ensuring that the company has "real customers" to prevent TelexFree from promoting a "money game."[22] In May 2013, Nehra received a complaint from a Florida resident who compared TelexFree to a company the U.S. Securities and Exchange Commission ("SEC") sued in August 2012 called "Zeek Rewards."[23] Nehra forwarded the email to Merrill and wrote, "I am on board to defend a program that sells long distance to customers. . . no mention of that below." In June 2013, Nehra forwarded yet another complaint that TelexFree was operating as an illegal Ponzi/pyramid scheme. In the email Nehra asked Merrill, "Continued payment of commissions requires customer sales – does it not?" Merrill responded by saying (despite all mounting evidence to the contrary) that the "incentive to sell [the TelexFree product] was "strong."[24]

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[21] Nehra Email, 1/16/2013 at 5:53 pm, titled "INFORMATIONS."

[22] Nehra Email, 3/18/2013 at 12:12 pm, titled "20% buy back in TelexFree inventory." In that same exchange, Nehra explained to Merrill, "Here is why having non-Associate customers [meaning arms-length retail customers buying the product] is so important. If the only people who buy your customer product are your own Associates – the regulators say or presume – since you have no 'real' customers – what you are selling is not a real consumer product, but a fee you charge Associates to play the money game and to recruit more into the program."

[23] Paul Burks, the former president of Zeeks Rewards, was indicted in the Western District of North Carolina and charged with running an illegal ponzi scheme (No. 3:14-cr-208). He was convicted at trial in July 2016.

[24] Nehra Email, 6/10/2013 at 7:46 pm.

B. The Brazil Injunction

On April 8, 2013, TelexFree received an investigation letter from the Massachusetts Securities Division ("MSD"). In the letter, dated April 4, 2013, the MSD explained that it was "conducting an inquiry into TelexFree, Inc.'s . . . business operations in the Commonwealth of Massachusetts." As part of the inquiry, the MSD requested documents including profit and loss statements and balance sheets for the past year.

Shortly thereafter, in June 2013, a court enjoined TelexFree's operations in Brazil (having concluded that TelexFree was a pyramid scheme) and froze more than $300 million in Ympactus accounts. TelexFree's marketing director in the United States was flooded with phone calls about the Brazilian shut down of TelexFree and its potential impact on TelexFree in the United States. As a result, the marketing director hosted an internet conference call for TelexFree promoters, with Wanzeler and Merrill, to answer those questions. The call was later posted on YouTube. During the call, Wanzeler assured the audience that they had talked to their lawyers in Brazil and "I'm sure 99% we can fix this problem today and tomorrow." Wanzeler further added that it was not going to affect TelexFree operations in the United States. Merrill then seconded Wanzeler, assuring listeners that "what Carlos said is very true . . . things will work itself out in Brazil" and "it does not affect the U.S. market."[25]

C. The Newport Conference

Shortly after Brazilian authorities shut down TelexFree in Brazil, TelexFree pivoted and focused on the United States. On July 26-27, 2013, TelexFree hosted its first corporate event in Newport Beach, California. The featured speakers at the conference included Merrill and Wanzeler, as well as Gerald Nehra; it was Merrill who asked Nehra to speak at the conference,

[25] GEX 373 (YouTube Video, File Z2vdJYJX6s8, posted June 20, 2013).

and Nehra did so on the understanding that TelexFree would be making changes to its compensation plan to make it more compliant with the law.

Specifically, Merrill told Nehra that they were going to change the "buy-back" provision of the compensation plan, the provision that allowed AdCentral and AdCentral Family account holders to make $1040 or $5200 a year, respectively per account owned. Merrill told Nehra that they would cap the buy back commissions at the amount the promoter had paid into TelexFree, so, *e.g.*, if a promoter had bought an AdCentral Family plan for $1425, then he could only make $1425 selling VoIP back to TelexFree, thus removing the profit incentive. The change would also mean that TelexFree would no longer pay out more money that it was bringing in for ad posting.

In advance of his talk, Nehra also had some questions about the numbers of customers that TelexFree had. Merrill, in turn, tasked two people (Ryan Mitchell and Jay Borromei) to look at the Diskavonatade database and report those numbers. During a series of emails between July 23 and 30, 2013, Mitchell gave Merrill (and in turn, Nehra) detailed numbers regarding actual phone calls,[26] but as far the number of actual customers, Merrill indicated that, "The customers is more complicated it is an ongoing IT issue." In a July 26, 2013 email, Nehra repeated the request, and asked Merrill to assure him that "[t]he company bottom line comes PRIMARILY from services being sold and consumed by end users and the commissions paid out to reps comes PRIMARILY from services being sold and consumed by end users and that the end user consumers are NOT all reps."[27]

[26] In an email dated July 30, 2013, at 11:12 pm, Mitchell indicated that there were 75,739 accounts that had made at least one phone call in the past three months, but indicated that he was unable to tell if these were free accounts or active accounts (TelexFree gave new participants 60 minutes free on their VoIP system).

[27] Nehra Email, 7/26/2013 at 7:36 am, titled "California event."

On July 10, 2013, still a few weeks before the conference, Merrill followed up on the issue of altering the buy-back provision, in an email to Nehra, Wanzeler and Costa in which he said, "The only change we would like to make is that associates will only be able to sell back the account up to the point that they have recouped what they have paid for that Package or roughly that amount."[28] But the change was never made. Later on in 2014, long after the Newport conference, Merrill told Nehra that the wanted to make the change but had been "outvoted."

During the Newport conference, Merrill spoke to the crowd about the strong "brothership" he had with Wanzeler, and said they had been in business together since 1988. Merrill then made his pitch for TelexFree. He talked about how corporations and Fortune 500 companies "squeeze the employees until there's nothing left," and told the crowd that corporations feared the power of network marketing: "They fear the strength in numbers that network marketing produces. They fear the freedom that we all share here in the business." At the end, Merrill told them TelexFree was getting ready for "Stage Two" and said, "God bless you, stay with us, we're ready to take on those corporations."

Following Merrill's presentation, Wanzeler took the stage and addressed TelexFree's Brazilian legal problems by invoking religious belief and telling the crowd, "Trust in God, and trust the law . . . it'll open up again. We very close to this get fixed." Wanzeler then talked about how the Brazilian injunction had hurt a million people in Brazil, offered to say a few words in Portuguese to all those people, paused, and broke down crying. Merrill stood by his side and comforted him. Wanzeler's tears brought the crowd to its feet in a standing ovation.

Nehra, as agreed, spoke at the conference. During his talk, Nehra told the crowd that they "are in the right place." Nehra's apparent legal blessings were predicated on Merrill's assurances

[28] Nehra Email, 7/10/2013 at 10:33 am, titled "New Buy Back Clause."

that TelexFree could change the buy-back provision: Nehra told the crowd, "you are on very solid legal ground," an assessment based on the fact that, "from what I've heard from Jim and Carlos in the implementation phase, and Jim and Carlos have promised me that they are going to follow my guidance . . ." Nehra also expressly ducked a question from the crowd about the Brazilian injunction, telling the crowd that he was "the MLM specialist attorney for TelexFree in the U.S. only," and reminding them that "I should not be used as marketing tool[.]"

