

# Neora Triumphs over FTC in Landmark Case

Texas direct seller successfully defends itself against all charges, business model upheld



In a pivotal ruling, Dallas-based direct sales firm Neora has prevailed against the Federal Trade Commission (FTC) in a multi-year legal case that has drawn the focus of industry executives, direct selling participants and regulatory agencies. The U.S. District Court for the Northern District of Texas, Dallas Division, announced its decision on Sept. 28, 2023, stating that the FTC failed to provide substantial evidence to support its claims that Neora operated as a pyramid scheme. After a seven-year battle, the ruling comes as a major win for Neora and

the direct selling channel at large, affirming the legality of the company's business model.

In the 56-page ruling, Judge Barbara Lynn denied every FTC claim against the company as well as its CEO, Jeffrey Olson, rejecting the Commission's argument that Neora was operating as an illegal pyramid scheme and that it made deceptive income and product claims. The decision represents the first instance of a direct selling company successfully defending itself against pyramid scheme allegations in court.

**Case History – An Unprecedented Response Leads to Decisive Victory**

In 2016, Neora was targeted by the consumer advocacy group Truth in Advertising (TINA). According to the TINA website, "TINA.org investigated Neora, formerly known as Nerium International, a Texas-based multilevel marketing company that sells a line of skin care products, as well as supplements, and found that

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the company and its distributors used unsubstantiated disease-treatment claims to market products and atypical income claims to recruit distributors.” TINA subsequently requested that the FTC open an investigation of Neora.

On June 21, 2016, the FTC issued a 28-page Civil Investigative Demand (CID) to Neora, and over the next three and a half years, the company provided the Commission with millions of documents, emails, sales and compensation data files.

Despite having access to this information, as well as the analysis of econometrician Dr. Walter Vanaele — the former economic advisor to the FTC’s Director of the Bureau of Economics who argued that Neora was not a pyramid scheme — the FTC demanded that Neora stop operating as a multi-level marketing company and that its owner, Olson, cease working in the direct selling channel.

On Nov. 1, 2019, just hours before the FTC brought its charges against the company, Neora and Olson filed a 60-page countersuit complaint against the FTC in Chicago Federal Court challenging the Commission’s “intimidation tactics” against the company and the direct selling channel as a whole.

Neora and Olson’s lawsuit sought declaratory and injunctive relief, asking the court to officially state that its business model does not constitute a pyramid scheme. It also aimed to block the FTC from initiating civil

administrative proceedings against Neora and other direct sellers already deemed legal under state laws.

Neora’s complaint stated that the FTC’s actions against it and other direct sellers violated a recent presidential executive order aimed at preventing federal agencies from altering existing regulations without following proper procedures, including public notice. Neora argued that the FTC sidestepped these requirements to pursue its enforcement actions.

Neora’s lawsuit was ultimately dismissed for lack of subject matter jurisdiction. The court ruled that the claims presented were not “ripe for judicial resolution” and that the plaintiffs could defend themselves in the FTC’s enforcement action.

### **FTC Sues Neora and Its Owner/ CEO**

A five-count lawsuit was filed by the FTC on the same day as Neora’s suit, Nov. 1, 2019, in the U.S. District Court of New Jersey. In it, the Commission alleged that Neora and Olson operated the company as an illegal pyramid scheme (Count 1); violated Sections 5 and 12 of the FTC Act by making unsubstantiated income claims (Count 2) and product claims, including efficacy and establishment claims (Counts 3 and 4). The defendants were also accused of providing the “means and instrumentalities” for Brand Partners to disseminate the allegedly non-compliant claims (Count 5).

Also included in the lawsuit were Signum Biosciences and Signum Nutralogix, two companies that were suppliers of the active ingredient in two of Neora’s products, a brain health supplement called EHT that is derived from coffee.

The FTC alleged that, starting in 2014, the defendants made unsupported health claims about their EHT products, including claims that these products could help treat or prevent conditions such as Alzheimer’s, Parkinson’s and chronic traumatic encephalopathy (CTE), a progressive neurodegenerative disease associated with head trauma and concussion.

In the week-long trial held in October 2022, U.S. District Judge Lynn weighed whether the FTC was entitled to injunctive relief against the defendants. Originally, the FTC had also sought monetary damages under Section 13(b) of the FTC Act.

However, following the Supreme Court’s 2021 decision in *AMG Capital* that the Commission could not obtain monetary redress through 13(b), the court dismissed the FTC’s claims for financial redress.

