



Legal Guide U-2

RULES PROHIBITING LOTTERIES (California Penal Code section 319 and following)

July 2012

California law prohibits lotteries. A lottery is any scheme for the disposition of property by chance among persons who have paid or promised to pay any value for the chance of obtaining the property, with the understanding that it will be disposed of by chance.¹ The name by which the scheme is known is immaterial.

A lottery consists of three elements: (1) a prize, (2) consideration, and (3) distribution of the prize by chance.² California courts have interpreted these elements broadly.

The first element, a prize, includes but is not limited to money, property, or a trip.³ A prize may also arise from the fees themselves in the form of a pool.⁴ For example, in one case, the prize of money could be obtained only if a participant successfully progressed through the scheme's several phases.⁵ In another case, the prize was the right to play a free game.⁶

The second element of a lottery is payment of consideration by the participant in order to be eligible to win a prize. Consideration includes any exchange of value. For example, courts have found consideration present where participants each paid \$.25 in exchange for a bingo card or for small plastic rings used to play a game of chance,⁷ or where participants paid \$1.00 in exchange for both a short subscription to a bulletin and a ticket for a drawing.⁸ However, an empty beverage container, when deposited in a reverse vending machine, or the postage used to return an entry form are not "consideration."⁹

Courts have used certain rules to decide whether a scheme includes consideration because it is not always clear. If a person is eligible to win a prize without purchase, there is no consideration and the contest is legal. In such a case, if some people *may* pay money - for example, an admission charge or a product - there is not necessarily consideration if other people may enter without such a purchase. If eligibility to win a prize is limited to those who have paid money, however, there is consideration. Alternatively, if some persons *must* pay in order to have a chance at a prize while others do not, there is consideration.¹⁰

The final element of a lottery is distribution of the prize by chance. The element of chance is present in a scheme even if the game contains some elements of skill, if chance is the dominant factor in determining an outcome.¹¹ Thus, bridge is a game of skill, although there is an element of chance resulting from the deal of the cards.¹² Conversely, bingo is a game of chance.¹³

There are three major exceptions to the law prohibiting lotteries. The California Constitution authorizes the California State Lottery and empowers the Legislature to authorize

cities and counties to allow bingo for charitable purposes.¹⁴ Lastly, a raffle conducted by a non-profit, tax-exempt organization for a charitable purpose is also permissible.¹⁵

Example of a Lottery

Assume that a store conducts a promotion in which \$50 of merchandise is given to several customers each week. In order to be eligible to win the prize, a customer must write his or her name and telephone number on the back of the cash register receipt of purchase from the store and deposit the receipt in a box at the store. Several receipts are drawn by the store at random each week, and the winners are notified by telephone. In addition, the store awards prizes each week randomly to two people who walk into the store.

This scheme is a lottery and is unlawful under Penal Code section 319. Prize and distribution-by-chance elements clearly are present. Since not all persons are eligible to win a prize, and since, in order to be eligible to win a prize, a person *must* make a purchase and use their receipt, consideration is also present. The consideration element is not removed from the scheme by allowing some people to have a chance at a prize without paying.

Endless Chain Schemes

A pyramid sales scheme (called an “endless chain scheme” in California) also may be a lottery. An endless chain is a plan for distributing property under which a participant pays valuable consideration for the chance to receive compensation for getting other persons to participate in the plan, or for a chance to receive compensation when one of those additional persons introduces a new participant. (The term “compensation” does not include payment based on sales to an ultimate consumer whose purchase is not made in order to participate in the plan.)

The law prohibits endless chain schemes.¹⁶ California courts reviewing endless chain schemes have concluded that they are inherently deceptive because rewards promised by the scheme can only accrue to any level of participants in the pyramid if it grows to another level. At some point, further recruitment becomes impossible.¹⁷

An endless chain contains the three elements necessary to constitute a lottery. An endless chain scheme typically awards cash or product bonuses or rebates based on the participant’s sales volume and on the sales volume of participants below him or her in the pyramid. Such an award satisfies the prize element in the definition of a lottery. The same award based on sales to non-participating consumers also satisfies this element.

Endless chain schemes typically require participants to purchase products or memberships, or to make financial commitments in order to be eligible for bonuses or rebates. This purchase requirement satisfies the consideration element.

