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BLOG

Neora Part II: Lessons About Deceptive Claims

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In Part One of our series about the pivotal decision in the *Neora* case, we provided a high-level overview of the court's decision and its potential widespread effect on the direct sales industry. In this article, we focus on the court's analysis of the FTC's claims that Neora was responsible for deceptive claims made by its distributors—Brand Partners (BPs)—in addition to those Neora allegedly made directly, and key points that can help your company minimize FTC scrutiny related to similar claims.

SUMMARY OF THE FTC'S DECEPTIVE CLAIMS ALLEGATIONS

The FTC alleged that Neora was violating Section 5(a) of the FTC Act by making deceptive claims (1) that BPs are likely to earn "substantial income" and (2) about the health effects of EHT and Neora's EHT products. The FTC also sought to hold Neora responsible for not only its own direct representations but also the representations of its BPs under agency principles. In addition, the FTC alleged Neora violated sections 5 and 12 of the FTC Act by "furnishing consumers with the 'means and instrumentalities' to mislead others—namely, by disseminating materials" that enabled BPs to make the claimed misrepresentations.

LESSON #1: AVOID EVIDENCE OF CONTROL OVER YOUR DISTRIBUTORS

The FTC argued that Neora's BPs should be considered Neora's agents, thus allowing the Court to hold Neora liable for deceptive claims made by BPs. It argued that Neora controlled its BPs by "approving applications, disciplining and terminating BPs, prohibiting BPs from selling competing products, and restricting BPs to using only approved marketing materials," and therefore, according to the FTC, BPs are agents of Neora.

Applying Fifth Circuit case law, Judge Lynn quickly dismissed this theory because the FTC failed to offer any evidence that supported an actual or apparent agency relationship. She emphasized that Neora "does not control and has no right to control how much BPs work (if at all), how much they spend in pursuit of the business opportunity or how they exercise their choice of work activities." She also highlighted that Neora's policies expressly state that its BPs are not agents of Neora and have no authority to bind Neora to any obligation. The FTC provided no evidence to contradict what the record reflected—Neora's lack of control. Accordingly, the court determined that BPs are not agents of Neora, and Neora was not legally responsible for their deceptive claims.

Importantly, the court noted that even if BPs were considered agents, Neora's robust compliance program, including its guidance and training for its BPs on making permissible claims and use of disclaimers, undermines the FTC's argument that Neora should be legally liable for deceptive claims by BPs. The court added that the FTC's own guidance acknowledges that it is "unrealistic" for a direct sales company to be aware of every statement made by its distributors, but a strong compliance program to identify, address, and remove deceptive claims demonstrates the organization's commitment to avoiding such claims.

Key Takeaway: Eliminate Elements of Control Where Possible. Judge Lynn's decision turned on a key principle: control. Your distributors are independent contractors. Thus, they should have the flexibility to operate with as much freedom as possible while also protecting your company from illegal actions they may take and other potentially existential threats to the Company (like downline raiding). For example, policies and guidance prohibiting you distributors from making misleading claims and reasonably crafted provisions prohibiting recruitment and competition are vital to protecting your Company and are unlikely to evidence improper control under agency law. But, unless absolutely necessary from a business standpoint, try not to impose restrictions on how and where your distributors can sell your products and activities your distributors must engage in (such as supporting their downline). And of course, your policies should include a clear statement that your distributors are independent contractors and do not have any authority to bind your company.

We strongly recommend that direct sellers take the time to review their policies to eliminate appearance of undue control. This is especially important considering the flood of independent contractor misclassification claims being brought in California against direct sellers—a key element of such claims in the extent to which the company controls its distributors. Winston has extensive experience reviewing policies to ensure your company's intent is properly conveyed within this legal framework.

Key Takeaway: Implement a Robust Compliance Program: See below discussion.

LESSON #2: DECEPTIVENESS IS ALL ABOUT "NET IMPRESSION"

The court next turned its attention to allegedly deceptive income and product claims made by Neora itself. The court relied on precedent from various circuit courts and considered whether: "(1) there was a representation, omission or practice (2) that was likely to mislead customers acting reasonably under the circumstances, and (3) the representation, omission or practice was material." The court cited prior FTC cases that highlighted that representations about anticipated income are generally material and likely to mislead customers because they are at the core of a consumer's decision to engage in the business opportunity. That said, courts look at the "net impression" such claims create and recognize that using a disclaimer "may not inoculate the harm of a misrepresentation if, despite the disclaimer, the consumer may reasonably believe that a statement of unusual earning potential represents typical earnings." Judge Lynn applied this same standard in analyzing the allegedly improper income and product claims at issue in *Neora*.