### **Case Transferred to Dallas Court**

In a July 27, 2020, ruling, the Federal District Court in New Jersey approved a motion from Neora and Olson to

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— *Larry Steinberg, Chair, Multilevel Marketing Industry Group, Buchalter*



relocate their case to the Fifth Circuit U.S. District Court in Dallas, contrary to the FTC's preferred New Jersey venue. Following this win, Neora informed the Federal District Court in Chicago on Aug. 14 that it would drop its Chicago lawsuit against the FTC and consolidate all claims into the Dallas case.

### **The 5th Circuit's *Torres* Pyramid Test**

In determining what constitutes an illegal pyramid scheme, the Texas court used the Fifth Circuit's framework from *Torres v. SGE Management* as a test, rather than the more well-known and cited *Koscot* test, which the Fifth Circuit has never formally adopted. The *Torres* criteria require courts to examine how a multi-level marketing business functions in reality.

Unlike the *Koscot* test, the *Torres* test has specific guidelines more aligned with the Fifth Circuit's jurisprudence. Under the *Torres* test, a court needs to consider two main factors:

1. The court must examine how the multi-level marketing (MLM) company operates in actual practice, not just according to its stated policies or promotional materials.
2. The primary consideration is whether the MLM business focuses almost exclusively on recruitment rather than the sale of actual goods or services. If the primary business activity is recruitment and not sales, it is more likely to be deemed an illegal pyramid scheme.

### **Court Rejects Opinions of FTC's Expert Witness**

In a major blow to the Commission's case, the court dismissed the testimony of Dr. Stacie Bosley, a frequently cited expert witness for the FTC and the FTC's only witness to testify in support of its pyramid scheme claim.

Bosley testified that 96% of Neora's approximately 400,000 distributors, or Brand Partners (BPs), have lost money.



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— Brent Kugler, Partner, Scheef & Stone LLP



She claimed that Neora's rewards structure is mainly recruitment-based, rather than tied to actual sales, making it a pyramid scheme. The court found issues with Dr. Bosley's assumptions, which didn't consider BPs who buy products for personal use rather than to qualify for rewards.

Dr. Bosley's analysis was based on three key assumptions: 1) An ultimate user is someone who buys the product solely for its value and not for a business opportunity. 2) Rewards don't have to be completely unrelated to sales to ultimate users for a system to be a pyramid scheme. 3) BPs primarily buy products to pursue business opportunities, thus not qualifying as ultimate users.

The court, however, pointed out that the FTC offered no tangible evidence supporting the third assumption. Neora presented data suggesting that some BPs are motivated by product discounts, challenging the FTC's claims.

The court also criticized the FTC for failing to consider evidence about why BPs make purchases, contrary to its own 2018 guidance. The court concluded that while the FTC may speculate that Neora BPs could be purchasing products to qualify for recruitment incentives, it provided no solid evidence to support this theory, thereby failing to meet the criteria for proving Neora as a pyramid scheme.

### **Court Validates Neora's Disclaimer and Disclosure Statements**

In response to the Commission's accusations of non-compliant earnings claims, the court acknowledged some issues with the examples provided by the FTC but pointed out that many dated back to before 2019 or were from now-discontinued programs.

For recent earnings claims, the court highlighted that Neora included a prominent disclaimer stating there was no guaranteed income level for Brand Partners. The disclaimer also directed viewers to an Income Disclosure Statement. The court found Neora's efforts to align its policies with FTC guidelines issued in 2018 and suggestions from the Direct Selling Self-Regulatory Council (DSSRC) to be significant.

### **FTC Unable to Prove Neora Responsible for Statements Made by Brand Partners**

Count 3 alleged that Neora falsely claimed its EHT product was effective at preventing and treating several medical conditions, including Alzheimer's and Parkinson's diseases. Count 4 charged Neora with falsely asserting that EHT has been scientifically proven to prevent or treat these conditions.

The FTC's case heavily relied on recent statements by Neora Brand Partners (BPs) on social media linking EHT with various diseases. However, the court found that the FTC did not prove that Neora was responsible for the BPs' false claims. Furthermore, while the FTC pointed to older misrepresentations made in 2015, the court noted that those materials were outdated and that Neora had advised against making such medical claims.

In a footnote, the court detailed further its opinions on the relationship between BPs and the defendants.

“As discussed, the FTC has not established that BPs are Defendants' agents, and thus the Court disregards statements or representations by BPs in evaluating whether Defendants have violated § 5 of the FTC Act by making misleading representations regarding BPs' potential income. However, even if BPs are considered Defendants' agents for purposes of the income and product claims, the Court concludes that there is no basis to impose liability on Defendants for statements by BPs in light of a rigorous compliance program and proactive efforts Defendants take to curb problematic statements by BPs through training efforts, approved marketing materials, and enforcement of the relevant policies in the P&Ps.”



