Legal Issues Affecting Promotions and Sweepstakes

For years, direct selling companies have used promotions and incentives such as cruises, cars and jewelry to motivate and reward their distributors. Well-run promotions enhance good will, can generate brand awareness and may improve sales. However, these promotions have grown increasingly more sophisticated and the method of conducting them more complicated. Promotions such as sweepstakes, gift cards and awards are governed by a collection of inconsistent laws. Direct selling companies want to avoid conducting raffles or lotteries that violate federal or state laws and should be aware of federal and state regulations when offering legitimate promotions and sweepstakes.

Private lotteries or raffles (unless charitable) are illegal in most states. Federal and state jurisdictions define a lottery as a promotion that contains three elements:

a. A prize
b. Chance
c. Consideration

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A prize is defined as anything of value awarded to the winner. Chance is self-defining and typically involves selecting a winner by a random method over which the entrant has no control. Consideration takes two forms: monetary, in which the entrant must expend something of tangible value to participate, or non-monetary, where the entrant must spend a substantial amount of time or effort that will benefit the sponsor. In order to conduct a legitimate promotion, companies must eliminate one of the three elements.

Most promotions conducted by direct selling companies eliminate either the element of chance or of consideration. For example, a promotion that provides that the existing sales force will win a prize if they meet a certain sales level would not be a sweepstakes if no element of chance is involved; i.e., the prize will be awarded if the sales level is attained. However, a company promotion that is open to anyone who becomes a salesperson within a certain period of time could be problematic. If a fee or payment is required to become a salesperson, arguably those individuals who become salespeople after the start of the promotion would have paid consideration for the right to enter, turning a legitimate promotion into an illegal lottery. Direct selling companies must also be careful when conducting any type of promotion involving recruitment of new salespeople, as those new salespeople might feel pressured by an existing salesperson—whose primary motivation is to win a prize—to enter the business.

A problematic promotion is one that provides for entry to any salesperson who obtains $500 in personal volume by a certain date during the promotion.

Many direct selling companies conduct promotions or sweepstakes that involve chance. These sweepstakes may be conducted without legal issues arising if federal and state laws are followed. However, legal issues may arise if a direct selling company limits entry to a promotion involving chance (a drawing or sweepstakes) to those in the sales force who reach a specific sales level within a set period of time. It is not problematic for a company to offer a promotion only to a specific category of the sales force, provided that the category is established at the beginning of the promotion. For example, a promotion is legal if it limits entry to salespeople who, at the beginning of the promotion, have $500 in personal volume in a month. However, a problematic promotion is one that provides for entry to any salesperson who obtains $500 in personal volume by a certain date during the promotion.

Generally speaking, federal and state laws require specific statements to be contained in the official rules, which must be provided to every entrant. Federally, the Federal Deception Mail Prevention Enforcement Act imposes various additional restrictions on sweepstakes that involve the mail.

New York and Florida require that companies obtain a surety bond and register with the state if the total amount of prizes awarded exceeds $5,000. These filings must be completed in New York and Florida at least 30 days and seven days respectively, prior to the start of the promotion.

Direct selling companies must have detailed official rules for the promotion. There are certain provisions that should appear in all rules. These provisions include, but are not limited to, the following: (i) method of entry, (ii) method of determining winners, (iii) odds of winning, (iv) eligibility (age, resident, exclusion of employees and family members of sponsor), (v) duration (commencement date and termination date), (vi) award date, (vii) statement that no purchase is necessary, (viii) random nature of the drawing, (ix) limitation of sponsor's liability, (x) entrant's liability for taxes, (xi) detailed information concerning the prizes, (xii) requirement of affidavit of eligibility and liability and publicity release, and (xiii) availability of a winners' list.

The contents of promotion rules often depend on the type of prize being awarded. If a company is awarding a travel prize, they should disclose exactly what is included in the prize, including the number of travelers (including the winner) allowed, airfare (coach or first class, one way or round trip), accommodations (hotel name, occupancy or rating), ground transportation (car rental, shuttle bus), meals (specific meals, locations or limitations), and additional tickets (events, concerts or others). If a company awards an automobile, it should describe (i) whether it is new or used, (ii) the make, model and year, (iii) whether it is standard or automatic, (iv) the entrant's responsibility for tax, title, license and insurance, and (v) any limitations on the legal age of the winner.

Companies should also be mindful of the growing number of prize and gift notification statutes. Legal issues do not stop once a prize is awarded. If a company wants to use information about the winner in company promotions or otherwise, they must get a publicity release from the winner. A company may be required to file a Form 1099 with the Internal Revenue Service in connection with the awarding of prizes. It is important to inform the winner that he or she is responsible for all taxes, including sales and income taxes.

Online promotions present an additional level of complexity. The Internet has raised new questions with respect to the implementation of a promotion. The issue as to whether Internet access constitutes consideration under the law has not been fully resolved. The best solution is to provide an alternative method of entry, such as by mail or fax. Because the vast majority of giveaway regulations are found at the state level, online giveaways that reach across the entire Internet must take into account the laws of all fifty states. At times, it may be difficult to tell who the entrant really is. In a dispute as to who submitted the entry, a company should state that the entrant will be determined by who established the e-mail account. A company should also consider requiring that an entrant scroll down through the rules, and click "I accept" before entering.

Another type of promotion often used by direct selling companies is the issuance of gift certificates or gift cards. If a gift certificate or gift card is truly "given away," and no consideration is paid either by cash or by earning the card through selling a specific amount, state laws typically will not apply. Generally, these statutes exempt gift cards or certificates that are free or given away to a customer as part of a loyalty award or promotional program. However, many companies sell gift certificates or gift cards for their face value, or they award them if certain sales goals are met. Most state laws addressing gift cards or gift certificates focus on expiration dates (the presence or absence thereof), dormancy and service charges, maintenance of records, and disclosure of certain information about the certificates. Some states restrict expiration dates or dormancy or service charges. Dormancy charges (assessed by reducing the value of the card) are charges that occur when the card is not used within a specified period of time, or if the value of the card falls below a certain amount. Service charges are usually implemented to cover the administrative costs to maintain the cards. Finally, in many states, gift certificates are specifically covered under the escheat laws, and a direct selling company should be aware of such laws.

To summarize, the steps a direct selling company can take to minimize or avoid legal issues in conducting a promotion include (i) establishing and following official rules, (ii) including a free method of entry, (iii) filing registrations in a timely manner in Florida, New York and Rhode Island, if required, (iv) treating all methods of entry equally, (v) awarding all announced prizes unless the rules state otherwise, and (vi) obtaining an affidavit of eligibility and publicity release. Promotions can be a successful marketing tool if properly conducted.

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