

Intellectual Property and Technology Update

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Navigating the Legal Minefield of Prize Promotions

Promotions that offer a prize to the winner of a sweepstakes or contest are an effective way to market products and services and, in light of the vast opportunities to reach people in this day and age, are becoming more prevalent. E-mail blasts, social networking, mobile-device marketing, and blog promotions have enabled companies to market their promotions to far more people in far less time. While the accessibility of the Internet and mobile technologies make them attractive from a marketing perspective, the lack of geographical boundaries makes compliance with potentially applicable laws and regulations increasingly difficult.

In the United States, two general areas of law are implicated by promotions with a prize component: (1) gambling laws which prohibit private lotteries, and (2) those aimed generally at protecting consumer participants that either impose particular operational requirements or prohibit certain operational activities. Compliance with one set of laws does not ensure compliance with the other, and in each case the applicable law may vary from state-to-state. Additionally, depending on other factors such as the industry of the operator, the age of the consumer, and the mechanism of communicating with the consumer, in addition to many other possible considerations, other laws may apply. Further, and beyond the scope of this article, promotions open to residents of jurisdictions outside the United States must comply with the laws of any relevant jurisdiction.

Avoiding Violation of Laws Prohibiting Unlawful Lotteries

Federal and state laws prohibit lotteries other than those authorized and conducted by the state. A lottery contains three elements: (1) prize; (2) chance; and (3) consideration.

Eliminating one of the three elements removes the scheme from the ambit of lottery prohibitions. It is for this reason that prize promotions are typically conducted in one of two structures.

What are commonly referred to as "sweepstakes" are promotions where the element of consideration has been eliminated. Chance and prize remain present where a prize is awarded to a winner selected based on chance, such as a random drawing. Determining whether consideration has been eliminated can be tricky, and different states may treat the question in different ways. Consideration may include a fee, a product purchase requirement, or the requirement that the entrant expend extensive time or effort.

Although it is widely suggested that elimination of a fee for entry or offering a free alternate method of entry acts to eliminate consideration, the free method of entry must be genuine, it must be offered to all persons on an equal basis, and the chances of winning must not increase (or decrease) for those that contribute a thing of value versus those that elect to claim the free alternate method of entry. Additionally, some courts have found consideration in non-monetary expenditures such as requiring completion of a lengthy

survey, submitting extensive personal information (or at least more personal information than necessary to administer the promotion) or submission to a sales presentation. Similarly, there is some concern, at least at a scholarly level, that any payment, such as a fee for Internet service for an online only sweepstakes or a postage payment for a mail-in sweepstakes, is consideration. The classification of such ancillary requirements can be avoided so long as consumers are not specifically induced to make the purchase. Additionally, some courts and regulators take a harsh view when the expenditure is not associated with anything of real value, in spite of the option for a free alternate method of entry.¹

What is commonly referred to as a “contest” is a promotion where the element of chance is eliminated by the selection of a winner based on skill. For example, essay and photo competitions. Because the element of chance has been eliminated, a contest will likely not violate state lottery laws where a fee to enter or other consideration is required in a genuine contest of skill. However, as discussed below, many states have laws specifically applicable to promotions that prohibit operators from charging a fee for entry in a skill contest.

While it is easier to see the application of laws related to lotteries, sweepstakes and contests when the element of “prize” is clearly identifiable, there are other circumstances where lottery, sweepstakes or contest principals could be relevant in seemingly ordinary business transactions. A new area of interest subject to a lottery analysis is penny auctions. In a penny auction, an individual pays a specified amount of money to bid against others for an item at an extremely reduced price. Typically, all amounts paid by bidders for the *right to bid* (as opposed to the amount bid for the item itself) are forfeited and one bidder wins the right to purchase the item at the price of their final bid. In an ordinary auction, there is no question that there is no “prize” being offered because the bidders are all vying to win the right to pay an agreed amount for the item won; there can be questions raised, though, when the right “won” is the right to buy an item at substantially less than its fair market value. In these circumstances, then, questions can also be raised as to whether the penny auction involves elements of chance which could bring the auction within the gambit of lottery laws.²

Prize Promotion Requirements and Proscriptions

In addition to laws prohibiting private lotteries, state and federal law contain provisions governing the method of operation for a prize promotion. The specific provisions apply, in many cases, to both sweepstakes and contest promotions. The following are a few of the generally applicable requirements.

