THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

NERIUM INTERNATIONAL, LLC N/K/A NEORA, LLC AND JEFFREY OLSON Plaintiffs, V. FEDERAL TRADE COMMISSION, Defendant.	)	CIVIL ACTION NO.: 1:19-cv-7189

PLAINTIFFS' ORIGINAL VERIFIED COMPLAINT FOR DECLARATORY JUDGMENT, PRELIMINARY, AND PERMANENT INJUNCTIVE RELIEF

COMES NOW Plaintiffs Nerium International, LLC n/k/a Neora LLC ("Nerium") and its founder and CEO Jeffrey Olson, (collectively "Plaintiffs") and file this their Original Complaint for Declaratory Judgment, Preliminary, and Permanent Injunctive Relief against the Federal Trade Commission ("FTC"). In support of their complaint and request for injunctive relief, Plaintiffs would show as follows.

I. SUMMARY

1. A business cannot operate without being able to know the law. Improper attempts to retroactively change federal law and to effectively preempt state law are unconstitutional. This is especially pernicious when a powerful federal government agency such as the FTC attempts to improperly, unilaterally, and retroactively change the law. The FTC has not done this with passage of a new law by Congress or through the agency's own formal Rulemaking. On the contrary, it has done this through issuance of "Guidance," similar documents, press conferences, and through the threat of filing "fencing in" enforcement actions. This behavior of the FTC is *precisely* the

behavior that the President prohibited in his October 9, 2019 Executive Orders.[1] The Executive Orders are premised on the stated principle that "Regulated parties must know in advance the rules by which the Federal Government will judge their actions."[2] The FTC's ad hoc enforcement actions against MLMs violate the explicit directive: "No person should be subjected to a civil administrative enforcement action or adjudication absent prior public notice of both the enforcing agency's jurisdiction over particular conduct and the legal standards applicable to that conduct."[3] Instead, the FTC has engaged in what Acting Director of the Office of Management & Budget ("OMB") Russ Voight described as "stealth regulation" that results in "people being bullied by their federal government."[4] Similarly, on November 16, 2017 the U.S. Attorney General issued a memorandum prohibiting Department components from issuing guidance documents that effectively bind the public without undergoing the notice–and-comment rulemaking process.[5]

2. This complaint tells the story of how the FTC is trying to put an end to a long standing, legitimate, and popular method of making direct sales to consumers: multi-level marketing ("MLM"). The FTC has repeatedly recognized the various attributes of MLMs and that

[1] President's Executive Order 13891 "Promoting the Rule of Law Through Improved Agency Guidance Documents" found at https://www.federalregister.gov/documents/2019/10/15/2019-22623/promoting-the-rule-of-law-through-improved-agency-guidance-documents
President's Executive Order 13892 "Promoting the Rule of Law Through Transparency and Fairness in Civil Administrative Enforcement and Adjudication" found at https://www.federalregister.gov/documents/2019/10/15/2019-22624/promoting-the-rule-of-law-through-transparency-and-fairness-in-civil-administrative-enforcement-and
See also President's press conference announcing the Executive Orders at 3:35 found at https://www.cnbc.com/2019/10/09/watch-trump-signs-executive-orders-on-transparency-in-federal-guidance-and-enforcement.html

[2] President's October 9, 2019 Executive Order on Promoting the Rule of Law Through Transparency and Fairness in Civil Administrative Enforcement and Adjudication, Section 1

[3] Ibid.

[4] See President's press conference announcing the Executive Orders at 20:20. https://www.cnbc.com/2019/10/09/watch-trump-signs-executive-orders-on-transparency-in-federal-guidance-and-enforcement.html

[5] November 16, 2017 Attorney General Memorandum found at https://www.justice.gov/opa/press-release/file/1012271/download
See also January 25, 2018 DOJ Memo at https://www.justice.gov/file/1028756/download

they are legal.[6] For example, MLMs distribute products or services through a network of salespeople who are not employees of the company and do not receive a salary or wage.[7] Instead, members of the company's salesforce usually are treated as independent contractors, who may earn income depending on their own sales efforts, revenues and expenses.[8] An MLM's reliance upon its existing salespeople to recruit additional salespeople necessarily creates multiple levels of "distributors" or "participants" organized in "downlines who collectively share in the commissions earned from the sales that are generated."[9] The FTC has also repeatedly recognized that MLMs are dependent upon the recruitment of new business opportunity participants as their sales force, that paying compensation for product purchases made by the business participant sales force for their own end use is legal, and that most people who join legitimate MLMs make little money, no money, or lose money.[10] Nevertheless, the FTC has now enunciated that these very same features of legitimate MLMs somehow make them illegal pyramid schemes. The FTC also now asserts that "push[ing][11] distributors to recruit new distributors" (although an indicia of a legal MLM) is an indicia of whether or not an MLM is a pyramid scheme. In short, the FTC now is attempting to enforce an amorphous, vague, undefined, and wholly subjective **"Over-emphasis on recruiting" pyramid scheme test**. As set forth below, to describe this new test, the FTC has now unilaterally announced, adopted and outlawed the new concepts of "Threshold"

[6] Source: FTC January 2018 "Business Guidance Concerning Multi-Level Marketing" https://www.ftc.gov/tips-advice/business-center/guidance/business-guidance-concerning-multi-level-marketing
See also October 3, 2019 FTC Press Conference announcing FTC settlement with AdvoCare found at https://www.facebook.com/federaltradecommission/videos/508585946387892/
[7] *Id.*
[8] *Id.*
[9] Id.
[10] *Infra* at p. 33-35.
[11] As set forth below, note the use of the word "push" rather than the use of the phrase "primarily pushed".

compensation, "Convex" compensation, and "Duplication" compensation. All without proper rulemaking.

3. In the MLM context, the States, the federal government, and the courts have correctly addressed pyramid scheme claims against entities that do not sell legitimate products, but rather concentrate on the sale of their "business opportunity." Because of the lack of sales of products, pyramid schemes must necessarily fail.

4. When Plaintiff Jeff Olson launched Plantiff Nerium in 2011 with a compensation plan and business structure designed to comply with state laws (which have been preempted by federal law), federal law, and court decisions, he could not have known that in 2018-2019 Defendant FTC would decide to improperly reinterpret the law on pyramid schemes without proper legislation or rulemaking and, instead, utilize the enormous pressure of its so-called "fencing in" strategy[12] in an attempt to unilaterally and retroactively change the definition of a "pyramid scheme" under the FTC Act. The FTC has been utilizing this "fencing strategy" in an effort to effectively outlaw MLM's, which are a ubiquitous business in the United States.). MLMs are legal in the United States. Literally millions of Americans are participants in MLMs. Hundreds of thousands are or have been participants in Nerium selling over a billion dollars of desired products. Yet, the FTC's newly announced standards that it seeks to apply to Nerium and Mr. Olson would put virtually all MLMs out of business based on the FTC's baseless assumption that no incentives can be paid for recruitment of participants even when the MLM makes robust sales to satisfied consumers. Mr. Olson also could not have imagined that the:

[12] On May 14, 2018, FTC Commissioner Chopra issued a memo advocating for increased use of "fencing in". He issued the memo less than 2 weeks after he was sworn in as an FTC Commissioner on May 2, 2018.
https://www.ftc.gov/system/files/documents/public_statements/1378225/chopra_-_repeat_offenders_memo_5-14-18.pdf

(1) FTC would require Nerium *to prove itself* innocent of being a pyramid scheme;

(2) FTC, despite repeated requests, would flatly ***refuse*** to disclose the alleged economic analysis it was relying upon to support its pyramid scheme allegations, and would maintain that it did not have to disclose same to Nerium until suit is filed;

(3) FTC's actions would require Nerium to incur millions of dollars to retain renowned econometrician, Dr. Walter Vandaele, to produce a very costly and thorough economic analysis definitively establishing that Nerium has not been operating as a pyramid scheme;

(4) FTC, when faced with its lack of substantive criticisms of Dr. Vandaele's economic analysis, would belatedly pivot to citing its authority to legislate through enforcement under what it considers to be its "organic statute," the FTC Act;

(5) FTC would proclaim that it is their duty as "Plaintiffs" (rather than an enforcement agency) to utilize this threat of enforcement and "fencing in" strategy;

(6) FTC would seek to "eliminate" multi-level marketing in the United States through the use of enforcement and "fencing in" rather than through a proper change in the law or through proper rulemaking[13];

(7) FTC would pronounce a "moral duty" to bring enforcement actions, even when the FTC knows it will lose the lawsuit[14];

(8) FTC would recognize that the mere act of their asserting a "pyramid scheme" allegation (regardless of the law or facts) could cause the swift destruction of the MLM, depriving the MLM of the means and opportunity to defend itself and, thus, depriving the MLM of effective due process;

(9) FTC would proclaim an intention to single out MLM's and ban the payment of compensation to MLM business participants' supervisors (i.e. "up line") above the MLM business participant who actually made the sale;

(10) FTC would effectively seek to change the law to eliminate the practice of MLMs paying <u>any</u> compensation for recruitment of business opportunity participants;

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[13] See e.g. Commissioner Chopra's "The Case for Rulemaking Under 'Unfair Methods of Competition". Sept. 6, 2018 Hearing #1 on Competition and Consumer Protection in the 21st Century, Docket ID FTC-2018-0074.

[14] See e.g. https://www.law360.com/articles/1171376/ftc-commissioner-wants-to-bring-the-hard-merger-cases citing Cmr. Slaughter ("...even if we're not sure that we're going to win, even if we're not likely to win because of various factors, we still have an obligation to bring the case").

(11) FTC stated intention to effectively change the law so that compensation of business opportunity participants would be made solely (rather than "primarily") on product sales;

(12) FTC seeking to effectively change the law by "fencing in" Compensation Plans to only allow commission payments to the business opportunity participant who actually makes the product sale and perhaps only one person above the seller (thus eliminating the "multi" from multi-level marketing);

(13) FTC would reject federal court opinions issued against the FTC and, nevertheless, ban paying compensation to MLM business participants for their own end use product consumption;

(14) FTC Consumer Bureau Director would erroneously proclaim in prepared remarks the "groundbreaking" event of a major MLM "admitting" to being a pyramid scheme; and

(15) FTC Consumer Bureau Director would orally proclaim new standards to determine whether a company is a pyramid scheme, without going through proper Rulemaking;

(16) FTC would threaten to ban MLMs such as Nerium from the MLM industry if they did not agree to "fencing in" changes in their business operations that are not required by law;

However, these are just some of the self-proclaimed "Plaintiffs" tactics that have been adopted by the FTC. This is *precisely* the bureaucratic behavior that the President sought to prohibit in his October 9, 2019 Executive Orders and the Department of Justice in its 2018 Memorandum.

5. Plaintiffs thus files this suit to reign in the FTC's actions. Plaintiffs request that the Court declare and issue supporting preliminary and permanent injunctive relief set forth below in the Prayer of this Complaint.

II. PARTIES

6. Plaintiff Nerium is a Texas limited liability company with its corporate headquarters at 4201 Spring Valley Rd., Suite 900, Farmers Branch, Texas 75244. Nerium transacts or has transacted business in this District.

7. Plaintiff Jeffrey Olson ("Mr. Olson") is the sole owner and CEO of Nerium and sues in that capacity. Mr. Olson maintains his office at Nerium's corporate headquarters.

8. Defendant the FTC "is an independent agency of the United States Government created by statute. 15 U.S.C. §§41-58. The FTC enforces Section 5(a) of the FTC Act, 15 U.S.C. §45(a), which prohibits unfair or deceptive acts or practices in or affecting commerce."[15]

III. BACKGROUND

A. MLMs

9. Multi-Level Marketing companies (also called "Direct Selling companies") ("MLMs") are legal under every state law in the United States and under federal law. The leading national trade organization representing the industry is the Direct Selling Association ("DSA"). The DSA has estimated that 20.5 million Americans are involved in direct selling.[16] Accordingly, differentiating between legal MLMs and illicit pyramids is a matter of importance to millions of Americans, the MLM industry, and the economy as a whole. Rather than adopting advertising budgets to market to end users, MLMs use network marketing to recruit and build out independent representative sales teams. The FTC has thus long recognized that the recruitment of other business participants is a core hallmark of MLM's.

B. Pyramid Schemes In the Context of an MLM

10. The definition of an illegal "pyramid scheme" in the MLM context has been well understood by multilevel marketing sales companies), the lead MLM trade organization the Direct Selling Association ("DSA"), the FTC, and the courts alike.

[15] See FTC's proposed Complaint.
[16] Ohlhausen, Maureen K., Opening Remarks for the 2017 DSA Fall Conference, 2017 WL 5202554 at *3 (Nov. 7, 2017).

11. Every State in the Union has adopted statutes expressly dealing with pyramid schemes. In most states, including Illinois[17], an illegal pyramid scheme generally consists of a business which offers an opportunity whereby the business compensates the business participant ***primarily*** (i.e. more than 50%) for signing up other business participants rather than ***primarily*** for product sales.

12. In 2017-2018, Congress considered whether it should adopt an amendment to the FTC Act which would expressly define and make pyramid schemes illegal under the FTC Act. As set forth below, neither Bill made it out of Committee. However, the failed Bills highlight that no federal law, including the FTC Act, provides a definition of a pyramid scheme.[18]

13. As a result, the FTC now improperly argues that an MLM legally operating and not considered a pyramid scheme under the laws of the various states can suddenly find itself being accused of being a pyramid scheme by the FTC; not under the express language of the FTC Act or under a Rule properly adopted by the FTC but, rather, as a result of the FTC's revised belief of what constitutes a pyramid scheme.

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[17] Illinois §17-60. Promotion of pyramid sales schemes.
(a) A person who knowingly sells, offers to sell, or attempts to sell the right to participate in a pyramid sales scheme commits a Class A misdemeanor.
(b) The term "pyramid sales scheme" means any plan or operation whereby a person, in exchange for money or other thing of value, acquires the opportunity to receive a benefit or thing of value, ***which is primarily*** based upon the inducement of additional persons, by himself or others, regardless of number, to participate in the same plan or operation ***and is not primarily contingent*** on the volume or quantity of goods, services, or other property sold or distributed or to be sold or distributed to persons for purposes of resale to consumers. For purposes of this subsection, "money or other thing of value" shall not include payments made for sales demonstration equipment and materials furnished on a nonprofit basis for use in making sales and not for resale.
Texas Business & Commerce Code §17.461 (a)(6)
"(6) "Pyramid promotional scheme" means a plan or operation by which a person gives consideration for the opportunity to receive compensation that is derived ***primarily*** from a person's introduction of other persons to participate in the plan or operation rather than from the sale of a product by a person introduced into the plan or operation.

