JONES DAY

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PITFALLS OF SWEEPSTAKES AND CONTESTS

Your marketing people announce that they have been working for weeks on a promotion for customers and potential customers who will be attending the leading industry trade show in New York in two months. They have arranged for the sponsors of the show to include an ad for the promotion in the registration materials that will be mailed directly to purchasing departments of companies in the U.S. and Canada. The promotion will be a "sweepstakes" in which each participant will receive an entry into a drawing by visiting three different company-sponsored booths at the show. The drawing will be held on the last day of the show, and the "grand prize" winner will receive a $6,000 trip for two to Tahiti. Participants must be present at the drawing to win. The marketing department must deliver the final version of the ad for the trade show registration materials in one week. They have prepared a half page of six rules, adapted from examples taken off the Web, and want approval from management or the general counsel.

* * *

Of course, it isn't that easy. Sweepstakes and contests are governed by an array of U.S. federal and state laws. Canada and Quebec have their own laws. While marketing consultants and fulfillment houses will help develop a promotion and marketing materials, they typically do not take responsibility for legal compliance.

In structuring a promotion, there are three main legal goals to keep in mind:

1. Avoid having the promotion characterized as a lottery.
2. Avoid running afoul of false-advertising laws, by making full disclosure of the rules and all material issues attendant to the promotion.
3. Have a rule in advance for whatever could go wrong.

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AVOIDING A LOTTERY

Whenever a company decides to run either a sweepstakes or a contest, it must be careful to structure the promotion so that it is not characterized as a lottery under federal or state laws. Conducting a lottery is akin to gambling and in a few states may be classified as a felony.

A promotion will be deemed a "lottery" if it has three features: (1) consideration to enter, (2) chance, and (3) a prize. Generally, a sweepstakes (a random drawing for a prize) is not classified as a lottery, because it lacks consideration (*i.e.*, something of value that an entrant is required to give). True "contests" do not qualify as lotteries, because skill replaces chance (*e.g.*, the best golfer, the best slogan). Even though a sweepstakes or a contest may not be considered an illegal lottery, such promotions are still regulated by law. Depending on how a promotion is structured (and what unique issues the structure may raise), it may be necessary to review the laws of each state in which the sponsoring company will target potential participants.

SWEEPSTAKES

Sweepstakes possess two of the three characteristics of a lottery: chance and a prize. Therefore, in order to avoid classification as a lottery, a sweepstakes must not involve consideration.

"Consideration" is defined as requiring the entrant to give something of value in order to enter the drawing. The most easily identified or typical form of consideration is requiring that a purchase or a payment be made to enter, *e.g.*, by buying a cell phone or even paying the registration fee to attend the trade show at which a drawing will be held. Consideration may also exist by merely requiring an entrant to exert substantial effort or time, *e.g.*, requiring an entrant to fill out a lengthy marketing questionnaire or requiring participants to visit three booths at a trade show. While the issue is not clear, 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 economic opportunity for the sponsor (*e.g.*, a numismatics trading company asking participants to describe their coin collections).

In some cases, a sweepstakes that would otherwise be classified as an illegal lottery because consideration is present can be made legal by making a "free" method of entry available (*e.g.*, permitting an entrant to send in his name on a postcard without having to purchase the sponsor's product or fill out the survey). The sponsor, however, may not discriminate in its treatment of sweepstakes entrants. Those who give some consideration to enter may not be treated any differently, or any more favorably, than those who do not give any consideration. The odds of winning must be the same for both. Dealing with the two differently would create pressure for entrants to choose to provide some consideration, turning the sweepstakes into an illegal lottery.

Some states require that the sweepstakes be registered. For example, New York and Florida require registration and posting of a bond if the retail value of the prize to be given away exceeds $5,000 and the sweepstakes is run in connection with the sale or advertisement of consumer products or services. If the promotion meets these criteria, the sweepstakes will need to be registered or the rules will specifically need to exclude residents of these states from participating. Registration in New York and Florida must be made *in advance* of the promotion's start; in New York, the period is 30 days. Each of these jurisdictions will fine violators.

In addition, the focus of the Federal Trade Commission and many of the state laws regulating sweepstakes is on disclosing specified material information to the entrants. The official rules of most sweepstakes must therefore include such things as the name and address of the sponsor, the duration of the sweepstakes, the prizes given away, the retail value of the prizes, and the odds of winning. The rules must also disclose the eligibility for entry, the conditions for entering, and any limitations in connection with the sweepstakes.