Official Rules

As a matter of practice, and as required in many states, each sweepstakes or contest should have a set of official rules disclosing its terms and conditions which should be provided to the consumer when the consumer is notified about the promotion. The rules act as contract terms between the operator and the participant and, therefore, all material terms should be disclosed therein. The rules should additionally attempt to anticipate and cover, to the greatest extent possible, anything that could go wrong with the conduct of the promotion.

Some commonly required disclosures include the odds of winning, eligibility requirements, including age or geographic restrictions based on state and country of residence, the start and end date and time of the promotion, how the winner will be chosen, specific details about the prize including a description and its approximate retail value, the name and address of the sponsor and, as discussed below, that no purchase is necessary to enter or win the promotion. Additional requirements may be imposed depending on the type of promotion and the jurisdiction.

No Purchase Necessary

In addition to providing that no purchase is necessary as a means of complying with lottery law, some state and federal laws also provide that in specific instances operators of prize promotions operated in conjunction with a sales solicitation must not require a purchase to enter or win, and must clearly disclose the same and provide consumers with a method of entry alternate to purchasing the product. For example, the makers of Tylenol paid \$52,000 to the New York Attorney General to settle lawsuits based on claims that consumers were confused by the advertisements for the sweepstakes and thought that they had to purchase Tylenol to enter, since “no purchase was necessary” was located at the bottom of the advertisement in small print.

Similarly, although in the unlawful gaming context consideration may be present in a skill contest, as discussed above, some states have specific consumer protection provisions

1. For example, companies that sell long distance phone cards with attached game pieces that provide a chance to play a game run through a computer terminal on the premises. Regulators in several states have determined that persons who paid for the cards regarded them as having no value as a phone card and, most recently, the North Carolina legislature amended existing law to specifically provide that operating such a scheme is unlawful. 1997 Tex. AG LEXIS 9, DGC-Adm. 012 (Cal. New 5-4-99), North Carolina S.L. 210-103 (HB 80).
2. While a certain level of skill may be required to win an auction (e.g. in timing a bid appropriately and knowing when and how much to raise a bid), the requisite level of skill necessary to establish that an activity is one of “skill” as opposed to one of “chance” varies from state-to-state.

prohibiting purchase requirements altogether. In those cases, either no purchase may be required or a free method of entry must be offered even if the contest is one of skill.

Advertisements

Many states have requirements regarding what must be included in advertisements for prize promotions. In many states, at a minimum, the material provisions of the official rules must be printed in all print advertising for the sweepstakes or stated in radio and television advertisements. Further, solicitation material containing prize promotions must not use language that would suggest that the recipient has already won, has been specially selected, or that includes a fake check to suggest the same, unless the recipient has in fact won the prize.

Bonding and Registration Requirements

In some states, registration and/or posting of a bond is required for certain prize promotions. By way of example, in New York and Florida, games of chance with total prizes exceeding \$5,000 must be registered and a bond must be posted in the aggregate amount of the prizes offered; Rhode Island requires registration of games of chance conducted through retail outlets with prizes in excess of \$500; and in Arizona, certain skill contests that entail a purchase to enter must be registered with the state Attorney General's office.

Miscellaneous

Other non-promotion-specific laws and regulations may also be implicated. For example, Internet promotions that are directed toward children must comply with state and federal children's privacy laws. Mobile technology promotions must comply with the rules for the Federal Do Not Call Registry and

similar state and federal telemarketing restrictions. Additionally, prize promotions advertised by direct e-mail solicitations must comply with federal and state anti-SPAM provisions. Federal law requires certain disclosures in rules and sweepstakes materials and requires sponsors to implement a name removal system that allows individuals to request removal of their names from mailing lists.

Further, depending on the method of Internet or mobile communication utilized and the product or prize offered, myriad other laws, regulations or policies may be implicated. For example, the FTC has guidelines applicable to blog promotions, and Facebook has specific requirements for promotions offered through the site. Additionally, many states have laws prohibiting prize promotions involving items such as alcohol and cigarettes.

Conclusion

As the popularity of sweepstakes and contests continues to grow and develop, and more such promotions migrate to the Internet and mobile device technologies, marketers will need to stay aware of and adapt to the variety of laws regulating such promotions. Careful planning and carefully drafted documentation can be a key to making promotions successful. In some cases, laws that would otherwise make running a planned promotion impossible, or at least cumbersome, can be met by carefully structuring the promotion to minimize their impact. In other cases, carefully planning compliance procedures ahead of time can avoid unexpected headaches as the promotion is launched. In all cases, potential problems and consequences of unforeseen circumstances can be minimized by a solid set of governing documents. Specialist advice should be sought about the specific circumstances of any proposed promotion. ■

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