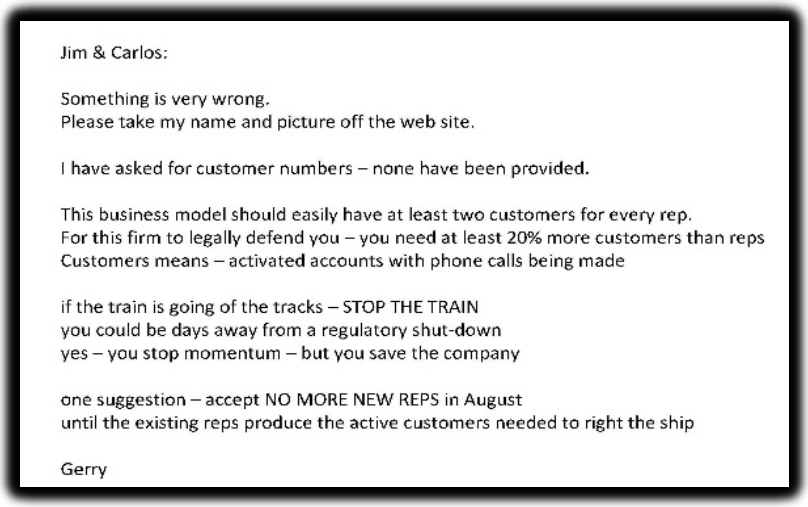
But Merrill did use Nehra as marketing tool. In an earlier email dated January 9, 2013, Merrill discussed with Ryan Mitchell bringing on board someone with MLM experience as a way to "leverage his . . . knowledge as Marketing tool [sic]. Just like we did with Gerry Nehra. Gerry gives our agent comfort that our business model is legally sound. We used his Bio on our Website."[29] Nehra's biographic information was indeed prominently displayed on the website, under "Legal Department."[30]

Following the Newport Beach conference, Nehra was deluged with emails and questions about whether TelexFree was an illegal pyramid and/or Ponzi scheme. The emails provided a clear picture of what was actually going on. Individuals were investing huge sums of money into TelexFree. For example, on July 29, 2013, Nehra received an email from a promoter who invested $12,000. Nehra forwarded the email to Merrill and asked, "How does someone put $12,000 in? not what I approved . . . if the train is about to go off the tracks . . . put the brakes on – now . . . this firm can only defend a business model that sell a service to customers that are using the service . . . I strongly recommend you track and post on your web site – Your ACTIVE customer activity."

[29] Mitchell Email, 1/9/2013 at 11:24 am.

[30] GEX 44 (Nehra biography page from Telexfree site).

Days later, on July 30, 2013, Nehra forwarded another email to Merrill about another inquiry into the legality of TelexFree, with the following warning:



Jim & Carlos:

Something is very wrong.
Please take my name and picture off the web site.

I have asked for customer numbers – none have been provided.

This business model should easily have at least two customers for every rep.
For this firm to legally defend you – you need at least 20% more customers than reps
Customers means – activated accounts with phone calls being made

if the train is going of the tracks – STOP THE TRAIN
you could be days away from a regulatory shut-down
yes – you stop momentum – but you save the company

one suggestion – accept NO MORE NEW REPS in August
until the existing reps produce the active customers needed to right the ship

Gerry

Days later, in an email response on July 31, 2013, Merrill suggested that the email Nehra forwarded was from a "competitor," and said, "We do have plenty of customers and we are making the changes to increase qualifications. Is our reporting inefficient yes but we do have customers."[31]

D. The Banks

Meanwhile, over time, Merrill opened and maintained most of TelexFree's bank accounts. As Merrill knew, finding a financial institution willing to hold millions of dollars of promoter contributions was a problem. TelexFree needed bank accounts to hold new money from new promoters, which it then used to pay commissions and bonuses to earlier investors. For those promoters directly depositing to TelexFree's accounts, the information about what account to use

[31] Nehra Email, 7/31/2013 at 9:14 am, titled "telex free account."

was typically posted on TelexFree's website.[32] The banks, however, repeatedly shut down TelexFree's accounts, which could have disrupted the flow of money.

While Merrill claimed to have been "very upfront" with the banks about TelexFree's business, bank employees take a different view. For example, on June 6, 2013, Merrill met with an assistant manager at a TD Branch in Worcester, and became uncomfortable when he saw a video camera on her desk. Merrill asked why the camera was there, angled his body away from the camera, and moved a placard on Brown's desk to obstruct the camera's view of Merrill. Uncomfortable with Merrill's vague descriptions of TelexFree's business, TD Bank directed the branch manager to follow up with Merrill. After weeks of trying to track Merrill down, he finally met with Merrill in October 2013. Merrill described the TelexFree business model to Dos Santos, but failed to mention anything about the ad-posting aspects of TelexFree's compensation plan. Soon after, TD Bank told Merrill the bank was closing TelexFree's account.

TelexFree fraudulently presented the closure of its bank accounts as a positive sign. On August 8, 2013, Citizens Bank notified TelexFree that it was closing TelexFree's account. Shortly thereafter, TelexFree's marketing director spoke on an investor call (posted on YouTube on August 9, 2013) about the closure. He indicated that their current bank was not allowing them to do any more transfers because "you guys have far exceeded the amount of transfers that you can do on a given week[.]" The marketing director described this event as "really exciting" and said, "Now, the exciting thing is that it's happening because we're growing so fast and doing so many transfers and it's – I'm tickled."

[32] *See* Merrill MSD Testimony at 203.

E. Merrill Receives More Warnings, TelexFree Throws More Parties

By mid-August 2013, TelexFree recruited another attorney, Jeff Babener, who also specialized in multi-level marketing companies. After being briefed on TelexFree's compensation plan, Babener's advice to Merrill was blunt and unequivocal: in its current form, TelexFree is a pyramid scheme. For the next seven months, Babener repeatedly warned Merrill and Wanzeler that they were running an illegal enterprise and were facing, as Merrill himself described it in an email on October 1, 2013, "business failure and or jail." For example, in an email sent on February 9, 2014, Babener bluntly reminded Merrill and Wanzeler that, "Since you retained us in August, I explained that you had an unknown window of time to implement a more compliant program because you were running pyramid/Ponzi scheme (even if you felt you were doing nothing wrong) and that you were on thin ice before regulatory action, civil or criminal, might occur." Outside discussions with their legal counsel, Merrill and Wanzeler kept this to themselves.

On Babener's advice, TelexFree hired Arizona-based consultants to fix TelexFree's compensation plan. Nevertheless, in every public presentation and conference call, Merrill, Wanzeler, and TelexFree spoke only of "phenomenal growth," and indeed watched as hundreds of thousands of people continued to sign up with TelexFree in late 2013 and early 2014. On November 5 and 6, 2013, TelexFree hosted a corporate event in Orlando, Florida. The event was described as a "Super Weekend" and TelexFree sold tickets to the event for a staggering $196 per person. Merrill addressed the crowd, blaming negative rumors and criticism of the company as a pyramid scheme as uninformed bluster from commentators. And despite the warning signs to the contrary, Merrill assured the crowd that they could "trust and believe" in what they were doing:

> I hate to bring up a negative, but it's important. Because negatives get turned into positives. We have plenty of blogs out there that, you know, don't – don't always speak kindly about us, they don't know us. But we know what they're about. They want you guys to go on their website and your competitors will go on their website,

> drawing traffic that will help them earn a living. I don't blame them. It's business. But what a difference is between you people is trust and belief in what we're doing, and I thank you all for believing in us and helping us get to that next level.