[18] *See* Direct Selling Association "Anti-Pyramid Language Myth vs. Fact" at https://www.dsa.org/docs/default-source/direct-selling-facts/hr-3409-myth_fact_sheet.pdf?sfvrsn=2

14. This is despite the fact that the States and the FTC have long recognized the propriety of MLMs compensating business participants ***primarily*** on the basis of product sales rather than recruitment of additional business participants. *In re Amway Corp.*, 93 F.T.C. 618 (1979). As recognized by the FTC:

> [p]yramid schemes…all share one overriding characteristic. They promise consumers or investors large profits based ***primarily*** on recruiting others to join their program, not based on profits from any real investment or real sale of goods to the public.[19]

"Pyramid schemes are said to be inherently fraudulent because they must eventually collapse." *Webster v. Omnitrition Int'l, Inc.*, 79 F.3d 776, 781 (9th Cir. 1996). In 2014, the Ninth Circuit adopted the *Koscot* pyramid scheme test:

> [A] pyramid scheme is characterized by the payment by participants of money to the company in return for which they receive (1) the right to sell a product and (2) the right to receive in return for recruiting other participants into the program rewards which are ***unrelated to sale of the product to ultimate users***.

15. *FTC v. BurnLounge, Inc.*, 753 F.3d 878, 883 (9th Cir. 2014) (emphasis added) citing *Omnitrition*, 79 F.3d at 781 and *FTC vs. Koscot Interplanetary*, 86 F.T.C. 1106, 1181 (1975). In *BurnLounge*, the Ninth Circuit explicitly held that "Not all MLM businesses are illegal pyramid schemes." The law has long required that in order to establish that a MLM is a pyramid scheme, the FTC must establish that the actual compensation paid to the MLM business participants is ***primarily*** for recruiting other business participants and that the *sine quo non* is that the compensation payments be ***unrelated*** to product sales. The above judicial interpretations have even been reflected in FTC Staff's own Guidance on MLMs.[20]

[19] See May 13, 1998 FTC Public Statement https://www.ftc.gov/public-statements/1998/05/pyramid-schemes.

[20] https://www.ftc.gov/tips-advice/business-center/guidance/business-guidance-concerning-multi-level-marketing

16. The focus of the analysis has always been on the relation of compensation to product sales because it is indicative of the inherent flaw in illegal pyramids – eventuality of collapse. An illegal pyramid primarily pays compensation for recruiting from the sign-up fees of the new recruits, and is thus doomed to collapse because eventually there is no one left to recruit. A legitimate MLM like Nerium is not destined to collapse because it pays compensation primarily from the sales of products, and can sell products in perpetuity so long as there is consumer demand. The FTC's new emphasis on **to whom** the compensation is paid rather than the source of the funds paid as compensation is contrary to the established law because it does not address the inherent fraud of an illegal pyramid – the inevitability of collapse. Nerium's data shows that its compensation is primarily based on product sales and is never paid solely for recruiting, thus Nerium is not an illegal pyramid because it is not certain to collapse if it runs out of new recruits.

C. FTC Threats to Sue While Refusing to Release Economic Analysis

17. Beginning in July 2018, the FTC's Chicago office threatened to sue Plaintiffs ***in this Court***:

> …under Section 13(b) of the Federal Trade Commission Act ('FTC Act'), 15 U.S.C. §53(b), to obtain temporary, preliminary, and permanent injunctive relief, rescission or reformation of contracts, restitution, the refund of monies paid, disgorgement of ill-gotten monies, and other equitable relief for Defendants' acts or practices in violation of Sections 5(a) and 12 of the FTC Act, 15 U.S.C. §§45(a), 52.[21]

18. The FTC claims to have an economic analysis establishing that Nerium has been or is currently an illegal pyramid scheme under the FTC Act. However, despite repeated requests by Plaintiffs, the FTC has flatly ***refused*** to provide Plaintiffs with the FTC's alleged economic

[21] *See* FTC's proposed Complaint. Recently, as a result of the 7th Circuit's *en banc* denied Opinion in *Credit Bureau* referenced below, the FTC has threatened to sue one of Nerium's suppliers and Plaintiffs in New Jersey.

analysis. Instead, the FTC has pivoted to an ever-changing, amorphous and completely subjective definition of what it now believes constitutes a pyramid scheme under the FTC Act.

D. Investigation of Nerium

19. On June 21, 2016—over three (3) years ago--the FTC's Chicago office initiated an investigation of Nerium by issuing a very broad, 28 page long, Civil Investigation Demand. The CID stated that the "Subject of Investigation"[22] was as follows:

> Nature and Scope of Investigation:
>
> To investigate whether unnamed persons, partnerships, or corporations, or other engaged directly or indirectly in the advertising or marketing of dietary supplements, foods, drugs, devices, or any other product or service intended to provide a health benefit or to affect the structure or function of the body have misrepresented or are misrepresenting the safety or efficacy of such products or services, and therefore have engaged or are engaging in unfair or deceptive acts or practices or in the making of false advertisements, in or affecting commerce, in violation of sections 5 and 12 of the Federal Trade Commission Act, 15 U.S.C. §§ 45 and 52. The investigation is also to determine whether Commission action to obtain redress for injury to consumers or others would be in the public interest.[23]

20. Since then, Nerium has literally spent millions of dollars producing at least sixteen waves of documents, ***complete*** copies of its internal databases through 2017[24], and detailed economic analysis of same. Nerium has engaged in an incredibly frustrating, completely non-productive series of discussions lead by the FTC's Chicago Staff. FTC Chicago Staff's pyramid scheme allegations are legally and factually flawed. Instead, the FTC seeks to preclude Nerium, and seemingly numerous other entities, from being able to operate as an MLM and indeed improperly threaten Nerium's existence as a company.

[22] CID at page 1, Item 3.
[23] *Id.* referencing "See attached resolutions".
[24] It is not clear how the FTC could alleged that Nerium is currently a pyramid scheme when it has not asked for or analyzed any data past 2017.

21. The FTC publically admits that a MLM's company's data is the key to whether or not a company is operating as a pyramid scheme:

> So, we intend to stay active in this area, and as industry leaders, we hope and expect you to pay attention to how your business operates.
>
> How do distributors really make money under your Compensation Plan?
>
> What does your Compensation Plan incentivizing?
>
> ***Are gathering the necessary data to allow you to determine and understand why your distributors and customers are purchasing product, selling product and joining the program. If you're not doing that, why aren't you doing that?***
>
> ***I urge you to gather data and closely review your incentives to avoid the risk that your business is operating as an illegal pyramid***. You perfectly situated to get it right in your company and consequently to promote consumer protection and competition. An we want you to get it right.[25]

Similarly, the FTC's January 2018 Guidance states that:

> In evaluating MLM practices, the FTC, in accord with established case law, focuses on how the structure as a whole operates in practice… [and that] assessment of an MLM's compensation structure is a fact-specific determination that the FTC makes after careful investigation.[26]

Since whether or not Nerium is a pyramid scheme is inherently a fact-specific inquiry focused on how Nerium's compensation plan operates in practice, Nerium's actual data is central to the entire inquiry. However, when confronted with Nerium's actual data that establishes that it is not a pyramid scheme ***under the law***, the FTC conveniently pivoted, abandoned the law, and adopted a subjective review of the prose of a compensation plan to argue that regardless of the actual data,

[25] DSA Legal & Regulatory Seminar: October 8, 2019 UNOFFICIAL TRANSCRIPT: Remarks of Andrew Smith and Q&A at 7 (emphasis added)
[26] FTC January 2018 "Business Guidance Concerning Multi-Level Marketing" at Item 4 https://www.ftc.gov/tips-advice/business-center/guidance/business-guidance-concerning-multi-level-marketing

the prose somehow illegally incentivizes behavior which it believes is indicative of a pyramid scheme.

22. Specifically, approximately two (2) years ago, at great expense, Plaintiffs' retained renowned Ankura econometrician Dr. Walter Vandaele[27], to conduct an analysis of Nerium's data. The FTC and Ankura have both had access ***to the same Nerium data*** for the years 2011-2017. The tables and calculations prepared by Dr. Vandaele have been shared with the FTC. The FTC has admitted ***that it has no material issues or concerns with the calculations or methodologies used by Dr. Vandaele.*** Nevertheless, despite repeated requests, the FTC has ***flatly refused*** to provide Nerium with its own alleged analysis upon which it bases its belief that Nerium is a pyramid scheme.[28] In fact, the FTC has advised that it does not intend to share its analysis with Plaintiffs until **after** a lawsuit is filed. ***In short, the FTC flatly refuses to show Nerium why it thinks it is a pyramid scheme until after a lawsuit is filed.***

23. Meanwhile, Dr. Walter Vandaele's analysis establishes that ***77 percent*** of commissions paid by Nerium in the 2012 to 2017 time period are for sales of product to ultimate end users. ***This greatly exceeds the law's "primarily" standard***. Further, in 2016 and 2017, about 60 percent of Nerium's total sales were to non-business participant "Preferred Customers". Dr. Vandaele's analysis further establishes that in 2017 (the last full year of data requested and produced to the FTC), approximately **82%** of the commissions paid through the Nerium Compensation Plan are based on sales of products. ***Again, greatly exceeding the law's***

[27] Dr. Vandaele is a University of Chicago-trained econometrician who previously served as the Assistant Director for Regulatory Evaluation and Economic Advisor at the FTC's Bureau of Competition. Dr. Vandaele was the lead econometrician for Herbalife during its negotiations with the FTC. Dr. Vandaele remains based in D.C. as Senior Managing Director of Ankura. His bio can be found at https://ankura.com/people/walter-vandaele/.

[28] An initial worksheet provided by the FTC failed to analyze a critical data file—very large product sales to Nerium's non-business participant "Preferred Customers". Since then, no FTC analysis has been shared with Plaintiffs.

"primarily" standard. Likewise, Dr. Vandaele's analysis shows that, conservatively, in 2017, approximately 83% ($120 million) of total Nerium Product Purchases ($145 million) were for end use consumption. Indeed, in 2017, approximately 60% ($87 million) of total product purchases ($145 million) were made by Nerium's Preferred Customers. These figures are not that of a pyramid scheme.

24. This is no surprise. Nerium's business model, by design, addresses prior pyramid case concerns about requiring participants to purchase the products they hope to sell in advance of making those sales—a practice known as "inventory loading" which often left participants with garages full of unwanted product they were required to purchase. By contrast, Nerium's operations avoid any material inventory loading because Nerium fulfills product orders with ***shipment by the company directly to the end user***. With this model, MLM participants have little, if any, incentive to purchase product for anything other than their own or their family's end use consumption.

25. The FTC states a concern that Nerium "incentivizes recruiting" as well as sales. However, all MLMs incentivize recruiting and sales. The MLM model depends upon making sales and getting other people to make sales from which a participant can also profit. It is this reliance on product sales that differentiates legal MLMs from illegal pyramid schemes. The question is whether Nerium ***primarily*** pays compensation (i) for recruiting new Brand Partners or (ii) for sales of products for end use consumption. Ankura's analysis clearly shows that the latter is the case. Nerium has no bonuses or commissions that are paid simply for recruitment and Brand Partners do not have to purchase any minimum amount of product in order to become a Brand Partner or to earn sales commissions.

26. The FTC's real concern appears to be that Nerium's senior Brand Partners make too much money and that entry level Brand Partners don't make enough money. Such concerns

might be leveled at a variety of businesses, if not virtually every business, in the United States. However, that does not make Nerium or any other business a pyramid scheme. Nerium acknowledges that the FTC may have some claims of long past alleged income misrepresentations and product efficacy (though most are not meritorious); but regardless, they do not provide a basis for labeling Nerium a pyramid scheme. Nor would it prohibit Nerium from compensating more senior Brand Partners who mentor and guide other Brand Partners any more than the FTC can prohibit a company from paying its senior sales managers in an effort to increase the compensation of their entry-level sales force.

27. In short, if Nerium is a pyramid scheme, then there are likely no legal MLMs in the U.S. This simply cannot be the law and it is not.

E. FTC's Authority

28. Section 5(a) of the FTC Act, 15 U.S.C. §45(a), grants the FTC authority to pursue targets for "unfair or "deceptive acts or practices in or affecting commerce":

> (a) Declaration of unlawfulness; power to prohibit unfair practices; inapplicability to foreign trade
>
> (1) Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.
>
> ***
>
> (4) (A) For purposes of subsection (a), the term "unfair or deceptive acts or practices" includes such acts or practices involving foreign commerce that—
>
> (i) cause or are likely to cause reasonably foreseeable injury within the United States; or
>
> (ii) involve material conduct occurring within the United States.
>
> (B) All remedies available to the Commission with respect to unfair and deceptive acts or practices shall be available for acts and

> practices described in this paragraph, including restitution to domestic or foreign victims.[29]

29. The FTC takes the position that "Deceptive" practices are defined in its October 14, 1983 "FTC Policy Statement on Deception" "as involving a material representation, omission or practice that is likely to mislead a consumer acting reasonably in the circumstances. Interestingly, the "Policy Statement" was not adopted through rulemaking and is thus likely not enforceable."[30] However, by statute, "[a]n act or practice is unfair if it causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition."

30. **Notably absent from the FTC Act is any reference at all to pyramid schemes**. Therefore, in 2017 and 2018, the U.S. Congress considered two Bills which would have provided the FTC with the express power to pursue pyramid schemes (as opposed to "unfair or deceptive acts or practices in or affecting commerce") claims. As set forth below, neither of these Bills passed out of Committee.

31. The FTC's efforts to define and proclaim Nerium and other MLMs as pyramid schemes outside of these standards, (especially without proper rulemaking) are thus improper.

32. Section 5(b) of the FTC Act sets forth the proper procedure which the FTC is to follow should it "have reason to believe that any such person, partnership, or corporation has been or is using any unfair method of competition or unfair or deceptive act or practice in or affecting commerce". 15 U.S.C. §45(b). However, Section 5(b) does *not* authorize the FTC to initiate the

[29] 15 U.S.C. §45(a)

[30] See Pollack & Teichner, The Federal Trade Commission's Deception Enforcement Policy, 35 DePaul Law Rev 125, 126 (1985) (""Since the Policy was not adopted through established administrative agency rulemaking or adjudicative proceedings, the public never had a chance to participate in its creation.").

action in court. On the contrary, the procedure is ***administrative.***[31] Despite repeated requests from Plaintiffs, the FTC has flatly refused to utilize this administrative process.

