

# ESSAY

## A MULTILEVEL MARKETING COMPANY'S BATTLE TO SURVIVE AN FTC PYRAMID SCHEME ACTION

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After three years of investigation and protracted settlement discussions,<sup>1</sup> the Federal Trade Commission (FTC) and a Texas-based multilevel marketing (MLM) company, Nerium International, LLC (n/k/a Neora, LLC) (Nerium), filed dueling lawsuits against one another on November 1, 2019. Nerium struck first, filing a sixty-page declaratory judgment action against the FTC in Illinois federal district court.<sup>2</sup> Less than two hours later,<sup>3</sup> the FTC filed a five-count complaint against Nerium in New Jersey federal district court.<sup>4</sup>

Although Nerium purports to seek relief on behalf of “the MLM industry as a whole,”<sup>5</sup> it is likely that Nerium’s back-handed tactic of racing

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1. See Plaintiffs’ Original Verified Complaint for Declaratory Judgment, Preliminary, & Permanent Injunctive Relief ¶ 19, *Nerium Int’l, LLC v. FTC*, No. 1:19-cv-07189 (N.D. Ill. Nov. 1, 2019), ECF No. 1 [hereinafter Plaintiff’s Verified Complaint].

2. *Id.*

3. See Plaintiff Federal Trade Commission’s Memorandum of Law in Opposition to Defendants Neora, LLC & Jeffery Olson’s Motion to Dismiss or, in the Alternative, to Transfer this Action, & for Other Additional Relief at 5, *FTC v. Neora, LLC*, No. 3:19-cv-19699-FLW-TJB (D.N.J. Dec. 23, 2019), ECF No. 18 [hereinafter FTC’s Opposition to Motion to Dismiss].

4. See Complaint for Permanent Injunction & Other Equitable Relief, *FTC v. Neora, LLC*, No. 3:19-cv-19699-FLW-TJB (D.N.J. Nov. 1, 2019), ECF No. 1.

5. Plaintiff’s Verified Complaint, *supra* note 1, ¶ 101.

to the courthouse to preemptively sue the FTC will end up doing more harm than good to the MLM industry. Nerium was able to get out in front of the charges that it operates a pyramid scheme because the FTC informed the company three days prior that the agency would soon file a complaint against Nerium—as well as its CEO, Jeffrey Olson, and its supplement supplier—if a settlement could not be reached.<sup>6</sup> The FTC has since signaled that it will not likely forewarn potential MLM defendants again of imminent filings, lest the agency should once again find itself the defendant. Further, Nerium is far from the ideal MLM company to lead the charge for the industry. Since its inception, Nerium has used inappropriate income claims and illegal disease treatment claims to promote its business and sell products.<sup>7</sup>

Although Nerium asserts that it filed its complaint in Illinois because, among other things, that is where the FTC lawyers who conducted the investigation “reside,”<sup>8</sup> its action is a clear case of forum shopping. The move can best be described as a not-so-veiled attempt to challenge the FTC in a jurisdiction that Nerium believes is more likely to agree with its wish list—a fact highlighted in a recent amici curiae brief filed by twenty-two states, the District of Columbia, and Puerto Rico.<sup>9</sup> The brief supports the FTC’s attempt to overturn *FTC v. Credit Bureau Center*,<sup>10</sup> a Seventh Circuit decision curtailing the agency’s ability to obtain monetary equitable relief under Section 13(b) of the FTC Act.

In the Illinois action, Nerium claims that the FTC “is attempting to unilaterally and retroactively outlaw multi-level marketing” and “take the ‘multi’ out of multi level [sic] marketing.”<sup>11</sup> The complaint posits that the FTC is attempting “to improperly, unilaterally, and retroactively change the law” when it comes to what is a pyramid scheme.<sup>12</sup> Among other things, Nerium asks the court to declare that:

**[1]** When reviewing multi-level marketing companies for possible illegal pyramid activities, the FTC must count product purchases by participants in the MLM as

6. See FTC’s Opposition to Motion to Dismiss, *supra* note 3, at 9–10.

7. See *Summary of Action*, TRUTH IN ADVERT., <https://www.truthinadvertising.org/nerium-summary-of-action/> (last visited June 17, 2020).