Although Wanzeler had assured the crowd in Newport Beach that the situation in Brazil would soon be fixed (before breaking down in tears), Ympactus (TelexFree in Brazil) remained shut down. Whenever asked about the shutdown, Merrill and Wanzeler blamed competitors and corruption, even though their new attorney, Jeff Babener, warned Merrill and Wanzeler that the "big flaw from a pyramiding/Ponzi standpoint" with TelexFree had "already come to pass in Brazil."[33]

Then TelexFree threw a party on a cruise ship. On December 15-16, 2013, TelexFree hosted its second corporate sponsored event in Brazil, a two-day event on cruise ship off the Brazilian coast (complete with helicopter). Merrill told the assembled crowd that TelexFree was "just getting started." After the cruise, TelexFree offered a DVD of the event for sale that featured Brazil promoters who had become millionaires, and staged images of Merrill arriving at the ship as a celebrity.

To be sure, early participants to TelexFree in the United States and Brazil did in fact become millionaires – a not uncommon aspect of pyramid schemes. Top promoters like Sann Rodrigues, Santiago De la Rosa, and Randy Crosby recruited thousands into their "down-line" and hosted independent conferences and "training sessions" at hotels using PowerPoint presentations downloaded from the website. But these promoters were not selling or using TelexFree's VoIP product. They were making millions from ad posting and recruitment. They were also in frequent contact with TelexFree corporate headquarters and its marketing director.

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[33] Babener Email, 10/1/13.

VII. Merrill Distributes $10,000,000 in Illegal Proceeds to Himself, Wanzeler & Costa

Despite all this, in late December 2013, Merrill, Wanzeler, and Costa decided to pay themselves millions from TelexFree accounts. On December 26, 2013, Merrill caused more than $10,000,000 to be transferred from TelexFree's bank account at Fidelity Cooperative Bank to Merrill and Wanzeler's personal accounts: $3,000,000 for Merrill, $3,500,000 for Wanzeler, and $3,500,000 earmarked for Costa. Of this total amount, at least $9,000,000 came directly from money paid by new participants to join TelexFree. Upon receipt, Merrill divided his haul into different investment accounts.

On January 21, 2014, the MSD issued subpoenas for records and Merrill and Wanzeler's testimony. Babener described the action as "serious and is an escalation" and warned Merrill that his testimony will be under oath and can be used against you in a criminal proceeding. Despite this, on March 5, 2014, TelexFree's marketing director, after speaking with Merrill about rumors of an investigation, hosted a conference call in which he denied any type of investigation and said that "there's nothing going on." On March 25, 2013, Merrill did testify before the MSD. Among other things, he significantly downplayed his involvement in TelexFree's compensation plan.

VIII. TelexFree Collapses

Finally, on March 9, 2016, TelexFree altered its compensation plan to require promoters to sell more of the VoIP product before qualifying for bonuses. Or at least on paper. Many promoters simply bought themselves additional VoIP plans as a cost of doing business, because they were doing so well posting ads and recruiting other people. But thousands more, having no desire to actually sell anything and perhaps seeing the writing on the wall, began yanking their money out of TelexFree (recall that a promoter could leave his earned bonuses and commissions in the TelexFree system as "credits" to be used later, or could cash them out). Over the next six

weeks, TelexFree hemorrhaged millions of dollars a week. On April 13, 2014, after TelexFree's accountant told them they owed billions of dollars to their promoters, TelexFree declared bankruptcy.

LEGAL ISSUES

I. The Offenses Charged in the Indictment

The superseding indictment charges the defendants with three offenses: one count of conspiracy to commit wire fraud (18 U.S.C. § 1349); eight counts of wire fraud (18 U.S.C. § 1343); and eight counts of money laundering, *i.e.*, engaging in monetary transactions with proceeds of a specified unlawful activity (18 U.S.C. § 1957).

A. Conspiracy to Commit Wire Fraud & Substantive Wire Fraud

Count One of the superseding indictment charges Merrill and Wanzeler with conspiring to commit wire fraud. Section 1349 of Title 18 says:

> Any person who attempts or conspires to commit any offense under this chapter shall be subject to the same penalties as those prescribed for the offense, the commission of which was the object of the attempt or conspiracy.

Section 1343 of Title 18 says in pertinent part:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than five years, or both.

Conspiracies under 18 U.S.C. § 1349 carry a maximum penalty of 20 years, as opposed to the five-year cap under 18 U.S.C. § 371.

"To sustain a conspiracy conviction [under 18 U.S.C. § 1349], the government must adduce proof beyond a reasonable doubt (1) that an agreement existed to commit the particular crime; (2)

that the defendant knew of the agreement; and (3) that he voluntarily participated in it." *United States v. Wyatt*, 561 F.3d 49, 54 (1st Cir. 2009); *see also, e.g., United States v. Black-White*, 2013 WL 2155297, *2 (D. Mass. May 16, 2013) (citing *Wyatt*).[34]

Counts Two through Nine charge Merrill and Wanzeler with substantive wire fraud, based on Merrill, in December 2013, wiring $10,000,000 out of TelexFree accounts to personal accounts belonging to Wanzeler and him.

The elements of wire fraud are as follows:

1. That there was a scheme, substantially as charged in the indictment, to defraud [or to obtain money or property by means of false or fraudulent pretenses];

2. That the scheme to defraud involved the misrepresentation or concealment of a material fact or matter [or the scheme to obtain money or property by means of false or fraudulent pretenses involved a false statement, assertion, half-truth or knowing concealment concerning a material fact or matter];

3. That the defendant knowingly and willfully participated in this scheme with the intent to defraud; and

4. That an interstate wire communication was used, on or about the date alleged, in furtherance of this scheme.

[34] As construed by the First Circuit, there appears to be no overt act requirement in § 1349, which makes sense: the statutory text is nearly identical to that of 18 U.S.C. § 1956(h) (conspiracy to launder money), and 21 U.S.C. § 846 (conspiracy to distribute drugs), neither of which requires proof of an overt act. A district court squarely addressed this issue in 2010 and, citing decisions interpreting 18 U.S.C. § 1956(h), held that 18 U.S.C. § 1349 has no overt act requirement. *See United States v. Berger*, ___ F.Supp.2d ___, 2010 WL 4237925, *2-5 (W.D. Pa., Oct. 21, 2010) ("Defendant's motion for dismissal of count I is denied because there is no statutory requirement of an overt act in 18 U.S.C. § 1349[.]"). Note, though, that the First Circuit's position seems to conflict with other circuits. *See, e.g., United States v. Reed*, 350 Fed. Appx. 675, 2009 WL 3471073, **2 (3rd Cir., Oct. 29, 2009) (discussing sufficiency of Rule 11 colloquy, stating § 1349 elements as requiring overt act); *United States v. Cunningham*, 679 F.3d 355, 373 (6th Cir. 2012) ("To secure a conviction for conspiracy to commit wire fraud, the government must prove beyond a reasonable doubt that the defendant 'knowingly and willfully joined in an agreement with at least one other person to commit an act of [wire] fraud and that there was at least one overt act in furtherance of the agreement.'"). The issue should not matter here; TelexFree was based in Marlborough, Massachusetts, where Merrill spent much of his time administering the company's affairs.

