DIRECT SELLING ASSOCIATION
1667 K Street, NW, Suite 1100 | Washington, DC 20006-1660
202.452.8866 | Fax 202.452.9010 | www.dsa.org

MEMORANDUM

TO: Board of Directors
Executive Contacts
General Counsel Committee
Ethics & Self-Regulation Committee
Government Relations Committee
Communications Committee
Lawyers' Council

FROM: DSA Legal & Government Relations Team

SUBJECT: Federal Trade Commission Action Against Neora

DATE: November 4, 2019

On November 1, the Federal Trade Commission (FTC) filed a lawsuit in United States District Court of New Jersey against DSA member Neora (formerly known as Nerium), its owner Jeffrey Olson, Signum Biosciences and Signum Nutralogix. The complaint contains five counts:

- Operating an illegal pyramid scheme;
- False earnings claims as to Neora International and Jeff Olson;
- False and unsubstantiated product efficacy claims;
- False establishment claims that the defendants falsely represented the effectiveness of products; and
- Promoting deceptive acts/practices.

The FTC is requesting injunctive relief and damages.

The FTC settled with the two Signum companies barring them from making future claims set out in the complaint.

On November 1, Neora also filed a claim for declaratory judgment against the FTC in the United States District Court in Illinois prior to the FTC filing their complaint. This complaint was filed in United States District Court of New Jersey.[1]

In the past several months, the company has kept DSA informed on its negotiations with the FTC and while we have informed DSA members of an impending action, at Neora's request, we were unable to divulge the company or specific details.

Pyramid Scheme Allegations

The FTC alleges that Neora and Olson have been operating a pyramid scheme using the *Koscot* test in which participants pay money to the company in return for which they receive (1) the right to sell products, and (2) in return for recruiting other participants into the program, the right to receive rewards which are unrelated to the sale of products to ultimate users.

The allegations and complaint of unlawful compensation structures are similar to the remarks by Bureau of Consumer Protection Director Andrew Smith at last month's DSA Legal & Regulatory Seminar. Mr. Smith described three reward systems that the Commission would review:

- Threshold-based: Rewards that begin or increase exponentially at specific thresholds
- Convex: Rewards where higher levels of expenditure earn great rewards
- Duplication-based: Great rewards for participants with larger downlines

Although these terms are not specifically used in the complaint, they appear to be consistent with the FTC's analysis.

Incentivizing Substantial Upfront Investment

The suit alleges the company requires a substantial upfront investment from business partners (BPs) by encouraging them to purchase "success packs" of products upon enrollment that range from $500-$1,000. Consumers can also purchase a basic kit of motivational and promotional materials for $49.95.[2]

The complaint also states that to be eligible for any compensation, BPs must spend $80 on auto-delivery of products, or their customers must spend $120 on auto-delivery. Although the complaint states there was an exception to the auto-delivery requirement if $250 was sold to retail customers.

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[1] The complaint sought Declaratory Judgment, Preliminary, and Permanent Injunctive Relief against the FTC. The complaint alleges the FTC is attempting to define the company as a pyramid scheme without proper regulatory or legislative authority.

[2] If there was an unreasonably high entrance fee, it would violate the DSA Code of Ethics and FTC guidance going back many years.

Prioritization of Recruitment

The complaint alleges that minimal income can be made through product sales because there is minimal profit between the prices consumers pay the BP and the amount the BP pays to purchase products from the company. The FTC also claims that according to the company's data, less than 1% of rewards are paid on the sales of products to consumers and the retail opportunity is difficult because consumers can purchase products at lower prices on Amazon or other platforms.

DSA has discussed the issue of unauthorized sales as a significant issue for direct selling companies over the past five years. We believe this is the first time the FTC has mentioned unauthorized sales in a complaint.

The FTC claims the primary basis of earning compensation as a salesperson is through recruitment rather than product sales. The example cited is a fast start program offered by the company that pays commission for recruiting three new BPs with a 2000 qualifying volume or nine preferred customers with 1000 qualifying auto-delivery. The complaint states that because the recruiting option paid more and was easier to achieve compensation was tied to recruitment and would thus be unlawful. It also asserts the sales option was eliminated from the most recent compensation plan.

