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BLOG

Recent Decision in the Neora Litigation Confirms the FTC Still Has Substantial Power Despite the *AMG Capital* Decision

AUGUST 4, 2021

In April of this year, the Supreme Court's unanimous *AMG Capital* decision significantly limited the FTC's enforcement power by ending its ability to recover monetary damages against defendants under Section 13(b) of the FTC Act. We've warned before that the impact of *AMG Capital* is limited and that the FTC still has multiple ways to cause pain for direct sellers and other companies within its jurisdiction. And a recent decision out of the Northern District of Texas underscores the fact that *AMG Capital* did not leave the FTC powerless. *See FTC v. Neora LLC*, No. 3:20-cv-1979, 2021 U.S. Dist. LEXIS 144314 (N.D. Tex. Aug. 2, 2021).

In November 2019, the FTC filed a complaint under Section 13(b) of the FTC Act against Neora and other affiliated defendants, alleging that Neora, a direct seller of supplements, skin creams, and other health and beauty products, was operating an illegal pyramid scheme. The FTC's complaint sought preliminary and permanent injunctive relief, as well as equitable monetary relief to redress injury to consumers.

Following the *AMG Capital* decision, Neora moved for judgment on the pleadings on three grounds. First, Neora sought dismissal of the entire action because the FTC brought a federal court case seeking a permanent injunction without first using the administrative process provided under Section 5 of the FTC Act. Second, Neora argued in the alternative that a permanent injunction was improper because the FTC had not pleaded that Neora was violating or about to violate the law. Third, Neora sought dismissal of the requests for monetary relief, citing *AMG Capital*.

The FTC agreed with Neora that *AMG Capital* foreclosed its ability to seek equitable monetary relief under Section 13(b), and the court had no trouble dismissing the FTC's requests for consumer redress, including rescission or reformation of contracts, restitution, the refund of monies paid, and disgorgement of ill-gotten monies. But the court rejected Neora's other arguments, leaving the FTC with several tools to use against direct sellers in future litigation.

Neora's argument that the FTC was required to use the administrative process before seeking a permanent injunction in court, if successful, would have dealt a major blow to the FTC's enforcement power. The administrative procedures in Section 5 of the FTC Act are lengthy and burdensome and require a written complaint to the respondent, a chance for the respondent to appear and argue that an order should not be entered against it, a written report by the FTC, an opportunity for the respondent to file a petition for review, and a right to appeal an order in a federal circuit court. The court held that notwithstanding "one sentence in *AMG Capital* suggesting that a permanent injunction under § 13(b) *may be* related to a previously issued preliminary injunction or temporary restraining order" preventing unfair and deceptive practices during the pendency of an administrative proceeding, neither the text of Section 13(b) nor the *AMG Capital* decision requires the FTC to use the administrative process before seeking a permanent injunction.

Neora also argued that although Section 13(b) only allows the FTC to obtain injunctive relief where a defendant "is violating, or is about to violate" the FTC Act, the FTC based its request for a permanent injunction on Neora's alleged past conduct. For example, Neora argued that the complaint's pyramid scheme allegations relied on a compensation plan that was discontinued years previously. The court rejected Neora's argument, concluding that "past conduct can give rise to a reasonable inference of current or future violations, either in conjunction with other circumstances or where the past violations are extensive." The court determined that the FTC's complaint sufficiently pleaded that Neora was violating or about to violate the FTC Act in large part because the complaint identified many alleged misleading income and product claims that were posted on social media in the months leading to the filing of the complaint. The complaint also alleged misleading income and product claims that were allegedly made to large bodies on Neora's distributors. The court further found the following allegations and facts also helped to illustrate likely current or future violations: (1) the allegation that more than 95% of Neora distributors paid more to Neora each month than they earned; (2) Neora never acknowledged its past misconduct or made assurances that it would not repeat such misconduct in the future; and (3) the allegation that Neora's compensation plan had characteristics of an illegal pyramid scheme.

The upshot is that even in the wake of *AMG Capital*, the FTC can still make life very difficult for direct sellers, exposing them to expensive and protracted litigation, or worse, injunctions that could fundamentally alter the way the company does business (if it is permitted to continue operating at all). It is important to take steps now to prevent the FTC from placing a target on the backs of your company and its executives and top distributors. The most important ways to do this are to robustly audit your compliance function to ensure it is finding and remedying misleading product and income claims quickly and efficiently, and to scour your compensation plan to remove any "red flags" that would encourage the FTC to come knocking at your door. Winston has extensive experience advising clients in these areas and would be happy to help your company reduce its risk of becoming the FTC's next target.

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