Finally, an endless chain typically distributes the prize “by chance,” as that term is defined in the lottery context. In an endless chain, chance is the dominant factor because a participant’s success depends on the activities of the scheme’s promoters¹⁸ and the activities of those below the participant in the chain.¹⁹ Further, the success of a participant in an endless chain also depends in major part on the saturation of the market which occurs as the pyramid expands, and is typically not within the participant’s control.²⁰

Example of an endless chain scheme that is a lottery: A company markets products through a hierarchy of consultants. A person becomes a consultant through the sponsorship of another consultant, and by paying twenty-five dollars for registration. Each consultant is encouraged to purchase a sample inventory of products from his or her sponsoring consultant, although company literature says no purchase is required. Nonetheless, company strongly encourages the purchase of the sample inventory and payment of the registration fee as a package, because a consultant cannot earn commissions without purchasing inventory.

The company encourages consultants to recruit others and to sell its products to the recruits, who in turn are encouraged to recruit others and to sell the company's products to them, through three generations. There may also be retail sales. The consultant can purchase products for resale only from his or her sponsoring consultant, who has purchased the products from the company. The company encourages all consultants to purchase products in advance of need.

The consultant earns commissions on his or her own sales and on the sales of the consultants in his or her network, who must purchase their products from him or her. The consultant also receives rebates on the products purchased from the sponsoring consultant based on the total sales volume of the consultant's network.

The consultant can earn promotions to consultant 2 and consultant 3 by achieving specified sales volumes by his network and specified volumes of purchases for resale to his network. As a consultant ascends in the hierarchy the individual receives increased commissions, greater rebates on products purchased, and bonuses, as determined by sales and purchase volumes.

This scheme is both an endless chain and a lottery. It is an endless chain because the consultant pays consideration for the chance to introduce additional consultants into the scheme and to receive compensation from their sales. The scheme also depends on an endless chain of middlemen (new consultants), encourages inventory purchases by consultants at all levels, and does not emphasize retail sales.²¹

This scheme is also a lottery. The prize element is present in the form of commissions, rebates, and bonuses. The consideration element is present because participants *must* purchase products in order to receive the commissions, rebates, and bonuses. The element of distribution by chance is present in that a participant's success depends in large part on the activities of the scheme's promoters, the activities of those below the participant in the chain, and also on the saturation of the market as the chain expands.

Penalties and Enforcement

Any person who prepares or operates a lottery, furnishes lottery tickets, or assists in conducting a lottery is guilty of a misdemeanor.²² Any property offered for distribution through a lottery is subject to summary attachment and is forfeited to the State.²³ Any person who prepares, proposes, or operates an endless chain scheme which fits the definition given above is guilty of a public offense punishable by imprisonment in county jail or state prison.²⁴

Misdemeanor provisions also prohibit any person from selling a share or interest in any lottery, or a share or interest which depends on the event of any lottery; from receiving valuable consideration upon an agreement to repay any sum or to deliver any property if any lottery ticket

or number in any lottery wins or loses; and from promising to pay any sum or to deliver any property upon any contingency which depends on the drawing of any ticket in any lottery.²⁵

These forfeiture and misdemeanor provisions are enforceable by the Attorney General or by any district attorney. The lottery and endless chain provisions also may be enforced through civil actions filed by private parties, district attorneys, the Attorney General, certain city attorneys, and agencies of the state.²⁶ Depending on the nature of the civil action, remedies include civil penalties of up to \$2,500 for each violation, injunction, and restitution.²⁷ If the lottery includes false or misleading statements, remedies may include an additional civil penalty of up to \$2,500 for each violation.²⁸

A participant in an endless chain scheme may rescind (revoke) his or her contract with the scheme, and may recover payments made under the scheme (less payments received from the scheme).²⁹

Exceptions

In addition to the California State Lottery, the California Constitution provides two other major exceptions to the prohibition against lotteries. In 1976, the Constitution was amended to include this provision: “Notwithstanding [the prohibition against lotteries] the Legislature by statute may authorize cities and counties to provide for bingo games, but only for charitable purposes.”³⁰ Similarly in 2000, the Constitution was further amended so that the Legislature could authorize eligible organizations to conduct raffles as a funding mechanism provided that at least 90% of the gross receipts from the raffle go directly to beneficial or charitable purposes. This percentage may be amended by statute.³¹