See HORNBY, J., PATTERN CRIMINAL JURY INSTRUCTIONS § 4.18.1343 (2015).[35]

1. *Specific Intent to Defraud Can Be Proven Through Evidence of Reckless Disregard for Truth or Falsity*

The intent element of wire fraud can be met with evidence of reckless disregard for the truth, as well as with evidence of "conscious avoidance" of, or "willful blindness" to, facts that rendered the defendant's statements false.

The Supreme Court has reaffirmed this point. *See, e.g., Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976) (defining scienter, that is, "a mental state embracing an intent to… defraud," as including reckless disregard for the truth). And other courts, both in the First Circuit and in others, have agreed. For example, in *Williams v. United States*, 979 F.2d 844, 1992 WL 332029 (1st Cir. 1992), Williams tried to withdraw his guilty plea because, at his Rule 11 hearing on charges of mail and securities fraud, he admitted only to acting with "reckless disregard" for investor funds. The First Circuit found Williams's colloquy sufficient and affirmed the district court's denial of his motion. The appellate court stated that "the scienter element under the mail and securities fraud statutes can be satisfied by something less than fraudulent intent or knowing falsehoods," *id*. at *2 (citing *United States v. Gay*, 967 F.2d 322, 326 (9th Cir. 1992) ("We have repeatedly held that reckless indifference alone will support a mail fraud conviction."); and *United States v. Brien*, 617 F.2d 299, 312 (1st Cir. 1985) ("conscious avoidance" of truth satisfies the scienter requirement for a mail fraud conviction)).[36]

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[35] *See also United States v. Vazquez-Botet*, 532 F.3d 37, 63 (1st Cir. 2008) (government must prove "(1) the defendant's knowing and willing participation in a scheme or artifice to defraud with the specific intent to defraud, and (2) the use of . . . interstate wire communications in furtherance of the scheme," quoting *United States v. Sawyer*, 85 F.3d 713, 723 (1st Cir. 1996)). The false representations must be material. *See, e.g., United States v. Blastos*, 258 F.3d 25, 28-29 (1st Cir. 2001).

[36] *See also, e.g., United States v. London*, 66 F.3d 1227, 1241 (1st Cir. 1995) (misapplication of bank funds; acknowledged wide scope given in establishing intent to defraud, including reckless disregard); *United States v. Rodriguez-Alvarado*, 952 F.2d 586, 590 (1st Cir. 1991) (bank fraud; holding that a reckless

Other circuits are in accord. The *Gay* decision, cited by the First Circuit in *Williams*, is a multi-level marketing case. *See* 967 F.2d at 326. The defendants, officers of a direct marketing company, made false and misleading misrepresentations to their investors. *Id.* The Ninth Circuit, in the course of affirming an instruction allowing the jury to convict for mail fraud based on the defendants' "reckless indifference" to the truth of their statements, explained that it had "repeatedly held that reckless indifference alone will support a mail fraud conviction." *Id.*

As another example, in a securities and mail fraud case involving an investment scam, the Sixth Circuit said

> Alternatively, the prosecution may prove that the defendant was reckless – that he made "an extreme departure from the standards of ordinary care[ ] [by omitting information] which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Sanders v. John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977) (internal quotation marks and citation omitted); *see also Auslender v. Energy Mgmt Corp.*, 832 F.2d 354, 356-57 (6th Cir. 1987). In either case, the belief, even if *bona fide*, that no investor will suffer a loss from a knowing or reckless material misstatement or omission, is not a defense to securities or mail-fraud charges. *United States v. Stull*, 743 F.2d 439, 446 (6th Cir. 1984).

United States v. DeSantis, 134 F.3d 760, (6th Cir. 1998) (emphasis added); *see also, e.g., United States v. Munoz*, 233 F.3d 1117, 1136 (9th Cir. 2000) ("This Court has repeatedly held that reckless indifference to the truth or falsity of a statement satisfies the specific intent requirement in a mail fraud case."); *United States v. Boyer*, 694 F.2d 58 (3rd Cir. 1982) (specifically rejecting argument that, by telling jury that "specific intent to defraud" can be proven through evidence of recklessness, court improperly lowered intent standard in fraud cases); *United States v. Cen-Card Agency/C.C.A.C.*, 724 F. Supp. 313, 316 (D.N.J. 1989) ("The Government may establish intent

disregard for bank funds established an intent to defraud); *Giragosian v. United States*, 349 F.2d 166, 168 (1st Cir. 1965) (aiding and abetting willful misapplication of federal funds; noting that some level of reckless disregard satisfies intent to defraud).

under the [mail and wire fraud] statutes simply by showing that the defendant made material misrepresentations of fact with reckless disregard to their truth or falsity.").[37]

Courts vary in the terminology they use to describe the standard, some using the term "reckless indifference,"[38] some the term "reckless disregard" or "reckless falsity,"[39] while others explain that intent to defraud can be met with evidence of an "extreme departure from standards

[37] *See also, e.g., U.S. ex rel. O'Donnell v. Countrywide Home Loans, Inc.*, No. 15-496, 2016 WL 2956743, at *6-7 (2nd Cir. May 23, 2016) (mail and wire fraud; defining intent to defraud as a statement "knowingly or recklessly false and made with an intent to induce harmful reliance"); *United States v. Kennedy*, 714 F.3d 951, 958 (6th Cir. 2013) (mail and wire fraud; holding that reckless disregard for the truth of statements to investors sufficed for intent to defraud); *Goodman Life Income Trust v. Jabil Circuit, Inc.*, 594 F.3d 783, 790-91 (11th Cir. 2010) (securities fraud; explaining that "scienter consists of intent to defraud or 'severe recklessness' on the part of the defendant"); *United States v. Philip Morris USA Inc.*, 566 F.3d 1095, 1121 (D.C. Cir. 2009) (mail and wire fraud; holding that reckless disregard suffices to demonstrate intent to defraud); *United States v. DeRosier*, 501 F.3d 888, 898 (8th Cir. 2007) (wire fraud; holding that reckless disregard is "an acceptable specification of the term intent to defraud"); *Ottmann v. Hanger Orthopedic Grp., Inc.*, 353 F.3d 338, 343-44 (4th Cir. 2003) (securities fraud; holding that a plaintiff may allege scienter by showing defendant was reckless); *United States v. Welch*, 327 F.3d 1081, 1105 (10th Cir. 2003) (mail and wire fraud; recognizing that a defendant's reckless indifference to misrepresentations could establish intent to defraud); *United States v. Quadro Corp.*, 928 F. Supp. 688, 696 (E.D. Tex. 1996), *aff'd*, 127 F.3d 34 (5th Cir. 1997) (holding that reckless disregard to the truth or falsity of representations sufficed for intent to defraud); *United States v. Gay*, 967 F.2d 322, 327 (9th Cir. 1992) (mail fraud; holding that "recklessness alone will support a mail fraud conviction"); *United States v. Boyer*, 694 F.2d 58, 59 (3rd Cir. 1982) (mail fraud and securities fraud; affirming that intent to defraud can be satisfied if an untrue representation is made because of defendant's recklessness).

[38] *See, e.g., Welch*, 327 F.3d at 1105; *Munoz*, 233 F.3d at 1136; *Gay*, 967 F.2d at 327; *United States v. Hathaway*, 798 F.2d 902, 909 (6th Cir. 1986) (holding that "one who acts with reckless indifference as to whether a representation is true or false is chargeable as if he had knowledge of its falsity").