### **Means and Instrumentalities Count Dismissed**

The FTC alleged in Count 5 that Neora and its affiliates violated consumer protection laws by distributing deceptive marketing materials to its representatives. These materials allegedly misled consumers about earning potential and the scientific backing of Neora's EHT products.

However, the court found that Neora provided clear guidelines and ongoing training to its BPs to ensure compliant income and product statements. Additionally, the FTC did not contest the company's income disclosure statements or its compliance materials. The court concluded that Neora did not provide the means for its Business Partners to deceive consumers, thereby finding no violation of Section 5 of the FTC Act.

### **DSA Files Amicus Brief**

On July 20, 2023, the Direct Selling Association (DSA) submitted a “friend of the court” brief for consideration. This action came after the FTC drew the court's attention to a recent Arizona case against Success by Health, where the latter was deemed a pyramid scheme.

In its submission, DSA emphasized existing legal parameters for lawful compensation models, specifically citing that rewards should be “mainly based on recruitment.” The DSA brief supplemented a more extensive document that the Association had previously submitted prior to the trial.

After the court's decision was announced, DSA President and CEO Joseph Mariano stated, “The court cited the company's robust inventory repurchase agreement and strong compliance efforts that all DSA members abide by. The decision reinforces the importance of these principles as core tenets of consumer protection and Neora's adherence to them as part of their membership in the association.”

### **Legal Perspectives on the Neora Case**

Various legal minds across the direct selling channel recognize that this case

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will have far-reaching implications that will affect future FTC actions against direct sellers.

“Though there is much in this decision to celebrate, this is not time to spike the football,” cautions Larry Steinberg, chair of the Multilevel Marketing Group at Buchalter law firm.

“Perhaps the biggest takeaway from the court’s decision is that, if a company can prove that its business is primarily driven by retail sales, and if a company devotes the resources necessary for a proactive and robust compliance effort, a court will not simply rubberstamp the FTC’s conclusory and unproven allegation that the business opportunity is a pyramid.”

Steinberg continues, “There are many elements in the decision worthy of note, but one which will be of great use to the industry going forward is a recognition that a distributor’s purchase of products which have demonstrated retail demand and real value should not, without convincing evidence, automatically be considered as a business expense and a cost of the business opportunity.

“Given Neora’s preferred customer program, which constituted 80% of the company’s sales, any company without a healthy preferred customer program would be well advised to give serious consideration to instituting and supporting such a program.”

John Sanders, a partner at Winston & Strawn, highlights the significance of the court’s rejection of many important elements of the FTC’s case, but cautions the Commission will likely be better prepared in future litigation.

“The outcome of the FTC’s case against Neora represents a significant victory for the direct selling industry,” Sanders says. “In the recent past, the FTC has persistently pushed new theories for what constitutes unlawful conduct. Judge Lynn’s rejection of many of the FTC’s theories goes a long way in providing much-needed guidance to legitimate direct sellers.



“The court’s rejection of the FTC expert’s opinion that sales to distributors cannot constitute sales to end users is an important win. So too was the court’s acceptance of Neora’s contention that not all distributors sign up to earn compensation.

“However, the industry should not read too far into the decision,” Sanders warns. “A close reading of the opinion makes clear that the decision could have gone the other way if Neora did not have data and other evidence to demonstrate that it operated a legitimate business in practice. The FTC could also have done a far better job adducing evidence of its claims. You can expect the FTC to be far better prepared should it bring a future case against a direct selling company.”

Brent Kugler, a partner at Scheef & Stone LLP, notes the importance of the court’s rejection of the Commission’s subjective criteria for a pyramid scheme, relying instead on established case law.

“One of the positives from FTC v. Neora is the Court’s refusal to apply an expanded definition of pyramid scheme beyond that found in existing case law and FTC interpretative publications,” Kugler says.

“A concerning development in the fall of 2019 was the FTC’s espousal of new criteria for defining an illegal

compensation plan, notably Andrew Smith’s public comments about ‘threshold-based’ and ‘duplication-based’ compensation structures.

“In *Neora*, the court framed its analysis of the FTC’s pyramid scheme allegations around existing case law, notably *Koscot* and its Fifth Circuit progeny, *Torres v. SMG Management*, and FTC’s 2004 Staff Advisory Opinion and 2018 Guidance to the MLM Industry, which set forth FTC position statements on factors distinguishing between a legal compensation structure and an illegal pyramid.

“The Court rejected FTC’s attempt to move the goal posts delineating what constitutes an illegal pyramid based upon unpublished, subjective criteria,” Kugler says. “Just as importantly, the Court cited the FTC’s lack of published guidance to industry on permissible earnings claims as a key factor in finding that Neora is not liable for publishing deceptive or misleading income claims.”

**SSN**



David Bland is the publisher of *Social Selling News*.