

13-653

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

FEDERAL TRADE COMMISSION,
STATE OF CONNECTICUT,
Plaintiffs-Appellees,

v.

ANGELINA STRANO,
Relief Defendant,
Nominal Defendant – Appellant,

LEANSPA, LLC, *et al.*,
Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT

BRIEF FOR APPELLEES

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JURISDICTIONAL STATEMENT

The Federal Trade Commission (“Commission” or “FTC”) initiated this action in the United States District Court for the District of Connecticut seeking relief under Section 13(b) of the Federal Trade Commission Act (“FTC Act”), 15 U.S.C. § 53(b), and Section 917(c) of the Electronic Fund Transfer Act (“EFTA”), 15 U.S.C. § 1693o(c). The State of Connecticut brought this case under the Connecticut Unfair Trade Practices Act (“CUTPA”), Chapter 735a of the Connecticut General Statutes, and Conn. Gen. Stat. § 42-110m. The district court had jurisdiction pursuant to 15 U.S.C. §§ 45(a), 53(b) and 1693o(c), and 28 U.S.C. §§ 1331, 1337(a), and 1345, and had supplemental jurisdiction under 28 U.S.C. § 1367 over Connecticut’s state law claims.

On January 29, 2013, the district court issued a preliminary injunction against relief defendant Angelina Strano. Strano filed her Notice of Appeal on February 21, 2013, and that notice was timely pursuant to Fed. R. App. P. 4(a)(1)(B). This Court has jurisdiction under 28 U.S.C. § 1292(a)(1).

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

1. Whether the district court had subject matter jurisdiction to adjudicate whether particular assets are controlled by defendant Mizhen and thus subject to a pre-existing asset freeze.

2. Whether the district court had the equitable authority to freeze assets held in the name of the relief defendant Strano, but controlled by her spouse, defendant Mizhen.
3. Whether the district court abused its discretion in concluding that the FTC and Connecticut were likely to succeed in showing that defendant Mizhen controlled the disputed assets.
4. Whether, after defendant Mizhen failed to disclose a disputed asset on his financial disclosure form provided to the FTC and Connecticut, the agencies were judicially estopped from arguing that Mizhen controlled the asset when, after originally asserting that the asset was held by the relief defendant Strano, the agencies later learned from third-party bank records that the asset was controlled by Mizhen.

STATEMENT OF THE CASE

A. Nature of the Case, the Course of Proceedings, and the Disposition Below

This is a review of a preliminary injunction order in which the district court froze certain assets held in the name of relief defendant Angelina Strano, but that were controlled by defendant Boris Mizhen, Strano's husband. Mizhen orchestrated an alleged nationwide deceptive weight-loss scheme that defrauded consumers of more than \$30 million.

In November 2011, the FTC and the State of Connecticut (collectively, “agencies”) filed a complaint alleging that Mizhen and three companies he controlled (collectively referred to as the “LeanSpa defendants”), deceptively sold various purported weight-loss and related health products in violation of the FTC Act, EFTA, and CUTPA. (A.34-67)¹ On the same day, the agencies filed an *ex parte* motion for a temporary restraining order (“TRO”), (A.71-76), which the court below granted in part. (A.204-222)

Later that month, the court entered a stipulated preliminary injunction which, *inter alia*, froze assets that were “[o]wned or controlled, directly or indirectly, by any Defendant, in whole or in part,” including Mizhen. (A.297-301) In July 2012, the agencies filed an amended complaint adding additional liability defendants, as well as Strano as a relief defendant. (A.481-524)

In September 2012, the agencies filed a motion for a preliminary injunction seeking to freeze certain assets in Strano’s possession (as well as those belonging to another individual defendant). (A.571) As to Strano, the agencies sought to freeze brokerage accounts held under the name

¹ Items in the Joint Appendix are referred to as “(A.xx)”. Items in the Special Appendix are referred to as “(SPA.xx)”. Items in the district court’s docket (not included in the appendices) are referred to as “(D.xx)”.

“Fellsmere Farm, LLC” (“Fellsmere accounts”), and a property located in Guilford, Connecticut held under the name “3124 Boston Post Road, LLC” (“Boston Post Road property”), all of which the agencies alleged were funded by moneys derived from business activities Mizhen had engaged in prior to forming LeanSpa. The agencies argued that such funds were in fact Mizhen’s and thus subject to the November 2011 preliminary injunction. The agencies additionally sought to freeze proceeds from the LeanSpa defendants’ deceptive practices that Strano had received.

On January 29, 2013, district court Judge Hon. Janet C. Hall granted the agencies’ motion. *Federal Trade Commission et al. v. LeanSpa LLC, et al.*, No. 3:11-cv-1715, 2013 WL 331233, 2013-1 Trade Cases ¶ 78,247 (D. Conn.) (A.970-987) (SPA.26-43) The court first held that it had subject matter jurisdiction over both assets in Strano’s possession that were controlled by Mizhen and funds she received that were proceeds of LeanSpa’s scheme. The court also held that it had the authority to freeze such assets under its inherent equitable authority and under Section 13(b) of the FTC Act. (A.974-979) (SPA.30-35)

The court next held that Mizhen did in fact control the Fellsmere Farm LLC (and its associated accounts) and the 3124 Boston Post Road, LLC, even though those assets were held in Strano’s name. (A.979-985) (SPA.35-

41) The court – relying on bank record evidence from the FTC’s forensic accountant – concluded that the Fellsmere accounts were funded principally by Mizhen from a previous business, and that the funds in those accounts were then used to fund the LeanSpa entities, other Mizhen businesses, and to pay for Mizhen’s personal obligations. (A.979-980) (SPA.35-36) The court rejected Strano’s factual contentions about the source and disposal of the Fellsmere accounts, including the claim that she funded the LeanSpa entities through a purported \$4 million line of credit, concluding that the supposed “loan” from Strano was essentially a sham and that she was not a bona fide secured creditor. (A.982-983) (SPA.38-39)

The court next held that the Boston Post Road property also was controlled by Mizhen, based on undisputed evidence that Mizhen bought the property and then promptly transferred it to Strano for no consideration. (A.984-985) (SPA.40-41) Finally, the court froze \$297,000 of Strano’s assets, which it found were derived from LeanSpa’s fraudulent activities. (A.985-986) (SPA.41-42)

B. Statement of the Facts

1. Background

a. Mizhen placed his assets in Strano's name

Mizhen and Strano were married in 2001. (A.664, A.896 ¶15)

Mizhen admitted -- in explaining the couple's "estate planning" strategy, including why he transferred the half-million dollar Boston Post Road property to Strano -- that he usually turns over his income to Strano and retains almost nothing in his own name: "[w]e have been doing the estate planning since 2004. And the way the estate planning worked all these years is, I tried to own the businesses and my wife owns her things as well personal (sic) assets and we just try to grow them together. So I do my part, she does her part." (A.659) Consistent with this financial arrangement, Mizhen testified that his income supports the family, but their home is placed in Strano's name and she pays the mortgage, stating: ". . . my wife pays the mortgage, but the agreement's been since day one that I derive the income and I give her the money and she actually pays the mortgage. So it's my salary that—that supports it, but she pays it." (A.658-659) Their financial arrangement is further confirmed by the lack of assets placed in

Mizhen's name that have been located and frozen thus far,² even though Strano has possessed in her name several million dollars in assets (including the Fellsmere accounts and the Boston Post Road property) (A.676-689, A.786-803, A.806, A.810, A.816-827, A.829-847), and Mizhen's companies (including the LeanSpa companies and his previous businesses, Media Network and New Age Opt In) received approximately \$50 million from consumers from these schemes. (A.375, A.662)

Consistent with their financial plan to put all of his (and joint) assets in her name, the couple (1) established brokerage accounts held under the name "Fellsmere Farm, LLC," and (2) acquired a property known as "3124 Boston Post Road," both of which were funded by moneys generated from Mizhen's prior businesses and placed under Strano's name.