[39] *See, e.g., DeRosier*, 501 F.3d at 898; *Willis v. United States*, 87 F.3d 1004 (8th Cir. 1996) (agreeing with the majority of courts that reckless disregard is sufficient to prove intent); *Williams*, 979 F.2d at *2; *United States v. Hoffman*, 918 F.2d 44, 46 (6th Cir. 1990) ("reckless disregard of the interests of the bank is equivalent to intent to injure or defraud"); *United States v. Schaflander*, 719 F.2d 1024, 1027 (9th Cir. 1983) (holding that reckless disregard is sufficient to sustain a mail fraud conviction); *Boyer*, 694 F.2d at 59; *United States v. Bradberry*, 1999 WL 420617, *2 (N.D. Tex. 1999) (noting that "reckless disregard" is sufficient to prove specific intent to defraud, and that "[a] showing of evil motive by the defendant is not necessary to prove fraud"); *Cen-Card Agency/C.C.A.C.*, 724 F. Supp. at 316.

of ordinary care."[40] But all agree on the fundamental point that the scienter requirement of wire fraud can be satisfied by a showing of recklessness.

In a similar vein, the First Circuit has also held that a specific intent to defraud can be satisfied by evidence of conscious avoidance of information that one's statements are untrue or misleading. *See, e.g., United States v. Brien*, 617 F.2d 299, 312 (1st Cir. 1980). In *Brien*, the First Circuit upheld a jury instruction providing that conscious avoidance of whether representations are accurate can satisfy the element of intent to defraud in a case of conspiracy to commit mail and wire fraud. *Id*. By avoiding knowing whether their statements to investors were false or misleading, the defendants sufficiently demonstrated the requisite intent to defraud. *Id.*[41]

B. Pyramid Schemes are a Form of Wire/Mail Fraud

Proving wire fraud of course requires proving that the defendant engaged in "a scheme to defraud." *See, e.g., United States v. Cassiere*, 4 F.3d 1006, 1011 (1st Cir. 1993). As courts have repeatedly held, a pyramid scheme[42] constitutes "a scheme to defraud" for purposes of proving a

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[40] *See, e.g., United States v. DeSantis*, 134 F.3d 760, 764 (6th Cir. 1998) (explaining that the prosecution may show defendant had intent to defraud by proving he was reckless, or "made an extreme departure from the standards of ordinary care").

[41] This is akin to the doctrine of willful blindness: "Willful blindness serves as an alternate theory on which the government may prove knowledge." *United States v. Pérez–Meléndez*, 599 F.3d 31, 41 (1st Cir. 2010). "The purpose of the willful blindness theory is to impose criminal liability on people who, recognizing the likelihood of wrongdoing, *nonetheless consciously refuse to take basic investigatory steps*." *United States v. Rothrock*, 806 F.2d 318, 323 (1st Cir. 1986) (emphasis added). To establish willful blindness, the government must show that (1) the defendant was aware of a high probability of wrongdoing and (2) consciously and deliberately avoided learning of the wrongdoing. *See Pérez–Meléndez*, 599 F.3d at 41; *United States v. Azubike*, 564 F.3d 59, 66 (1st Cir. 2009). Direct evidence is not required; "what is needed are sufficient warning signs that call out for investigation or evidence of deliberate avoidance of knowledge." *Azubike*, 564 F.3d at 66.

[42] A pyramid scheme is a Ponzi scheme, with a recruitment element. Where a straight Ponzi scheme involves paying investors a promised return with funds, not from investment returns, but from money deposited by later investors, a pyramid scheme also incentivizes participants to recruit others. *See, e.g., In re Sheetex, Inc.*, No. 98-52263-JDW, 1999 WL 739628, at *2 (Bankr. M.D. Ga. Sept. 21, 1999) (distinguishing Ponzi and pyramid schemes). So, in TelexFree and numerous other pyramid schemes, participants paid a significant sum to participate in the company's compensation system, after which they

violation of 18 U.S.C. § 1343. *See, e.g., United States v. Cantwell*, 41 F. App'x 263, 271 (10th Cir. 2002) ("Pyramid schemes constitute schemes to defraud under the mail and wire fraud statutes.").[43]

For example, in *United States v. Gold Unlimited, Inc.*, the defendant company offered a "gold matching program" in which new participants made a down payment on a portion of gold and paid off the remaining balance by recruiting new members to join the program. 177 F.3d 472, 475 (6th Cir. 1999). Affirming a fraud conviction at trial, the court explained that if the government could prove to a jury that the company was a pyramid scheme, the jury would necessarily have to find that defendants had devised a scheme to defraud, because pyramid schemes inherently defraud their participants. *Id.* at 485. The Sixth Circuit unambiguously held that "as a matter of law, an illegal pyramid scheme constitutes a scheme or artifice to defraud." *Id*. at 478.

Similarly, in *United States v. Cantwell*, the defendant appealed his mail and wire fraud convictions on the grounds that it was error to allow the government to call an expert witness on

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received bonuses for recruiting others. Those bonuses were paid, not with money from the sale of a given product, but from sums paid into the system by newer participants. *See, e.g., In re Koscot Interplanetary, Inc.* 86 F.T.C. 1106 (1975) (seminal FTC decision defining a pyramid scheme); *United States v. Gold Unlimited, Inc.*, 177 F.3d 472, 479-80 (6th Cir. 1999) (discussing pyramid scheme characteristics, noting use of initial buy-in fees, instead of product sales, to generate revenue); *Webster v. Omnitrition Int'l, Inc.*, 79 F.3d 776, 788 (9th Cir. 1996) (describing profit through recruitment instead of product sales, including ongoing recruitment by one's own initial recruits, as the *sine qua non* of pyramid schemes).

[43] *See also, e.g., United States v. Gold Unlimited, Inc.*, 177 F.3d 472, 478 (6th Cir. 1999) ("Unquestionably, an illegal pyramid scheme constitutes a scheme to defraud."); *Webster v. Omnitrition Int'l, Inc.*, 79 F.3d 776, 786 (9th Cir. 1996) (explaining that an illegal pyramid scheme is inherently fraudulent because it will inevitably collapse); *Sec. & Exch. Comm'n v. Tropikgadget FZE*, 146 F. Supp. 3d 270 (D. Mass. 2015) (holding that defendants were operating a "pyramid scheme to defraud their investors"); *Kerrigan v. ViSalus, Inc.*, 112 F. Supp. 3d 580, 607 (E.D. Mich. 2015) (holding that, as a matter of law, pyramid schemes are schemes to defraud in violation of 18 U.S.C. § 1343); *Day v. Fortune Hi-Tech Mktg. Inc.*, No. 10-CV-305-GFVT, 2014 WL 4384443, at *5 (E.D. Ky. Sept. 3, 2014) (same); *In re Indep. Clearing House Co.*, 77 B.R. 843, 860 (D. Utah 1987) ("One can infer an intent to defraud future undertakers from the mere fact that a debtor was running a Ponzi scheme. Indeed, no other reasonable inference is possible.").

the subject of pyramid schemes because the testimony was unfairly prejudicial. 41 F. App'x at 270-71. The court rejected the argument, explaining that because pyramid schemes are "schemes to defraud," the expert's testimony was highly relevant to proving the crimes charged. *Id.* The court ultimately concluded that because the jury found that the defendant had operated a pyramid scheme, and a pyramid scheme constitutes a scheme to defraud, the first element of wire fraud had been satisfied. *See id.*

Other courts have explained that pyramid schemes are inherently fraudulent because, like Ponzi schemes, they are inherently unsustainable. *See, e.g., Webster v. Omnitrition Int'l, Inc.*, 79 F.3d 776, 788 (9th Cir. 1996). "[T]he very reason for the *per se* illegality of Endless Chain schemes is their inherent deceptiveness and the fact that the 'futility' of the plan is not 'apparent to the consumer participant.'" *Id.* (internal quotation marks omitted). Because participants who join pyramid schemes do not fully understand the structure of the company when they first buy in, they are misled into believing they will receive substantial returns. *See id.* As a result, courts have repeatedly recognized that the basic structure of pyramid schemes necessarily make them schemes to defraud. *See id.*

C. Engaging in Unlawful Monetary Transactions

Counts Ten through Seventeen of the superseding indictment charge Merrill and Wanzeler with money laundering, specifically, with knowingly using more than $10,000 in proceeds from some form of criminal activity (here, wire fraud) in a monetary transaction, in violation of 18 U.S.C. § 1957.