[31] 15 U.S.C. §45(b) ("Whenever the Commission shall have reason to believe that any such person, partnership, or corporation has been or is using any unfair method of competition or unfair or deceptive act or practice in or affecting commerce, and if it shall appear to the Commission that a proceeding by it in respect thereof would be to the interest of the public, it shall issue and serve upon such person, partnership, or corporation a complaint stating its charges in that respect and containing a notice of a hearing upon a day and at a place therein fixed at least thirty days after the service of said complaint…").
See also FTC 's April 2019 "A Brief Over view of the Federal Trade Commission's Investigative, Law Enforcement, and Rulemaking Authority" found at: https://www.ftc.gov/about-ftc/what-we-do/enforcement-authority

> "A. Administrative Enforcement of Consumer Protection and Competition Laws
> ***In the administrative process, the Commission determines in an adjudicative proceeding*** whether a practice violates the law. Under Section 5(b) of the FTC Act, the Commission may challenge "unfair or deceptive act[s] or practice[s]," "unfair methods of competition," or violations of other laws enforced through the FTC Act, by instituting an administrative adjudication. When the Commission has "reason to believe" that a law violation has occurred, the Commission may issue a complaint setting forth its charges. If the respondent elects to settle the charges, it may sign a consent agreement (without admitting liability), consent to entry of a final order, and waive all right to judicial review. If the Commission accepts the proposed consent agreement, it places the order on the record for thirty days of public comment (or for such other period as the Commission may specify) before determining whether to make the order final.
>
> ***
>
> **1. Administrative Adjudication**
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> ***If the respondent elects to contest the charges, the complaint is adjudicated before an administrative law judge ("ALJ") in a trial-type proceeding conducted under the Commission's Rules of Practice***. The prosecution of a matter is conducted by FTC "complaint counsel," who are staff from the relevant bureau or a regional office. Upon conclusion of the hearing, the ALJ issues an "initial decision" setting forth his or her findings of fact and conclusions of law, and recommending either entry of an order to cease and desist or dismissal of the complaint. Either complaint counsel or respondent, or both, may appeal the initial decision to the full Commission. In limited cases, including certain merger cases, the Commission's rules provide that the appeal is automatic.
>
> Upon appeal of an initial decision, the Commission receives briefs, holds oral argument, and thereafter issues its own final decision and order. The Commission's final decision is appealable by any respondent against which an order is issued. The respondent may file a petition for review with any United States court of appeals within whose jurisdiction the respondent resides or carries on business or where the challenged practice was used. FTC Act Section 5(c), 15 U.S.C. Sec. 45(c). If the court of appeals affirms the Commission's order, the court enters its own order of enforcement. The party losing in the court of appeals may seek review by the Supreme Court. Commission decisions and orders are available on this site."

33. The remedial options available in FTC Act administrative proceedings – consent decrees and cease and desist orders – evidence the statutory emphasis on protecting consumers by stopping unfair practices and securing compliance with the law. By its steadfast refusal to share any data analyses prior to filing suit, the FTC clearly has no interest in securing voluntary compliance with the law. Nerium has no opportunity to take corrective action if the FTC will not share what it finds troubling in Nerium's sales and compensation data. The FTC's actions are also contrary to the stated goal to "foster greater private-sector cooperation in enforcement, promote information sharing with the private sector, and establish predictable outcomes for private conduct."[32]

34. With regard to filing lawsuits in court, Section 13(b) of the FTC Act, 15 U.S.C. §53(b), does grant the FTC authority to file suit in court under certain circumstances. However, it only expressly authorizes the FTC to obtain temporary, preliminary, and/or permanent injunctive relief. It does not expressly 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" as claimed by the FTC.[33] It further only expressly authorizes the FTC to seek injunctive relief if and when the target "***is violating, or is about to violate***, any provision of law enforced by the Federal Trade Commission".[34]

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[32] President's October 9, 2019 Executive Order on Promoting the Rule of Law Through Transparency and Fairness in Civil Administrative Enforcement and Adjudication, Section 1

[33] *FTC v. Credit Bureau Center, LLC*, Slip Op. Nos. 18-2847 & 18-3310 (7th Cir. August 21, 2019) (*en banc* reviewed denied) (emphasis added) (citing to and finding that the plain language of Section 13 only allows for injunctive relief, and not monetary relief such as restitution); *See also FTC v. Bronson Partners, LLC*, 654 F. 3d 359, 368 (2d Cir. 2011) ; *FTC v. DIRECTV, Inc.*, No. 15-cv-01129-HSG, at *42-43 (N.D. Cal. Aug. 16, 2018); *FTC v. Trudeau*, 569 F.3d 754, 769-770 (7th Cir. 2009) ("If any part of [compensatory equitable relief] winds up being punitive instead of remedial, then criminal proceedings are required to sustain it.").

[34] *FTC v. Shire Viropharma, Inc.*, 917 F.3d 147, 155 (3rd Cir. 2019). (Section 5(b) is an administrative remedy. FTC must first go through administrative process *before* seeking redress in the Courts. Section 13 provides Court remedy, but only for *ongoing* violations).

35. In criticizing several recent federal court opinions confirming the narrow scope of the FTC's authority, the FTC has referred to the FTC Act as "organic":

> You know what it's so there have been a couple of recent court cases that have called into question the FTC's ability to obtain injunctions and to obtain money relief ***under our organic statute*** for in federal court for unfair and deceptive practices.[35]

Although it is true that the FTC Act is "organic" in the sense that is a statute that establishes the FTC and defines its authorities and responsibilities, it is not a statute that can "organically" change at the whim of the FTC. The FTC must act within Constitutional and statutory parameters.

36. In fact, even in criticizing the recent *Credit Bureau Center, en banc* reconsideration denied, Opinion of the Seventh Circuit[36] and the Third Circuit's recent opinion in *Shire* (which was not appealed by the FTC), the FTC itself recognizes that the very action with which it has threatened Plaintiffs in this Court, Section 13(b), is ***not*** available against Plaintiffs. The fact that the FTC opened its investigation over three (3) years ago without seeking injunctive relief is evidence that the FTC does not believe that Plaintiffs are operating a "rip and tear fraud" such that the FTC could file a colorable Section 13(b) lawsuit.

37. Further, the FTC admits that the FTC itself has actually found it necessary to seek Congressional action to **grant it the new authority** to recover monetary relief:

> The second case is a little more dramatic probably than the Shire Viro-Pharma case, that's the case in the seventh circuit is called *Credit Bureau Center*. And their three-judge panel of the Seventh Circuit overruled in part nearly 30 years of precedent, in the Seventh Circuit to hold that ***our statute (again section 13(b)) doesn't authorize us to obtain money relief, to obtain restitution or disgorgement, in an injunctive action in federal court***.

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[35] DSA Legal & Regulatory Seminar: October 8, 2019 UNOFFICIAL TRANSCRIPT: Remarks of Andrew Smith and Q&A at 8 (emphasis added)

[36] At the time of this filing, the FTC has not sought *certiorari* at the U.S. Supreme Court.

> There is an element here, of these cases for these, are cases where ***13(b) is a statute that we use to bring to justice companies, that we would all agree are fraud just rip and tear fraud***. These are companies that are essentially stealing money from consumers, and we have to run into court. We have to get a temporary restraining order. We have to get an asset freeze. We have to appoint a receiver because ***there is no way that the company can be run in a legitimate manner***.
>
> ***So that's the status is the statute that we use for that***. So there's an element here that these decisions are making the world safe for fraudsters, and I would note that ***this could be fixed with a stroke of Congress's pen.*** [37]

38. The FTC has further criticized, but did not appeal, the recent *Shire* opinion from the Third Court of Appeals. *Shire* prohibits the FTC from seeking injunctive relief unless, as is typical in cases seeking injunctive relief, it establishes that its target ***is violating, or is about to violate***, the FTC Act. In short, the FTC may not rely upon past actions that are no longer occurring. It must establish a *current* violation of the FTC Act. This would be true of any other litigant seeking injunctive relief. Nevertheless, in its criticism of the Court, the FTC argues that it should have the power to obtain injunctive relief in response to *past* violations because *other statutes it enforces* allegedly expressly grants it that power.[38] Of course, however, this admission proves the point. The FTC Act does *not* provide the FTC that power. Notably, despite this fact, the FTC has stated that the Court's Opinion, from which the FTC ***did not*** appeal or seek certiorari, "has not had a major impact on [the FTC's enforcement program]." Of course, this should not be a surprise in light of the FTC's strategy of "legislation through enforcement" through its use of its threats of litigation and "fencing in" strategy. As succinctly stated by the FTC's Director of its Consumer Bureau, Andrew Smith:

[37] DSA Legal & Regulatory Seminar: October 8, 2019 UNOFFICIAL TRANSCRIPT: Remarks of Andrew Smith and Q&A at 9 (emphasis added).
[38] *Infra* at p. 9.

> So the first of these is from the Third Circuit is called Shire Viro-Pharma v. FTC, and this was earlier this year in February.
>
> So our statute says, when I'm talking about that, I mean the FTC Act more specifically section 13(b) of the FTC Act says that whenever we at the FTC have reason to believe that any person partnership or corporation is violating or is about to violate any provision of law enforced by the FTC, we can go to court to get an injunction. Is violating or is about to violate. ***So there are other statues that we enforce that talk about: we can go to court to obtain an injunction when the individual has violated is violating or will violate***. So is violating or about to violate: the Third Circuit held was an imminence standard that they either have to be engaged currently in the practice of violating the law, or they have to be about to do so again.
>
> And for the lawyers in the room, you'll know that this is kind of upside down and that in order to obtain an injunction against the company, we need to show that there is a likelihood that misconduct will recur-- not that the person, that there's any imminence to their potential violation of the law. So essentially, what the Third Circuit is saying is that we need to prove more to get into court than we would need to prove to win our injunctive action. We made that argument to the Third Circuit, and they weren't having any of it. So, so we now are faced with this with this particular decision in the Third circuit.
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> ***
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> So I will say that you know, we continue to be mindful of this decision from the third circuit. ***I don't think so far that it has had a major impact on our enforcement program***, but going forward, we obviously-- are we obviously respect the decision in the court and --we but we intend to continue to vigorously enforce our statute.[39]

39. Perhaps most telling is the FTC's very public statement that these Court Opinions have not and will not change the FTC's enforcement behavior:

> So, we are looking at all of our options here including Supreme Court Appeal of the *Credit Bureau Cente*r decision. The bottom line is that we respect the decision of these courts but we also recognize that the great weight of the authority notwithstanding the Seventh Circuit opinion, the great weight of the authority still favors us at

[39] DSA Legal & Regulatory Seminar: October 8, 2019 UNOFFICIAL TRANSCRIPT: Remarks of Andrew Smith and Q&A at 8-9 (emphasis added).

> the FTC and ***we will continue to aggressively pursue monetary relief for consumers who legally were deceived or was untreated unfairly***.[40]

40. The remaining statutory section threated by the FTC, Section 12 of the FTC Act, deals solely with "false advertisements" and thus does not appear applicable to the FTC's pyramid scheme claims against Plaintiffs.[41]

IV. JURISDICTION AND VENUE

41. This action arises under the Section 5(a) of the FTC Act, 15 U.S.C. §45(a), and the Declaratory Judgment Act, 28 U.S.C. §§2201 and 2202. This Court has subject matter jurisdiction pursuant to 28 U.S.C. § §1331 and 1137(a).[42] Plaintiff's cause of action is based upon, and seeks judicial interpretation of, 15 U.S.C. §45(a).

42. As the FTC has asserted in its draft Complaint, "Venue is proper in this District under 28 U.S.C. § 1391(b)(2), (b)(3), (c)(2), and (d), and 15 U.S.C. § 53(b)." Plaintiff believes that Venue is also proper in this District pursuant to 28 U.S.C. § 1391(b)(2) because a substantial part of the events or omissions giving rise to the claim occurred within this District. Indeed, the CID in this matter was issued and the ensuing investigation was conducted from the FTC's

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[40] *Id.at 9.*

[41] 15 U.S.C. §52(a) provides as follows:

> "(a)Unlawfulness
> It shall be unlawful for any person, partnership, or corporation to disseminate, or cause to be disseminated, ***any false advertisement***—
> (1)By United States mails, or in or having an effect upon commerce, by any means, for the purpose of inducing, or which is likely to induce, directly or indirectly the purchase of food, drugs, devices, services, or cosmetics; or
> (2)By any means, for the purpose of inducing, or which is likely to induce, directly or indirectly, the purchase in or having an effect upon commerce, of food, drugs, devices, services, or cosmetics.
> (b)Unfair or deceptive act or practice
> The dissemination or the causing to be disseminated of any false advertisement within the provisions of subsection (a) of this section shall be an unfair or deceptive act or practice in or affecting commerce within the meaning of section 45 of this title."

[42] The FTC has asserted, "this Court has subject matter jurisdiction pursuant to 28 U.S.C. § §1331, 1137(a), and 1345."

Chicago office. Until the *Credit Bureau* decision was decided, the FTC' position was consistently that if this matter could not be resolved, suit would be filed ***in this Court***. Only after *Credit Bureau* did the FTC decide that it would sue in the New Jersey in the Third Circuit; despite the fact that Nerium's relevant product supplier is located in Colorado. This is a primary reason that Plaintiffs have chosen to file this action in this Court rather than be subject to the FTC's apparent forum shopping efforts.

V. FACTUAL BACKGROUND

A. FTC Court Losses

43. As set forth below, the FTC has recently suffered a string of federal court losses regarding the extent of its authority to file lawsuits without first exhausting its administrative process[43], regarding its authority to recover monetary relief[44], and its authority to seek injunctive relief[45]. It is expected that other Circuit Courts will follow suit, especially because their own prior opinions are based upon prior Seventh Circuit panel precedent which the Seventh Circuit has, in a recent *en banc* denied opinion, held has now been overruled by the U.S. Supreme Court.[46]

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[43] *FTC v. Shire Viropharma, Inc*., 917 F.3d 147, 155 (3rd Cir. 2019). (Section 5(b) is an administrative remedy. FTC must first go through administrative process *before* seeking redress in the Courts. Section 13 provides Court remedy, but only for *ongoing* violations).

[44] *FTC v. Credit Bureau Center, LLC*, Slip Op. Nos. 18-2847 & 18-3310 (7th Cir. August 21, 2019) (*en banc* reviewed denied) (finding that the plain language of Section 13 only allows for injunctive relief, and not monetary relief such as restitution); *See also FTC v. Bronson Partners, LLC*, 654 F. 3d 359, 368 (2d Cir. 2011) ; *FTC v. DIRECTV, Inc*., No. 15-cv-01129-HSG, at *42-43 (N.D. Cal. Aug. 16, 2018); *FTC v. Trudeau*, 569 F.3d 754, 769-770 (7th Cir. 2009) ("If any part of [compensatory equitable relief] winds up being punitive instead of remedial, then criminal proceedings are required to sustain it.").

[45] *FTC v. Credit Bureau Center, LLC*, Slip Op. Nos. 18-2847 & 18-3310 (7th Cir. August 21, 2019) (*en banc* reviewed denied) (finding that the plain language of Section 13 only allows for injunctive relief, and not monetary relief such as restitution); *See also FTC v. Bronson Partners, LLC*, 654 F. 3d 359, 368 (2d Cir. 2011).