² Based on financial information obtained by the Receiver, the agencies had represented in the district court that approximately \$2.2 million of the LeanSpa defendants' (including Mizhen's) assets had been located and frozen pursuant to the November 2011 stipulated PI (D.122 at 2, 5) – a figure undisputed by either Mizhen or Strano. The two largest components of the \$2.2 million in frozen funds consist of approximately \$1.46 million in frozen LeanSpa company assets (consisting primarily of funds possessed by the defendants' payment processors) (A.378, A.385, A.420), and a tax refund to Strano and Mizhen of approximately \$665,000. (A.332) Consistent with these undisputed figures, only about \$160,000 of the frozen funds consist of other assets held in Mizhen's name or by the couple jointly.

b. Mizhen funded, benefitted from, and had access to, the Fellsmere accounts

The record shows that Mizhen was the primary funder of the Fellsmere accounts. (A.673-674 ¶¶10-11, A.676-687, A.784) Prior to owning the defendant LeanSpa companies, Mizhen owned an online lead generation business called “Media Network, Inc.” (“Media Network”) and its parent company, “New Age Opt In, Inc.” (“New Age”), which generated approximately \$20 million in revenues between 2003 and approximately 2009. (A.656, A.662)³

Bank records show that, between 2005 and 2007, Mizhen transferred at least \$8.7 million from New Age and Media Network bank accounts he controlled into a joint account at Citizens Bank (#0637). (A.676-677 ¶15, A.699-706, A.784) Of the \$8.7 million contributed by Mizhen into the joint

³ In June 2010, Microsoft filed a lawsuit against Mizhen, Media Network, and New Age (and several other defendants) alleging that the defendants “conspired and executed a scheme to create millions of unauthorized Microsoft Hotmail e-accounts that Defendants used to sanitize their spam email messages in an attempt to circumvent Microsoft’s Hotmail spam filters.” *See Microsoft Corp. v. Mizhen et al.*, No: 2:10-cv-966 (W.D. Wa. filed June 6, 2010) (A.159-203) (emphasis in original). Mizhen paid Microsoft \$1 million from a LeanSpa company bank account to settle the lawsuit. (A.660) Mizhen had previously been sued by Microsoft in 2003 for allegedly operating a similar scheme designed to circumvent Microsoft’s Hotmail spam filers and disseminate large volumes of spam email, and which led to a permanent injunction against Mizhen and his companies. *Microsoft Corp. v. Merchant Commerce, LLC, et al.*, No. 03-2-15706-6 SEA (Wash. Super. Ct. Mar. 8, 2004). (A.197-203)

account, approximately \$6.9 million was transferred into brokerage accounts established under the name “Fellsmere Farm, LLC,” an entity incorporated in October 2005 and placed in Strano’s name as manager. (A.677 ¶16, A.707-720, A.784, A.786-804)⁴

The \$6.9 million consisted of two distinct asset flows. First, approximately \$4.5 million was transferred between January 2006 and August 2006 into a Fellsmere account at Merrill Lynch. (A.677-679 ¶¶16, 18, 19, A.707-720, A.721-725, A.784) Funds from this Merrill Lynch Fellsmere account were transferred in 2006 and 2007 to an identically named Fellsmere account at Wachovia Bank (now Wells Fargo).⁵ Second, another \$2.4 million from the joint account at Citizens Bank (again funded from Mizhen’s New Age and Media Network businesses) was transferred

⁴ Strano represented that she had a 97% ownership interest in the Fellsmere accounts, with Mizhen’s role limited to co-trustee of a trust that owns 3% of Fellsmere. (A.898 ¶¶21-22) Even if 97% of the brokerage assets were placed in her name, however as shown below, nearly all the Fellsmere funds ultimately derived from Mizhen’s prior business activities.

⁵ Approximately \$5.8 million (consisting of deposits from the joint bank account, other sources, and earnings) were transferred from the Merrill Lynch Fellsmere account (#7014) in September 2006 to the Wachovia Fellsmere account (#4521). (A.677-680 ¶¶17-20, A.721-725, A.726-742, A.784, A.935-937) Further, an additional \$608,000 was transferred from the same Merrill Lynch Fellsmere account to the same Wachovia Fellsmere account between October 2006 and January 2007. (A.682 ¶23, A.721, A.726-742, A.784)

directly to the primary Fellsmere account at Wachovia (#4521) between September 2006 and March 2007. (A.682-684 ¶¶24, 25, A.730, A.784)

Mizhen was also the chief beneficiary of the brokerage accounts. In 2010 more than \$3.1 million was withdrawn from the Wells Fargo Fellsmere accounts and transferred to a joint bank account at Wells Fargo, and then usually immediately withdrawn from that joint account and deposited into the LeanSpa companies' accounts or accounts of other companies owned or controlled by Mizhen. (A.672-674 ¶¶8-11, A.687-689 ¶¶30-33, A.743-748, A.749-760, A.784) Funds from the Fellsmere accounts were also used to pay Mizhen's personal obligations, including \$1.2 million in April 2007 for a tax payment and \$99,000 in October 2007 for an annuity. (A.726-727)

Finally, Mizhen was authorized to trade and make withdrawals from the principal Fellsmere account (ending in #4521) from the time it opened in September 2006. (A.813-814) Further, he periodically requested and received account balances for all the Fellsmere accounts, and had the ability to withdraw funds from those accounts. (A.816-827) Thus, Mizhen principally funded the Fellsmere accounts through his prior businesses and later used those accounts to fund the LeanSpa companies, other businesses, and his personal obligations.

c. Mizhen purchased the Boston Post Road property, which he transferred to Strano for no consideration

Mizhen also transferred his interests in real property – funded from his previous businesses – to Strano without consideration. On January 29, 2010, Mizhen signed a contract to buy an undeveloped property located at 3124 Boston Post Road in Guilford, Connecticut for \$525,000. (A.829-832) Soon afterwards, Mizhen assigned his interest in that property to an entity called “3124 Boston Post Road, LLC,” which Mizhen registered with the Connecticut Secretary of the State on March 8, 2010, as “Member, Manager.” (A.834-838) On March 17, 2010, \$500,000 was deposited into the couple’s joint bank account from a Media Network account and a Fellsmere account funded originally through Mizhen’s previous businesses. (A.840) On March 18, 2010, \$505,000 was transferred from that joint account to an account to fund the purchase. (A.841) The sale closed the next day.

According to Connecticut public records, Mizhen remains the sole “member/manager” of the Boston Post Road, LLC.⁶ However – typical of their family “estate plan” – Mizhen assigned his formal interest in 3124

⁶ See Connecticut Secretary of the State, Commercial Recording Division, <http://www.concord-sots.ct.gov/CONCORD/PublicInquiry?eid=9740&businessID=0998073> (search for “3124 Boston Post Road, LLC”) (last visited May 24, 2013).

Boston Post Road, LLC on April 20, 2010, to Strano “for no consideration.”
(A.847)⁷

2. Proceedings below

On November 7, 2011, the FTC and the State of Connecticut filed a Complaint (A.34-67), and an *ex parte* motion requesting a TRO (A.71-76), against Mizhen and three corporate entities he controlled, LeanSpa, LLC, NutraSlim, LLC, and NutraSlim, U.K. Ltd. (collectively, the “LeanSpa companies,” and together with Mizhen, the “LeanSpa defendants”). The complaint alleged that the LeanSpa defendants deceptively marketed and sold various “purported weight-loss and related health products under various brand names,” and in so doing violated Sections 5 and 12 of the FTC Act, 15 U.S.C. §§ 45(a), 52; the EFTA, 15 U.S.C. § 1693e(a); Section 205.10(b) of Regulation E, 12 C.F.R. § 205.10(b); and the CUTPA, Conn. Gen. Stat. § 42-110b, *et seq.* (A.34-67) More specifically, the complaint alleged that Mizhen, with the assistance of marketing affiliates, used fake online news stories to advertise that his acai berry and other products caused rapid and substantial weight loss without any special diet or exercise, and which lured consumers into pay small shipping charges for “free” samples of

⁷ As noted above, less than two months later, on June 6, 2010, Microsoft sued Mizhen and his lead generation enterprise for running an alleged email spamming operation. *See supra* at 8 n.3.

the product. Mizhen and his companies then allegedly enrolled consumers into continuity plans that were difficult to cancel and charged consumers \$79.00 or more monthly without their authorization. The court granted in part on November 14, 2011, the motion for a TRO that, *inter alia*, froze the assets of the LeanSpa defendants. (A.204-222)

After the parties filed a consent motion stipulating to a preliminary injunction (A.223-228), on November 22, 2011, the court entered a Stipulated Preliminary Injunction Order (“stipulated PI”) against the LeanSpa defendants, including Mizhen. (A.287-328) The November 2011 stipulated PI provided that the asset freeze shall apply to any “assets” that are: (a) “[o]wned or controlled, directly or indirectly, by any Defendant, in whole or in part . . .;” (b) “[h]eld for the benefit of any Defendant;” (c) “[i]n the actual or constructive possession of any Defendant;” or (d) “[o]wned, controlled by, or in the actual or constructive possession of any corporation, partnership, limited liability company, or other entity directly or indirectly owned, managed, or controlled by any Defendant” (A.297-301)

On July 26, 2012, the agencies filed an amended complaint adding the primary lead generator Mizhen had used in his scheme, LeadClick Media Inc., its successor, LeadClick Media, LLC (collectively, “LeadClick”), and LeadClick’s former principal Richard Chiang as defendants, and Strano,

Mizhen's spouse, as a relief defendant. (A.481-524) The amended complaint alleged violations of the same provisions of the FTC Act, EFTA, Regulation E, and CUTPA, and also sought to recover funds from relief defendant Strano. (A.487 ¶16) Strano filed a motion to dismiss on August 17, 2012 (D.109), which the district court denied on January 29, 2013.