Section 1957(a) says in relevant part:

> Whoever, in any of the circumstances set forth in subsection (d), knowingly engages or attempts to engage in a monetary transaction in criminally derived property of a value greater than $10,000 and is derived from specified unlawful activity, shall be punished as provided in subsection (b).

To establish a violation of 18 U.S.C. § 1957, the government must prove that:

1. the defendant engaged or attempted to engage in a "monetary transaction"[44] with a value of more than $10,000;

2. the defendant knew that the property involved in the transaction had been derived from some form of criminal activity; and

3. the property involved in the transaction was actually derived from specified unlawful activity.

See, e.g., HORNBY, J., PATTERN CRIMINAL JURY INSTRUCTIONS § 4.18.1957 (2015); *United States v. Benjamin*, 252 F.3d 1, 6-9 (1st Cir. 2001); *United States v. Richard*, 234 F.3d 763, 767 (1st Cir. 2000).

The statute further specifies that "the Government is not required to prove the defendant knew that the offense from which the criminally derived property was derived was specified unlawful activity." 18 U.S.C. § 1957(c); *Richard*, 234 F.3d at 768. Also, unlike wire fraud, a § 1957 conviction does not require willfulness, but only "knowledge" that the property involved in the transaction was derived from criminal activity. *See* 18 U.S.C. § 1957(a) ("knowingly").

II. Evidentiary Issues that May Arise

Beyond testimony, the government's evidence comes from several sources, including records seized from TelexFree headquarters; TelexFree's database of transactional data; bank and brokerage records; email from various accounts; video segments, mostly captured from YouTube; and domestic and foreign incorporation documents.

[44] A "monetary transaction" is a deposit, withdrawal, transfer or exchange, in or affecting interstate or foreign commerce, of funds or monetary instruments (as defined in section 1956(c)(5)) by, through, or to a "financial institution" (as defined in 18 U.S.C. § 1956), including any transaction that would be a financial transaction under § 1956(c)(4)(B). *See* 18 U.S.C. § 1956(f). The term is narrower than the term "financial transaction," as used in § 1956, in that it requires that a "financial institution" and at least $10,000 be involved in the transaction.

A. Anticipated Evidence Stipulations

Most of the above material is straightforward, and we anticipate that the parties will reach at least some stipulations as to the admissibility, or at least the authenticity, of much of it, and also as to certain undisputed elements of the offenses charged in the indictment.

At this point, though not final, as to elements it appears that the parties will stipulate that the wirings underlying counts 2 – 17 traveled interstate, and that the financial institutions implicated in counts 10-17 are "financial institutions" for purposes of 18 U.S.C. § 1956(a).

As to admitting exhibits, though not final, it appears that the parties will reach agreement on the admissibility of bank records, business records from third party vendors that did business with TelexFree, and certain public records (like incorporation documents). Again, though not final, it appears that the parties will also agree on at least the authenticity of email exhibits, and perhaps to the admissibility of some portion of them. Finally, the parties also continue to negotiate about a potential stipulation to the admission of archived screen shots from the Internet Archive.[45]

[45] The Internet Archive is a non-profit organization that maintains an Internet utility called the "Wayback Machine," which was created in the early 2000s and is available for free at www.archive.org. In short, the utility continuously surveys the Internet and captures, in real time, images of existing web sites. It then archives those images by date and site name and makes the information available to the public. The purpose is to preserve a record of the history and development of the Internet. *See, e.g., Healthcare Advocates, Inc. v. Harding, Early, Follmer & Frailey*, 497 F. Supp. 2d 627, 631 (E.D. Pa. 2007) (explaining Internet Archive). Archived site pages are routinely admitted into evidence; in fact, by this point, the Archive is so widely accepted that courts simply take judicial notice of its contents. *See, e.g.*, *Martins v. 3PD, Inc.*, 2013 WL 1320454, at *16 n.8 (D. Mass. Mar. 28, 2013) (Woodlock, J.) ("I take judicial notice of the various historical versions of the 3PD website available on the Internet Archive at Archive.org as facts readily determinable by resort to a source whose accuracy cannot reasonably be questioned."); *Erickson v. Nebraska Mach. Co.*, 2015 WL 4089849, at *1 n.1 (N.D. Cal. July 6, 2015) (copyright infringement action; taking judicial notice of archived site pages).

Once exhibit lists are exchanged, the parties will continue to negotiate admissibility issues and file finalized stipulations with the Court.

Certain other potential evidentiary issues are discussed below.

B. Email – Statements To and From the Defendant

1. *Statements by Merrill, Admitted Against Him, are Admissible*

The government anticipates admitting into evidence approximately 100 emails over the course of the trial. Most of these contain statements by Merrill himself, which are admissible under FRE 801(d)(2)(A) as statements by a party, offered against that party. *See, e.g., Shervin v. Partners Healthcare Systems, Inc.*, 804 F.3d 23, 45 (1st Cir. 2015) (noting that email drafted by defendant could be admissible as statement by party opponent); *United States v. Siddiqui*, 235 F.3d 1318, 1323 (11th Cir. 2000) (holding emails sent by defendant admissible under FRE 801(d)(2)(A)); *United States v. Safavian*, 435 F. Supp. 2d 36, 43 (D.D.C. 2006) (same).[46]

As for emails that are part of a chain, the government will redact those portions that are inadmissible hearsay. *See, e.g., Safavian*, 435 F. Supp. 2d at 43 (explaining that redactions may be necessary where portions of an email chain contain inadmissible hearsay). "Each link in the chain must be admissible, either because it is an admission and thus not hearsay or under some other hearsay exception." *Vazquez v. Lopez-Rosario*, 134 F.3d 28, 34 (1st Cir. 1998).

Other emails contain statements by co-defendant Wanzeler and other co-conspirators which, subject to a *Petrozziello* finding, are admissible as co-conspirator statements under FRE 801(d)(2)(E). *See also, e.g., United States v. Martinez-Medina*, 279 F.3d 105, 113-114 (1st Cir. 2002).

2. *Statements Made* to *Merrill Are Also Admissible to Show His*

[46] Note that written materials, *e.g.*, business records created by the defendant or at his direction, are also non-hearsay admissions. *See, e.g., United States v. Williams*, 837 F.2d 1009, 1013 (11th Cir. 1988).