The FTC asserted that various Neora promotional materials were misleading or deceptive, as they included videos and photos with high-earning BPs holding oversized checks, posing with luxury cars, and emphasizing their luxurious lifestyles. To the FTC, these representations were not only misleading, but also material, as they conflicted with reality—most BPs do not reach such income levels. Judge Lynn agreed that some representations were problematic and did not include any "curative disclaimers or qualifiers," but the claims at issue were made years ago before Neora rebranded and made operational changes to minimize the use of deceptive claims. For example, the court noted that Neora "no longer describes BP's earning full-time income, and avoids using dollar amounts or terms such as 'millionaires' club,' 'financial freedom,' 'residual' or 'dream' income, or 'dream lifestyle.'" Instead, Neora now describes potential earnings as "modest supplemental income" and consistently uses its income disclosures in marketing materials. In addition, Neora revised its policies to provide guidance to distributors about permissible claims and implemented guidance from the Direct Selling Self-Regulatory Council. And for more recent claims at issue, the FTC failed to offer any evidence that Neora's representations, which included tempered descriptions of income potential accompanied by large, clear disclaimers, created a net impression that misled consumers. Thus, Judge Lynn determined that:

the passage of time, coupled with Defendants' recognition of and explanation for the prior infractions and associated changes to Neora's practices—namely, lack of FTC guidance on permissible income statements, and prompt adjustments to Neora's practices when "tea leaves" from the FTC materialize—renders any Nerium-era misrepresentations largely irrelevant when assessing whether Neora is currently violating the Act. Instead, the evidence at trial establishes that Defendants aspire to abide by the law regarding permissible income claims, and in the absence of clear guidelines on what the law is, **have revisited and revised their practices** over time.

As for product claims, the FTC alleged that two individual defendants made deceptive claims about the efficacy of EHT. The court determined that one of the highlighted product claims was on a website that Neora was not involved in creating. And for the other, the court determined that while the individual defendant made an improper medical claim on stage during an event, Neora had taken the proper steps to warn against this behavior before the defendant made such a representation. And the court found no objectionable information in Neora's materials regarding EHT. Accordingly, the Court shut down the FTC's claims about deceptive product claims.

Key Takeaway: Eliminate Potentially Misleading Claims From Company Materials and Use Accurate Income Disclosure Statements. In *Neora*, the court emphasized the importance of using accurate income disclaimers. With income claims, a strong disclaimer highlights that results are atypical, the result of hard work, and vary among individuals. But disclaimers alone will not rescue a deceptive claim. Instead, companies should be careful to avoid atypical representations. Like Neora, it is important to avoid phrases that suggest that a consumer can obtain "full-time" or "residual" income. Similarly, photos or videos of high-performing distributors going on lavish vacations or flaunting luxury cars are unlikely to be cured without a very robust disclaimer and are likely to draw FTC scrutiny even with a proper disclaimer.

It is important to note that the *Neora* decision did not change the law or give direct sellers a safe harbor for deceptive claims that cannot be cured by a disclaimer. As such, we continue to urge our clients to emphasize that consumers looking to join the business opportunity can earn a "modest income" and to include a link to the full income disclosure statement accurately reflecting typical distributor earnings. And where a company wishes to make atypical claims, we strongly recommend that the company make very clear with conspicuous language that only a very few distributors reach that level of income and they did so through extraordinary hard work and dedication to their business.

The *Neora* opinion highlights some best practices your company should consider in reviewing your current marketing materials and creating new materials, as well as considerations for ensuring your income disclosure statement and related disclaimers convey the right message to minimize legal exposure. If you need assistance analyzing your current promotional materials, disclaimers, and disclosures, please reach out.

LESSON #3: A ROBUST COMPLIANCE PROGRAM IS A MUST

The FTC argued that Neora further violated sections 5(a) and 12 of the FTC Act "through furnishing consumers with the 'means and instrumentalities' to mislead others—namely, by disseminating materials misrepresenting" the potential earnings for BPs and the efficacy and scientific basis of EHT and Neora's EHT products.

Judge Lynn rejected the FTC's "means and instrumentalities" claim, finding that Neora's business practices contradict any assertions that it was in any way providing methods for its BPs to deceive consumers. The court highlighted that nothing in Neora's materials included misrepresentations about EHT or Neora's EHT product. It also highlighted that Neora had a comprehensive compliance program to educate its BPs on what constitutes a permissible income claim, including sample social media posts showing how to prominently feature the income disclaimer and statement, continuous training to reinforce this guidance, and a compliance department who constantly searched for deceptive claims and administered corrective action as needed. The court determined that these measures show "a concerted and consistent effort for Neora to inform and train BPs with the tools and knowledge to sell Neora products without making misleading income or product statements, and to find and correct missteps as they happened." Thus, the court found that there was no violation under the FTC's means and instrumentalities theory.

Key Takeaway: Implement and Audit Your Compliance Programs. Neora's robust compliance and training program was central to the court's decision about deceptive claims and provides guidance to direct sales companies on key components of such a program. For Neora, the court highlighted these elements: (1) express language in the policies prohibiting deceptive claims; (2) a process requiring use of company-approved marketing materials; (3) a "Field Compliance Guide" provided to BPs with guidance on marketing Neora products and the business opportunity, including best practices on the use of mandatory income and product disclosures; (4) appropriately worded full income disclosure statements; and (5) an in-house compliance department that monitors and addresses violations of policies relating to income and product/services claims.

Compliance programs are not one-size-fits-all, but there are key components that are a must. Your company should have a robust compliance program that: (1) prohibits deceptive and misleading claims; (2) educates distributors as to permissible claims and required use of income disclosure statements in conjunction with such claims; and (3) monitors for deceptive claims and enforce its policies prohibiting such claims when they are found. It is important that the company can show that its monitoring procedures produce results—that is, that they can quickly and efficiently identify improper claims and resolve those claims. If your company has hundreds of misleading claims identified via its monitoring procedures that have not been resolved, such evidence will be used against you in potential FTC and other litigation. Winston often audits its client's compliance programs and provides concrete advice as to how those programs can be improved. If you need guidance implementing a system or want assistance with better optimization, we can help.

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