(D.198)

On September 11, 2012, the agencies filed a motion for a preliminary injunction seeking to freeze certain assets held by Chiang and Strano.

(A.571) As to Strano, the agencies sought to freeze the Fellsmere accounts and the Boston Post Road property the agencies alleged were acquired using funds from Mizhen's previous business activities and subject to his control, and should therefore be frozen under the terms of the November 2011 stipulated PI. The agencies also sought funds that Strano allegedly received directly from the LeanSpa defendants. *Id.* After hearing argument on the motion (D.197), the court granted the agencies' motion as to Strano on January 29, 2013. (A.970-987) (SPA.26-43)⁸

In its ruling, the court first determined that it had subject matter jurisdiction over both the assets in Strano's possession traceable to LeanSpa's fraud, as well as other assets controlled by Mizhen (even if

⁸ On January 16, 2013, the court granted the parties' consent motion and entered a stipulated preliminary injunction as to defendant Chiang. (D.196)

nominally in Strano's name). (A.976-979) (SPA.32-35) The court invoked its inherent authority to fashion equitable relief, particularly to maintain the status quo pending final resolution, including the "power to issue freeze orders against nonparties." (A.977) (SPA.33) (citing *SEC v. Wencke*, 622 F.3d 1363, 1367 (9th Cir. 1980) and *SEC v. Hickey*, 322 F.3d 1123 (9th Cir. 2003)). The court also distinguished *SEC v. Cherif*, 933 F.2d 403 (7th Cir. 1991), which remanded a case where the record was inconclusive as to whether a nonparty should have been named as a nominal defendant or as a defendant who participated in the fraudulent scheme. Unlike *Cherif*, which discussed whether a federal securities statute provided authority to freeze the nonparty's assets, the court here held that its inherent equitable authority to issue the asset freeze, the asset freeze was necessary to give effect to a pre-existing order (the stipulated PI), and there was no concern that the agencies were "seeking to end-run the requirement to establish subject matter jurisdiction over a party it believes is complicit in the allegedly deceptive scheme." (A. 978) (SPA.34) The court concluded that it had the inherent equitable authority, and authority under the FTC Act Section 13(b), to freeze assets belonging to Mizhen, but in Strano's possession. (A.978-79) (SPA.34-35)

The court next found that Mizhen in fact controlled the Fellsmere accounts and the Boston Post Road property held in Strano's name. (A.979-985) (SPA.35-41) As for the Fellsmere accounts, the court found (based on bank record evidence reviewed by a FTC forensic accountant) that those accounts were principally funded by Mizhen – through his previous New Age lead generating business – and then transferred to the LeanSpa defendants and other entities controlled by Mizhen and used to pay Mizhen's personal obligations. (A.979-980) (SPA.35-36) The court found (based on the accountant's calculations) that "over 80 percent" of the funds transferred from the Fellsmere accounts to the LeanSpa defendants in 2010 could be traced back to Mizhen through his former companies. (A.980) (SPA.36)⁹

The court rejected Strano's claim that she was the source of the funds from New Age to the Fellsmere accounts because Mizhen owned New Age at the time funds were transferred to the accounts. (A.981-82) (SPA.37-38) The court also discredited Strano's testimony that she controlled the funds disbursed from the Fellsmere accounts to the LeanSpa entities through a \$4 million line of credit, concluding that she was "not a bona fide secured

⁹ The accountant subsequently revised his calculations slightly, recognizing that he could not identify the source of certain funds in the Merrill Lynch Fellsmere account (#7014). The accountant concluded that, even assuming that Mizhen was not the source of those unidentified funds, he still provided through New Age over 76% of the funds deposited into that Fellsmere account. (A.935-937)

creditor,” because it “was not an arms-length loan,” there were no required interest payments or financial statements, and the ultimate source of funds in the Fellsmere accounts derived from Mizhen through his former companies. (A.982-983) (SPA.38-39) The court thus concluded that “Mizhen, not Strano, was the one controlling the account and determining where and how the assets were used.” (A.983) (SPA.39)

The court next found that the Boston Post Road property also was controlled by Mizhen, based on the agencies’ evidence showing that Mizhen bought the property with his own funds and then transferred the property (through an LLC he created) to Strano for no consideration. (A.984-985) (SPA.40-41) Finally, the court froze \$297,000 of Strano’s personal assets, which it found derived from the LeanSpa defendants’ activities. (A.986) (SPA.42) On February 21, 2013, Strano filed her notice of appeal.¹⁰ (A.988-991)

STANDARD OF REVIEW

This Court reviews a district court order granting a preliminary injunction, including one imposing freezing assets, for abuse of discretion. *Smith v. SEC*, 653 F.3d 121, 127 (2d Cir. 2011) (citation omitted). A district

¹⁰ Strano has only appealed that portion of the court’s order applicable to the Fellsmere accounts and the Boston Post Road property but not that portion freezing the \$297,000 derived from the LeanSpa defendants’ scheme. *See Strano Br.* at 15 n.6.

court abuses its discretion when “it base[s] its ruling on an erroneous view of the law or on a clearly erroneous assessment of the evidence.” *New York ex rel. Spitzer v. Operation Rescue National*, 273 F.3d 184, 193 (2d Cir. 2001) (quoting *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 405 (1990)).

The standards in this preliminary injunction proceeding brought by government law enforcement agencies are well established. The plaintiff agencies need only show “a likelihood of success on the merits.” *Smith*, 653 F.3d at 127-28 (citation omitted); *SEC v. Cavanagh*, 155 F.3d 129, 136 (2d Cir. 1998). They need not prove irreparable harm as there is a presumption of such harm in these cases. *See, e.g., Smith*, 653 F.3d at 127; *Cavanagh*, 155 F.3d at 132. Nor must they “make any showing that a future violation is likely, because [they are] not accusing the nominal defendant of any wrongdoing.” *Cavanagh*, 155 F.3d at 136.

Further, a preliminary injunction imposing an asset freeze requires a “lesser showing” than one enjoining conduct, because an asset freeze is a provisional remedy that merely preserves the status quo to assure the availability of effective final relief and does not require satisfying the requirements to enjoin a statutory violation. *See Smith*, 653 F.3d at 128 (citation omitted); *SEC v. Heden*, 51 F. Supp.2d 296, 298 (S.D.N.Y. 1999). Rather, in a proceeding such as this one, the law enforcement agency need

only show that it is “likely ultimately to succeed” in a final judgment that these assets should be disgorged because they belong to the defendant.

CFTC v. Walsh, 618 F.3d 218, 225 (2d Cir. 2010) (citation omitted).

SUMMARY OF ARGUMENT

The district court acted entirely within its discretion by freezing the Fellsmere accounts and the Boston Post Road property held in the name of the relief defendant Angelina Strano, but that were in fact controlled by Strano’s husband, Boris Mizhen, a defendant in this action. The district court applied the proper legal standards to the facts to determine that the agencies were likely to succeed in showing that these assets belonged to Mizhen and thus were subject to the existing asset freeze against him.

Strano’s arguments that the district court lacked subject matter jurisdiction or authority to issue the asset freeze are without merit. The district court had jurisdiction to adjudicate the issue of ownership over the disputed assets even if Strano was not a named defendant. (Part A.1) The court also had the equitable authority to maintain the status quo and ensure the availability of effective final relief by freezing assets controlled by Mizhen but nominally possessed by Strano. (Part A.2)

The court applied the proper legal standards and factors in concluding that Mizhen controlled the disputed assets where he (1) funded the assets;

(2) benefitted from the assets; and (3) had access to the assets. The disputed assets were transferred to Strano as part of the couple's claimed grand "estate planning" arrangement to put all their assets into her name -- even those assets that derived from his prior business ventures. (Part B.1) The undisputed record shows that, consistent with this plan, Mizhen purchased the Boston Post Road property with his funds and promptly transferred the property to Strano without consideration. (Part B.2) The record also shows that Mizhen funded the Fellsmere accounts through income from his previous businesses, that he benefitted from those accounts, which were used to fund the LeanSpa defendants, his other businesses, and personal obligations, and that he had access to all these accounts. (Part B.3)

Finally, there is no merit to Strano's judicial estoppel argument. After Mizhen omitted information about the ownership of the Fellsmere accounts in his financial disclosure forms provided under court order, the government enforcement agencies learned through third-party discovery that the Fellsmere accounts belonged to Mizhen. The agencies then appropriately modified their position to reflect that newly acquired information. (Part C)

ARGUMENT

THE DISTRICT COURT PROPERLY GRANTED THE PRELIMINARY INJUNCTION FREEZING ASSETS CONTROLLED BY MIZHEN

From 2005 to 2010 defendant Boris Mizhen transferred millions of dollars from his business ventures to the Fellsmere accounts, and in 2010 transferred a half-million dollar real estate property to his wife, relief defendant Angelina Strano. These transfers were done as part of the couple's explicit plan to keep all the businesses (and presumably the associated risk) in Mizhen's name but placing all the profits and assets from those businesses into Strano's name – all while Mizhen reaped the benefits of those assets. Thus, even though those assets were placed in Strano's name, the district court properly held that the agencies were likely to succeed in showing that Mizhen has an equitable interest in and control over these assets, and that they were thus properly subject to the existing asset freeze against Mizhen as a provisional remedy pending final judgment. Because the district court applied the correct legal standards and its findings were not made in error, this Court should affirm its order.