[46] *FTC v. Credit Bureau Center, LLC*, Slip Op. Nos. 18-2847 & 18-3310 (7th Cir. August 21, 2019) (*en banc* reviewed denied)

44. In addition, in numerous litigated cases from the past several years, courts have repeatedly rejected attempts by the FTC to curtail health-related advertising that comports with the agency's own guidance.[47] The Courts have also rejected the FTC's attempts to assert jurisdiction over foreign activities.[48]

45. The FTC Commissioners themselves have recognized these court losses and, as a result, have recently requested that the U.S. Congress "clarify" (i.e. expand) the FTC's authority.[49]

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[47] *See, e.g., U.S. v. Bayer Corp.*, No. 07-01(JLL) (D.N.J. Sept. 24, 2015); *FTC v. Garden of Life, Inc.*, 845 F. Supp. 2d 1328 (S.D. Fla. 2012), aff'd, 516 F. App'x 852 (11th Cir. 2013); *Basic Research, LLC v. FTC*, No. 2:09-cv-00779-CW, 2014 U.S. Dist. LEXIS 169043, *35-36 (Nov. 25, 2014).

[48] For example, a court vacated a default judgment after finding that the defendant put forth "meritorious arguments" against the inclusion of foreign revenues in the monetary judgement sought by the FTC. *FTC v. Construct Data Publrs. A.S.*, No. 13-cv-01999, 2014 U.S. Dist. LEXIS 171677 (N.D. Ill. Dec. 11, 2014). The FTC had argued that, under Section 5(a)(4), in order to obtain "restitution [for] foreign victims," it need only show deceptive acts or practices "involving foreign commerce that (i) cause or are likely to cause reasonably foreseeable injury within the United States; or (ii) involve material conduct occurring within the United States." *Id.* at *22-23. The court disagreed, finding that the FTC ignored Section 5(a)(3), an important limitation on both parts of 5(a)(4). *Id.* That provision states clearly that Section 5 "'shall *not* apply to unfair methods of competition involving commerce with foreign nations *unless that conduct has a 'direct, substantial, and reasonably foreseeable domestic effect.'"* The court next opined that the FTC "moreover" failed to recognize that "in interpreting U.S. legislation there is a presumption that it is meant to apply only within the territorial jurisdiction of the United States." According to the U.S. Supreme Court, this presumption exists for the obvious reason that "United States law governs domestically but does not rule the world." *Microsoft Corp. v. AT&T Corp.*, 550 U.S. 437, 454 (2007).

[49] For example, on May 8, 2019, FTC Commissioner Wilson testified before the U.S. House Committee on Energy and Commerce Subcommittee on Consumer Protection and Commerce, and asked Congress to clarify the extent of the FTC's authority to obtain monetary relief under Section 13(b) of the FTC Act. *Oral Statement of Commissioner Christine S. Wilson as Prepared for Delivery Before the U.S House Co.* *https://www.ftc.gov/system/files/documents/public_statements/1519254/commissioner_wilson_may_2019_ec_opening.pdf* As explained in her testimony and again in an interview with the Competition Policy International (CPI), Commissioner Wilson expressed concerns about recent district court and appellate judges who questioned the FTC's authority under 13(b). Specifically mentioned were the recent decision of the U.S. Court of Appeals for the Third Circuit in *FTC v. Shire Viropharma Inc.*, and statements by Judge Diarmuid O'Scannlain in the Ninth Circuit case *FTC v. AMG Capital Management, LLC*, who urged the Circuit to sit *en banc* to review what he saws as wrongly-decided prior decisions that had allowed the FTC to pursue monetary damages under Section 13(b)." Commissioner Wilson similarly noted how one of the panel judges on the Seventh Circuit "aggressively challenged 30 years of the Circuit's own case law holding that the FTC can seek equitable relief under Section 13(b)" *See* https://www.competitionpolicyinternational.com/cpi-talks-12. Subsequently, in the very Seventh Circuit case referenced by Commissioner Wilson, the Seventh Circuit held in that *section* 13(b) of the FTC Act only permits the Commission to seek injunctive relief; it may not seek monetary relief, including equitable monetary relief such as restitution. *FTC v. Credit Bureau Center slip op. Nos 18-2847 & 18-3310 (7th Cir.*

46. In addition, the courts do not concur with various of the FTC's views concerning what constitutes an illegal pyramid scheme under the FTC Act. For example, in *BurnLounge,* the Ninth Circuit rejected the FTC's argument that end use sales made to MLM business participants could not be considered in paying compensation to business participants.[50]

47. The Seventh Circuit has recently held that "[b]y its terms, section 13(b) authorizes only restraining orders and injunctions".

> The Federal Trade Commission eventually took notice. It sued Brown under section 13(b) of the Federal Trade Commission Act ("FTCA"), 15 U.S.C. § 53(b), alleging that the websites and referral system violated several consumer protection statutes. The Commission sought a permanent injunction and restitution. Relevant here, the district judge found that Brown was a principal for his contractor's fraudulent scheme and that the websites failed to meet certain disclosure requirements in the Restore Online Shopper Confidence Act ("ROSCA"). Id. § 8403. The judge entered a permanent injunction and ordered Brown to pay more than $5 million in restitution to the Commission.
>
> Brown now concedes liability as a principal for his contractor's Craigslist scam. And he doesn't dispute that his own websites failed to meet some of ROSCA's disclosure requirements. So we have no trouble affirming the judge's decision to hold him liable for both. We also affirm the issuance of a permanent injunction. Brown's argument there rests on an erroneous understanding of the Eighth Amendment's Excessive Fines Clause.
>
> ***But the restitution award is a different matter. By its terms, section 13(b) authorizes only restraining orders and injunctions. But the Commission has long viewed it as also authorizing awards of restitution***. We endorsed that starkly textual interpretation three decades ago in FTC v. Amy Travel Service, Inc., 875 F.2d 564, 571 (7th Cir. 1989). ***Since Amy Travel, the Supreme Court has clarified***

August 21, 2019) *En Banc* review was denied. *See* https://www.courthousenews.com/wp-content/uploads/2019/08/FTCvCredit-Bureau.pdf.

[50] *Burnlounge, Inc. v, FTC*, 753 F.3d 878, 887 (9th Cir. 2014). The FTC previously took the same position in FTC. v. FHTM to obtain *ex parte* TRO relief, the appointment of a Receiver, and the freezing of FHTM's bank accounts; effectively killing the company without an adversarial substantive hearing or process. Co-founder and owner Paul Orberson literally died during the proceeding.

> ***that courts must consider whether an implied equitable remedy is compatible with a statute's express remedial scheme***. See Meghrig v. KFC W., Inc., 516 U.S. 479, 487–88 (1996). ***And it has specifically instructed us not to assume that a statute with "elaborate enforcement provisions" implicitly authorizes other remedies***. Id. at 487.
>
> ***Applying Meghrig's instructions, we conclude that section 13(b)'s grant of authority to order injunctive relief does not implicitly authorize an award of restitution***. Every reason Meghrig gave for not finding an implied monetary remedy applies here. Most notably, the FTCA has two detailed remedial provisions that expressly authorize restitution if the Commission follows certain procedures. Our current reading of section 13(b) allows the Commission to circumvent these elaborate enforcement provisions and seek restitution directly through an implied remedy. ***Stare decisis cannot justify adherence to an approach that Supreme Court precedent forecloses. Accordingly, we overrule Amy Travel and hold that section 13(b) does not authorize restitutionary relief. Because the Commission brought this case under section 13(b), we vacate the restitution award***.[51]

B. <u>FTC Using "Fencing In" Tactic</u>

48. Despite this legal background, the FTC has advocated for increased use of threatening lawsuits ***<u>based upon a new interpretation of its Guidance</u>*** should a target not agree to the FTC's demand that the target be "fenced in" by agreeing to business practices beyond what the law requires.

49. The FTC's "fencing in" strategy generally works against MLM's as follows. As the FTC has recognized, history has shown that the mere ***filing*** of a pyramid scheme lawsuit by the FTC (regardless of the facts or law) will likely cause the target MLM to go out of business because its business participant independent sales forces will resign.[52] Thus, depriving the target MLM, such as Nerium, of effective due process. The FTC takes advantage of this to threaten the

[51] *FTC v. Credit Bureau Center, LLC*, Slip Op. Nos. 18-2847 & 18-3310 (7th Cir. August 21, 2019) (*en banc* reviewed denied) (emphasis added) (finding that the plain language of Section 13 only allows for injunctive relief, and not monetary relief such as restitution);
[52] See e.g. *FTC v. AdvoCare, FTC v. FHTM, FTC v. BurnLounge, and FTC v. Vemma*.

target MLM that it will seek an enormous monetary judgment, often in excess of a $100 million[53], if the target MLM does not agree to "fencing in" changes to its business practices ***which are not required by law***. The FTC will not allow the target to formally deny the claims against it. Should the target have the temerity of wanting the settlement documents to honestly reflect that the target denies the FTC's allegations, the FTC will refuse to settle. For there to be a settlement, the FTC requires the target to "neither admit or deny" the allegations made by the FTC.[54] However, then after settlement the FTC does a public "about face" and claims that the target admitted to being a pyramid scheme or has its chosen Receiver proclaim that the target was a pyramid scheme.[55] All without the target being afforded an opportunity to effectively dispute same.

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[53] The FTC does not have civil penalty authority. Therefore, it often requires that the monetary relief be characterized as "equitable monetary relief" "restitution" or "disgorgement" to make allegedly injured "consumers" whole. However, the FTC takes the position that these "consumers" include independent contractor business participants in addition to traditional consumers of the MLM's products and services. Further, the large monetary judgment set forth in the judgment is often "suspended" in the very same judgment if the target pays a very small percentage of the judgment. *See* FHTM Stipulated Order at p. 7, Section III para. B ("Judgment in the amount of …$169,000,000 is entered…as equitable monetary relief… Defendants are ordered to pay $3,541,000 to the Commission in equitable monetary relief….[u]pon such payment…the remainder of the judgment is suspended…");
See Vemma Stipulated Order at p. 15 -23, Section VII ("Judgment in the amount of…$238,000,000 is entered…as equitable monetary relief…In partial satisfaction of the monetary judgment…Individual Defendants is ordered to..[p]ay to the Commission…$216,839 [and] $253,297 [and transfer specific assets]…[u]pon receipt by the Commission of all payments…transfers of assets…the remainder of the judgment…shall be suspended…").
See Hardman AdvoCare Stipulated Order at p. 6, Section VI B ("Judgment in the amount of…$4,000,000 is entered…as equitable monetary relief…Settling Defendants…are ordered to pay to the Commission…$100,000…Upon such payment and all other asset transfers…the remainder of the judgment is suspended.").

[54] See Stipulated Orders For Permanent Injunction and Monetary Judgment entered into by:
By FHTM at p. 3, para. 3 at
https://www.ftc.gov/system/files/documents/cases/140513fortunehitechstip.pdf;
by Vemma at p. 2, para. 3 at https://www.ftc.gov/system/files/documents/cases/161222_vemma_273-stipulated_final_order_redacted.pdf
by AdvoCare at p. 2, para. 3 at
https://www.ftc.gov/system/files/documents/cases/stipulated_order_advocare.pdf

[55] Minutes after the FTC's press conference announcing its settlement with AdvoCare, AdvoCare issued an "Important Update" press release correcting "the categorically false" statements made by the FTC, including the following:

50. These are precisely the tactics being utilized by the FTC against Plaintiffs.

C. FTC "Fencing In" Tactic Against Plaintiffs Is Not Legal

Without proper prior amendment of the FTC Act by Congress or the FTC's use of formal rulemaking[56], the FTC's "fencing in" tactic is not legal.[57] In fact, this tactic has been formally rejected by the United States Department of Justice. As the Department of Justice has recognized:

> Guidance documents can be used to explain existing law…But they should not be used to change the law or to impose new standards to determine compliance with the law. The notice-and-comment process that is ordinarily required for rulemaking can be cumbersome and slow, but it has the benefit of availing agencies of more complete information about a proposed rule's effects than the agency could ascertain on its own.[58]

51. In addition, on October 9, 2019, President Trump issued two (2) Executive Orders prohibiting all federal government agencies from utilizing "Guidance" and other "off the book" regulations to change the law.[59]

> "The FTC incorrectly stated in a press conference that AdvoCare had admitted to operating as a pyramid. This is categorically false. AdvoCare forcefully rebutted this charge in its discussions with the FTC. To this day, AdvoCare denies it operated as a pyramid."

October 2, 2019 AdvoCare "Important Update: 11:30 AM CST" press release at https://facts.advocare.com/

[56] "Under Section 18 of the FTC Act, 15 U.S.C. Sec. 57a, the Commission is authorized to prescribe "rules which define with specificity acts or practices which are unfair or deceptive acts or practices in or affecting commerce" within the meaning of Section 5(a)(1) of the Act. Among other things, the statute requires that Commission rulemaking proceedings provide an opportunity for informal hearings at which interested parties are accorded limited rights of cross-examination. Before commencing a rulemaking proceeding, the Commission must have reason to believe that the practices to be addressed by the rulemaking are "prevalent." 15 U.S.C. Sec. 57a(b)(3)."
FTC 's April 2019 "A Brief Over view of the Federal Trade Commission's Investigative, Law Enforcement, and Rulemaking Authority" found at:
https://www.ftc.gov/about-ftc/what-we-do/enforcement-authority

[57] On May 14, 2018, Commissioner Chopra issued a memo advocating for increased use of "fencing in". He issued the memo less than 2 weeks after he was sworn in as an FTC Commissioner on May 2, 2018.
https://www.ftc.gov/system/files/documents/public_statements/1378225/chopra_-_repeat_offenders_memo_5-14-18.pdf

[58] November 17, 2017 DOJ Memorandum (emphasis added). https://www.justice.gov/opa/pr/attorney-general-jeff-sessions-ends-department-s-practice-regulation-guidance

[59] See President's press conference announcing the Executive Orders at 3:35.
https://www.cnbc.com/2019/10/09/watch-trump-signs-executive-orders-on-transparency-in-federal-guidance-and-enforcement.html

Today we take bold new action to protect Americans from out of control bureaucracy and stop regulators from imposing secret rules and hidden penalties on the American people.[60]

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For many decades, federal agencies have been issuing thousands of pages of so called Guidance Documents, a pernicious kind of regulation imposed by unaccountable bureaucrats in the form of commentary on how Rules should be interpreted. ***All too often Guidance Documents are a back for regulators to effectively change the laws and vastly expand their scope and reach. Guidance has frequently been used to subject U.S Citizens and businesses to arbitrary and sometimes abusive enforcement actions***... Because of these materials and the fact that these materials are too often hidden and hard to find, many Americans learn of the rules only when federal agents come knocking on the door. This regulatory overreach gravely undermines our Constitutional system of government. Unelected, unaccountable bureaucrats must not be able to operate outside of the democratic system of government, imposing their own private agenda on our citizens. A permanent federal bureaucracy cannot become a fourth branch of government, unanswerable to American voters...[61]

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When Americans and the businesses are sued by government agencies there are sometimes not even given an explanation of what they do wrong and how they can fix it. [62]

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No American should ever face such persecution from their own government…today I am taking action to stop it. My first executive order will require agencies to publish Guidance Documents on line so that small businesses and everyday citizens can easily find them. **Agencies will have to seek public input on the most important guidance and the whole process will be closely overseen by the White House**…**Americans will no longer be subject to the rules of hidden games that are played on the public**. **The second order I will sign today will protect American citizens from secret interpretations of regulations, unexpected penalties and violations of their rights**. **From now on agencies will be required to** inform individuals about any case against them **and respond to**

[60] *Id.* at 3:35.
[61] *Id.* at 4:25.
[62] *Id.* at 10:56.