In order to avoid potential liability, besides providing the legally mandated disclosures, a sponsor should ensure that the rules of the promotion are properly drafted to deal with various potential outcomes in an attempt to avoid or head off claims from disgruntled entrants. For example, if the prize is a trip, will the winner have to bear the cost of transportation to the airport? What about meals? In what city may the flight originate? What if the flight is canceled or the hotel is closed temporarily?

CONTESTS

Contests generally do not qualify as lotteries because they lack the element of chance. Rather, the prize is awarded on the basis of the entrant's skill. For example, a contest may involve writing an essay on a particular topic, answering trivia questions, solving a puzzle, or competing in a sport. Because chance is lacking, contests generally require that the entrant give consideration to enter, although some states limit the nature of consideration that may be requested.

To qualify as a true contest, chance can in no way enter into the determination of the winner of the prize. The game must afford the entrants a real opportunity for the exercise of skill. Guessing games are generally not considered to be skill contests, since the element of chance is considered to predominate in determining the outcome of the game. In addition, a contest may not require the entrants to perform a nearly impossible task, such as counting how many jellybeans are in a jar, because chance will be found to predominate over skill. Lastly, the questions or puzzles cannot have several different possible answers, only one of which is "correct."

To make the contest truly a game of skill, the official rules must disclose the standards that will be used to judge the entries. These standards should be clear enough for entrants to understand what will be required to win. And, of course, the contest actually must be judged by these standards, by a judge who is qualified to make the determination of who meets them. Judging standards for contests can be based on such things as creativity and originality. The standards can be made more specific, *e.g.*, by stating that the entries will be judged 65 percent on creativity and 35 percent on originality. Ideally, the standards should be further defined by describing what is meant by "creativity" and "originality."

The most obvious example of having a rule for the unexpected is stating what happens in the event of a tie. If a tie is broken in what is otherwise a game of skill by a random drawing or flipping a coin, then the contest will be considered a game of chance and will be an illegal lottery. One can prevent this by awarding the prize to both tying entrants. Alternatively, the tie might be broken by providing that the judge's determination of the more heavily weighted criteria (*e.g.*, creativity if the criteria are weighted 65-35) will decide the winner.

Because contests lack the element of chance, it is generally permissible for the element of consideration to be present. Again, merely requiring an entrant to do something, such as writing an essay, will be sufficient effort for a finding of consideration. In addition, unlike in a sweepstakes, consideration sometimes may be permitted in a contest in the form of requiring the entrant to make a purchase or pay an entry fee.

Some states, however, do not permit the sponsor of a contest to require any form of purchase or to charge an entry fee but only permit consideration in the form of effort. These states may need to be excluded from certain contests. In any event, the value of the prize should not depend on the fees collected from the entrants, because then the gambling laws of the 50 states will come into play.

Many states also have specific disclosure requirements for contests. In particular, the rules must clearly disclose all money or other valuable consideration that must be given to win the prize. The other information required to be disclosed is similar to the disclosure requirements for sweepstakes.

DIRECT MAIL

The use of direct mail to promote sweepstakes creates additional disclosure burdens under both federal and state law, and it may be preferable to void participation in one or more jurisdictions rather than attempt to deal with the complexity and sometimes arbitrary mandates of these rules.

LEGALLY SANCTIONED GAMBLING

One might wonder how such games of chance as bingo fit into this analysis. Bingo involves a prize, chance, and consideration, so it is a lottery. It is made legal by special exceptions in state law. In Georgia, for example, bingo is legal in only two instances: (1) when run by nonprofits or tax-exempt organizations that have applied for and been granted state licenses, and (2) so-called recreational bingo, in which door prizes are noncash and the value does not exceed an amount stipulated by regulation of the Georgia Bureau of Investigation. (So, yes, those office raffles for charity may be technically illegal.)

With respect to the various state and multistate lotteries that are run today, they meet all the requirements for a lottery, but they are specifically sanctioned by state constitutions and exempted from the anti-lottery laws.

COMMON MISTAKES

These are some of the typical deficiencies we see in how companies run the promotions they sponsor:

- Failure to disclose material terms in general advertising of the promotion.
- Failure to provide a free method of entry.
- Failure to register when required (and to allow sufficient time to register).
- Failure to follow direct-mail disclosure statutes or to "void" the promotion in particular states.
- Assuming Canadian law is the same as U.S. law.
- Failure to set forth judging criteria in contests.
- Having multiple steps with one or more illegal lottery elements.
- Burying required disclosures in numerous, densely packed lines of fine print or remote internet links (or omitting them altogether).
- Failure to follow the sponsor's own rules, including by changing the rules in midstream.

