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Direct Seller's Data Counters FTC's Pyramid Scheme Complaint Based On 'Assumption' About Sales

by [Malcolm Spicer](#)

Ruling in Texas federal court on FTC complaint against Neora could serve as instructions for agency on how not to prosecute pyramid scheme allegations and for direct sellers about operating businesses so regulators find no hint of sales associates' compensation plans based more on recruiting additional participants than on selling products.

A Texas federal court ruling pokes holes in the Federal Trade Commission's expectations for alleging pyramid schemes against direct sellers by picking apart the agency's complaint against dietary supplement and beauty products firm Neora LLC.

The [ruling](#) by Judge Barbara Lynn in US District Court for North Texas on the FTC complaint for a permanent injunction could serve as instructions for the agency on how not to prosecute pyramid scheme allegations.

Direct sellers, or multi-level marketers, also could find instructions in the ruling published on 28 September about operating their businesses so the FTC and other regulators find no hint of a compensation plan for independent sales associates based more on recruiting additional participants than on selling products to end users.

Additionally, Lynn's ruling on the [complaint](#) filed in 2019 runs counter to trends in the FTC's enforcement on allegations of false and misleading advertising against direct sellers. Counter to the FTC's stance on direct sellers' "agency" for sales associates, the judge found that Neora isn't responsible for its representatives' claims.

She also found counter to the FTC's expectations for all consumer product firms' advertising by saying current ad claims for Neora's products,



NEORA OFFERS DIETARY SUPPLEMENTS INCLUDING PROTEIN POWDERS, ABOVE, AND A BEAUTY LINE INCLUDING SKIN CARE PRODUCTS, BELOW. Source: Source: Shutterstock

opposed to the claims the agency identified in its complaint, are compliant, which rebuts allegations about previous claims (*see related story*).

Whether Neora is operating as a pyramid scheme, Lynn wrote in the ruling, “hinges on whether sales to BPs [brand partners – the firm’s term for its representatives] are sales to ultimate users, and the FTC simply assumes that they are not.”

“The Court by no means suggests that [Neora’s] evidence is sufficient to predict or speak on the motivations of all BPs purchasing product from Neora; it is, however, sufficient to rebut [the FTC’s] assumption that no BPs purchase product for personal consumption,” Lynn added.

Although an expert testifying for the FDA in the bench trial conducted a year ago in Dallas – “the only witness to testify in support of the FTC’s pyramid scheme claim” – made an “assumption that all BP purchases are in pursuit of the business opportunity, the FTC provided no tangible evidence” showing whether any purchases were for a BP’s own use, according to the ruling.

Lynn, appointed to the court in 1999 by former President Clinton, wrote that the FTC argued that Neora’s evidence was unreliable, including an April 2022 third-party survey asking current and former BPs why they joined the firm; the top reason was to receive discounts on products or to earn free products.

“But the FTC makes no attempt of its own to unbundle BPs’ intent to consume Neora products as ultimate users from their motivation to participate in the business opportunity,” she stated, finding “there is a particularly compelling reason to do so here.”

The ruling points out “evidence that there exists a legitimate and substantial consumer demand for Neora’s products” with “the vast majority of Neora’s product sales,” between 75% and 80%, to “preferred customers,” consumers who regularly buy from the firm, receive price discounts and are not BPs.

The ruling notes that an estimated less than 1% of Neora’s product sales are made to retail customers, who don’t regularly make purchases and don’t receive discounts. Sales to preferred and retail customers are considered “ultimate end-user sales,” made “for personal use without the intent to resell to anyone else.”

Advertising law attorney John Villafranco told HBW Insight that Neora likely has a better system than many direct sellers for tracking its sales.

“I think this is really good news because I think it really suggests to those companies that their investments in compliance really will pay off,” said Villafranco, a partner at Kelly Drye & Warren LLP in Washington, noting that the “judge really gave the company a lot of credit for its efforts in compliance.”

The ruling also noted that although the firm doesn’t track sales its BPs, which currently number between 30,000 and 35,000, make from their own inventories, it tracks retail sales made through its website.

“That’s not always the case for a lot of direct sellers. For Neora it was a good thing that they had the data that was necessary to support their contention that there was legitimate retail demand,” Villafranco said.

He said all direct sellers, if they can, should have similar sales-tracking systems.

“They’re going to have to figure out another way to establish that there is legitimate retail demand. I think that if anything this case really does establish the proposition that retail demand, sales data remain significant in any pyramid analysis,” he said.