8. See Memorandum of Law of Defendants Neora, LLC, & Jeffrey Olson in Support of their Motion to Dismiss or, in the alternative, to Transfer this Action, & for Other Additional Relief at 17, *FTC v. Neora, LLC*, No. 3:19-cv-19699-FLW-TJB (D.N.J. Dec. 11, 2019), ECF No. 14-1 (“The NDIL is where . . . FTC’s counsel in this case reside”).

9. See Brief of the States of Illinois et al. as Amici Curiae in Support of Petitioner at 3, 7, *FTC v. Credit Bureau Ctr., LLC*, No. 19-825 (U.S. Jan. 30, 2020), 2020 WL 550753.

10. See *FTC v. Credit Bureau Ctr., LLC*, 937 F.3d 764 (7th Cir. 2019).

11. Plaintiff’s Verified Complaint, *supra* note 1, ¶¶ 55, 60.

12. *Id.* ¶ 1.

purchases by end users absent evidence that the products are being purchased for inventory, samples, or are otherwise not being used by the purchaser.<sup>13</sup>

**[2]** When reviewing multi-level marketing companies for possible illegal pyramid activities, the FTC must analyze the source of funds being used to pay compensation and determine if the compensation is being paid primarily by revenue from sales of products for end use.<sup>14</sup>

**[3]** The FTC may not bring any civil administrative enforcement proceeding or adjudication alleging an illegal pyramid scheme under the FTC Act against a company that conforms its business practices to state statutes defining and prohibiting illegal pyramids unless the FTC first promulgates a rule pursuant to full APA [Administrative Procedure Act] procedures that establishes a different federal definition of an illegal pyramid scheme, or the FTC Act is amended to include such a definition.<sup>15</sup>

Nerium also requests that the court declare that it is not, and never has been, a pyramid scheme.<sup>16</sup> All told, Nerium seeks a dozen declarations that read more like a legislative manifesto than remedies that a court could properly grant. Essentially, Nerium is seeking to have the court legislate from the bench. Ironically, in response to the FTC's allegations of Nerium's improper tactics, the company instead asks the court—untethered from a true case or controversy—to order relief in the form of an advisory legal opinion that vindicates the rights of the entire MLM industry. Such a public rights action would most certainly be an illegitimate exercise of judicial power.

Many in the MLM industry have cheered Nerium's lawsuit against the FTC and have committed their support to the beleaguered company in its fight against the federal agency. In fact, Nerium has set up a legal defense fund to help defray the costs of its clash with the FTC.<sup>17</sup> To date, the company has reportedly spent more than \$2 million in legal fees and more than \$1 million on an expert report.<sup>18</sup> Unsurprisingly, the expert report opines that Nerium is not a pyramid scheme.<sup>19</sup>

There are, however, substantive problems with Nerium's lawsuit. Among them, the complaint relies heavily on irrelevant material to argue that the FTC is attempting to improperly change the law when it comes to pyramid schemes. For example, Nerium's complaint contains allegations concerning the FTC's investigation of the company,<sup>20</sup> raises grievances regarding past

13. *Id.* ¶ 101(6).

14. *Id.* ¶ 101(7).

15. *Id.* ¶ 101(11).

16. *Id.* ¶ 101(3)–(4).

17. Letter from Jeff Olson, CEO, Neora, LLC (2019), <https://www.truthinadvertising.org/wp-content/uploads/2020/03/Direct-Selling-Action-Fund-Letter.pdf>.

18. *Id.*

19. See FTC's Opposition to Motion to Dismiss, *supra* note 3, at 2.

20. See Plaintiff's Verified Complaint, *supra* note 1, ¶¶ 19–27.

settlement discussions,<sup>21</sup> and even focuses on comments made by an FTC employee at a Direct Selling Association conference that did not necessarily reflect the views of the Commission.<sup>22</sup>

Nonetheless, Nerium's complaint appears to have served a cathartic process for the company, its founder, and the MLM industry as a whole; an industry increasingly unsettled by recent FTC actions and enforcement. After bringing only four pyramid scheme cases in the past eleven years, the FTC went into high gear and announced pyramid scheme actions against three different MLMs in a four-month period.<sup>23</sup> In October 2019, the FTC reached a settlement with AdvoCare International, L.P., which stipulated to paying a \$150 million judgment and ceasing operations as a "Multi-Level Marketing" company in lieu of charges that it operated a pyramid scheme.<sup>24</sup> Then, in November 2019, Nerium and the FTC filed their dueling lawsuits and, in January 2020, the FTC sued Success By Health, alleging the company operates as a pyramid scheme.<sup>25</sup> Further worrying for the MLM industry is the FTC's high rate of success when it comes to these types of actions. In the last twenty-eight cases brought by the FTC against MLMs alleging the companies are in fact pyramid schemes, the agency has either won on summary judgment or at trial, or otherwise obtained a favorable settlement.<sup>26</sup>