IGNORE AT YOUR PERIL

Marketing personnel dislike the burdens of legal compliance: the length and complexity of promotion rules, the mandated disclosures, alterations to the layout and design of collateral materials, and the time it may take to file the rules and post a bond. However, a promotion gone bad can lead to bad publicity, and promotions laws are increasingly being enforced.

ACTION BY COMPETITORS FOR UNFAIR COMPETITION

You're Being Watched. In 2005, Burger King's franchisee representative sued McDonald's, alleging that McDonald's engaged in false and deceptive conduct (under the Lanham Act) by diverting business away from Burger King with McDonald's promotional games. The suit related to McDonald's Monopoly game, which was targeted by an embezzlement ring that allegedly stole winning game pieces. The Burger King franchisee representative alleged that McDonald's continued to run the promotion even after it learned of the problems. The lawsuit was dropped about a month after it was filed; however, it demonstrates that one's competitors follow promotions and can and will take advantage of a company's improperly run promotions.[1]

ACTION BY DISGRUNTLED CONTESTANTS

Don't Be Cute. Two companies that attempted to make a joke out of their contests ended up having the joke backfire. A restaurant in Florida ran a contest in which the winner thought she was winning a new Toyota car. However, the restaurant, as part of an April Fools' Day joke, actually intended to give away a new toy Yoda (the character from *Star Wars*). In settlement of the dispute, it appears the restaurant did give the winner a new Toyota.[2] Similarly, a radio DJ in Los Angeles offered a Hummer H2 in a weeklong on-air "contest" in which listeners were supposed to follow how many miles two Hummer H2 vehicles traveled. After hiring a baby-sitter so that she could go to the station to receive her prize, the "winner" was presented (on April Fools' Day) with a radio-controlled model. The winner filed suit for $60,000—the cost of a real H2.[3]

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1. Eric Herman, "Burger King Franchisees Sue McDonald's over Monopoly," *Chicago Sun-Times*, Aug. 24, 2005, at 76.
2. "Dream Car Is a 'Toy Yoda,' " *St. Petersburg Times*, July 28, 2001, http://www.sptimes.com/News/072801/State/Dream__car__is__a___toy__Y.shtml (on file with authors); "Former Hooters Waitress Settles Toy Yoda Suit," *USA Today*, May 9, 2002, http://www.usatoday.com/news/nation/2002/05/09/toy-yoda.htm.
3. "April Fool's Prank Brings Suit," *USA Today*, July 14, 2005, http://www.usatoday.com/news/offbeat/2005-07-14-hummer__x.htm.

ACTION BY GOVERNMENT ENTITIES

Be Conspicuous. Tylenol held a sweepstakes entitled "Survivor All-Stars—Tylenol Push Through the Pain Game." Consumers were confused by the advertisements for the sweepstakes and thought that they had to purchase Tylenol to enter. Only at the bottom of the advertisement, in fine print, was there a statement that no purchase was necessary to enter. In a suit brought by the New York State Attorney General, Tylenol settled by paying $52,000 in civil penalties and costs. It also agreed to (1) refrain from saying that consumers must purchase a product in order to enter a sweepstakes, (2) clearly and conspicuously indicate that no purchase is necessary to enter the sweepstakes, and (3) disclose the method of entry that does not require a purchase.[4]

"No" Purchase Means No. In a series of sweepstakes offering big-ticket prizes, A&P Food Stores automatically entered customers who made purchases using its "Bonus Savings Card," but otherwise failed to provide customers with a free method of entry at its retail locations. In addition, the company failed to post official rules conspicuously in the stores (including number and value of prizes and states in which residents could participate) and failed to register the promotion. A&P entered into a settlement with the New York State Attorney General in 2004 under which A&P agreed in future promotions to make entry forms readily available at its retail locations, regardless of whether the consumer makes a purchase, and to correct the other deficiencies. It also agreed to pay $38,000 in civil penalties and costs.[5]