“It’s absolutely critical. However you are able to maintain that sales data is going to really advance your defense if you’re someday required to defend against a pyramid claim.”

Whither Your 2018 Guidance, FTC?

Lynn, the senior judge in the district, also pointed out the FTC’s failure to provide evidence supporting the assumption is contrary to its 2018 guidance on compliance by direct sellers, or multi-

‘Aspire To Abide By’ Advertising Laws Crucial For Direct Seller’s Defense Against FTC Complaint

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In other finding at odds with previous court decisions, federal judge says direct seller Neora doesn’t have an “agency relationship” to its independent sales representatives and isn’t responsible for ad claims they post.

[Read the full article here](#)

Neora’s Supplier Settled

The FTC’s complaint against Neora also targeted Signum Biosciences Inc., supplier of the active ingredient for Neora’s EHT supplement – proprietary coffee extract eicosanoyl-5- hydroxytryptamide – as deceptively promoting Nerium’s EHT

level marketers, with its prohibition against misleading claims, a document which notes settlements with two dietary supplement marketers as examples for the agency's enforcement policies. (Also see "[Supplement Sector Settlements Frame FTC Guidance On Direct Sellers' Compensation Claims](#)" - HBW Insight, 4 Jan, 2018.)

The judge explained that the guidance "observed that, when considering the issue of multi-level marketing participants' internal consumption, the FTC is likely to consider 'information bearing on whether purchases were in fact made to satisfy personal demand to consume the product'."

She further referenced the text of the guidance as stating products "purchased and consumed by [direct sellers' sales associates] to satisfy their own genuine product demand—as distinct from all product purchased by participants that is not resold—is not in itself indicative of a problematic MLM compensation structure."

And the agency affirmed an advisory opinion it published in 2004 by stating in the guidance that the FTC's analysis "involves a comprehensive analysis of a variety of factors."

The FTC opinion stated that "when evaluating the issue of participants' internal consumption, the FTC staff is likely to consider" factors including "whether features of the MLM's compensation structure incentivize or encourage participants to purchase

supplements.

Signum, of Monmouth Junction, NJ, settled with the agency in 2019 and agreed not to make baseless claims about EHT or other supplements and to provide evidence for the commission's enforcement against Neora.

Neora noted the settlement at the time. "It is unfortunate that the FTC has now responded to our lawsuit by suing our company in New Jersey, citing product statements made years ago by one of our suppliers with which, interestingly, the FTC has now settled for no money," it said.

The Neora complaint filed in November 2019 was the FTC's second in a month and its third in three years alleging a supplement and personal care direct seller operated a pyramid scheme rather than generating most of its revenues through sales to consumers. In October that year, the commission announced AdvoCare International L.P., of Plano, TX, admitted to operating as a pyramid scheme and agreed to pay \$150m in fines and to no longer operate in multi-level marketing but to use only a single-tier direct-sales model. (Also see "[Advocare Out Of Pyramid Scheme, Into Single-Tier Sales Under FTC Settlement](#)" - HBW Insight, 2 Oct, 2019.)

In 2016, Vemma Nutrition Co. agreed in 2016 not to operate a pyramid scheme and its CEO agreed to pay nearly \$500,000 in fines, although the Tempe, AZ, firm said it did not admit to conducting a pyramid scheme and

product for reasons other than satisfying genuine demand” and information indicating “whether purchases were in fact made to satisfy personal demand to consume the product,” according to Lynn’s ruling.

Neora Went Offensive On Defense

The FTC declined to comment, including whether it planned to appeal Judge Lynn’s ruling to the Fifth Circuit Court of Appeals.

Unlike the typical response from other direct sellers the FTC has targeted in complaints alleging pyramid schemes along with advertising violations, Dallas-based Neora didn’t agree to settle but filed a complaint seeking an order to block the FTC action before it was filed. (Also see ["Direct Seller Neora Pushes Back On FTC Pyramid Scheme, False Claims Complaint"](#) - HBW Insight, 4 Nov, 2019.)

The firm, which launched in 2011 as Nerium International LLC before changing its name in 2019, was represented by attorneys with Foley & Lardner LLP.

In a 2 October release, Neora co-CEO Deborah Heisz said the ruling “affirms what we have known all along – that Neora is an ethical company.”

"Our brand partners have worked diligently to build their businesses and this ruling is a testament to their hard work and dedication. We are proud to be part of an industry that empowers entrepreneurs – especially women – and creates real opportunities for success," Heisz said.

that it was not required to pay a fine. (Also see ["Vemma's FTC Settlement Points Out Pyramid Scheme Charge"](#) - HBW Insight, 16 Dec, 2016.)