Bingo

Penal Code section 326.5 makes the playing of bingo lawful as long as the game is authorized by a city or a county ordinance.³² Cities or counties may only authorize bingo games conducted by non-profit organizations,³³ mobile home park associations, and senior-citizen organizations.³⁴ The games are to be operated and staffed only by members of the authorized organization that organized the game.³⁵

Although all games must be open to all members of the public, players must be physically present when and where the game is played and no minors may play.³⁶ Both regular bingo and “break open” bingo may be authorized.³⁷ If one form of the game is authorized, however, the other may not necessarily be authorized also.³⁸ In other words, a city or county can authorize regular bingo without authorizing break open bingo.³⁹

The receipts from bingo are only to be used for charitable purposes.⁴⁰ In fact, the proceeds or profits must be kept in a special fund or account and may not be commingled with any other fund or account.⁴¹ No “profit, wage, or salary” may be paid from the proceeds of any bingo game, including to the members organizing and staffing the game.⁴² One exception to that rule is that security personnel employed by the organization conducting the bingo game, who are not members of the organization, may be paid from the games’ proceeds.⁴³ Expenses that are the cost of doing business, such as attorney’s fees, may also be deducted from the gross receipts.⁴⁴ Other allowable expenses to be paid from the proceeds include: prizes, a portion of the overhead, and license fees.⁴⁵ The total value of prizes awarded may not exceed \$250 per game.⁴⁶

Penalties and Enforcement

It is a misdemeanor for any person to receive or pay a “profit, wage or salary” from any bingo game.⁴⁷ A fine of up to \$10,000 may be assessed for violations of this provision, as well as for the provisions regulating payment to security personnel.⁴⁸ In addition, any other violations of the requirements regulating bingo are misdemeanors.⁴⁹ The enforcement provisions applicable to the unlawful operation of a lottery are also applicable in this context.

Raffles

The Legislature has authorized raffles to be conducted for charitable purposes by “eligible organizations,” such as private, non-profit organizations.⁵⁰ In addition, the organization must be tax-exempt and have been qualified to do business in California for at least a year before the raffle.⁵¹

The elements of a raffle are: (1) a prize, (2) distributed by chance, (3) to a person who has paid money for a paper ticket, which provides the opportunity to win, and which has a detachable coupon or stub, both of which have a unique identification, (4) and the winner is determined by a draw from among the detached coupons or stubs.⁵² The draw must be conducted in California by someone over 18-years old.⁵³

At least 90% of the gross receipts from the sale of raffle tickets for a single draw must be used by the organization conducting the raffle for beneficial or charitable purposes within the California.⁵⁴ Or it may use those revenues to benefit another private, nonprofit, eligible organization.⁵⁵ The funds shall not be used for any purpose outside California.⁵⁶ Sources of funds other than the sale of the raffle tickets may be used to pay for conducting the raffle.⁵⁷ In addition, anyone paid to operate the raffle must be an employee of the organization and may not be paid from the proceeds that should be dedicated to charitable purposes.⁵⁸ Raffle tickets may not be offered or sold over the Internet, although the organization’s website may announce the raffle.⁵⁹

An organization may not conduct a raffle unless it registers annually with the Department of Justice. A fee may be required in order to register.⁶⁰ The organization may contact the Department of Justice for a registration form (which is also available on the Internet).⁶¹ Once registered, the organization must file an annual report with the Department (on a form supplied by the Department) that includes: (1) the aggregate gross receipts from the operation of raffles, (2) the aggregate direct costs incurred by the organization from the operation of raffles, and (3) the charitable purposes for which proceeds of the raffles were used, or the identity of the eligible organization that received the proceeds, and the amount of those proceeds.⁶² Certain organizations, primarily religious corporations, educational institutions, and hospitals, are exempt from the registration requirements.⁶³

A raffle is exempt from these requirements if: (1) it involves a general and indiscriminate distribution of tickets, (2) the tickets are offered on the same terms as the tickets for which a donation is given, and (3) a participant is not required to pay for a chance to win.⁶⁴

Penalties and Enforcement

The Attorney General, a district attorney, city attorney, or county counsel may take administrative or criminal action for violations of the requirements for conducting a raffle.⁶⁵ The Department of Justice may seek recovery of the costs incurred in investigating or prosecuting an action against the organization.⁶⁶ The enforcement provisions applicable to the unlawful operation of a lottery are applicable in this context, as well.