State of Mind

The government also anticipates admitting various statements made *to* Merrill by others, not for the truth of those statements, but to prove Merrill's state of mind. *See, e.g., United States v. Thompson*, 279 F.3d 1043, 1047 (D.C. Cir. 2002) ("An out-of-court statement that is offered to show its effect on the hearer's state of mind is not hearsay under Rule 801(c)."); *United States v. Paredes-Rodriguez*, 160 F.3d 49, 57 (1st Cir. 1998) (testimony admitted to show what prompted witness to take subsequent action).

This point matters because during the conspiracy several people, primarily TelexFree's lawyers but also others, simply told Merrill that he was running a pyramid scheme. Statements "offered not for their truth but offered only for context, do not constitute hearsay." *United States v. Bailey*, 270 F.3d 83, 87 (1st Cir. 2001). Courts consistently admit statements that would otherwise constitute hearsay when those statements are offered to show knowledge or intent.[47] A recent Second Circuit case is on all fours. In *United States v. Dupree*, 706 F.3d 131 (2nd Cir. 2013), the district court denied a motion *in limine* to admit a restraining order as evidence that Dupree "knew of, and intended to violate, a contractual obligation to maintain funds at Amalgamated Bank." *Id.* at 133. The Second Circuit vacated the district court's order, explaining that the restraining order was not hearsay because the government had admitted it to show that Dupree "was put on notice" of his contractual obligations – not to prove the truth of the order's contents.

[47] *See e.g., United States v. Page*, 521 F.3d 101, 107 (1st Cir.), *as modified* (Sept. 3, 2008), *modified*, 542 F.3d 257 (1st Cir. 2008) (upholding admission of recorded conversation overheard by defendant because government offered it not to "prove the drug transaction described in the phone conversation" but to "rebut [defendant's] theory that he [acted] unwittingly in providing counter surveillance during a drug deal"); *United States v. Johnson*, 71 F.3d 539, 543 (6th Cir. 1995) (upholding admission of employee's testimony about telephone conversation she overheard in which doctor told defendant "[you are] going to have to stop writing prescriptions like that," because statement was "evidence of the defendant's knowledge that he was prescribing medication without a legitimate medical purpose and outside the course of professional practice").

Id. at 137. So it is here, with volumes of email Merrill received warning him that he was presiding over a pyramid scheme.

Moreover, courts have repeatedly held – including in pyramid scheme cases – that testimony from company lawyers and other hired professionals is admissible to support an inference as to the defendant's state of mind.[48] As discussed further below, to the extent this kind of testimony is "expert" testimony, it does not run afoul of FRE 704(b) because it does not opine on Merrill's state of mind to commit the offense. *See, e.g.*, *Gish*, 518 F. App'x at 875.[49]

Finally, this kind of testimony – that others warned Merrill that he was participating in a pyramid scheme – is not unfairly prejudicial under FRE 403. In cases where knowledge and intent "play a central role," evidence of the defendant's state of mind is "of significant importance" and thus highly probative. *Dupree*, 706 F.3d at 138. Second, the risk that this evidence will result in unfair prejudice does not substantially outweigh its considerable probative value. The First Circuit has repeatedly held that evidence of a defendant's state of mind does not violate FRE 403 when "knowledge, intent, [or] lack of accident . . ." are "of special relevance in the case." *United States v. Doe*, 741 F.3d 217, 231 (1st Cir. 2013).

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[48] *See, e.g., United States v. Platt*, 608 F. App'x 22, 28 (2nd Cir. 2015) (pyramid scheme case; holding that testimony from attorneys about advice they gave to defendants in the fraudulent scheme was properly admitted); *United States v. Jensen*, 573 F. App'x 863, 871 (11th Cir. 2014) (Ponzi scheme case; holding that memorandum written by attorney about the company's legality was properly admitted); *United States v. Gish*, 518 F. App'x 871, 875 (11th Cir. 2013) (testimony from attorneys about legal advice given to defendants was admissible); *Gold Unlimited*, 177 F.3d at 487 (pyramid scheme case; "opinions of six states that the defendants operated an illegal scheme constitute very probative evidence of knowledge, plan, and intent"); *United States v. Neal*, 27 F.3d 1035, 1049 (5th Cir. 1994) (lawyer's testimony that he advised defendant that company was likely an illegal money laundering operation properly admitted).

[49] "Although expert testimony as to a defendant's state of mind at the time of the offense is barred by Federal Rule of Evidence 704(b), the record here is clear that the challenged testimony did not do so. The lawyers testified as to what they told Gish and Ettenborough about the legality of their scheme. They did not testify as to what Gish and Ettenborough thought about that advice, nor as to any other state of mind they might have had at the time. That conclusion was left for the jury to infer."

The principle has been applied in Ponzi and pyramid cases. *See, e.g.*, *Jensen*, 573 F. App'x at 871 (Ponzi scheme case; "Mackey's intent was the lynchpin of his defense, and this evidence [the lawyer's memorandum] was highly probative of that intent."). In *United States v. Platt*, a recent pyramid scheme case,[50] a lawyer warned participants in the scheme that it was illegal.and that advice was relayed to the defendants. *See* 608 F. App'x at 27. The Second Circuit affirmed the trial court's decision to admit the lawyers' testimony:

> This evidence was undoubtably [sic] relevant because it tended to undermine defendants' good faith defense that they relied on the advice of attorneys, transmitted by other gifting table participants, that the tables were operating legally. We have noted that "[e]vidence of others' knowledge" may be "highly relevant [where it] ha[s] ... been supplemented by evidence supporting the conclusion that such knowledge was communicated to [the defendant]."

Id. The Second Circuit also went on to find that the evidence "d[id] not engender the unfair prejudice against which Rule 403 is directed." *Id*. at 28.

C. Expert & Auditor Testimony

1. *The Government's Anticipated Witnesses*

The government anticipates calling three witnesses at trial for whom it has made expert disclosures: Timothy Martin, Jean Louis Sorondo, and Kenneth Kelly. Martin and Sorondo work for Huron Consulting Group, the consulting firm that employs Stephen Darr, the Chapter 11 trustee appointed to administer TelexFree's affairs. (All three men previously worked for Mesirow Financial Consulting, LLC.) Dr. Kelly is a staff economist at the Federal Trade Commission, the federal agency responsible for civil enforcement against pyramid schemes operating in the United States.

[50] The defendants in *Platt* organized and ran "gifting tables," which were structured as "exponentially expanding pyramids," and focused entirely on recruiting female members to join and provide "gifts" to pre-existing members in order to move up the ranks of the "tables." 608 F. App'x at 25.

Martin and Sorondo are not "expert" witnesses, *per se*; their primary role is to explain and summarize the vast amount of transactional data available in TelexFree's networked servers. Once mined, the data demonstrates TelexFree's fraudulent nature, for example, that TelexFree made little or no money from each VOIP sale and that, of the millions of VOIP plans it "sold," about 3% were ever actually used. As to Dr. Kelly, he is a *bona fide* expert witness who, based on experience and training, will explain the fundamental features of pyramid schemes and his own financial analysis of TelexFree's compensation plan.