> **their arguments**. **It will be the agency's duty to fully educate small businesses about new regulatory changes**…[63]

52. The FTC's enforcement actions to eliminate MLMs with new definitions and theories are exactly the "attempts to regulate the public without following the rulemaking procedures of the APA" described in the President's Executive Orders.[64] "Americans deserve an open and fair regulatory process that imposes new obligations on the public only when consistent with applicable law and after an agency follows appropriate procedures."[65] The Executive Orders are premised on the stated principle that "Regulated parties must know in advance the rules by which the Federal Government will judge their actions."[66] The FTC's ad hoc enforcement actions against MLMs violate the explicit directive: "No person should be subjected to a civil administrative enforcement action or adjudication absent prior public notice of both the enforcing agency's jurisdiction over particular conduct and the legal standards applicable to that conduct."[67] Instead, the FTC has engaged in what Acting Director of the Office of Management & Budget ("OMB") Russ Voight described as "stealth regulation" that results in "people being bullied by their federal government."[68]

53. Nevertheless, the FTC is using "fencing in" and threats of ***filing*** pyramid scheme lawsuits against legitimate MLMs should they not agree to the "fencing in".

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[63] *Id.* at 13:55

[64] President's October 9, 2019 Executive Order 13891 "Promoting the Rule of Law Through Improved Agency Guidance Documents" at Section 1, found at https://www.federalregister.gov/documents/2019/10/15/2019-22623/promoting-the-rule-of-law-through-improved-agency-guidance-documents

[65] *Id.*

[66] President's October 9, 2019 Executive Order13892 "Promoting the Rule of Law Through Transparency and Fairness in Civil Administrative Enforcement and Adjudication" at Section 1, found at https://www.federalregister.gov/documents/2019/10/15/2019-22624/promoting-the-rule-of-law-through-transparency-and-fairness-in-civil-administrative-enforcement-and

[67] *Id.*

[68] See President's press conference announcing the Executive Orders at 20:20. https://www.cnbc.com/2019/10/09/watch-trump-signs-executive-orders-on-transparency-in-federal-guidance-and-enforcement.html

54. The FTC has adopted this "fencing in" approach based upon its unilateral, new interpretation of the FTC's Guidance, in an attempt to unilaterally and retroactively change the law and rules on how MLMs must operate, without proper prior amendment of the FTC Act by Congress or the FTC's use of formal rulemaking.[69]

D. FTC's Demands Beyond the Law

55. In short, the FTC is attempting to unilaterally and retroactively outlaw multi-level marketing by:

(1) refusing to share the economic analysis it claims to have establishing that a MLM is a pyramid scheme[70];

(2) demanding the elimination of paying of compensation to those in the up line of the person actually making the sale and perhaps only one person above the seller [71]; and

[69] June 14, 2019, DSA President Joseph Mariano's June 14, 2019 summary memo of the DSA's June 11, 2019 meeting with FTC Chair Simon and his staff. President Mariano noted that:

> "I also expressed the concerns that we have heard from the direct selling community regarding the Commission's enforcement posture and views of the industry including the speculated misgivings about the business model such as personal use and multi-level compensation."

See also https://www.law360.com/articles/1161129/a-potential-new-fight-over-ftc-s-13-b-authority
Similarly, on October 8, 2019 DSA President Joseph Mariano repeated these thoughts:

> "Nonetheless, we are still concerned, and many people in this room are concerned, there is a basic misunderstanding about direct selling and how it works. Perhaps even worse, there is potential hostility and skepticism regarding direct selling notwithstanding your words, that as a result in an impressive posture toward even legitimate direct selling companies, specifically during various closed-door meetings, it has been reported that members of the FTC staff and others at every level in the organization have openly expressed disdain and hostility for direct selling, particularly multilevel compensation … and this skepticism has resulted in something of a confirmation bias with regard to certain facts and aspects of how direct selling companies, many legitimate direct selling companies were, including common practices such as recruitment of new sales people, compensation as based upon … requirements … actual sales … and even the use of product by sales people, so-called personal use … it has also been expressed that we, there's a concern that the FTC has perhaps an unexpressed agenda of defense in direct selling businesses through a series of actions like last week … and that their goal actually is … to eliminate multilevel marketing, multilevel compensation…"

[70] The FTC advises that it will not release its analysis to Plaintiffs until a lawsuit is filed.
[71] The FTC has been unable to cite to any authority for this proposition.

(3) demanding the prohibition of consideration of a business participant's own purchases as end use consumption.[72]

This is not the law.

56. Nevertheless, it was reported that this was the situation involving leading MLM AdvoCare's May 2019 announcement that it would no longer operate as a multi-level marketing company.[73]

57. On October 2, 2019 the FTC held a press conference wherein it confirmed its new "groundbreaking" interpretation of how MLMs are considered pyramid schemes and announced same through its October 2019 FTC "Consumer Information" web page titled "Multi Level Marketing Businesses and Pyramid Schemes".[74] ***It should be noted that this new web page was also not created as a result of the passage of new or amended law or as a result of formal rulemaking***. Although the FTC has repeatedly recognized that Multi Level Marketing is legal[75],

[72] Courts have already rejected the FTC's interpretation of the law. *FTC v. BurnLounge, Inc.*, 753 F.3d 878, 883 (9th Cir. 2014)

[73] https://www.law360.com/articles/1161129/a-potential-new-fight-over-ftc-s-13-b-authority

[74] https://www.consumer.ftc.gov/articles/0065-multi-level-marketing-businesses-and-pyramid-schemes

[75] "**1. What is direct selling? What is multi-level marketing?**
Direct selling is a blanket term that encompasses a variety of business forms premised on person-to-person selling in locations other than a retail establishment, such as social media platforms or the home of the salesperson or prospective customer.
Multi-level marketing is one form of direct selling. Generally, a multi-level marketer (MLM) distributes products or services through a network of salespeople who are not employees of the company and do not receive a salary or wage. Instead, members of the company's salesforce usually are treated as independent contractors, who may earn income depending on their own revenues and expenses. Typically, the company does not directly recruit its salesforce, but relies upon its existing salespeople to recruit additional salespeople, which creates multiple levels of "distributors" or "participants" organized in "downlines." A participant's "downline" is the network of his or her recruits, and recruits of those recruits, and so on.
2. Under Section 5 of the FTC Act, what is an MLM with an unlawful compensation structure, which is sometimes called a pyramid scheme?
The most widely-cited description of an unlawful MLM structure appears in the FTC's *Koscot* decision, which observed that such enterprises are "characterized by the payment by participants of money to the company in return for which they receive (1) the right to sell a product and (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to the sale of the product to ultimate users." *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1181 (1975)."
Source: FTC January 2018 "Business Guidance Concerning Multi-Level Marketing"

that MLMs are dependent upon the recruitment of new business opportunity participants as their sales force[76], that paying compensation for product purchases by business participant sales force for their own end use is legal, and that most people who join legitimate MLMs make little money, no money, or lose money[77], the FTC has now enunciated that these features of legitimate MLMs

https://www.ftc.gov/tips-advice/business-center/guidance/business-guidance-concerning-multi-level-marketing

[76] "Multi-level marketing is one form of direct selling. Generally, a multi-level marketer (MLM) distributes products or services through a network of salespeople who are not employees of the company and do not receive a salary or wage. Instead, members of the company's salesforce usually are treated as independent contractors, who may earn income depending on their own revenues and expenses. Typically, the company does not directly recruit its salesforce, but relies upon its existing salespeople to recruit additional salespeople, which creates multiple levels of "distributors" or "participants" organized in "downlines." A participant's "downline" is the network of his or her recruits, and recruits of those recruits, and so on."
Source: FTC January 2018 "Business Guidance Concerning Multi-Level Marketing"
https://www.ftc.gov/tips-advice/business-center/guidance/business-guidance-concerning-multi-level-marketing
"Multilevel marketing is a method of selling products and services directly to consumers where existing distributors ***recruit new distributors*** and are paid a percentage of the new distributors' sales. Multilevel marketing is not inherently illegal and business can and do engage in lawful multilevel marketing campaigns."
Source: October 3, 2019 Press Conference announcing FTC settlement with AdvoCare
https://www.facebook.com/federaltradecommission/videos/508585946387892/
"If you join an MLM, you'll be a salesperson. Your job will be to sell the company's product and, in many cases, to convince other people to join, invest, and sell. If you don't like selling, or if you're uncomfortable asking people you know to put their time and money into a business venture, joining an MLM is a bad idea."
Source: October 2019 FTC "Multi-Level Marketing Business and Pyramid Schemes" web page
https://www.consumer.ftc.gov/articles/0065-multi-level-marketing-businesses-and-pyramid-schemes

[77] "Most people who join legitimate MLMs make little or no money. Some of them lose money."
"If you're considering joining an MLM, know that some MLMs – even ones that aren't pyramid schemes – may not be a wise investment."
"You might think that, with your smarts and hard work, you can earn substantial income through the MLM. In fact, most people who join MLMs and work hard make little or no money, and some of them lose money."
"Every business venture has risks. MLMs are no different. Even if the start-up costs seem low, additional expenses can add up quickly. Expenses can include training and travel costs, website fees, promotional materials, costs to host parties, and costs to buy products."
"Many MLMs make you buy training or marketing materials, or pay for seminars on building your business. You may need to book travel and pay for hotels and meals. Make sure you know what you must pay for, and how much it will cost over time."

somehow make them illegal pyramid schemes.[78] The FTC also now asserts that "push[ing] distributors to recruit new distributors" (although an indicia of a legal MLM) is an indicia of whether or not an MLM is a pyramid scheme.[79] Note the use of the word "pushed" rather than the proper use of the phrase "primarily pushed". The word "primarily" is absent from the FTC's web page and in Director Smith's press conference.

58. Similarly, during his October 8, 2019 presentation to the DSA Legal & Compliance Summit, FTC Consumer Protection Bureau Director Smith announced that building a sales force (a hallmark of an MLM) is an indicia of a pyramid scheme:

> So here are some takeaways on compensation schemes from our prior-- from our prior cases.

Source: October 2019 FTC "Multi-Level Marketing Business and Pyramid Schemes" web page at ftc.gov/MLM https://www.consumer.ftc.gov/articles/0065-multi-level-marketing-businesses-and-pyramid-schemes

Director Smith repeated this statement during his October 3, 2019 Press Conference wherein he stated: "***But most people in even legitimate MLMs will earn very little money or may spend more than they make***." Source: October 3, 2019 Press Conference announcing FTC settlement with AdvoCare

[78] See also https://www.law360.com/competition/articles/1206024/advocare-deal-puts-ftc-s-13-b-authority-in-spotlight?nl_pk=f75a0ed1-3a7d-4b4b-b75f-598b11d9a7bf&utm_source=newsletter&utm_medium=email&utm_campaign=competition

("There are a number of notable aspects to the complaint and consent order for those seeking to stay on the right side of the law and avoid an FTC investigation or enforcement action. First, section one of the consent goes well beyond the limitations imposed in the Herbalife settlement and suggested by the FTC's multilevel marketing business guidance by prohibiting AdvoCare from participating in multilevel marketing altogether.

Specifically, the order prohibits the company from participating in any plan where the participant recruits others to a downline and receives compensation that is based, in whole or in part, upon purchases, sales or any other activities of the downline.

This is a notable departure from prior orders addressing compensation plans, which historically have prohibited participation in an illegal pyramid scheme or Ponzi scheme, or in a multilevel marketing program that involves payment of money in return for the right to receive rewards for recruiting other participants, which are unrelated to sales to nonmembers — effectively cross-referencing the long-standing definition of pyramid scheme.[4] It is also a shift from the Herbalife settlement, which requires verification of retail receipts and imposes specific limits on compensation but does not wholly prohibit multilevel marketing.")

[79] "We have alleged that AdvoCare ***is a pyramid scheme because*** the Defendants, through their compensation scheme and false earnings claims, ***pushed distributors to recruit new distributors***." Source: October 3, 2019 FTC Press Conference announcing FTC settlement with AdvoCare at 9:56 minutes (emphasis added) https://www.facebook.com/federaltradecommission/videos/508585946387892/

> First, does your program overly incentivize recruitment rather than product sales? We have seen distributors encouraged by the MLM or by their up-line to recruit, recruit, and recruit. As I called it, I think last week, recruiting recruiters who recruit, who recruit recruiters.[80]

59. Further, despite clear authority to the contrary[81], the FTC is again rejecting consideration of not only ***end use sales*** to business participants ***but all sales*** to business participants.[82] Despite recognizing that most MLM participants do not make money, the FTC now indicates that not making enough money is a major indicia of a pyramid scheme[83].

60. Further, the FTC now would prohibit MLMs from providing compensation to participants unless (1) it is based solely on the purchase of product directly from the company by a customer; (2) only business participant is compensated per purchase; and (3) no compensation is provided for purchases by someone who has been a business participant within six months of purchase[84]. ***In short, the FTC wishes to take the "multi" out of multi level marketing***.

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[80] DSA Legal & Regulatory Seminar: October 8, 2019 UNOFFICIAL TRANSCRIPT: Remarks of Andrew Smith and Q&A at 6 (emphasis added).

[81] *See e.g. BurnLounge*.