NOTICE: The Department of Consumer Affairs strives to make its legal guides accurate in every respect. However, this legal guide is only a guideline and is not a definitive statement of the law. Questions about the law's application to specific circumstances should be directed to an attorney.

This publication is available on the Internet. See the Department of Consumer Affairs' homepage at www.dca.ca.gov.

This document may be copied, if all of the following conditions are met: the meaning of the copied text is not changed; credit is given to the Department of Consumer Affairs; and all copies are distributed free of charge.

Originally prepared by John C. Lamb, Senior Staff Counsel, January 1999. Last updated July 2012 by Rebecca Bon, Staff Counsel.

ENDNOTES

¹ Penal Code, § 319.

² E.g., *California Gasoline Retailers v. Regal Petroleum of Fresno, Inc.* (1958) 50 Cal.2d 844 [330 P.2d 778].

³ E.g. *Regal Petroleum*; *People v. Cardas* (1933) 137 Cal.App.Supp. 788 [28 P.2d 99]; *People v. Gonzales* (1944) 62 Cal.App.2d 274 [144 P.2d 605].

⁴ *Hotel Employees and Restaurant Employees Intern. Union v. Davis* (1999) 21 Cal.4th 585, 592 [88 Cal.Rptr.2d 56, 62, 981 P.2d 990, 996].

⁵ *People v. Shira* (1976) 62 Cal.App.3d 442 [133 Cal.Rptr. 94].

⁶ *People v. Settles* (1938) 29 Cal.App.2d (Supp.) 781 [78 P.2d 274].

⁷ *People v. Shira, supra*.

⁸ *Holmes v. Saunders* (1952) 114 Cal.App.2d 389 [250 P.2d 269].

⁹ *Haskell v. Time Inc.* (E.D.Cal. 1994) 857 F.Supp.1392.

¹⁰ *People v. Shira, supra*.

¹¹ *People v. Shira, supra*.

¹² *In re Allen* (1962) 59 Cal.2d 5 [27 Cal.Rptr. 168].

¹³ *People v. Shira, supra*.

¹⁴ Cal. Const., Art. IV, section 19; see Penal Code section 326.5.

¹⁵ Penal Code, § 320.5(a).

¹⁶ Penal Code, § 327.

¹⁷ *People v. Bestline Products, Inc.* (1976) 61 Cal.App.3d 879 [132 Cal.Rptr. 767].

¹⁸ *Webster v. Omnitrition* (9th Cir. 1996) 79 F.3d 776.

¹⁹ Cf. *Finster v. Keller* (1971) 18 Cal.App.3d 836 [96 Cal.Rptr. 241].

²⁰ *Securities and Exchange Commission v. Glenn W. Turner Enterprises, Inc.* (D. Or. 1972) 348 F.Supp. 766, *aff'd* (9th Cir. 1973) 474 F.2d 476.

²¹ *People v. Bestline Products, Inc. supra*; *Bounds v. Figurettes, Inc.* (1982) 135 Cal.App.3d 1 [185 Cal.Rptr. 480]. "Operate" a lottery is explained in *People v. Sanchez* (1999) 62 Cal.App.4th 460, 469, 471 [72 Cal.Rptr.2d 782, 787, 788-789] ("operate" does not apply only to creators and designers of the scheme; "operate" denotes ongoing conduct which advances the program of an existing entity; here, the defendants called participants to announce meetings, held many meetings in their home, conducted the meetings and lectured at them, explained the scheme's rules and requirements, prepared pyramid charts and collected money).

²² Penal Code, §§ 319, 322, 323, 326.

