

An Introduction To Sweepstakes And Contests Law



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Whatever else your client wants from its marketing, a jackpot of problems isn't one of them.

SWEEPSTAKES AND PRIZE CONTESTS in various forms have been used as a means to promote commerce for hundreds, if not thousands, of years. These promotions have not lost their appeal, even in an economy saturated with media and advertising. Indeed, the development of a culture of gambling, with gaming resorts increasingly popular as vacation destinations, and many states and Native American tribes offering casinos, horse-racing, lotteries, and other forms of gambling, has encouraged increased development of sweepstakes and contests. The availability of online systems for advertising and conducting promotions, moreover, has further heightened interest in these promotional schemes.

The drive to take advantage of promotion fever, however, is not without risk. When a business runs either a sweepstakes or contest, the business must structure the promotion to avoid characterization as a lottery under federal and state law. In general, lotteries, other than those sponsored by governments, are illegal. Moreover, sweepstakes and contests are governed by a variety of federal and state laws, requiring registration, prohibiting specific practices, and defining the limits of permissible promotions. These laws have changed frequently over the past few years. These laws, moreover, are often so broadly

drafted that they could be applied to almost every type of promotion (customer appreciation giveaways, trade show drawings, employee sales incentive contests, and raffles, among others). Official interpretations of these broad statutes and rules, such as the opinions of state attorneys general, vary widely, even with respect to the most common forms of regulations.

As a result of this patchwork of law, entry into a poorly considered sweepstakes or contest (jointly called here “promotions”) can be a trap for the unwary promoter. (Outsourcing responsibility for the promotion to a marketing firm or other service provider, moreover, may not solve the problem. The sponsor of the promotion may be subject to regulation and enforcement actions even if the promotion is administered by another entity.) Failure to follow pertinent statutes and regulations regarding promotions can lead to government inquiries, civil enforcement actions, and even criminal penalties. The adverse publicity associated with a mishandled promotion, moreover, may defeat the entire purpose of the effort.

This article seeks to provide a basic introduction to sweepstakes and contests law, which should permit a prospective promoter to ask the right questions before beginning such a promotion. Although it is hoped that this article will provide a good grounding in the most essential elements of promotions regulation, it is important to recognize that there is no “one-size-fits-all” form of promotion. The purposes and circumstances of promoters vary; rules appropriate for one promotion may not work well for another. Thus, review of any proposed promotional scheme by a competent, experienced professional is essential.

THE BASIC LAW: WHAT IS AN ILLEGAL LOTTERY? • A promotion may be characterized

as a lottery if it has all three of the following elements:

- Chance;
- A prize; and
- Consideration.

Generally, “sweepstakes” (random drawings for a prize) are not classified as lotteries, because they lack consideration (i.e., something of value that the entrant must provide to participate in the sweepstakes). True “contests” (tests of skill), moreover, do not qualify as lotteries, because chance is replaced by ability and effort.

Even though a sweepstakes or contest may avoid characterization as an illegal lottery, promotions are nevertheless heavily regulated by state and federal laws. Depending on how a promotion is structured (and what unique issues that structure may raise), determination of the lawfulness of a promotion could require review of the law in each state where a business seeks to undertake the promotion.

SWEEPSTAKES ISSUES • Sweepstakes are regulated by both state and federal law. Sweepstakes (typically random drawings for prizes) possess two of the three characteristics of a lottery: chance and a prize. Therefore, to avoid classification as a lottery, a sweepstakes promotion must not involve consideration. Arguably, characterization as an illegal lottery might also be avoided by eliminating the element of a prize. “Amusement” gambling, such as the playing of pinball, is not generally considered gambling, in that the only “prize” awarded is more playing time. Yet, even this premise may be challenged. *See United States v. Sixteen Electronic Gambling Devices*, 603 F. Supp. 32 (D. Haw. 1984) (meters to record credits, plus knockoff switches to reset count for next player, indicated use of machine in gambling). In practical terms, this no-prize avenue may not be worth pursuing, since few participants

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would pursue entry into a promotion with no real prize.

The Consideration Question

State legislatures and courts apply varying rules to determine what is consideration. Valuable consideration generally requires parting with cash or something of marketable value. This is the majority view and the modern view among states. A minority of states, however, apply the view that any benefit to the promoter is consideration.

Effort To Participate

The existence of consideration thus may turn on the amount of effort required to participate in the sweepstakes (and the amount of the potential benefit to the promoter). Consideration is generally not present when the entrant's efforts are minimal and the promoter's benefits are restrained. Thus, completing a mail-in entry form, listening to the radio, watching television, completing a simple survey, calling a toll-free number, or going into a store to enter (with no purchase necessary)—these are typically not considered steps that involve consideration.

Does The Entrant Give Something Of Value?