[82] "If the MLM is not a pyramid scheme, it will pay you based on your sales ***to retail customers***, without having to recruit new distributors."
Source: October 2019 FTC "Multi-Level Marketing Business and Pyramid Schemes" web page at ftc.gov/MLM
https://www.consumer.ftc.gov/articles/0065-multi-level-marketing-businesses-and-pyramid-schemes

[83] "A pyramid encourages recruitment of new participants into the business opportunity without regard to whether those new participants will have a meaningful retail sales opportunity. It is impossible for all of the participants in a pyramid scheme to earn the promised earnings. There will always be a huge number of distributors at the bottom of the pyramid that cannot be sustained by the available demand for the product. The only participants who earn money are at the very top of the pyramid."
"Most distributors won't be able to recruit enough people to earn back the money that they have invested into the scheme, much less make a profit. This certainty of consumer loss renders pyramid schemes inherently unfair and deceptive and the FTC will continue to take aggressive action against them."
Source: October 3, 2019 Press Conference announcing FTC settlement with AdvoCare
https://www.facebook.com/federaltradecommission/videos/508585946387892/

[84] See https://www.law360.com/competition/articles/1206024/advocare-deal-puts-ftc-s-13-b-authority-in-spotlight?nl_pk=f75a0ed1-3a7d-4b4b-b75f-598b11d9a7bf&utm_source=newsletter&utm_medium=email&utm_campaign=competition

61. The new FTC MLM and Pyramid web page announced in the press conference is dated October 2019 on the bottom of the page. It is labeled "FTC Consumer Information" rather than "Guidance". It initially contains some fairly non-controversial statements.[85]

62. However, FTC Consumer Bureau Director Andrew Smith erroneously proclaimed during a scripted press conference announcing its settlement with AdvoCare that another "groundbreaking" development was that AdvoCare had admitted that it was operating as a pyramid scheme: "Significant that we have a large well known marketing company that is admitting that it was operating as a pyramid".[86] This was a very unusual scripted statement in light of the fact that, as set forth above, a core tactic adopted by the FTC is that in demanding settlements the FTC flatly *refuses* to allow a target to deny liability. On the contrary, the FTC demands that the target agree to the FTC's now-stock language "…neither admit or deny the allegation". Should the target have the temerity of wanting the settlement documents to honestly reflect that the target denies the FTC's allegations, the FTC will refuse to settle.[87]

63. Minutes after the FTC's press conference AdvoCare issued an "Important Update" press release correcting "the categorically false" statements made by the FTC, including the following:

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[85] See e.g. "A pyramid encourages recruitment of new participants into the business opportunity without regard to whether those new participants will have a meaningful retail sales opportunity. It is impossible for all of the participants in a pyramid scheme to earn the promised earnings. There will always be a huge number of distributors at the bottom of the pyramid that cannot be sustained by the available demand for the product. The only participants who earn money are at the very top of the pyramid."
"Most distributors won't be able to recruit enough people to earn back the money that they have invested into the scheme, much less make a profit. This certainty of consumer loss renders pyramid schemes inherently unfair and deceptive and the FTC will continue to take aggressive action against them."
https://www.consumer.ftc.gov/articles/0065-multi-level-marketing-businesses-and-pyramid-schemes

[86] Source: October 3, 2019 Press Conference announcing FTC settlement with AdvoCare at 27:56-29:30 minutes
https://www.facebook.com/federaltradecommission/videos/508585946387892/

[87] Similarly, the FTC has adopted the tactic of demanding outrageously high judgment amounts in the settlement "Stipulated Order and Judgment"; only to render them a nullity in the same document by "suspending" the payment of same. *Supra* at 27.

> "The FTC incorrectly stated in a press conference that AdvoCare had admitted to operating as a pyramid. This is categorically false. AdvoCare forcefully rebutted this charge in its discussions with the FTC. To this day, AdvoCare denies it operated as a pyramid."[88]

64. During his October 8, 2019 speech to the Direct Selling Association's Legal & Compliance Summit, Director Smith admitted that his scripted statement was not true:

> So again, allegations and I should say-- because I was not careful enough and saying this last week-- that those allegations are neither admitted nor denied by AdvoCare or by the other defendants, including the individual defendants."[89]

65. In response to MLM industry questions regarding the FTC's attempt to change the law, Director Smith responded:

> So I have been asked, in fact, I was just asked immediately prior to this talk, whether the FTC has changed its position on multilevel marketing and the answer is an emphatic, no: that multilevel marketing continues to be legal, that there's nothing inherently unlawful about the direct selling model. I personally think that multilevel marketing can be superior in many ways to traditional retailing in that it depends on a direct relationship between sellers and consumers and allows companies to reach consumers that they wouldn't necessarily otherwise reach and it allows for sales to consumers and communities that might be underserved by traditional retail. That's one part of it.
>
> The other part of it is for the distributors that entrepreneurial consumers have the opportunity to try to supplement their income, and the multilevel business structure allows you, as businesses, to tap into existing networks among distributors and potential distributors and customers and prospective customers.
>
> ***But, an over-emphasis on recruiting can turn a multi-level marketing company into a pyramid***.

[88] See October 2, 2019 AdvoCare "Important Update: 11:30 AM CST" press release at https://facts.advocare.com/

[89] DSA Legal & Regulatory Seminar: October 8, 2019 UNOFFICIAL TRANSCRIPT: Remarks of Andrew Smith and Q&A at 3.

66. The FTC is thus now rejecting the previous FTC and Court-announced "primarily" (i.e. 51% or more of compensation) objective standard regarding emphasis on recruiting and replacing it with an ambiguous and amorphous "over-emphasis" standard. In fact, the FTC has expressly rejected the very pyramid scheme tests which the FTC itself and the Courts have adopted. FTC Consumer Bureau Chief Smith put it best when, on October 8, 2019, he advised the industry that

> ***We hear that company revenues are derived primarily from purchases by end-users not from purchases by distributors….All of that is beside the point.***[90]
>
> We hear that company revenues are derived ***primarily*** from purchases by end users--not from purchases by distributors . . . ***So all of these arguments, although possibly relevant, are ultimately beside the point.***[91]

67. In short, the FTC now is attempting to enforce an amorphous, vague, undefined, and wholly subjective **"Over-emphasis on recruiting" pyramid scheme test**. To describe this new test, the FTC has now unilaterally announced, adopted and outlawed the new concepts of "Threshold" compensation, "Convex" compensation, and "Duplication" compensation.

E. FTC Adopts New "Recruitment Based Compensation" Pyramid Scheme Test Evidenced By 3 New Elements: "Threshold Rewards", "Convex Rewards", and "Duplication Rewards".

68. The FTC has long recognized that the recruitment of other business participants is a core hallmark of multi level marketing. Rather than adopting advertising budgets to market to end users, MLMs use network marketing to recruit and build out independent representative sales teams. The FTC (and the Courts) have thus long recognized that the law requires that in order for the FTC to establish that a MLM is a pyramid scheme, the FTC must establish that the actual

[90] *Id.*
[91] *Id.*at 6.

compensation paid to the MLM business participants is ***primarily*** for recruiting other business participants and that the *sine quo non* is that the compensation payments be ***unrelated*** to product sales.

69. Nevertheless the FTC has now adopted circular logic and intends to outlaw such recruitment simply if the FTC believes that there is a "need to recruit". The FTC has thus now announced a new pyramid scheme test of illegal "Recruitment Based Compensation" evidenced by three (3) new elements: "Threshold Rewards", "Convex Rewards", and "Duplication Rewards".

70. First, the FTC has now announced the new pyramid scheme concept of a "Threshold Reward" as being compensation "that begins or increases exponentially at specific thresholds." In short, the compensation paid increases with increasing product sales.

71. Second, The FTC has now announced the new pyramid scheme concept of "Convex Rewards" as being compensation which increases "with greater levels of expenditure".

72. Third, the FTC has now announced the new pyramid scheme concept of "Duplication Rewards" as being compensation being based upon the size of a down-line sales force. In short, like in many sales forces, if the larger sales force makes more sales, the larger the compensation. Of course, this is the essence of any legitimate MLM.

73. On October 8, 2019, FTC Consumer Director Smith announced these new pyramid scheme concepts to the industry as follows:

> ***So a note on compensation structure, which I think is probably the key for us in evaluating whether a legitimate multilevel marketing company has strayed into pyramid country***. Pyramid schemes have a long history at the FTC, you guys probably know this, and it dates back to our Holiday Magic case in 1974. Our challenge, and probably your challenge too, has always been distinguishing a legitimate, a good direct selling opportunity from a pyramid scheme. And our Koscot Interplanetary case, and this is 1975, the Commission defined a pyramid scheme as an MLM that charges participants for the right to sell products, and that compensate

participants for recruitment, ***unrelated*** to product sales to end-users. The second element, compensation for recruitment ***unrelated*** to product sales was characterized in Koscot as the ***sine qua non*** of a pyramid scheme.

And by encouraging **aggressive recruitment** of a downline, this type of compensation is the source of potential consumers in just that we see arising from pyramid schemes. ***So this injury from recruitment based compensation can be magnified by threshold-based rewards--and I'll explain what these terms mean: threshold-based rewards, convex rewards, and duplication rewards.***

So what's threshold based rewards-- a reward that begins or increases exponentially at specific thresholds. So you earn nothing for the first $1500 in product purchases, but then after $1500, the rewards go up exponentially. So it's not a linear relationship between the end-user and compensation.

Convex rewards are rewards where greater levels of expenditure earn greater rewards. So rather than a threshold, like a hockey stick, the curve looks like that.

Duplication based rewards: greater rewards for participants with larger downlines. You don't earn any compensation for sales by the first three individuals in your downline, or you don't earn, or you earn compensation for sales from the distributors in the level immediately below you, but you earn more compensation if they also recruit.

So these are the kinds of rewards that we have seen in some of our cases. I want to caution that compensation schemes, compensation plans can be very complicated and there can be many ways to earn even in a legitimate MLM. And they can be difficult to explain to others so, but I think this is an area, in the course of our investigations and our enforcement we have been heavily focused.

So for us, the key to evaluating whether an MLM operates like a pyramid is compensation. And again this pyramid compensation model is one which requires distributors to recruit others to recoup their initial expenses and to seek to obtain earnings from the venture. The problem with a pyramid compensation model is, like a chain letter, it's mathematically impossible for most of the distributors in the scheme to attain even modest earnings, and that's what we're focused on at the FTC.

We typically hear a variety of arguments from companies in response to our allegations that they are a pyramid scheme. We hear

that the MLM sells unique products and services that consumers want and therefore offers distributors a meaningful retail opportunity. ***We hear that company revenues are derived primarily from purchases by end users--not from purchases by distributors***. We hear that the required costs of startup such as starter kits, the required costs to become a distributor are very low. We hear that the MLM itself doesn't make deceptive earnings, lifestyle, or product claims and that the distributors are independent contractors. ***So all of these arguments, although possibly relevant, are ultimately beside the point***. The key is the compensation. ***Pyramid schemes, as I say pyramid schemes and legitimate companies often adopt complicated compensation schemes with a variety of rewards for achieving different goals but at the end of the day if distributors are compensation of the basis of recruitment particularly if that compensation scheme relies on threshold-based, convex or duplication based rewards we believe that consumer injury is likely even where the MLM offers actual products or real retail opportunity***.[92]

***

With respect to the last question, which was what about and up line that earns a commission on real sales to real people, real end-users, real retail demand by the downline? I think that's what we're looking for. I would say that we have some concern about compensation for fees that are also paid by the downline. So compensation that you earn for starter packages or compensation to the up line for purchases of training materials educational materials seminar fees.

I also would think about convex rewards where I think that that can, you know, you don't earn anything on the first five thousand dollars in sales by your downline. But then you really start to earn and that, what we're looking at, again, is the is the incentivizing distributors to recruit recruiters who recruit recruiters. And there are ways to do that, even where that compensation is based exclusively on real sales to real people. ***But that's what we also see in our enforcement actions: is that compensation based exclusively on real sales to real end-users is--I don't believe that we have seen a compensation scheme that is based exclusively on that.*** There are a lot of ways to earn: it can be complicated, but there is always in our cases, there have always been ways to earn that aren't based solely on sales to end-users. We believe, right, that's these are allegations again based

[92] DSA Legal & Regulatory Seminar: October 8, 2019 UNOFFICIAL TRANSCRIPT: Remarks of Andrew Smith and Q&A at 6 (emphasis added)

> on our evaluation of what can be very complicated compensation systems.[93].

74. The reaction from the MLM industry speaks volumes. This new test for a pyramid scheme was not only improperly adopted without Congressional action or through proper FTC rulemaking. In addition, the new test of a pyramid scheme is vague, ambiguous, and incapable of being objective analysis.

75. Plaintiffs have attempted to identify the FTC's source for these new tests and supporting concepts. The FTC attributes them to undisclosed "research" and "testing". It is thus not clear, but it appears that rather than going through proper rulemaking, the FTC simply sought out the advice of its newest MLM economic trial consultant to develop these new tests and concepts.

F. FTC Conflates Income & Lifestyle Claims with Legal Test of a Pyramid Scheme

76. But that is not all. The FTC now conflates improper earnings and lifestyle claims with the legal test of a pyramid scheme. Material, untrue earnings claims and lifestyle claims have long been considered typical "unfair or deceptive act or practice(s) in violation of section 45(a)(1)" rather than "pyramid scheme" claims. However, the FTC now seeks to conflate same:

> I am, by trade, a financial services lawyer, but I am familiar with multilevel marketing and the multi-level marketing business model, so ***I have in the context of our recent efforts with respect to multi-level marketing companies, been thinking a lot about these issues***.
>
> And if you think about, you know, the multi-level marketing companies that have sort of gone off the rails and start to veer into pyramid country, and then I think of a classic pyramid like a chain letter. And that it depends on the recruitment of new participants' payout to existing participants and a pyramid as compared to a legitimate MLM encourages recruitment of new participants into the business opportunity without regard to whether those new participants have meaningful sales, retail sales opportunity. The term

[93] *Id.* at 12.

> that I've heard used for this type of recruitment, multiple levels of distributors is duplication.
>
> This means the compounding of recruits that's necessary to build a profitable downline, and we may come back to that term as we go through this morning's talk. ***So this need to recruit could lead to distributors to make wild and unsubstantiated earnings and lifestyle claims to prospects***. We know from research done by DSA that Joe just referred to, and others by the way, not just DSA that even successful distributors will most likely earn very modest amounts of money. ***So when we hear distributors claiming that you can make millions of dollars working from home, that's going be a problem for us***. [94]

G. FTC's requirement that MLM's make a "Determination of Earnings"

77. The FTC has thus also now decided, based upon the FTC's own undisclosed "research" and "testing", that "truthful testimonials", ***even with express disclaimers***, are no longer legal. This raises significant First Amendment issues. The FTC has further announced that in order to avoid the FTC ***bringing a pyramid scheme claim because it believes that the MLM company has made improper earning and lifestyle claims***, each MLM will now "need to know and need to be able to show" what *each* independent representative actually "spends" on their business.

> ***So with respect to earnings and lifestyle claims, here are the rules of the road***.
>
> Representations by MLMs or their distributors have to be truthful, non-misleading, and substantiated. ***For earnings claims to be truthful and substantiated you will need to know and need to be able to show that, after taking into account expenses, the outcome you or your distributor is claiming is the generally expected achievement of distributors. This means that you need to know what your distributors earn but also what they spend***. This is an important point.
>
> Distributors usually have to spend money on their business, whether it be cost of product, website fees, costs for samples and parties, costs associated with attending company conferences or purchasing training, or educational materials. The earnings claims need to reflect those costs. So, hypothetical

[94] DSA Legal & Regulatory Seminar: October 8, 2019 UNOFFICIAL TRANSCRIPT: Remarks of Andrew Smith and Q&A at 3-4 (emphasis added).