Finally, as noted above, the government may call TelexFree's own lawyers – Gerald Nehra and Jeffrey Babener – to testify about their dealings with Merrill. Both men told Merrill he was running an illegal enterprise (that is, that TelexFree was operating as a pyramid scheme), a conclusion both men reached based on their specialization in this field. Indeed, TelexFree hired both men in the first place because they are prominent specialists in the legal aspects of multi-level marketing companies. Consequently, while Nehra and Babener are certainly percipient witnesses, their testimony will also contain elements of expert testimony, since they will explain the advice and warnings they gave directly to Merrill during the course of the conspiracy. (The government made an FRE 703 disclosure about this potential testimony as well.)

2. *Expert Testimony Concerning TelexFree's Transactional Data, and Whether TelexFree Was Operating as a Pyramid Scheme, is Admissible*

All of the above testimony is admissible. As to Martin and Sorondo, as noted, they are more akin to "auditor" witnesses than expert witnesses. That is, their role is to summarize how they reviewed and digested a truly huge amount of transactional data, and then to present their findings in summary form. Summary evidence of this kind is routinely admitted under FRE 1006. *See, e.g., Colon-Fontanez v. Municip. of San Juan*, 660 F.3d 17, 29-31 (1st Cir. 2011) (affirming admission of summary charts based on voluminous underlying data that, while admissible, could

not be conveniently examined in court).[51] The government's charts will be produced to the defense well ahead of trial, and during the discovery process Merrill received, or was invited to access, all underlying documents and data.

Note that, where feasible (for example, bank and brokerage records), the government anticipates entering the records underlying summary charts into evidence along with the charts themselves.[52] But as to TelexFree's database of transactional data, it comprises hundreds of terabytes housed on over 40 servers; it probably is not feasible to admit the underlying data, though the parties are still discussing this issue.

As to Dr. Kelly's testimony – concerning the general characteristics of pyramid schemes and how TelexFree's operations fit those characteristics – this sort of testimony is admissible in pyramid scheme cases. For example, in *United States v. Platt*, described above, Dr. Kelly presented the same type of testimony, first discussing pyramid schemes generally and then how the defendants' "gifting tables" scheme had the characteristics of a pyramid scheme. The defendants moved to exclude the testimony below, citing FRE 704 and 403.[53] The district court allowed the testimony, and the Second Circuit affirmed. The appeals court observed that in his testimony Kelly did not conclude that the scheme was "illegal," or cite elements of the statutes

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[51] *See also, e.g., United States v. Whitfield*, 590 F.3d 325 (5th Cir. 2009) (affirming admission of summary charts synthesizing bank records and check activity, to show transfer of money from attorney to judges in bribery prosecution); *United States v. Thrower*, 746 F.Supp.2d 303, 307 (D. Mass. 2010) (admitting summary charts showing patterns gleaned from defendants' check cashing activity).

[52] *See, e.g., United States v. Milkiewicz*, 470 F.3d 390, 396 -397 (1st Cir. 2006) ("W]hile in most cases a Rule 1006 chart will be the only evidence the fact finder will examine concerning a voluminous set of documents . . . in other instances the summary may be admitted in addition to the underlying documents to provide the jury with easier access to the relevant information.").

[53] Rule 704(b) says that "[i]n a criminal case, an expert witness must not state an opinion about whether the defendant did or did not have a mental state or condition that constitutes an element of the crime charged or of a defense."

under which the defendants were charged. 608 F. App'x at 29. Nor did he draw conclusions about the defendants' mental state, which would have violated FRE 704(b). *Id*. at 29-30.

Similarly, in *Federal Trade Comm'n v. Burnlounge, Inc*., a civil enforcement action against a multi-level marketing scheme based on selling (or not) music and other merchandise, a former colleague of Dr. Kelly (also an FTC staff economist) testified about the general characteristics of pyramid schemes and mathematical projections based on Burnlounge's compensation plan. The Ninth Circuit affirmed the lower court's admission of this testimony, rejecting the defendants' *Daubert* and related challenges. *See* 753 F.3d 878, 889-90 (9th Cir. 2014); *see also, e.g., United States v. Cantwell*, 41 F. App'x 263, 269-71 (10th Cir. 2002) (pyramid scheme case; affirming admission of expert testimony on characteristics of pyramid schemes and how they applied to defendants' company, rejecting arguments under FRE 402, 403, 701 and 704); *United States v. Gold Unlimited, Inc*., 177 F.3d 472, 475, 481-82 (6th Cir. 1999) (pyramid scheme case; government admitted expert testimony on company's marketing materials and likelihood of collapse).[54]

The partially "expert" testimony of attorneys Nehra and Babener are similarly admissible. As long as they testify about the advice they gave Merrill – rather than to Merrill's mental state beyond whatever Merrill said in response – their testimony is not barred by FRE 704(b). For example, in *United States v. Gish*, a mail and wire fraud case, the government elicited expert testimony from the company's attorneys, who had advised the defendants about their investment

[54] *See also, e.g*., *Federal Trade Comm'n v. Vemma Nutrition Co.*, No. CV-15-01578-PHX-JJT, 2015 WL 11118111, at *3 (D. Ariz. Sept. 18, 2015) (pyramid scheme case; allowing testimony by FTC economist); *Federal Trade Comm'n v. Skybiz.com, Inc*., No. 01-CV-396-K(E), 2001 WL 1673645, at *2 (N.D. Okla. Aug. 31, 2001), *aff'd sub nom. F.T.C. v. Skybiz.com, Inc.*, 57 F. App'x 374 (10th Cir. 2003) (same); *Federal Trade Comm'n v. Five-Star Auto Club, Inc.*, 97 F. Supp. 2d 502, 531 (S.D.N.Y. 2000) (same). *Cf. United States v. Lamattina*, 889 F.2d 1191, 1193-94 (1st Cir. 1989) (explaining that because expert witness did not testify about defendant's mental state, but rather discussed what "loansharking" means and opined about conversations about loansharking, testimony not prohibited by FRE 704(b).

firm's illegality during the course of the scheme. 518 F. App'x at 875. On appeal, the defendants claimed that the testimony violated Rule 704(b). *Id.* at 873. One of the defendants – fielding a defense similar to one likely in this case – also claimed that she did not know she was committing fraud and that she was merely her co-defendant's "innocent dupe." *Id.* at 874. Affirming admission of the lawyers' testimony, the Eleventh Circuit explained that because the lawyers did not attest to what the defendants thought about their advice, the testimony was not barred by Rule 704(b). *Id.* Instead, the court recognized that the testimony was highly probative on the issue of whether the defendants were defrauding investors. *Id.*[55]

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Respectfully submitted,

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Date: September 28, 2016

[55] *See also, e.g., United States v. Augustin*, 611 F.3d 1105, 1123 (2nd Cir. 2011) ("[T]his prohibition [Rule 704(b)] does not require the exclusion of expert testimony that supports an obvious inference with respect to the defendant's state of mind if that testimony does not actually state an opinion on this ultimate issue, and instead 'leaves this inference for the jury to draw.'"); *United States v. Valle*, 72 F.3d 210, 215-16 (1st Cir. 1995) ("Though Rule 704(b) bars experts from opining on the ultimate issue of a defendant's felonious intent, the rule does not prohibit experts from testifying to predicate facts from which a jury might infer such intent.").

CERTIFICATE OF SERVICE

I hereby certify that this document, filed through the ECF system, will be sent electronically to the registered participants as identified on the Notice of Electronic Filing, and paper copies will be sent to those indicated as non-registered participants, on September 28, 2016.

/s/ *Andrew Lelling*
Andrew E. Lelling