A. The District Court had Jurisdiction to Issue a Preliminary Injunction Freezing Assets It Concluded Were Likely to Belong to Mizhen

Strano first asserts that the district court lacked subject matter jurisdiction over her because she is not accused of any wrongdoing. Strano Brief (“Br.”) at 18-22. She later argues that the court lacked the equitable authority to issue an asset freeze over the disputed assets. Strano Br. at 38-46. However, because she was named only as a relief defendant -- and in this context as the nominal holder of assets belonging to Mizhen -- the agencies need not assert subject matter jurisdiction with respect to any actions she has taken. Further, because the court has the equitable authority to freeze assets in the possession of a nonparty but that in fact belong to a defendant in order to preserve the possibility of effective final relief, it had jurisdiction to adjudicate the issue of ownership over those disputed assets and the authority to issue the preliminary injunction order.

1. The court had jurisdiction to adjudicate this matter

While Strano claims that the district court lacked jurisdiction over her because she is not alleged to have engaged in any wrongdoing, Strano Br. at 18-22, controlling precedent makes clear that the court had the requisite jurisdiction to adjudicate the ownership over the disputed assets. Indeed, *Cherif*, a case relied upon by Strano, stands for the principle that because the

FTC and Connecticut named Strano only as a nominal or relief defendant, they “need not assert an independent basis of subject matter jurisdiction” over her. 933 F.2d at 415. In fact, regarding the issues on appeal, Strano is simply a nonparty custodian who holds assets belonging to the named defendant Mizhen. Because there is no legal claim asserted against her, “it is unnecessary to obtain subject matter jurisdiction over [her] once jurisdiction over the defendant is established.” *Id.* at 414 (citations omitted); *see also CFTC v. Kimberlynn Creek Ranch, Inc.*, 276 F.3d 187, 191-92 (4th Cir. 2002) (“once the district court has acquired subject matter jurisdiction over the litigation regarding the conduct that produced the funds, it is not necessary for the court to separately obtain subject matter jurisdiction over the claim to the funds held by the nominal defendant” who is “joined purely as a ‘means of facilitating collection.’”) (*citing SEC v. Colello*, 139 F.3d 674, 676 (9th Cir. 1998)).

In this case the relevant inquiry is not subject matter jurisdiction over Strano’s actions, but jurisdiction to determine if the disputed assets belong to Mizhen and thus were properly frozen under the November 2011 stipulated PI. Over this issue, the court clearly had jurisdiction. *See Cherif*, 933 F.2d at 414 n.11 (“Courts have jurisdiction to decide the legitimacy of ownership claims made by non-parties to assets alleged to be proceeds of securities

laws violations.”) (citation omitted). Indeed, Strano’s argument that the court lacked subject matter jurisdiction assumes that these assets are not controlled by Mizhen. In fact, the evidence clearly shows that these assets were transferred to Strano from Mizhen as part of the couple’s explicit plan to put all the businesses (and presumably the associated risk) in Mizhen’s name, while putting all the assets and income, including profits from these businesses, into Strano’s name.

Thus, Strano’s reliance on *Cherif* is misplaced. Strano Br. at 19-20. In *Cherif*, the Seventh Circuit remanded a preliminary injunction order by the district court that barred Sanchou, the nominal defendant and the cousin of the primary wrongdoer Cherif, from disposing of bank account assets held in Sanchou’s name. 933 F.2d at 407. The Seventh Circuit remanded the case because the district court’s findings were ambiguous as to whether the cousin should be treated as a nominal defendant or a named defendant who directly engaged in securities law violations. *Id.* at 415. It was in this context of the “inconclusive” nature of the claim against the cousin that the Seventh Circuit made the unremarkable statement that the securities laws do not support an asset freeze against a “non-party, one against whom no wrongdoing is alleged,” if the actual basis for the freeze was a law violation. *Id.* at 413-14.

However, nothing in *Cherif* precluded imposing a freeze over assets in the cousin's name, as a nominal defendant, on the theory that he had "no ownership interest in the property which is the subject of litigation." *Id.* at 414. Thus, Strano is simply incorrect when she suggests that the district court's authority to issue equitable relief was limited to named liability defendants, excluding nonparties like Strano who hold the assets of a defendant. Strano Br. at 21. Indeed, *Cherif* recognized that federal courts have the authority to issue injunctive relief against a nonparty that holds the assets of a defendant. *See e.g., id.* at 414 n.11 ("If the non-party has no ownership interest in the disputed assets, equitable relief can be sought from the nonparty") (*citing Deckert v. Independence Shares Corp.*, 311 U.S. 282 (1940)); *id.* at 415 n.14 (approving issuance of injunction against nonparty) (*citing Int'l Controls Corp. v. Vesco*, 490 F.2d 1334, 1355 (2d Cir. 1974) (affirming asset freeze against a non-party that held legal title over a yacht where defendants used it and may have funded its purchase)). *Cherif* even noted that the asset freeze against the nonparty cousin was "valid" if the accounts did not belong to him so he was properly named as a nominal defendant. *Id.* at 415.¹¹

¹¹ For these reasons, Strano's further reliance on *FTC v. Cleverlink Trading, Ltd.*, No. 05 C 2889, 2006 WL 1735276 (N.D. Ill. 2006) is misplaced. *See* Strano Br. at 21. In fact, *Cleverlink* applied *Cherif* to a case brought under

The district court properly distinguished *Cherif* by noting, in particular, that here Strano was only named as a relief defendant so there were no concerns that the agencies were “seeking to end-run the requirement to establish subject matter jurisdiction over a party it believes is complicit in the allegedly deceptive scheme.” (A.977-978) (SPA.33-34) Thus, contrary to Strano’s contention, Strano Br. at 22, the district court directly addressed and resolved that it had jurisdiction to adjudicate Strano’s claim to the disputed assets.

2. The court had the equitable authority to freeze assets it concluded were likely to belong to Mizhen

Strano makes the related argument that the district court lacked the equitable authority to freeze assets in the possession of a relief defendant. Strano Br. at 21, 38-46. This argument is also without merit.

Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), provides in pertinent part that “in proper cases the Commission may seek, and after proper proof, the court may issue a permanent injunction” to enjoin violations of any law enforced by the FTC. Similarly, CUTPA grants the State of Connecticut the power to apply “for an order temporarily or permanently restraining and

the FTC Act to hold that it had “subject matter jurisdiction to decide the legitimacy of a [third party’s] claim to [disputed] assets.” *Id.* at *5 (citing *FTC v. Productive Mktg, Inc.*, 136 F. Supp. 2d 1096, 1103 n. 7 (C.D. Cal. 2001) (court had “*in rem* jurisdiction over the receivership assets in [third party corporation’s] possession.”)).

enjoining the continuance of such act or acts or for an order directing restitution and the appointment of a receiver in appropriate instances, or both.” Conn. Gen. Stat. § 42-110m(a). Additionally, CUTPA permits the court to “award the relief applied for or so much as it may deem proper . . . and such other relief as may be granted in equity.” *Id.*

It is well established that, incident to the express statutory authority in Section 13(b) to issue a permanent injunction, a district court may exercise its full equitable power to fashion effective relief. *See, e.g., FTC v. Bronson Partners, LLC*, 654 F.3d 359, 365 (2d Cir. 2011); *accord SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1103 (2d Cir. 1972) (“Once the equity jurisdiction of the district court has been properly invoked by a showing of a securities law violation, the court possesses the necessary power to fashion an appropriate remedy.”). This is particularly so in cases invoking the public interest, such that a court’s equitable powers in an enforcement action under Section 13(b) “assume an even broader and more flexible character than when only a private controversy is at stake.” *Porter v. Warner Holding Co.*, 328 U.S. 395, 398 (1946); *see also SEC v. Wencke*, 622 F.2d 1363, 1371 (9th Cir. 1980) (“The Supreme Court has repeatedly emphasized the broad equitable powers of the federal courts to shape equitable remedies to

the necessities of particular cases, especially where a federal agency seeks enforcement in the public interest.”).¹²

Based on these principles, it is well established in this Circuit that “once the equity jurisdiction of the district court properly has been invoked, the court has power to order all equitable relief necessary under the circumstances,” including an interim asset freeze to assure the availability of effective final relief. *Smith*, 653 F.3d at 128 (citations omitted); *accord SEC v. Unifund SAL*, 910 F.2d 1028, 1041 (2d Cir. 1990) (asset freeze “assures that any funds that may become due can be collected.”); *Manor Nursing*, 458 F.2d at 1105 (same). Other circuits agree. *See, e.g., Kimberlynn Creek Ranch*, 276 F.3d at 192-93; *FTC v. Affordable Media, LLC*, 179 F.3d 1228, 1236 (9th Cir. 1999); *FTC v. U.S. Oil & Gas Corp.*, 748 F.2d 1431, 1434 (11th Cir. 1984).