> example of a business whose distributors earn on average, $5000 a year but it costs them $2,500 to make that $5,000. There's a serious problem if the MLM or the distributor tells consumers that they make $5,000 in gross income without mentioning the cost.
>
> ***Also, with respect to providing truthful and substantiated income, you need to gather and consider data about what all your distributors earn and spend; not just those who earn money. So we've seen this in our cases where companies (MLM's or distributors) have omitted non-earners from income disclaimers, claiming that those non-earners were not quote-unquote "active." So from our perspective, that's not going to cut it. You're going to show average earnings claims. You have to include everybody in the program***.
>
> ***
>
> Point Number Two, Testimonials. ***Even truthful testimonials can be problematic.*** Why's that? Because based on the research that we have done, consumers take away from a testimonial such as "I earned $5,000 last year" consumers take away from that, the message that, I can achieve that-¬that that's going to be me" "That's going to be me." In fact, we know that the MLM or the distributor probably doesn't have the data to back up that claim, which we can determine in an investigation. But even if you do have that data to substantiate the claims, those earnings have to be typical.
>
> And we know again form research done by DSA and others that vanishingly few distributors will ever make that kind of money. So a testimonial like that is going to be a red flag for the FTC. And a disclaimer may not be adequate to correct that misleading testimonial. FTC guidance, that even truthful testimonials from a small percentage of individuals who do earn career level income from MLM are likely to be misleading unless the advertising or the presentation, also makes clear that the amount earned or lost by most distributors. ***Based on our testing at the commission, statements such as "results not typical" or "results based on experiences of a few people" and "you're not likely to have similar results" are not going to cut to spell typicality-- to dispel the impression that those earnings representations are typical.***[95]

78. The fact that the FTC's requirement that MLM's make a "Determination of Earnings" is new was made clear in a question raised immediately after it was announced by Director Smith:

[95] *Id.*at 4.

Jeff Babener: You hear me? I can I say thank you. My name is Jeff Babner, where I'm an attorney, and we represent a number of direct selling companies in the industry. It's very good presentation. Thank you.

I have a question, and I think this is one that Peter would want to know on behalf of our new Council, ***and that is what appeared to me in your presentation was possibly a new ask by the FTC regarding determination of earnings*** going all the way back to the 1979 Amway decision. You know, there was a requirement of basically showing average earnings, and we understand what was that should be. But over the last many years and we've been involved in helping develop many average earnings presentation charts, etc. for major companies. It is always been based on gross earnings or payments that the distributors. I'm not aware, ***I may not be aware of any earnings disclosure that has ever gone behind the curtain to look at the actual costs of distributors, and I and I think that it would be a daunting task for companies to try to investigate, with their Distributors***. It's hard enough for them to look at other issues regarding sales and destination of product. But to try to understand what were their costs? Attended some meetings, taxi cab rides, training, buying books, or whatever. So what I'm trying to understand is-- I've never seen it. I've never seen it utilized, and I'm wondering whether or not in the going forward, this is a new ask by the FTC of companies to be analyzing?

Andrew Smith: So that's fair enough, and I would say that in the first instance, what we see are our disclaimers or earning statements, whatever we want to call them income disclosures that say 75% earn $250 or less a year, you know, whatever. Then whatever that number and that's all it'll say. It won't explain that; that's gross and that it's not net of what it cost to earn that money.

Now, you also can estimate probably what the costs are. I mean, you know certain costs, for example, if there is a required purchase in order to be eligible to receive any compensation, that you will at least know that. You know that it's the $49 a month or $1500 a month or whatever. The number is so there is so I think that you're not completely at sea, but I would say that in the first instance, at least you need to have you need to show and explain that this is not necessarily what they actually earned. This is their gross income and that they had expenses in order to earn that amount. Now, I'm looking over sort of plaintively at Lois. Does that sound about right? Yeah. Right. So at the very least you could do it means putting aside, your taxicabs and airplane tickets and things like that, which I take your point, and that's going to be different from person to person, but you do know what the required or even the average what people actually purchase and of course of the year in order to make in order to continue to participate in the program and make that money that you're disclosing is gross.

> Then, maybe one? Okay. Alright. There we go. So one more, one more question in the back. Now this it's going to be I know it's going to be a big fat softball . . . .[96]

H. FTC's New Rejection of Return Policies

79. Although the FTC has ***required*** MLMs to implement product return policies in order to offset the FTC's traditional pyramid scheme claim of "inventory loading", the FTC now rejects these very return policies:

> So this raises a question about refund policies, so a quick note on how refund policy, on refund policies and how they relate to inventory loading. The bottom line here is that a refund policy is one factor that we consider as a part of our comprehensive examination of a compensation plan. ***But even the perfect refund policy would not by itself be sufficient to rebut evidence that Distributors are buying products to earn bonuses and compensation and/or meet compensation thresholds***.[97]

I. FTC Now Rejects Independent Contractor Liability

80. The FTC has also announced that it now will reject the concept of independent contractor liability and will hold the MLM itself liable for misrepresentations made by their independent contractor business participants:

> ***So a final point on lifestyle and earnings claims is that we at the FTC are going to hold MLM's responsible for misrepresentations by their distributors.*** You probably notice that I have been talking about representations by both MLM's and their distributors and saying that both MLM's and distributors should avoid making misleading earnings claims. In many of our cases, we have named the MLM as well as key distributors in our complaints and enforcement actions. But you--we consider you--your distributors the key person.
>
> ***Many of you may argue that the distributors are independent contractors. We've heard that argument before, but we have nonetheless been able to***

[96] DSA Legal & Regulatory Seminar: October 8, 2019 UNOFFICIAL TRANSCRIPT: Remarks of Andrew Smith and Q&A at 13-14 (emphasis added)
[97] *Id.*at 7.

> ***hold advertisers liable for deceptive marketing by their publishers. So this is a context outside of MLM and also within MLM. So we have actually litigated decisions where Courts have held that an advertiser is responsible for an affiliate, a publisher, someone who is advertising even two, three, four generations removed from that advertiser. We've had successful decisions in the Seventh Circuit, Second Circuit upheld on appeal, and the theory is an agency theory. Even though the paper between the parties is replete with disclaimers of employee status and full provisions that say "we are independent contractors."***[98]

VI. ATTORNEYS' FEES & EXPENSES: *LABMD V. FTC*

81. Plaintiffs seek their attorneys' fees and expenses. The FTC has recently repeatedly asserted baseless claims against legitimate companies. The Court's have started to push back on these assertions and awarded attorneys' fees and expenses. For example, on August 29, 2013, the FTC filed an administrative enforcement action against LabMD. The FTC issued a Cease & Desist Order. On September 29, 2016, LabMD appealed to the Eleventh Circuit. The Eleventh Circuit ruled in LabMD's favor, vacating the FTC's Cease & Desist Order as unenforceable. Lab MD filed an Application for Attorney's Fees under the Equal Access to Justice Act, 28 U.S.C. §2412(d) ("EAJA"). The "purpose of the EAJA is to eliminate for the average person the financial disincentive to challenge unreasonable governmental actions," and to "curb[] excessive regulation and the unreasonable exercise of Government authority." *Comm'r I.N.S. v. Jean*, 496 U.S. 154, 163-5 (1990) *citing* H.R. Rep. No. 96-1418, p. 12 (1980). Under the EAJA, a court shall award attorneys' fees to a prevailing party "unless the position taken by the United States in the proceeding at issue was substantially justified'." *Sullivan v. Hudson*, 490 U.S. 877, 884 (1989) citing 28 U.S.C. §2412(d)(1)(A). On May 6, 2019, the United States Court of Appeals for the Eleventh Circuit referred Petitioner LabMD's Application for Attorneys' Fees to the U.S. District Court for the Northern District of Georgia for appointment of a Special Master under Federal Rule

[98] *Id.*at 4-5.

of Appellate Procedure 48. On October 1, 2019 the Special Master found that "the FTC's position was not substantially justified" and found that the FTC should pay LabMD $843,173.67.

82. This is precisely the situation currently involving Plaintiffs. The process pursuant to which the FTC has been pursuing its over three (3) year investigation and threatened litigation against Plaintiffs has ignored the law.

VII. NO FEDERAL PREEMPTION

83. The United States Supreme Court has long recognized that Congressional intent must be "express" or "clearly manifest" if it intends to intrude into or disrupt state regulation of matters".[99] Therefore, the Court has cautioned against preemption of state authority in areas traditionally the province of the states.[100] Federal and state laws prohibiting "unfair or deceptive

[99] *See e.g. BFP v. Resolution Trust Corp*., 511 US 531, 542-44, 114 S.Ct. 1757, 1759-65, 128 L.Ed.2d 556 (1994) ("Federal statutes impinging upon important state interests 'cannot . . . be construed without regard to the implications of our dual system of government . . . . [W]hen the federal Government takes over . . . local radiations in the vast network of our national economic enterprise and thereby radically readjusts the balance of state and national authority, those charged with the duty of legislating [must be] reasonably explicit.'"); *Resolution Trust Corp*., 511 US at 544, 114 S.Ct. at 1764 (quoting Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum.L.Rev. 527, 539-40 (1947), quoted in *Kelly v. Robinson*, 479 USS 36, 49-50, n. 11, 107 S.Ct. 353, 360-62, n.11, 93 L.Ed.2d 216 (1986)); *see also Rapanos v. United States* , 547 US 715, 737-38, 126 S.Ct. 2208, 2223-24, 165 L.Ed.2d 159 (2006) (the Court's plurality opinion with regard Clean Water Act authority to regulate parties depositing fill material in locations denominated "waters of the United States" noting that "[r]egulation of land use, as through the issuance of development permits . .. is a quintessential state and local power" and that the Clean Water Act should clearly manifest the de facto creation of the Amy Corps of Engineers as a regulator of immense stretches of intrastate land); *Gonzales v. Oregon*, 546 U.S. 243, 270, 126 S.Ct. 904, 923, 163 L.Ed.2d 748 (2006) (citations omitted) (in declining to extend *Chevron* deference to Attorney General's rulemaking under the Controlled Substances Act that would preclude physician-assisted suicide under Oregon law, noting the "structure and limitations of federalism, which allow the States 'great latitude under their police powers to legislate as to the protection of the lives, limbs, health, comfort, and quiet of all persons.'").

[100] *See e.g. Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485, 116 S.CT. 2240, 2250, 135 L.Ed.2d 700 (1996) ("[B]ecause the States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly pre-empt state-law causes of action. In all pre-emption cases, and particularly in those in which Congress has 'legislated . . . in a field in which the States have traditionally occupied, . . . we 'start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress'" *quoting Rice v. Santa Fe Elevator Corp*., 331 US 218, 230, 67 S.Ct. 1146, 1152, 91 L.Ed.1447 (1947) and *Hillsborough Cty., Fl. v. Automated Medical Laboratories, Inc*., 471 US 707, 715-716, 105 S.Ct. 2371, 2376, 85 L.Ed.2d 714 (1985) but comparing to *Fort Halifax Packing Co. v. Coyne*, 482 US 1, 22, 107 S.Ct. 2211, 2223, 96 L.Ed.2d 1 (1987)).

practices" thus operate in a complementary fashion. See 16 C.F.R. 0.17. The FTC Act has no express preemption provision and it cannot be argued that Congress has implicitly preempted state unfair practice or deceptive practice laws. In fact, beginning in the mid-1960s, the FTC encouraged States to adopt unfair or deceptive practice legislation. Additionally, with respect to allegedly injured "consumers", the FTC Act's savings clause expressly provides that the remedies set out in 15 U.S.C. 57b are "in addition to, and not in lieu of, any other remedy or right of action provided by State or Federal law." 15 U.S.C. 57b(e).

84. As discussed above, every State in the Union has adopted statutes expressly dealing with pyramid schemes in the MLM context. Meanwhile, Congress has not expressly preempted state pyramid scheme laws. It should be noted that in 2017-2018, Congress considered whether or not it should adopt an amendment to the FTC Act which would expressly make pyramid schemes illegal under the FTC Act. The House Bill, H.R. 3409, was introduced by Representative Marsha Blackburn.[101] It was titled the "Anti-Pyramid Promotional Scheme Act of 2017".[102] A related Senate Bill, S.3, was introduced by Senator Orrin Hatch. It was titled the "Anti-Pyramid Promotional Scheme Act of 2018".[103] The House Bill stated that it was intended:

See also Cipollone v. Liggett Group, Inc., et al, 505 U.S. 504 (1992). In *Cippoline,* the United States Supreme Court considered whether federal law, the Federal Cigarette Labeling and Advertising Act ("FCLAA") preempted cigarette smokers' Maine Unfair Trade Practices Act ("MUTPA") claims. A plurality of the Court held that it did not. In concurring, Justices Blackman, Kennedy, and Souter concluded that the modified language of § 5(b) in the 1969 Act did not clearly exhibit the necessary congressional intent to pre-empt Maine law.

See also Altria Group Inc. et al. v. Good et al., 555 U.S. 70 (2008). The U.S. Supreme Court held that the FCLAA did not expressly or impliedly preempt all claims related to "smoking and health" under the Maine UTPA. The U.S. government itself filed an amicus brief in *Good* supporting the non-preemption of state law. See U.S. Government Amicus Brief filed in *Altria Group Inc. et al. v. Good et al*., No. 07-562 https://www.ftc.gov/sites/default/files/documents/amicus_briefs/altria-group-inc.et-al.v.good-et-al./080620_07-562bsacus.pdf

[101] The House Bill had 49 co-sponsors. https://www.congress.gov/bill/115th-congress/house-bill/3409/cosponsors

[102] https://www.congress.gov/bill/115th-congress/house-bill/3409

[103] https://www.congress.gov/bill/115th-congress/senate-bill/3

> To amend the Federal Trade Commission Act to prohibit pyramid promotional schemes and to ensure that compensation is not based upon recruitment of participants into a plan or operation, but on sales to individuals who use and consume the products or services sold, and for other purposes.104

The Congressional Research Service summarized the House Bill as follows:

> ***This bill amends the Federal Trade Commission Act to make it unlawful for any person to establish, operate, or promote a pyramid promotional scheme. "Pyramid promotional scheme" means*** any plan or operation in which individuals pay consideration for the right to receive compensation that is based upon recruiting other individuals into the plan or operation rather than ***primarily*** related to the sale of products or services to ultimate users.
>
> Furthermore, any person who establishes, operates, or promotes any plan or operation which sells or solicits the sale of consumer products or services in the home or otherwise outside of a permanent retail establishment, and which sells products or services to independent salespeople, shall have a bona fide inventory repurchase agreement.
>
> A violation of the bill shall be treated under the Act as an unfair or deceptive act or practice in, or affecting, commerce.[105]

The Senate Bill state that it was intended:

> To amend the Federal Trade Commission Act to prohibit pyramid promotional schemes to ensure that compensation is not based upon recruitment of participants into a plan or operation, but instead based primarily on sales to individuals who use, resell, or consume the products or services sold, protect participants, prohibit inventory loading, and for other purposes.[106]

The Congressional Research Service summarized the Senate Bill as follows:

> ***This bill amends the Federal Trade Commission Act to make it unlawful for any person to establish, operate, or promote a pyramid promotional scheme. "Pyramid promotional scheme" means*** any plan or operation in which individuals pay consideration for the right to receive compensation that is based upon recruiting other individuals into the plan or operation rather than ***primarily*** related to the sale of products or services to ultimate users.