Separately and also in 2016, Herbalife Nutrition Ltd. and the FTC reached a settlement on the agency's complaint alleging misleading business practices. In addition to imposing a \$200m fine, the settlement announced July 15 requires the Los Angeles-based firm, then operating as Herbalife Ltd., to determine compensation for its independent distributors based on actual retail sales, rather than on the number of additional product distributors they recruit into their networks, and it must show at least 80% of its revenues are to end-users. (Also see ["Herbalife Claims No Harm, But FTC Hails 'Unprecedented' Settlement's Impact"](#) - HBW Insight, 15 Jul, 2016.)

The settlement, on an FTC complaint stemming from an investigation launched in 2013 and limited to the global firm's US business, also requires distributors to be active for a year before launching "nutrition clubs," the practice of selling consumers daily consumption amounts that has been a key driver for sales in markets outside the US.

The FTC also required Herbalife to limit distributors' initial and monthly purchases, to allow more time for distributors to claim refunds and to hire an independent monitor to audit its compensation practices for seven years.

Founder and CEO Jeff Olson said the firm’s complaint challenged “the over-reach of the FTC.”

“We knew we would have a battle on our hands, but we were supremely confident that the facts and data would show the truth,” Olson said.

In an amicus brief, the Direct Selling Association said the FTC’s “overemphasis on recruiting” in its complaint against Neora would have “a profound impact on the state of the law and negatively impact operations of a sizeable portion of the United States economy.”



Source: Shutterstock

The association heightened self-regulation toward compliance by MLMs by funding BBB National Programs Inc.’s Direct Selling Self-Regulatory Council launched in 2019 to review advertising by direct sellers. In 2020, the council and the DSA developed guidance aimed at curbing ads with inflated earnings potential claims. (Also see "[Direct Sales Industry Guidance Responds To ‘Increase In Questionable Earnings Claims’](#)" - HBW Insight, 10 Jul, 2020.)

‘Holes In FTC’s Case’

Villafranco also sees the FTC’s allegations as exceeding what the facts of the case showed.

“It’s less about what Neora demonstrated and more about what Judge Lynn considered to be holes in the FTC’s case. I think that the judge felt pretty strongly that the FTC and its expert ... failed to establish that this was an illegal pyramid scheme,” he said.

He said the judge was clear in her dismissal of the opinion offered by the FTC’s expert, Stacie Bosley, an associate professor of economics at Hamline University and a business consultant with a particular focus on MLMs in the US and worldwide.

“I think that really was the critical turning point here,” Villafranco said.

In the ruling, Lynn said Bosley’s examination of Neora focused too much on the firm’s policies and too little on its sales data. She wrote that she “refuses to slavishly look only to the Compensation Plan in isolation, with blinders on to the actual operational data and internal

structure of Neora's business.”

Lynn wrote that “the Court is not blindly counting documents or words, but instead evaluating the materials before it holistically to see whether Neora primarily encourages its BPs to pursue recruitment of BPs in lieu of sales.”

The firm presented data showing 80% of its sales are to end users and 20% go to the BPs.

“I don't think that the judge was persuaded that the FTC rebutted that evidence,” Villafranco said.

“The FTC put a lot of stock in what they perceived as being a failure by Neora to demonstrate that individuals who are pursuing the business opportunity were making any money. The judge was unpersuaded by the FTC's profitability data, which she believed were considered in a vacuum.”

Villafranco said Lynn's ruling shows the FTC didn't consider the number of people buying and using Neora's products but instead focused on compensation for its BPs.

“That was enough in her mind to conclude that the FTC had failed to establish that it was an illegal pyramid scheme. ... because of the way that the decision was written with an emphasis on the holes in the FTCs case, I wouldn't expect the FTC to make these mistakes again,” he said.

“I think that it's inevitable that there will be another case at some point in the future. And when that case occurs, I would expect the litigators at the FTC to have learned from the judge's decision here about the nature and extent of evidence that it needs to present in order to establish businesses have an illegal pyramid scheme.”

Because Judge Lynn “concluded that there was a failure of proof” in the FTC's complaint against Neora, “I expect that they'll learn from this particular case,” Villafranco said.

“They'll put on a different case” in future pyramid scheme litigations, “let's put it that way, with evidence that will advance whatever theory it is they're advancing,” he added.