Further (and most pertinent to the issues here), “[t]he plenary powers of a federal court to order an asset freeze are not limited to assets held solely by an alleged wrongdoer, who is sued as a defendant in an enforcement action.” *Smith*, 653 F.3d at 128. Rather, an asset “freeze can apply to non-

¹² Strano erroneously points to 15 U.S.C. § 53(a)(1) as the statutory basis for the lower court’s authority to issue injunctive relief under the FTC Act. Strano Br. at 21. This provision, however, is limited to deceptive advertising. Rather, the Commission invoked 15 U.S.C. § 53(b) as the statutory basis for the court’s remedial authority. (A.482-83, A.521)

parties, such as relief defendants allegedly holding the funds of defendants.” *Heden*, 51 F. Supp. 2d at 299 (citing *U.S. v. First Nat’l City Bank*, 379 U.S. 378, 384 (1965)); accord *Kimberlynn Creek Ranch*, 276 F.3d at 192-93 (affirming asset freeze against a “custodian of the defendant’s assets, including a nominal defendant”).

Applying these principles, courts in this Circuit (affirmed by this Court) have frozen assets belonging to a named defendant, but held in the name of a nonparty (like Strano here), even where certain assets were not traced to the fraudulent scheme at issue, deeming such assets to be those of the defendant and covered by an existing freeze over the defendant’s assets. See *SEC v. McGinn, Smith & Co.*, 752 F. Supp. 2d. 194, 201-02, 207-08, 215-17 (N.D.N.Y. 2010), *vacated in part on other grounds*, *SEC v. Wojeski*, 752 F. Supp. 2d 220 (N.D.N.Y. 2010), *aff’d*, 432 Fed. App’x 10 (2d Cir. 2011) (summary order); *Heden*, 51 F. Supp. 2d at 299-300 (extending asset freeze over a brokerage account legally owned by the defendant’s father, finding that the account belonged to the defendant because he had access to the account he used to make trades).

The district court properly applied these principles to the facts here, holding that it had the authority to freeze assets in the possession of a nonparty like Strano, even if they were not proceeds derived from the fraud,

if they were controlled by Mizhen and thus subject to the November 2011 stipulated PI. (A.977-979) (SPA.33-35) In doing so, the district court relied upon two Ninth Circuit cases that upheld preliminary injunctive relief against nonparties, including an asset freeze where the assets were controlled by the named defendant. *See Hickey*, 322 F.3d at 1131-33 (court had authority to freeze the assets of a nonparty brokerage account nominally owned by defendant's mother where named defendant controlled the brokerage); *Wencke*, 622 F.2d at 1369-72 (upholding anti-litigation injunction against nonparties) (*citing, inter alia, Lankenau v. Coggeshall & Hicks*, 350 F.2d 61, 62 (2d Cir. 1965)). The *Wencke* court rejected the nonparty appellant's argument that it could not be enjoined where it was not accused of any wrongdoing and did not harbor ill-gotten gains: "[t]he power of a district court to . . . grant other forms of ancillary relief . . . derives from the inherent power of a court of equity to fashion effective relief." 622 F.2d at 1369. As *Hickey* later held, "the district court's authority to impose the asset freeze is supplied by the inherent power of the court to give necessary relief, along with the strong federal interest in insuring effective relief in [an agency] action brought to enforce" the law. 322 F.3d at 1133 (internal citations omitted).

Strano's attempts to distinguish *Wencke* and *Hickey* fail. Strano Br. at 40-42. First, she claims that neither case stands for the proposition that courts have inherent equitable authority to issue *preliminary* injunctive relief as both cases involved post-judgment proceedings. Strano Br. at 40-41. However, nothing in those two cases limited the court's equitable authority to postjudgment proceedings; rather, the underlying principle applied in those two cases – that a court's authority to issue orders against nonparties “derives from the inherent power of a court of equity to fashion effective relief,” *Wencke*, 622 F.2d at 1369 – applies equally to prejudgment proceedings like asset freezes. In *Hickey* and *Wencke*, the asset freeze and antiligation injunction were issued to ensure that the final judgment or contempt orders in those cases were effective. Here, the asset freeze over the Fellsmere accounts and the Boston Post Road property – found by the district court to be Mizhen's assets – were necessary to give effect to the November 2011 stipulated PI against Mizhen. The fact that Strano was not herself subject to the November 2011 stipulated PI in this case, Strano Br. at 41, is of no moment as the nonparties in *Hickey* and *Wencke* likewise were not subject to the earlier-entered orders.

Moreover, Strano is simply incorrect when she asserts that neither the lower court nor the agencies cited authority supporting prejudgment relief

against a nonparty. Strano Br. at 41. Many cases were cited authorizing such relief. *See, e.g., SEC v. Byers*, 609 F.3d 87 (2d Cir. 2010) (affirming antiligation injunction against nonparties); *Cavanagh*, 155 F.3d at 136-37 (affirming asset freeze over relief defendant).

Hickey is also not distinguishable based on the extent of control that the defendant in that case exercised over the nonparty brokerage. Strano Br. at 41. In fact, there is no indication that the defendant in *Hickey* funded the brokerage to the extent that Mizhen funded the Fellsmere accounts and paid for the Boston Post Road property; further, like the defendant in *Hickey*, Mizhen had access to and benefitted from the assets at issue. Indeed, similar to the defendant in *Hickey* funneling money through the brokerage to pay himself, here Mizhen funneled money from New Age to Fellsmere and then back to his businesses. Further, while *Hickey* stated that the defendant's "unfettered" and "complete" control over the nonparty brokerage justified a freeze in that case, it did not require such level of control, noting that it would simply be a more "difficult question" if less control were shown. *See id.*, 322 F.3d at 1133. More importantly, *Hickey*'s holding was based in large part on its realization that an asset freeze on the nonparty brokerage was necessary "to effectuate relief [*i.e.*, previously entered disgorgement and contempt orders on the defendant] *already given.*" *Id.* at 1133. Here, the

district court properly recognized that – given Mizhen’s acknowledgement that he essentially puts all his assets into Strano’s name while keeping the businesses in his name – the only way to “effectuate” the November 2011 asset freeze on Mizhen was to freeze the Fellsmere accounts and the Boston Post Road property and their millions of dollars of Mizhen’s assets.

Finally, *Wencke* cannot be distinguished simply because that case involved a receivership, Strano Br. at 41-42, as nothing in *Wencke* restricted a court’s equitable authority to impose preliminary relief against nonparties to the receivership context. Indeed, *Wencke* held broadly that “[t]he power of a district court to impose a receivership or *grant other forms of ancillary relief*. . . derives from the inherent power of a court of equity to fashion effective relief.” 622 F.2d at 1369 (emphasis added). Here, the district court properly relied upon *Wencke* and *Hickey* to conclude that it had the authority to freeze assets it found belonged to Mizhen.

3. The Supreme Court’s *Grupo Mexicano* decision does not preclude the preliminary equitable relief granted below

Although Strano concedes that “district courts are vested with broad equitable powers to fashion effective remedies,” she argues that, by freezing assets held in her name in this case, the court violated its statutory authority and the holding of *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond*

Fund, Inc., 527 U.S. 308 (1999). Strano Br. at 42-46. However, nothing in *Grupo Mexicano* limited the court’s authority to issue the asset freeze here.

In *Grupo Mexicano*, plaintiffs sued a company involved in a road construction project seeking breach of contract damages, as well as an asset freeze. 527 U.S. at 310-12. The Court considered whether “in an action *for money damages*, a [district court] has the power to issue a preliminary injunction preventing the defendant from transferring assets in which no lien or equitable interest is claimed.” *Id.* at 310 (emphasis added). The Court held that “the District Court had no authority to issue a preliminary injunction preventing petitioners from disposing of their assets pending adjudication of *respondents’ contract claim for money damages.*” *Id.* at 333 (emphasis added).