[104] https://www.congress.gov/bill/115th-congress/house-bill/3409/text
[105] https://www.congress.gov/bill/115th-congress/house-bill/3409
[106] https://www.congress.gov/bill/115th-congress/senate-bill/3/text

> Furthermore, any person who establishes, operates, or promotes any plan or operation that sells or solicits the sale of consumer products or services in the home or otherwise outside of a permanent retail establishment, and that sells products or services to independent salespeople, shall have a bona fide inventory repurchase agreement.
> A violation of the bill shall be treated under the Act as an unfair or deceptive act or practice in, or affecting, commerce.[107]

85. Neither Bill made it out of Committee. However, the failed Bills highlight that no federal law, including the FTC Act, provides a definition of a pyramid scheme. Further, there certainly is no express Congressional preemption of state laws defining whether or not a MLM is a pyramid scheme.

VIII. NO FTC RULEMAKING

86. The FTC Act only authorizes the Commission to adopt two different types of rules: "interpretive rules and general statements of policy," 15 U.S.C. 57a(a)(1)(A), and "rules which define with specificity acts or practices which are unfair or deceptive acts or practices," 15 U.S.C. 57a(a)(1)(B). As to the latter category only, called "trade regulation rules," 16 C.F.R. 1.7, the FTC Act imposes detailed procedural requirements. See 15 U.S.C. 57a(b) and (c), 57b-3(a)(1). Violation of a trade regulation rule "constitute[s] an unfair or deceptive act or practice in violation of section 45(a)(1)," 15 U.S.C. 57a(d)(3), and can be enforced through a civil action, 15 U.S.C. 45(m)(1)(A) (civil penalties for knowing rule violations); 15 U.S.C. 57b(a)(1), (b) (action to redress injury to consumers). ***The FTC has not adopted a "trade regulation rule" regarding whether or not a MLM is a pyramid scheme***.

87. Interpretive rules, which do not undergo the same procedural process, are not enforceable in their own right. Id; FTC Operating Manual (June 25, 2007) ch. 8.3.2. (industry

[107] https://www.congress.gov/bill/115th-congress/senate-bill/3

guide "does not have the force or effect of law and is not legally binding on the Commission or on the public in an enforcement action").

IX. NO *CHEVRON* DEFERENCE

88. The FTC's interpretation of whether or not a MLM such as Nerium is an illegal pyramid scheme (especially without formal rulemaking) is not entitled to deference by this Court. As set forth above, the definition of an illegal pyramid scheme is not ambiguous. On the contrary, it is the FTC's new definition of an illegal pyramid scheme which is ambiguous.

89. In 1984, the U.S. Supreme Court recognized the concept of "*Chevron* Deference. *Chevron U.S.A. Inc. v. Natural Resources Defense Council,* 467 U.S. 837 (1984). *Chevron* Deference stands for the proposition that federal courts should defer to a federal agency's interpretation ***of a statute*** if (1) the statute is ambiguous and (2) the agency interpretation is reasonable.

90. However, the U.S. Supreme Court has recently made clear that the reach of *Chevron* Deference is limited. On June 21, 2018 the U.S. Supreme Court held the *Chevron* Deference was not applicable because the statute at issue was not ambiguous. *Pereira v. Sessions,* 138 S.Ct. 2105 (2018). In a concurring opinion, Justice Kennedy noted that the concept of *Chevron* Deference needed to be reconsidered. *Id.* 138 S.Ct. at 2121. ("Given the concerns raised by some Members of this Court…it seems necessary and appropriate to reconsider, in an appropriate case, the premises that underlie *Chevron* and how courts have implemented that decision. The proper rules for interpreting statutes and determining agency jurisdiction and substantive agency powers should accord with constitutional separation-of-powers principles and the function and province of the Judiciary."). Similarly, in dissent, Justice Alito argued that *Chevron* should either be openly reexamined or followed. *Id.* 138 S.Ct. at 2129. ("In recent years, several Members of this Court

have questioned *Chevron*'s foundations… But unless the Court has overruled *Chevron* in a secret decision that has somehow escaped my attention, it remains good law.").

91. On May 28, 2019, the U.S. Supreme Court again held that *Chevron* deference does not apply to the scope of its review. *Smith v. Berryhill*, 587 U.S. __ (2019) (writing for the Court, Justice Sotomayor wrote, "*Chevron* deference 'is premised on the theory that a statute's ambiguity constitutes an implicit delegation from Congress to the agency to fill in the statutory gaps'….The scope of judicial review, meanwhile, is hardly the kind of question that the Court presumes that Congress implicitly delegated to an agency.") (citations omitted).

92. Similarly, *Chevron* is not the only federal agency deference doctrine to have come under severe criticism by the Supreme Court Justices. In recent years, a different, but similar, deference doctrine has come under fire: the *Auer* doctrine, which requires federal court deference to federal agency interpretations ***of their own ambiguous regulations***. *Auer v. Robbins*, 519 U.S. 452 (1997).[108]

[108] *Decker v. Northwest Environmental Defense Center*, 568 U.S. 597 (2013) (Chief Justice Roberts and Justice Alito suggested in their concurring opinion that *Auer* be reexamined. Justice Scalia wrote in his concurring opinion that *Auer* "contravenes one of the great rules of separation of powers.").
Perez v. Mortgage Bankers Association, 135 S.Ct. 1199 (2015). (Justice Thomas wrote in his concurring opinion: "The doctrine of deference to an agency's interpretation of regulations is usually traced back to this Court's decision in *Seminole Rock, supra*, which involved the interpretation of a war-time price control regulation… Although on the surface these cases require only a straightforward application of the APA, closer scrutiny reveals serious constitutional questions lurking beneath. I have 'acknowledge[d] the importance of *stare decisis* to the stability of our Nation's legal system.' 'But *stare decisis* is only an 'adjunct' of our duty as judges to decide by our best lights what the Constitution means.'… By my best lights, the entire line of precedent beginning with *Seminole Rock* raises serious constitutional questions and should be reconsidered in an appropriate case.") (Justice Alito wrote in his concurring opinion that the separate opinions by Justices Thomas and Scalia "offer substantial reasons why the *Seminole Rock* doctrine may be incorrect.*"). United Student Aid Funds v. Bryana Bible*, 578 U.S. __ (2016) (Justice Thomas, dissenting from denial of *certiorari*, wrote that, "Any reader of this Court's opinions should think that the doctrine is on its last gasp.)."

X. CAUSES OF ACTION

A. Count One: Declaratory Judgments Sought

93. Plaintiff hereby incorporates the allegations set forth above, all of which are fully re-alleged here.

94. Pursuant to the Declaratory Judgments Act, 28 U.S.C. §§ 2201(a) and 2202, Plaintiff requests that the Court enter a judgment construing the provisions of the FTC Act and declaring and clarifying the rights and obligations of the parties under the FTC ACT as they effect Plaintiffs' operations.

95. There is a live case or controversy between the parties. This is a situation that is ongoing, but even if temporarily stopped is capable of repetition, but evading review.

96. Plaintiffs and Defendant have fundamental disagreements regarding the interpretation and application of several provisions of the FTC Act. Declarations from this court would resolve this controversy and provide the parties with certainty regarding their legal rights and obligations related to same.

97. Plaintiffs thus asks that the Court declare the following:

(1) Although Section 13(b) of the FTC Act, 15 U.S.C. §53(b) only expressly authorizes the FTC to obtain temporary, preliminary, and/or permanent injunctive relief. It 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".[109]

(2) Section 13(b) of the FTC Act, 15 U.S.C. §53(b) only authorizes the FTC to seek injunctive relief if and when the target is "is violating, or is about to violate, any provision of law enforced by the Federal Trade Commission" and does not

[109] *FTC v. Credit Bureau Center, LLC*, Slip Op. Nos. 18-2847 & 18-3310 (7th Cir. August 21, 2019) (*en banc* reviewed denied) (finding that the plain language of Section 13 only allows for injunctive relief, and not monetary relief such as restitution); *See also FTC v. Bronson Partners, LLC*, 654 F. 3d 359, 368 (2d Cir. 2011) ; *FTC v. DIRECTV, Inc*., No. 15-cv-01129-HSG, at *42-43 (N.D. Cal. Aug. 16, 2018); *FTC v. Trudeau*, 569 F.3d 754, 769-770 (7th Cir. 2009) ("If any part of [compensatory equitable relief] winds up being punitive instead of remedial, then criminal proceedings are required to sustain it.").

authorize the FTC to seek injunctive relief for past conduct that has ceased absent evidence that it is likely to recur.

(3) Pursuant to the two Executive Orders on Promoting the Rule of Law issued by the President on October 9, 2019, the FTC may not bring any civil administrative enforcement proceeding or adjudication based upon a new interpretation, theory or test for an illegal pyramid scheme if it has not been published in the Federal Register and the public given a fair opportunity to comply.

(4) When reviewing multi-level marketing companies for possible illegal pyramid activities, the FTC must count product purchases by participants in the MLM as purchases by end users absent evidence that the products are being purchased for inventory, samples, or are otherwise not being used by the purchaser.

(5) 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.

(6) The FTC Act neither establishes nor prohibits any given ratio of compensation between those at the top and those at the bottom of a sales organization, and the FTC is not authorized to bring any civil administrative enforcement proceeding or adjudication based upon an alleged "inequity" in compensation.

(7) The FTC Act does not guarantee any rate of return on an MLM or any other business opportunity, and absent alleged specific misrepresentations, the FTC is not authorized to bring any civil administrative enforcement proceeding or adjudication based upon an allegation that "not enough participants make money.",

(8) Multi-level marketing, including the sharing of sales commissions with multiple levels of those who recruited, supervised, coached and/or trained the person making the sale, is a legal business practice and does not violate the FTC Act so long as compensation is paid primarily from revenue generated by sales of products or services for actual end use.

(9) 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 procedures that establishes a different federal definition of an illegal pyramid scheme, or the FTC Act is amended to include such a definition.

(10) The FTC's current interpretation of the FTC Act regarding pyramid schemes adopts an arbitrary and capricious standard that is not supported by evidence or prior law and thus is not a valid exercise of the FTC's power to protect consumers from unfair trade practices.

B. Count Two: Request for Injunctive Relief

98. Plaintiffs incorporate and re-allege as if fully set forth herein each and every allegation set forth above.

99. Plaintiffs also request that this Court, for the applicable grounds stated, enjoin and restrain Defendant from attempting to enforce its current interpretation of the FTC Act regarding pyramid schemes and permanently enjoin Defendant and its agents and employees from enforcing its current interpretation of the FTC Act regarding pyramid schemes.

VIII. CONDITIONS PRECEDENT

100. All conditions precedent for Plaintiff to recover in this action have been performed or have occurred.

IX. PRAYER FOR RELIEF

101. WHEREFORE, PREMISES CONSIDERED, PLAINTIFFS pray that the Defendant be cited to appear and answer herein, that a preliminary injunction issue, and, that upon final hearing, this Court enter declaratory judgment that:

Plaintiffs thus asks that the Court declare the following as to Plaintiffs and the MLM industry as a whole:

(1) Although Section 13(b) of the FTC Act, 15 U.S.C. §53(b) only expressly authorizes the FTC to obtain temporary, preliminary, and/or permanent injunctive relief. It 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".[110]

[110] *FTC v. Credit Bureau Center, LLC*, Slip Op. Nos. 18-2847 & 18-3310 (7th Cir. August 21, 2019) (*en banc* reviewed denied) (finding that the plain language of Section 13 only allows for injunctive relief, and not monetary relief such as restitution); *See also FTC v. Bronson Partners, LLC*, 654 F. 3d 359, 368 (2d Cir. 2011) ; *FTC v. DIRECTV, Inc*., No. 15-cv-01129-HSG, at *42-43 (N.D. Cal. Aug. 16, 2018); *FTC v. Trudeau*, 569 F.3d 754, 769-770 (7th Cir. 2009) ("If any part of [compensatory equitable relief] winds up being punitive instead of remedial, then criminal proceedings are required to sustain it.").

(2) Section 13(b) of the FTC Act, 15 U.S.C. §53(b) only authorizes the FTC to seek injunctive relief if and when the target is "is violating, or is about to violate, any provision of law enforced by the Federal Trade Commission" and does not authorize the FTC to seek injunctive relief for past conduct that has ceased absent evidence that it is likely to recur.

(3) Plaintiff Nerium has not been a pyramid scheme.

(4) Plaintiff Nerium is not a pyramid scheme.

(5) Pursuant to the two Executive Orders on Promoting the Rule of Law issued by the President on October 9, 2019, the FTC may not bring any civil administrative enforcement proceeding or adjudication based upon a new interpretation, theory or test for an illegal pyramid scheme if it has not been published in the Federal Register and the public given a fair opportunity to comply.

(6) When reviewing multi-level marketing companies for possible illegal pyramid activities, the FTC must count product purchases by participants in the MLM as purchases by end users absent evidence that the products are being purchased for inventory, samples, or are otherwise not being used by the purchaser.

(7) 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.

(8) The FTC Act neither establishes nor prohibits any given ratio of compensation between those at the top and those at the bottom of a sales organization, and the FTC is not authorized to bring any civil administrative enforcement proceeding or adjudication based upon an alleged "inequity" in compensation.

(9) The FTC Act does not guarantee any rate of return on an MLM or any other business opportunity, and absent alleged specific misrepresentations, the FTC is not authorized to bring any civil administrative enforcement proceeding or adjudication based upon an allegation that "not enough participants make money."

(10) Multi-level marketing, including the sharing of sales commissions with multiple levels of those who recruited, supervised, coached and/or trained the person making the sale, is a legal business practice and does not violate the FTC Act so long as compensation is paid primarily from revenue generated by sales of products or services for actual end use.

(11) 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 procedures that establishes a different federal definition of an illegal pyramid scheme, or the FTC Act is amended to include such a definition; and

(12) The FTC's current interpretation of the FTC Act regarding pyramid schemes adopts an arbitrary and capricious standard that is not supported by evidence or prior law and thus is not a valid exercise of the FTC's power to protect consumers from unfair trade practices.

Plaintiffs further request that the Court enter equitable and injunctive relief as is necessary and proper to give effect to such declarations (including, but not limited to, ordering the FTC to provide Plaintiffs with their alleged economic analysis establishing that Nerium is a pyramid scheme) and such other and further relief as the Court may deem just and proper.

Plaintiffs further request that the Court award them their reasonable and necessary attorneys' fees and costs of court.

Respectfully submitted,

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THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

NERIUM INTERNATIONAL, LLC N/K/A NEORA, LLC AND JEFFREY OLSON Plaintiffs	§ § § §	
	§	CIVIL ACTION NO.:
V.	§ §	
FEDERAL TRADE COMMISSION,	§ §	
Defendant	§ §	

DECLARATION OF DEBORAH HEISZ

I, Deborah Heisz, am over twenty-one (21) years of age of sound mind, and am competent to make this declaration pursuant to 28 U.S.C. §1746.

I am the Co-CEO of Neora, LLC.

I have reviewed the Original Verified Complaint for Declaratory Judgment, Preliminary, and Permanent Injunctive Relief to which this Declaration is attached and the statements therein are true and correct.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on October 31, 2019 in Addison, Texas.

Deborah Heisz