Given those odds, it is not likely that Nerium will win the day in its fight against the FTC. Indeed, there is no escaping the fact that Nerium will have to defend itself against allegations that it is, and has always been, a pyramid scheme. But in the meantime, Nerium's preemptive lawsuit appears to have benefited the company in two primary ways. First, its offensive stance has reassured Nerium's top distributors that they need not abandon the company for another MLM company. As Nerium states, it filed its lawsuit

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21. See *id.* ¶¶ 48–50.

22. See *id.* ¶ 9 & n.16 (relying on FTC Acting Chairwoman's remarks to support assertion that MLMs are legal, as well as important to Americans and the national economy); Maureen K. Ohlhausen, Acting Chairman, FTC, Opening Remarks for the 2017 DSA Fall Conference 1 n.1 (Nov. 7, 2017), [https://www.ftc.gov/system/files/documents/public\\_statements/1271503/2017-11-7\\_dsa\\_posting\\_version.pdf](https://www.ftc.gov/system/files/documents/public_statements/1271503/2017-11-7_dsa_posting_version.pdf) ("The views expressed in these remarks are my own and do not necessarily reflect the views of the [FTC] or any other Commissioner.")

23. See *FTC Pyramid Cases Post-Amway*, TRUTH IN ADVERT., <https://www.truthinadvertising.org/ftc-pyramid-cases-by-the-numbers/> (last updated Feb. 28, 2020).

24. Text of Proposed Order Against Defendants AdvoCare International, L.P., and Brian Connolly Only, *FTC v. AdvoCare Int'l, L.P.*, No. 4:19-cv-00715 (E.D. Tex. Oct. 2, 2019), ECF No. 2-1.

25. See Press Release, FTC, FTC Acts to Shut Down 'Success by Health' Instant Coffee Pyramid Scheme (Jan. 16, 2020), <https://www.ftc.gov/news-events/press-releases/2020/01/ftc-acts-shut-down-success-health-instant-coffee-pyramid-scheme>.

26. See *FTC Pyramid Cases Post-Amway*, *supra* note 23.

“so that [Nerium’s] network of independent [brand partners] would see there is no reason to leave under the threat of an FTC suit and that other MLMs would finally realize that they would be next if [Nerium] did not succeed in this fight.”<sup>27</sup>

Additionally, Nerium’s action appears to have delayed the FTC’s pursuit of a preliminary injunction while the parties battle over which court should have primary jurisdiction over the dispute. In both cases, there are pending motions to dismiss. In the Northern District of Illinois, the FTC argues in its motion that Nerium’s lawsuit must be dismissed for three reasons. First, the agency claims that to secure preemptive immunity from prosecution, Nerium’s only route to judicial review is through the APA since the Declaratory Judgment Act creates no independent cause of action against the government. The FTC also points out that since there is currently no final agency action that Nerium can challenge and the company already has an adequate, available remedy in the FTC’s enforcement action, Nerium fails to meet the prerequisites for filing a case against the agency pursuant to the APA.<sup>28</sup> Second, the FTC asserts that Nerium’s claims are not ripe for judicial consideration, as the determination of whether this MLM company is, or is not, a pyramid scheme is a factual issue that is unfit for a declaratory ruling.<sup>29</sup> Finally, the FTC urges the court to decline hearing the declaratory action as a matter of discretion because there is no need for duplicative litigation—this case would not resolve the entire controversy between the parties—and the act of Nerium filing its case to avoid litigation in New Jersey is the very type of “procedural fencing” that abuses the Declaratory Judgment Act.<sup>30</sup>

In its Opposition, Nerium takes the novel position that the APA does not apply in this case because the FTC intended to bring an enforcement action against it seeking injunctive relief pursuant to Section 13(b) of the FTC Act,<sup>31</sup> as opposed to an agency action under Section 5.<sup>32</sup> Thus, Nerium can “borrow” the jurisdiction conferred to the agency under the FTC Act to create a private right of action to pursue its declaratory judgment against the

27. See Reply Memorandum of Law of Defendants Neora, LLC, & Jeffrey Olson in further support of their Motion to Dismiss or Transfer this Action at 6 n.8, *FTC v. Neora, LLC*, No. 3:19-cv-19699-FLW-TJB (D.N.J. Dec. 30, 2019), ECF No. 19.