Other problematic issues with the company's compensation structure cited by the complaint are that BPs must recruit others to ascend in rank and also they were required to have higher monthly targets for their downlines.[3]

Additionally, certain rewards were only available to higher ranks, and commissions were only paid out when qualifying volume exceeded 300 qualifying volume points a month. The complaint concedes the threshold was recently changed, but does not describe how or if the change is still problematic.[4]

High Attrition Rates

The complaint alleges that according to the company's data, Neora had a 92% attrition rate between 2012 and 2017. The FTC says that high attrition motivates recruits to make significant upfront purchases before the recruits leave the company or stop making purchases. The complaint states that purchases by BPs in their first three months regularly comprise one-third to one-half of all purchasing volume.

The complaint sets forth that half of BPs discontinue buying products within six months, and only one third buy products after one year. It is the FTC's view that high attrition means that building and maintaining a downline of any desired size requires a perpetual focus on recruiting and replenishing. It is our understanding that the FTC's use of high attrition rates has not previously been used as evidence for an unlawful compensation structure in recent actions.

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[3] This would appear to track the duplication-based rewards structure concerns described by Mr. Smith.
[4] This analysis would appear to track with the threshold-based rewards Mr. Smith described when they are misused.

Income Representations and Fees

The complaint alleges misrepresentations about substantial income opportunities and the ability to achieve financial independence with Neora. Specifically, these include company brochures, and social media posts from Mr. Olson regarding those who have attained millionaire status. The company corporate channels, website, and BPs own social media posts also congratulate those achieving this status are included. The complaint also mentions the company's Young Entrepreneurs Program aimed at helping young professionals pay off student debt and lifestyle claims such as cars and trips for those achieving the status.[5]

The complaint contains averments regarding the disconnect between the purported opportunity to earn income and the company's data, which showed that less than 10% of BPs made more than they paid in fees and product purchases. The complaint also mentions that the company requires BPs fees to pay for sales aids, business cards, letterhead, conference registrations, and personalized websites.

Additionally, since the BPs are not classified as employees, but as independent contractors, they must undertake additional expenses to remit self-employment taxes for health insurance and typical "job-related benefits." We believe is the first time the FTC has included the obligations or independent contractor status in a lawsuit.

Product Claims

The complaint contains several averments related to unsupported health claims for ME Sports and Neora EHT by both the Neora and Signum defendants: ME Sports was the source for Signum parties, and Neora EHT was for the Nerium parties. In particular, the complaint alleges that these products were marketed to treat various diseases including Alzheimer's disease, Parkinson's, and Chronic Traumatic Encephalopathy. The complaint alleges that while testing was done on rodents to establish these claims, no human testing was undertaken as that approach would be too costly.

The FTC claims that Defendants were aware BPs were making deceptive product claims about EHT products and cite email correspondence from both companies' corporate teams as evidence. Several examples of health claims from the ME Sports website are cited (for health conditions such as concussions, brain health benefits, with endorsements from former NFL players Sidney Rice and Steve Weatherford. BPs who were also former NFL players, such as Cory Redding, are also profiled in the complaint. Several webpage screenshots and social media posts about purported links between the EHT products and diseases follow.[6]

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[5] DSA's Code of Ethics prohibits deceptive or misleading income representations and also includes specific steps that member companies must take to enable a reasonably informed evaluation by current and prospective salespeople.

[6] The DSA Code of Ethics requires that product claims made by member companies and their independent salespeople must be substantiated by competent and reliable evidence and must not be misleading. This requirement also comports with statements by the FTC officials in interpreting the FTC Act.

DSA Engagement with the FTC and Future Actions

DSA regularly meets with FTC representatives about the direct selling business model and consumer protection. Since Mr. Smith's remarks last month, DSA has met with FTC staff seeking further clarity on what the FTC views as lawful and unlawful compensation structures. DSA is coordinating with the General Counsel Committee to arrange a meeting between DSA executives and FTC officials.

DSA will also be hosting a webinar on November 12, updating membership on current conversations with the FTC. The DSA Executive Committee and Board of Directors will be discussing a public statement and potential engagement in the lawsuit including, but not limited to, filing an amicus brief.

DSA's Code of Ethics Administrator has been alerted to this action and will review the FTC's allegations regarding Neora. We will keep you updated on DSA's engagement in this matter, further filings in the case, and discussions with the FTC.

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