Consideration generally exists if the entrant must give something of value to enter the sweepstakes. The most easily identified or typical form of consideration is a requirement of a purchase or payment to enter the sweepstakes. However, consideration may also be found to exist when an entrant must exert substantial effort or time to participate in the promotion. For example, requiring an entrant to fill out a lengthy marketing questionnaire might constitute substantial effort. Some states may find consideration to exist if the sponsor of the sweepstakes receives a benefit through the entrant's efforts, such as a valuable competitive advantage or other economic opportunity.

Is There A “Free” Alternative?

In many cases, there is a way to avoid having a sweepstakes classified as an illegal lottery even when consideration is arguably present: Make an alternative “free” method of entry available. For example, the promoter could permit entrants to send their names on postcards without having to purchase any product or service. Yet another alternative approach is the offering of the promotion only to existing/prior customers. The promotion, in that instance, would not require new consideration for entry, and thus arguably would not contain the consideration element that could make the promotion a lottery.

Must Not Be Unduly Burdensome

The “free” entry form must not be unduly burdensome. In *Seattle Times Co. v. Tielsch*, 495 P.2d 1366 (Wash. 1972), the court noted that, even though participants were not required to make a purchase, they were required to spend hours in following a football forecasting contest. The court held that the requirement of consideration was met, because participants were required to do something that they would not otherwise do, and because there was an arguable benefit to the promoter.

“Equal Dignity”

Moreover, an “equal dignity” requirement applies. There can be no discrimination in treatment of sweepstakes entrants. Those who give some consideration to enter, either by making a payment or by exerting significant effort, may not be treated differently, or more favorably, than those who do not provide consideration. The odds of winning must be substantially similar for both. If the two groups are treated differently, the differential could create pressure for entrants to give consideration, and thus might transform the sweepstakes into an illegal lottery. Trivial differences (such as the requirement of mail-in postage for free entries, versus in-store entries) in most instances will not violate the “equal

dignity” rule. In *Glick v. MTV Networks*, 796 F. Supp. 743 (S.D.N.Y. 1992), the court found that consideration was not present, even though participants were required to pay a \$2.00 charge to use a “900” number. The court held that the use of the paid telephone system was merely a convenience to the participants, who could have pursued a cost-free entry system made available by the promoter.

Other Concerns About Sweepstakes

In addition to the basic lottery question, government regulators have expressed a host of other concerns about sweepstakes. Sweepstakes, in many instances, are targeted at vulnerable consumers, especially the elderly and poorly educated. Some promotions can create a false impression that a consumer has won something or that the consumer is close to winning. Others may give the false impression that a purchase improves the chances of winning the sweepstakes.

To combat these kinds of concerns, some states permit sweepstakes, but require registration of the promotion with one or more government agencies. Some states have laws or regulations that restrict sweepstakes in highly regulated industries. For example, California regulations prohibit alcoholic beverage licensees from conducting promotional contests in which cash prizes are given to consumers. Promotions involving tobacco, weapons, motor fuel, time-shares and financial services (to name only a few) may also be subject to special rules. Additionally, New York and Florida, for example, require registration if the retail value of the prize given away exceeds \$5,000 and the sweepstakes is run in connection with sale or advertisement of consumer products or services. In Rhode Island, registration is required if the retail value of the prize exceeds \$500 and the sweepstakes is run by a retail establishment to promote its business. Some states may also require a bond from the promoter. If the promoter wishes to avoid these kinds of requirements, the rules of the promotion must specif-

ically prohibit residents of the registration-requiring states from participating in the sweepstakes.

Disclosure Rules

Some states have passed specific laws or regulations that identify information that must be disclosed to potential entrants. Generally, such disclosures must explain the rules (method of entry, eligibility, and method of determining a winner), the odds of winning, the beginning and ending dates of the contest, and where a winners list may be obtained. The identity of the sponsor often must also be disclosed.

Drafting Sweepstakes Rules

Drafting clear rules for sweepstakes promotions can guard against potential problems. The rules (when accepted by the entrant by registration for the promotion) are essentially a contract between the promoter and the participants. The rules lay out the terms and conditions under which the promotion will be conducted. The rules may help shield the promoter from liability. In addition, the rules should be designed to demonstrate compliance with all applicable regulatory requirements.

Basic Elements

To a large extent, state regulation of gambling and promotions is highly individual. Thus, in preparing rules, attention to the rules in all jurisdictions where the promotion will be available is essential. Given prevailing legislation and rules in a majority of states, however, sweepstakes rules should generally contain at least the following elements:

- A statement that no purchase is necessary to enter or win;
- Details of entry procedures;
- Any limits on the number of times a person can enter (for example, one entry per person or household);
- The closing date of the sweepstakes and any other relevant deadlines;