The Court, however, specifically distinguished two of its earlier decisions that affirmed preliminary equitable relief, including asset freezes, in suits seeking an equitable remedy. The Court first distinguished *Deckert v. Independence Shares Corp.*, 311 U.S. 282 (1940), holding that “[t]he preliminary relief available in a suit seeking equitable relief has nothing to do with the preliminary relief available in [a suit] seeking equitable assistance in the collection of a legal debt.” 527 U.S. at 325.

The Court in *Grupo Mexicano* also distinguished *United States v. First Nat'l City Bank*, 379 U.S. 378 (1965), which affirmed a preliminary injunction barring a nonparty bank from transferring the defendant's assets, because the government had brought the suit under a statute authorizing injunctive relief and because it recognized that courts of equity will "go much farther both to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are involved." 527 U.S. at 326 (citations omitted).

Consistent with this precedent, the courts of appeals to have considered the issue have held that *Grupo Mexicano* does not prevent a court from issuing preliminary injunctive relief -- including asset freezes on nonparties -- where the plaintiff seeks equitable relief, particularly in a public enforcement action. *See, e.g., Kennedy Bldg. Assocs. v. CBS Corp.*, 476 F.3d 530, 535 (8th Cir. 2007) (affirming "the use of equity in support of equity"); *Animale Group Inc. v. Sunny's Perfume Inc.*, 256 Fed. App'x. 707, 708-09 (5th Cir. 2007); *SEC v. ETS Payphones, Inc.*, 408 F.3d 727, 734 (11th Cir. 2005) (asset freeze in public suit seeking disgorgement and civil damages); *In re Focus Media Inc.*, 387 F.3d 1077, 1085 (9th Cir. 2004); *CSC Holdings, Inc. v. Redisi*, 309 F.3d 988, 996 (7th Cir. 2002); *United*

States ex rel Rahman v. Oncology Assoc's, P.C., 198 F.3d 489, 494-99 (4th Cir. 1999) (asset freeze in public suit seeking equitable relief).

Here, the FTC and Connecticut seek various forms of equitable relief, including an injunction, restitution, disgorgement, and consumer redress under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), and the CUTPA, § 42-110m(a). (A.521 ¶¶138, 139) In short, *Grupo Mexicano* does not bar the sort of relief granted below.

B. The District Court Applied the Proper Legal Standards in Concluding that the Agencies Were Likely to Succeed in Showing that Mizhen Controlled the Boston Post Road Property and the Fellsmere Accounts

Strano next asserts that the agencies failed to show that Mizhen exercised sufficient control over the Fellsmere accounts and the Boston Post Road property to be considered his, and thus subject to the November 2011 stipulated PI. Strano Br. at 22-38. In doing so, however, she misinterprets governing case law, misapplies the relevant factors, and downplays the facts that persuaded the district court to find control.

1. The district court applied the proper legal factors

Strano first argues that the agencies were “excuse[d]” from alleging a claim against her only where they could show she had the “non-interested status of the nominal defendant,” which she asserts can only be shown where the “assets in question are so profoundly controlled by the culpable

defendant that they are ‘deemed’ to be the defendant’s,” and are “to the exclusion of the nominal owner.” Strano Br. at 23-27. Strano also asserts the agencies failed to show control by Mizhen over each asset sought to be frozen. Strano Br. at 26, 29. To the contrary, the lower court applied the proper legal standards and correctly held that the agencies were likely to show that Mizhen exercised sufficient control over the frozen assets. (A.979-985) (SPA.35-41)¹³

While the relevant caselaw requires that the defendant exercise some degree of “control” over the disputed assets to be deemed the beneficial owner, the cases provide a variety of ways of describing the level of control, and each case must necessarily turn on its own facts. Indeed, in the cases in this Circuit most analogous to the instant case – and which Strano admits applied the proper governing standard, *see* Strano Br. at 28 – the “central inquiry” in determining control is whether the defendant “treated an asset as

¹³ To the extent Strano asserts that the ownership of assets claimed by a nominal defendant can only be resolved after “an evidentiary showing,” Strano Br. at 24, here the district court concluded that the agencies were likely to succeed on their claim that Mizhen controlled the disputed assets after considering a number of exhibits (including the Mizhen deposition transcript and the Strano declaration) submitted by both parties. In any event, the asset freeze was only provisional pending final judgment and does not preclude the parties from obtaining additional evidence of control during discovery and adjudicating the final merits of this claim at trial.

his own,” to implicate an equitable or beneficial ownership interest. *McGinn*, 752 F. Supp. 2d at 207-08, 215-17; *Heden*, 51 F. Supp. 2d at 299-300.¹⁴

In *McGinn*, a case directly on point, the district court granted a preliminary injunction to freeze the stock account of a defendant’s spouse, finding it to be a joint account and thus covered by an existing asset freeze over defendant’s assets, because the defendant exercised control over and derived benefits from the account. 752 F. Supp. 2d at 207-08, 215-17.

Similarly, in *Heden*, the court extended an asset freeze over a brokerage account nominally placed in the name of the defendant's father, finding that the account in fact belonged to the defendant because he had access to the account which he used to make trades. 51 F. Supp. 2d at 299-300.

These courts considered the following factors in assessing whether a defendant exercised the requisite control over the assets to be considered his own: (1) whether the defendant transferred his own assets into the account, (2) whether the defendant had an interest in and benefitted from the account, and (3) whether the defendant had access to the account. *See, e.g. McGinn*,

¹⁴ *See also Whiting v. Dow Chemical Co.*, 523 F.2d 680, 685-86 (2d Cir. 1975) (“In a traditional sense, in the absence of a statutory definition, a beneficial owner would be a person who does not have the legal title to the securities but who is, nonetheless, the beneficiary of a trust or a joint venture,” and noting that “[c]ases where the husband simply buys stock and put the shares in his wife’s name are relatively simple . . .”).

752 F. Supp. 2d at 207-08, 215-16, *Heden*, 51 F. Supp. 2d at 299-300.¹⁵

Further, these cases found sufficient control where the assets were deemed to be “jointly owned” by both the defendant and the nominal defendant, and did not require, as Strano claims (Strano Br. at 27), the total “exclusion” of control by the nominal defendant.¹⁶

As detailed below, these are precisely the factors that the district court here relied upon in concluding that the agencies were indeed likely to succeed in their claim that Mizhen controlled the assets in question. With respect to both the Boston Post Road property and the Fellsmere accounts,

¹⁵ Strano asserts, however, that “historical sourcing” of an asset is insufficient to find the requisite control over the asset. Strano Br. at 32 (citing *FTC v. Leshin*, No. 06-61851, 2011 WL 617500, at *23 (S.D. Fla. Feb. 15, 2011), and *SEC v. Zubkis*, No. 97-cv-8086, 2003 WL 22118978, at *6 (S.D.N.Y. Sept. 11, 2003). However, in both *Leshin* and *Zubkis*, the courts froze or disgorged assets belonging to nonparties after assessing the *McGinn* and *Heden* factors, including the initial sourcing of the asset. *See, e.g., Leshin*, 2011 WL 617500, at *19-20 (ordering disgorgement of bank account funded by both a defendant and his innocent spouse where the defendant deposited more than what remained in the account); *Zubkis*, 2003 WL 22118978, at *6 (freezing nonparty company’s accounts in which the defendant was the largest shareholder and used the accounts for his personal use “to ensure that [defendant] has not used [the nonparty] to shield the assets that should be used to satisfy the ordered disgorgement and to resolve any legitimate competing claims to those assets.”).

¹⁶ *See Smith v. SEC*, 432 Fed. App’x. 10, 12-13 (2d Cir. 2011) (affirming asset freeze of stock account established in nonparty spouse’s name before the illegal activities occurred where named defendant “was a joint owner of that account”); *Heden*, 51 F. Supp. 2d at 299 (“If an asset belonging to a relief defendant is, in reality, *also* an asset of a defendant, then the freeze sought is against the defendant’s assets.”) (emphasis added).

the court below carefully considered the evidence concerning the origin of those assets, the ways in which they were used to benefit defendant Mizhen and his businesses, and his effective control over those assets. In each instance, the court concluded that the agencies were likely to succeed in showing that the assets were controlled by Mizhen, and therefore properly subject to the asset freeze in the preliminary injunction. Indeed, the court concluded unambiguously that “the Fellsmere Accounts are controlled by Mizhen” (A.983) (SPA.39), “that Mizhen, not Strano, was the one controlling the account and determining where and how the assets were used,” *id.*, and that “the [Boston Post Road] Property is controlled by Mizhen and that he treats the Property as his own.” (A.985) (SPA.41)¹⁷

These conclusions were based, moreover, on the district court’s careful review of the evidentiary record, including a sworn declaration provided by Strano and the deposition of Mizhen. The court rejected Strano’s testimony as not credible on a number of material factual points,¹⁸

¹⁷ Thus, Strano errs in arguing based on a single sentence in the decision, that the district court applied the wrong legal standard by adopting the terms of the September 2011 stipulated PI to freeze the disputed assets if they were only “indirectly” controlled by Mizhen. Strano Br. at 30-31.