28. See FTC’s Memorandum of Law in Support of its Motion to Dismiss for Lack of Subject Matter Jurisdiction or, in the alternative, Failure to State a Claim at 3-10, *Nerium Int’l, LLC v. FTC*, No. 1:19-cv-07189 (N.D. Ill. Dec. 23, 2019), ECF No. 19.

29. *Id.* at 11–13.

30. *Id.* at 13–15; N.J. Stat. Ann. § 2A:16-59 (2020).

31. See Federal Trade Commission Act, 15 U.S.C. § 53(b) (2018).

32. See 15 U.S.C. § 45.

Commission.<sup>33</sup> It further argues that the court should exercise its discretionary jurisdiction to hear the case because it will prevent duplicative litigation, clarify the legal rights of Nerium and the entire MLM industry, and preclude the FTC from forum shopping, among other things.<sup>34</sup> Nerium argues that the Court is not bound to only decide questions of law in its declaratory action, stating that “the requested declarations that Nerium has not been and is not now a pyramid scheme would follow inexorably from the other declaratory relief sought.”<sup>35</sup>

As a practical matter, MLM companies like Nerium are poorly situated to withstand a lengthy litigation battle against the FTC. While Nerium’s aggressive tactic of preemptively suing the FTC appears to have temporarily won it the allegiance of its distributors, it is likely that top brand partners will eventually lose faith and leave Nerium in favor of other MLMs that are perceived to be safer as the litigations wear on. The loss of distributors will then cascade into a loss of revenue for the company, which will then not be able to afford the mounting legal fees associated with defending itself in court. In fact, this is exactly the scenario that Nerium has predicted:

The FTC recognizes, and history has shown, the mere filing of a pyramid scheme lawsuit by the FTC (regardless of the merits) will likely put the target MLM out of business because its independent sales forces [sic] will resign, thereby depriving the MLM of effective due process . . . . To protect against the FTC’s threatened litigation, and the immediate threat it posed to Nerium and its ability to maintain its sales force, Nerium filed the Complaint . . . .<sup>36</sup>

Moreover, it was this exact argument that persuaded the FTC to delay filing its complaint against Nerium in order to give it one final chance to settle the case. The FTC explains:

Because [Nerium] had represented to the FTC’s Commissioners that public filing of the recommended complaint would have catastrophic consequences for its business, FTC staff took the unusual step of informing [Nerium] of the vote and offering as a courtesy, to delay filing the action for up to a week to give [Nerium] a final opportunity to make a revised settlement offer.<sup>37</sup>

In the end, the fate of Nerium will more likely be determined by its distributors than by the courts; an outcome the company predicted. If Nerium’s top distributors decide to leave the company and take their

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33. See Plaintiff’s Response in Opposition to Defendant FTC’s Motion to Dismiss for Lack of Subject Matter Jurisdiction or, in the alternative, Failure to State a Claim at 4–5, 9–13, *Nerium Int’l, LLC v. FTC*, No. 1:19-cv-07189 (N.D. Ill. Feb. 6, 2020), ECF No. 25.

34. *Id.* at 5–9.

35. *Id.* at 14 n.8.

36. *Id.* at 1–3.

37. FTC’s Opposition to Motion to Dismiss, *supra* note 3, at 9–10.

downlines with them, then it will be Nerium's undoing. That is to say, if Nerium's top-earning distributors are primarily motivated to stay with the company because of the monetary rewards associated with recruiting new sellers—as is often the case in MLMs—rather than being truly focused on selling and using the company's products, then the risk presented by the FTC's action will become too great and the top distributors will jump ship. This move to abandon the company would likely be for another, more economically favorable MLM company. If this scenario unfolds and results in Nerium's downfall, it will still prove the FTC right—that Nerium was a pyramid scheme premised on recruitment over product sales.