²³ Penal Code, § 325.
²⁴ Penal Code, § 327.
²⁵ Penal Code, §§ 321, 324.
²⁶ Bus. & Prof. Code, §§ 17200, 17204, 17206.
²⁷ Bus. & Prof. Code, §§ 17203, 17206, Civil Code, § 1689.2.
²⁸ Bus. & Prof. Code, § 17500.
²⁹ Civil Code, § 1689.2.
³⁰ Cal. Const., Art. IV, § 19, subd. (c).
³¹ Cal. Const., Art. IV, § 19, subd. (f) [Stats.1999 (S.C.A.11) (Prop. 1A, approved March 7, 2000)].
³² “Notwithstanding subdivision (a) the Legislature by statute may authorize cities and counties to provide for bingo games, but only for charitable purposes.” (Cal. Const., Art. IV, section 19, subdivision (c).) Penal Code, § 326.5.
³³ “[O]rganizations exempted from the payment of the bank and corporation tax by sections 23701a, 23701b, 23701d, 23701e, 23701f, 23701g, and 23701l of the Revenue and Taxation Code.” (Penal Code, § 326.5(a).)
³⁴ Penal Code, § 326.5(a).
³⁵ Penal Code, § 326.5(h).
³⁶ Penal Code, § 326.5(e), (g), (m).
³⁷ “‘Break open’ bingo is a game in which the participant purchases a sealed bingo card that is a predetermined winner or loser.” Penal Code, § 326.5; *Lubavitch Congregation v. City of Long Beach* (1990) 217 Cal.App.3d 1388, 1392-1393, [217 Cal.Rptr. 513].
³⁸ *Id.* at p. 1394.
³⁹ *Lubavitch Congregation. supra*, 217 Cal.App.3d at 1394.
⁴⁰ *Ibid.*
⁴¹ Organizations exempt from payment of the bank and corporation tax by Revenue and Taxation Code section 23701d, e.g., corporations or organizations operating exclusively for religious, charitable, scientific, literary, educational, amateur sports competition, or cruelty prevention purposes, must segregate their profits. (Penal Code, § 326.5(b).) All other organizations authorized must segregate their proceeds. (Penal Code, § 326.5(b).)
⁴² Penal Code, § 326.5(b), (h).
⁴³ Penal Code, § 326.5(b), (h).
⁴⁴ *Arden Carmichael, Inc. v. County of Sacramento* (2000) 79 Cal.App.4th 1070, 1078 [94 Cal.Rptr.2d 673, 678-679].
⁴⁵ Penal Code, § 326.5,(k)(1) - (k)(4).
⁴⁶ Penal Code, § 326.5(n).
⁴⁷ Penal Code, § 326.5(b).
⁴⁸ Penal Code, § 326.5(c).
⁴⁹ *Ibid.*
⁵⁰ Cal. Const., Art. IV, section 19, subd. (f); Penal Code, § 320.5(a), (c).
⁵¹ Penal Code, § 320.5(c). The organization must be exempt from taxation pursuant to Sections 23701a, 23701b, 23701d, 23701e, 23701f, 23701g, 23701k, 23701l, 23701t, or 23701w of the Revenue and Taxation Code. (*Ibid.*)
⁵² Penal Code, § 320.5(b)(1) - (b)(3).
⁵³ Penal Code, § 320.5(b)(3).
⁵⁴ Penal Code, § 320.5(b)(4)(A). This percentage may be changed by statute. (Cal. Const., Art. IV, § 19, subd. (f).)
⁵⁵ *Ibid.*
⁵⁶ *Ibid.*
⁵⁷ *Ibid.*
⁵⁸ Penal Code, § 320.5(d).
⁵⁹ Penal Code, § 320.5(f).
⁶⁰ Penal Code, § 320.5(h)(1)-(2).
⁶¹ *Ibid.*; <http://oag.ca.gov/charities/raffles>
⁶² Penal Code, § 320.5(h)(5)(A) - (h)(5)(C), (h)(6).
⁶³ “The registration and reporting provisions of this section do not apply to any religious corporation sole or other religious corporation or organization that holds property for religious purposes, to a cemetery corporation regulated under Chapter 19 of Division 3 of the Business and Professions Code, or to any committee as defined in Section 82013 that is required to and does file any statement pursuant to the provisions of Article 2 (commencing with Section 84200) of Chapter 4 of Title 9, or to a charitable corporation organized and operated primarily as a religious

organization, educational institution, hospital, or a health care service plan licensed pursuant to Section 1349 of the Health and Safety Code.” (Penal Code, § 320.5(h)(7).)

⁶⁴ Penal Code, § 320.5(m).

⁶⁵ Penal Code, § 320.5(i).

⁶⁶ Penal Code, § 320.5(j).