¹⁸ *See, e.g.*, (A.981) (SPA.37) (court notes that “Strano failed to provide sufficient documentation” backing up claim of sources of income); (A.982) (SPA.38) (based on conflicting evidence, the “court does not credit Strano’s testimony” regarding the sources of her income); (A.982) (SPA.38)

and instead credited the evidentiary showing made by the agencies. These findings were not clearly erroneous and should be affirmed on appeal. *See Smith*, 432 Fed. App'x. at 13 (district court did not commit clear error in concluding that defendant controlled assets held by nonparty spouse).

2. Mizhen controlled the Boston Post Road property

The undisputed evidence shows that Mizhen used funds from his previous New Age and Media Network lead generation businesses to enter into a contract to purchase the Boston Post Road property on January 29, 2010, and that the deal closed on March 19, 2010. (A.829-832); *see supra* at 11-12.¹⁹ Mizhen assigned his interest in the property to a LLC he created in March 2010. (A.834-838) Mizhen subsequently transferred his interests in the LLC to Strano *for no consideration* on April 20, 2010 (A.847) (and less than two months before he was sued by Microsoft in June 2010 for running an email spamming operation. (A.159-203)) This Court has held that such transactions, not conducted at arms-length, are not immune to freeze or

(rejecting Strano's assertion that payments from the Fellsmere accounts resulted from her loan because "the evidence tends to show that this was not an arms-length transaction"); (A.984) (SPA.40) (rejecting Strano's contention that the Boston Post Road property transfer "was made pursuant to an arms-length transaction").

¹⁹ Indeed, Strano's counsel confirmed at argument below that this property was paid for out of funds from the Fellsmere accounts. (A.963-64) (SPA.19-20)

disgorgement orders. *See Walsh*, 618 F.3d at 226 (holding that “the receipt of property as a gift, without the payment of consideration, does not create a ‘legitimate claim’ sufficient to immunize the property from disgorgement”) (*citing Cavanagh*, 155 F.3d at 137 and *SEC v. George*, 426 F.3d 786, 798 (6th Cir. 2005)).

Indeed, Mizhen testified that the property ended up in Strano’s name as part of the couple’s “estate planning” plan to place personal assets in her name while he held the business assets. (A.658-659) The evidence thus showed that, notwithstanding the transfer of the LLC to Strano, the property was funded by Mizhen’s prior business operations and given to Strano – for no consideration – as part of the couple’s plan to put all their collective assets into her name, likely as a method to avoid his business creditors.

After assessing the above-cited evidence and record carefully – and recognizing that “Strano offered no convincing explanation regarding why Mizhen needed to purchase the property on her behalf” – the district court properly concluded that “[t]aken together, these facts show that the Property is controlled by Mizhen and that he treats the Property as his own,” and thus

is subject to the November 2011 stipulated PI and asset freeze. (A.984-85) (SPA.40-41) This conclusion was not in error.²⁰

3. Mizhen controlled the Fellsmere accounts

Contrary to Strano arguments (Strano Br. at 34-36), the district court also properly concluded, based on its extensive review of the evidence, that the agencies were likely to show that Mizhen exercised control over the Fellsmere accounts. The court based this conclusion on the facts that: (1) Mizhen was the primary funding source for all of the Fellsmere accounts, having transferred assets from his prior lead generation businesses, New Age and Media Network, to the Fellsmere accounts; (2) funds from the Fellsmere

²⁰ Strano's only factual challenge to the court's conclusion is her claim that Mizhen has not been involved with the undeveloped property since he transferred it to her. Strano Br. at 33 n.15. There is, however, some evidence that Mizhen still maintains a significant role as a "member/manager" of the LLC. See Connecticut Secretary of the State, Commercial Recording Division, [http://www.concord-sots.ct.gov/CONCORD/PublicInquiry?eid=9740 &businessID=0998073](http://www.concord-sots.ct.gov/CONCORD/PublicInquiry?eid=9740&businessID=0998073) (search for "3124 Boston Post Road, LLC") (last visited May 24, 2013). Even if this were not the case, however, the mere fact that a defendant does not formally own an asset under state corporate law does not preclude a court from exercising its equitable authority and freezing that asset possessed by a nonparty if there are other indicia of control. See, e.g., *Hickey*, 322 F.3d at 1131 (concluding that failure to find that nonparty was alter ego of defendant under state law did not preclude freezing the nonparty's assets, because "[w]e do not think that state law limitations on the alter ego theory or doctrine are necessarily controlling in determining the permitted scope of remedial orders under federal regulatory statutes.") (citation omitted); *Zubkis*, 2003 WL 22118978, at *5 (noting that the agency had "made a strong showing that [the defendant] is adept at using the protections afforded by the corporate form to obscure the assets he has at his disposal.").

accounts were withdrawn for Mizhen's benefit to periodically fund his other business operations – including the LeanSpa defendants – and well as his personal obligations; and (3) Mizhen had access to each account, and had the authority to trade and make withdrawals from the principal Fellsmere account (#4521). (A.979-983) (SPA.35-39); *see also* (A.672-674 ¶¶8-11) Thus, applying the factors in *McGinn* and *Heden*, the court properly held that Mizhen exercised control over the Fellsmere accounts such that those assets should be considered his and frozen under the November 2011 stipulated PI.

As to the first factor, the district court found control based on undisputed evidence that Mizhen was the primary funding source for the Fellsmere accounts by depositing millions of dollars from his prior businesses, New Age Opt In and Media Network.²¹ The agencies' forensic accountant traced over \$8.7 million from a New Age bank account controlled by Mizhen and deposited into a joint account at Citizens Bank between April 2005 to May 2007 (A.673-674 ¶¶10-11, A.676-677 ¶¶14-15, A.699-706, A.784), and that more than \$6.9 million of the \$8.7 million from that joint account was transferred to the Fellsmere accounts between April

²¹ It is undisputed that Mizhen was the sole owner and manager of New Age during the period that these transfers occurred. (A.662, A.676-677, A.699-706)

2005 and May 2007. (A.677 ¶16, A.707-720, A.784); *see supra* at 8-10.²²

Indeed, Mizhen confirmed that, through 2009, he transferred a portion of the \$20 million generated from his lead generation companies through a joint account that flowed to the Fellsmere accounts. (A.662-63, A.665) As in *McGinn* and *Heden*, Mizhen's historical funding of the Fellsmere accounts strongly supports his control over those accounts.

Second, the district court recognized control by Mizhen based on bank records showing that funds from the Fellsmere accounts were withdrawn for Mizhen's benefit and deposited into his ongoing business concerns, including the LeanSpa defendants, Media Network, and Humboldt Payments (a payment processor), as well as to pay for his personal expenses. *See supra* at 10. These records showed that over \$3.1 million was transferred in

²² As shown above, the undisputed evidence shows that the \$6.9 million was transferred through two distinct asset flows. First, approximately \$4.5 million was transferred from the couple's joint account at Citizens Bank to one of the Fellsmere accounts at Merrill Lynch between January 2006 and August 2006, and subsequently transferred (along with the account's earnings and deposits from other sources) for a total of \$5.8 million in September 2006 to an identically named Fellsmere account (#4521) at Wachovia Bank. (A.677-680 ¶¶16-20, A.683-684, A.707-720, A.721, A.722-725, A.784, A.935-937). Second, \$2.4 million was transferred directly from the couple's joint account at Citizens Bank to the primary Fellsmere account (#4521) at Wachovia. (A.682-684 ¶¶24-25, A.730, A.784) *See supra* at 8-10. The evidence also shows that, other than account #4521, the other six Fellsmere accounts at Wachovia/Wells Fargo only had a *de minimis* amount of deposits from external sources in addition to transactions with other Fellsmere accounts. (A.680-681 ¶21, A.686-687 ¶29)

