

Section 13 (b)log: Direct Seller Stands Its Ground: Neora Seeks Declaratory Judgment Against the FTC, Challenging the Agency's Section 13(b) Authority

[John E. Villafranco](#)

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Section 13 (b)log



The continuing questions over the extent of the FTC's enforcement authority to obtain monetary relief under Section 13(b) did not stop the Commission from filing a lawsuit on November 1 against multi-level marketer Neora, LLC and its CEO Jeffrey Olson for purportedly operating an illegal pyramid scheme that used deceptive marketing to sell supplements, skin creams and other products.

Pursuant to Section 13(b), the FTC seeks an injunction to stop Neora's alleged pyramid scheme and an award of restitution to return money to consumers. The lawsuit, filed in the District of New Jersey, alleges that Neora (formerly known as Nerium International) and its CEO offered false promises that potential distributors could earn financial independence if they joined the company's pyramid scheme – while, in reality, most recruits would end up losing money.

The lawsuit comes as part of the Commission's larger efforts to crack down on multi-level marketing pyramid schemes. But interestingly, when it saw the lawsuit against it coming, Neora opted to lodge an aggressive attack of its own against the FTC.

In a lawsuit filed in the Northern District of Illinois (Seventh Circuit) against the FTC, Neora and Olson asked the court to declare that its company did not operate as a pyramid scheme. The company's complaint also asserted that the FTC is not authorized to seek restitution or disgorgement under Section 13(b) – effectively contending that the FTC's attempt to punish Neora by seeking restitution is not available as a remedy.

So what happens next? As an initial matter, the Department of Justice will have first crack at the

case, given that Neora is seeking a declaratory judgment. Regardless of whether DOJ or the FTC leads the government's response, we would expect a motion for a change of venue from Illinois to New Jersey, with argument that it is not possible to litigate the motion for declaratory judgment without litigating the facts of the underlying case. If the court agrees, the case would be moved to New Jersey where there is binding precedent that is more favorable to the Commission's position.

Section 13(b) Questioned in the Seventh Circuit

The company's choice of forum was no doubt driven by the Seventh Circuit's landmark decision earlier this year in *FTC v. Credit Bureau Center LLC*. In that case, the Seventh Circuit held that the FTC could not obtain monetary relief in the form of restitution under Section 13(b). The court reasoned that Section 13(b)'s text cites injunctions as the FTC's exclusive remedy, thus foreclosing the FTC from seeking restitution. As we have reported previously, the Seventh Circuit's decision overturned three decades of its own precedent and broke with eight other federal appellate courts.

The FTC has stated that the opinion will not change its enforcement behavior. In a recent panel discussion, FTC Chief Litigation Counsel Bikram Bandy remarked that *Credit Bureau Center* would not alter the Commission's approach to deterring fraud by seeking restitution. In ongoing litigation where the FTC is seeking monetary relief from defendants, according to Mr. Bandy, the FTC has prevailed (so far) on all motions raised by opposing counsel that have attempted to assert the legal theories advanced in *Credit Bureau Center* as a means of blocking a restitution award.

However, Mr. Bandy also noted that the FTC's desire to remain aggressive would continue in all circuits that have not adopted the *Credit Bureau Center* holding – which is to say, all circuits other than Seventh. Neora's decision to file against the FTC in the Northern District of Illinois means that the court will not be able to ignore *Credit Bureau Center's* holding relating to Section 13(b).

In a different development that also could have far-reaching implications for the FTC's ability to obtain civil monetary penalties, the U.S. Supreme Court granted certiorari on November 1 in *Liu v. SEC*. The Supreme Court will consider whether the SEC may obtain disgorgement under the Securities Act, which only mentions "equitable relief." The SEC has obtained disgorgement in many instances by asserting that it is a form of equitable relief, but Liu has asserted that disgorgement is a penalty – not an equitable remedy – and therefore is not permitted under a plain reading of the Securities Act. The Court's interpretation in *Liu* could prompt courts to reevaluate whether Section 13(b) of the FTC Act allows for restitution.

The FTC's Campaign Against Multi-Level Marketers

Why was Neora determined to go on the offensive? According to Neora's complaint, the FTC has been "improperly" reinterpreting the law on pyramid schemes without proper legislation or rulemaking in an attempt to effectively outlaw multi-level marketing (MLMs.) Neora alleges that the FTC assumes that no incentives can be paid for recruitment of participating distributors, even when the MLM makes robust sales to satisfied consumers.

In a statement, Andrew Smith, the Director of the FTC's Bureau of Consumer Protection, distinguished between legitimate MLMs and pyramid schemes, in alleging that Neora's business model functions as part of the latter: "Participants in legitimate multi-level marketing companies earn money based on actual sales to real customers, rather than recruitment. But pyramid schemes depend on recruitment of new participants to pay out to existing participants, meaning that the vast majority of participants will ultimately lose money."

In alleging that Neora directs its distributors to focus on recruiting instead of selling its product, the FTC cited a 2015 promotional video, where one of the company's top earners remarked that distributors must take three steps to "explode" their business: "Number one. Recruit. Number two: Recruit. Number three: Recruit." Beyond the recruitment-related allegations, the FTC also contended that Neora and its CEO deceptively promoted certain supplements as a means of curing concussions, chronic traumatic encephalopathy caused by brain trauma and Alzheimer's disease.

Neora was not the only company targeted in the FTC's investigation: the Commission also brought lawsuits against Signum Biosciences and Signum Nutralogix. Unlike Neora, both Signum entities agreed to settle with the FTC. As per the terms of the settlement agreement, both entities will stop making certain claims relating to specific supplements at issue.

On a similar note, last month, the FTC announced it had entered into a \$150 million settlement order with AdvoCare International, L.P. and its former chief executive officer. The settlement bans AdvoCare from the multi-level marketing business to resolve the FTC's charges that the company operated an illegal pyramid scheme that deceived consumers into believing that they could earn considerable income as distributors of health and wellness products. In announcing the settlement, the FTC's Smith stated: "The FTC is committed to shutting down illegal pyramid schemes like this and getting money back for consumers whenever possible."

Firing Back at the FTC

But will the FTC be permitted to continue seeking such restitution awards? In Neora's complaint against the FTC, the company alleges that the FTC had threatened to sue Neora in the Northern District of Illinois since July 2018 under Section 13(b). Neora claims that the FTC only threatened to sue in the District of New Jersey – where it eventually brought the lawsuit – as a result of the Seventh Circuit's contrary opinion in *Credit Bureau Center*.

In a detailed "factual background" section in its complaint, Neora covers the "string of federal court losses" suffered by the FTC relating to the extent of its authority to file lawsuits without first exhausting its own administrative process, regarding its authority to recover monetary relief and relating to its authority to seek injunctive relief. Neora's complaint predicts that "other Circuit Courts" will follow the Seventh Circuit's lead in limiting the FTC's enforcement powers to only restraining orders and injunctions under Section 13(b).

Thus, Neora seeks a declaration from the Northern District of Illinois that Section 13(b) does not authorize the FTC to seek "rescission or reformation of contracts, restitution, the refund of monies paid, disgorgement of ill-gotten monies, and other equitable relief" and instead only authorizes the Commission to seek injunctive relief for ongoing conduct.

If Neora succeeds, the FTC's goal of "getting money back for consumers" would no longer be on the table – at least within courts in the Seventh Circuit. Neora's hard-hitting approach to challenging the FTC's claims against it – especially by invoking the ongoing debate over Section 13(b) – certainly bears watching.

Stay tuned for more installments of the "Section 13 (b)log."