Don't Discriminate. Publishers Clearing House got into trouble for its promotions, allegedly by suggesting that a direct-mail recipient had won when he had not and that purchasing products increased a recipient's chances of winning. In 2000, Publishers Clearing House agreed to refund $16 million to customers in 23 states and the District of Columbia. In addition, it agreed to modify its promotions practices by inserting in all mailings a clear and conspicuous "sweepstakes fact box" that contains (1) a statement that purchases do not increase the chances of winning, (2) a statement that the consumer has not won, (3) a statement that the consumer does not have to buy anything to enter the sweepstakes, (4) the odds of winning the sweepstakes, and (5) a statement that the consumer can enter as many times as desired.[6] In that same year, Publishers Clearing House agreed to pay $30 million in settlement of a class-action lawsuit. However, not all states agreed to the terms of the $16 million settlement. In 2001, 26 states that rejected the earlier settlement entered into a settlement with Publishers Clearing House in which the company agreed to pay $34 million, consisting of $19 million in restitution to customers, $1 million in civil penalties, and $14 million for the states' litigation and administration expenses. The company also agreed not to make any false statements in its promotions and to treat all entrants the same, regardless of whether they purchased magazines.[7]

Do What You Say. In 2004, CVS Corporation ran a sweepstakes in which customers could win a trip to Hawaii. The advertisement for the sweepstakes indicated that customers would automatically be entered into the sweepstakes if

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4. Press Release, Office of the New York State Attorney General (Sept. 10, 2004) (on file with authors).
5. Press Release, Office of the New York State Attorney General (May 3, 2004) (on file with authors).
6. Peter Pae, "Sweepstakes Firm Agrees to Refunds, Disclosure," *L.A. Times*, Aug. 23, 2000, § A-1 at 1.
7. News Release, Office of the Texas Attorney General (June 26, 2001) (on file with authors).

they made prints from their digital cameras and used their CVS ExtraCare Cards. They also indicated that no purchase was necessary to enter and that anyone could enter online at CVS.com. However, when customers went online to enter, they were told that they could pick up an entry form in CVS stores. When customers went to CVS stores to enter, no entry forms were available, and they were told to make a digital-print purchase to enter. CVS settled with the State of New York for $77,000 in civil penalties and costs. Additionally, CVS agreed (1) to post the rules, regulations, and entry forms in conspicuous locations in its stores, (2) to inform staff members of the rules of the sweepstakes so that they would be able to inform customers of the proper way to enter without making a purchase, and (3) to disclose the nonpurchase method of entry on all advertisements as prominently as the purchase method of entry.[8]

Apparently CVS persisted in its haphazard sweepstakes practices, for in 2006 it once again was investigated by the New York State Attorney General for failing to provide an adequate means for customers to enter a sweepstakes without a purchase and was required to pay a $152,000 civil penalty for violating the previous settlement. In addition to the requirements listed in the previous settlement, CVS agreed to start a training and compliance program for employees involving placing signs and entry forms in CVS stores.[9]

Don't Use Mice Type. Both Tylenol and CVS were criticized for having failed to disclose prominently enough that no purchase was necessary to win. Avoid using "mice type" in making mandatory disclosures (*i.e.*, type that is distant from the main claim, buried in other text, or difficult to read).

LESSONS LEARNED

Sweepstakes and contests are heavily regulated by federal and state laws. Sponsoring companies should not try to devise rules and run promotions without expert legal advice. Legal counsel should be involved in developing a promotion from start to finish—from creating the structure of the promotion to assisting in making any post-promotion governmental filings. Sponsors and their counsel must consider state-specific requirements (*e.g.*, prohibitions on monetary consideration for contests, registration and posting of bonds, advance filing of official rules, and special direct-mail disclosures) and modify the proposed structure to fit the company's desired timing and tolerance level for the burdens of compliance. Basing official rules on those from third parties or a company's own previous promotions is only a starting point; the rules themselves, their presentation (*e.g.*, web site, store display, direct mail), and all collateral materials should be reviewed for conspicuousness of disclosures and general legal compliance.

Such advice does not need to be expensive in the long run. Over time, marketing personnel will absorb the themes touched on above and will be better able to structure promotions and their rules initially; however, each promotion tends to be somewhat different from the last, and different sets of laws may apply. Thus, legal counsel should always be consulted before each promotion.

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8. In re CVS Corporation, Assurance of Discontinuance, New York State Attorney General (June 22, 2004) (on file with authors).
9. Press Release, Office of the New York State Attorney General (Oct. 16, 2006) (on file with authors).

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General e-mail messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Sidney R. Brown
1.404.581.8275
srbrown@jonesday.com

Amy E. Vieta
1.212.326.3420
aevieta@jonesday.com

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