2010 from the Fellsmere accounts at Wells Fargo, through a jointly held bank account, “and then transferred, almost immediately” (usually on the same day and for the same or nearly the same amount) to bank accounts held by the LeanSpa companies or other Mizhen companies. (A.672-673 ¶¶8-9), A.686-689 ¶¶29-33, A.726-742, A.743-748, A.784) The agencies’ forensic accountant testified that these bank records showed “that the Fellsmere Farm money was treated like money from any Mizhen company – it was transferred between companies where and when it was needed . . . and is consistent with the showing . . . that Mizhen was the ultimate source of the money in the Fellsmere Farm Wachovia/Wells Fargo accounts.” (A.688 ¶32) As the district court concluded, the overwhelming portion of the funds transferred from the Fellsmere accounts (through the joint bank account) to the LeanSpa entities could be traced back to Mizhen through the New Age and Media Network companies he controlled. (A.980) (SPA.36) (citing A.673 ¶10) The district court also properly concluded that funds were transferred from the Fellsmere accounts for Mizhen’s personal obligations, including a \$1.3 million tax payment in 2007 and an annuity. (A.980) (SPA.36) (*citing* A.726-727)

Third, the agencies provided undisputed evidence that Mizhen had access to and monitored account balances of all the Fellsmere accounts, and

had the ability to withdraw funds for his benefit, in particular from the primary Fellsmere account (#4521). (A.813-814, A.816-827) Based on Mizhen's funding of the Fellsmere accounts, his receiving benefits from the accounts, and his monitoring and access to the accounts, the district court properly held that Mizhen controlled the accounts such that they were subject to the November 2011 freeze order. (A.979-983) (SPA.35-39)

Strano's attempts to rebut Mizhen's control of the Fellsmere accounts, including her assertion that the district court failed to engage in an "asset-by-asset" analysis, Strano Br. at 34-35, all fall flat. She first argues that the Fellsmere LLC entity itself is controlled by her and not Mizhen. Strano Br. at 34. Even if that were true (and the record only indicates that the LLC was placed in her name, A.786-804), it is irrelevant as she cannot contest that the LLC is a shell entity that consisted only of the brokerage accounts that were funded by Mizhen for his benefit.

Her further contention that the Fellsmere accounts were funded before LeanSpa's deceptive operations, *id.*, similarly is irrelevant as the agencies are not seeking to freeze these assets as ill-gotten proceeds from LeanSpa's scheme itself, but rather as assets belonging to Mizhen. Finally, she asserts that, even if Mizhen had the power of attorney over one account (#4521), the record lacks evidence of his trading on this account or control over the other

six Fellsmere accounts. Strano Br. at 35. In fact, Mizhen was provided full authority to trade and withdraw funds from account #4521 (A.813-14), there was substantial trading on this account, and this account was (by far) the primary source of Fellsmere funds (approximately \$3 million) used to fund (usually via the couple's joint bank account #4115) to Mizhen's other business concerns including the LeanSpa entities. (A.674 ¶11, A.680-81 ¶¶21-22, A.687-689 ¶¶30-33, A.727-728, A.731-32, A.743-748, A.749-760, A.784) Further, Mizhen's control over the other Fellsmere accounts is shown, not only by undisputed evidence reflecting that he had access to and monitored balances in all those accounts (A.816-827), but that he could also withdraw funds from those accounts (A.820), and because the other Fellsmere accounts were principally funded by Fellsmere account #4521 (A.680-687 ¶¶21-29, A.726-742), which (as shown above) was largely funded by Mizhen through his previous lead generation businesses. Thus, contrary to her argument, Strano Br. 34-35, the record fully supports the court's finding that Mizhen exercised the requisite control over all of the Fellsmere accounts.

Similarly, Strano's claims that Mizhen did not benefit from the Fellsmere accounts are all without merit. Strano Br. at 36-38. First, her assertion that, as a legal matter, the district court improperly relied on

McGinn because the facts in the two cases differ, Strano Br. at 36-37, is belied by the fact that the district court relied upon the essential factors reflecting control that were applied by *McGinn* (and affirmed by this Court in *Smith*, 432 Fed. App'x at 12-13).

Second, while Strano does not dispute that funds flowed from the primary Fellsmere account #4521 to the LeanSpa entities, Strano Br. at 34 n.16, she asserts that these payments were actually a legitimate loan she made to the LeanSpa defendants pursuant to a purported "Loan and Security Agreement" creating a \$4 million line of credit. Strano Br. at 37 (citing A.852-856) However, as the district court found, the evidence shows that the loan agreement between Strano and LeanSpa was a sham and that Strano was not a bona fide secured creditor. (A.982-83) (SPA.38-39)

For example, while the alleged agreement called for quarterly interest payments and monthly financial statements, (A.852-53), there is no showing that any such interest was ever paid or interest calculations made, that monthly financial statements were ever sent, that the alleged loan advances were recorded and sent to LeanSpa on a monthly basis, or that LeanSpa repaid loans back to Strano on a regular repayment schedule. (A.982) (SPA.38) As in *McGinn*, 752 F. Supp.2d. at 215-16, Strano's claim of being a bona fide creditor is undercut by the absence of any interest payments,

interest rate calculations, or payment schedules that are typical indicia of a legitimate “arms-length” loan.

Further, Mizhen himself failed to recognize Strano as a bona fide secured creditor when he attempted to assign certain LeanSpa companies’ assets – which presumably would have secured any “loan” from Strano – to defendant LeadClick. (A.864-69) Moreover, as shown above, the funds from the Fellsmere account #4521 that Strano relies upon as the source of the “loans” were initially funded by Mizhen through his earlier business operations, New Age and Media Network, and did not derive from any independent sources of income from Strano. (A.673-674 ¶¶10-11, A.676-687 ¶¶14-29, A.732, A.784) All of this evidence supports the district court’s conclusion that Strano was not a bona fide creditor, but simply facilitated Mizhen’s access to funds effectively under his control.

Finally, as for Mizhen’s tax obligation funded from the Fellsmere accounts, the record shows that the payment listed Mizhen solely as the “Source/Destination Account or Payee.” (A.726-727) Moreover, even if Strano shared in this benefit along with Mizhen, she does not contest that Mizhen benefitted at least jointly from the use of the Fellsmere accounts to fund this tax payment, *see* Strano Br. at 37-38, which is all that is required to

show control. *See McGinn*, 752 F. Supp. 2d at 207; *Heden*, 51 F. Supp. 2d at 299.

After extensively reviewing the evidence, the district court properly concluded that the agencies were likely to show that all of the Fellsmere accounts were controlled by and used for the benefit of Mizhen, and thus should be considered his assets subject to the asset freeze in the November 2011 stipulated PI. (A.983) (SPA.39) This conclusion should be upheld.

C. The Agencies Were Not Judicially Estopped from Arguing that the Fellsmere Accounts Should be Frozen Because They are Controlled by Mizhen

Finally, Strano argues that the agencies were judicially estopped from arguing that the Fellsmere accounts were frozen under the November 2011 stipulated PI as belonging to Mizhen, because they had previously argued in opposing an earlier motion by Mizhen to unfreeze a tax refund that Strano had “significant unfrozen assets” including the Fellsmere accounts. Strano Br. at 46-47 (citing A.350).

The agencies’ change in position, however, was entirely reasonable and is not barred by the doctrine of judicial estoppel. *See Bates v. Long Island R.R. Co.*, 997 F.2d 1028, 1037 (2d Cir. 1993) (doctrine of “judicial estoppel protects the sanctity of the oath and the integrity of the judicial process.”). At the time the agencies made their argument opposing release of the tax

refund (January 2012), the Fellsmere accounts (which the agencies noted were held in Strano's name) were indeed unfrozen and appeared to be freely available to Strano because there was little indication at the time that Mizhen controlled those accounts. The agencies' subsequent request to freeze the Fellsmere accounts in September 2012 was based on *new* evidence obtained from third party financial institutions in discovery after January 2012 reflecting Mizhen's control over the Fellsmere accounts that was omitted from Mizhen's financial disclosure statement he was required to submit as required by the court's November 2011 stipulated PI. (A.243-244)

The agencies also opposed Mizhen's motion on other grounds, including that the relief requested was premature and unsubstantiated, and that the court had previously released some of Mizhen's other funds so he could pay for his expenses. (A.350) As the district court found (A.985 n.3) (SPA.41 n.3), there is simply no showing that granting the agencies' subsequent request to freeze the Fellsmere accounts (once they had evidence that those assets actually belonged to Mizhen) in any way violated the "sanctity of the oath and the integrity of the judicial process." Strano's argument is, therefore, entirely without merit.

CONCLUSION

Based on the foregoing, this Court should affirm the district court's preliminary injunction order against Strano.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that the Brief for the Appellees Federal Trade Commission and State of Connecticut complies with the type-volume limitation set forth in Fed. R. App. P. 32(a)(7)(B) because it contains 11,990 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii), as counted by the Microsoft Word word processing program used to prepare the Brief.

I further certify that the Appellees' Brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because the Brief has been prepared in a proportionally spaced typeface in 14-point Times New Roman font.

Dated: May 28, 2013

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