STATE OF CALIFORNIA

LOTTERY COMMISSION

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CALIFORNIA STATE LOTTERY COMMISSION MEETING

TIME: 9:00 a.m.

DATE: Thursday, February 23, 2012 PLACE: California State Lottery

700 North Tenth Street Sacramento, California

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TRANSCRIPT OF PROCEEDINGS

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I N D E X

Description			
1. Call to Order	6		
2. Pledge of Allegiance	6		
3. Roll Call of Commissioners	6		
4. Closed Session			
5. Consider Approval of the Agenda	7		
6. Approval of the Minutes of October 6, 2011 Commission Meeting	l , 9		
7. Director's Report	9		
a. Director's Comments	9		
b. FY 2010-11 Financial Statements	28		
c. Lottery Sales Report	31		
d. Product Development Presentation	47		
e. Sales and Marketing Presentation	57		
f. Information Technology Presentation	69		
8. Consent Calendar	78		
9. Action Items			
a. Ratification Request of San Diego District Office Lease Extension and Amendment	79		

Desc	ripti	.on	Page
9.	Acti	on Items	
	b.	Ratification Request of BroadSpec, Inc. Contract Amendment No. 2	82
	С.	Ratification Request of Century Link Network Software Support and Maintenance Purchase Order	84
	d.	Ratification Request of Scratchers® Ticket Delivery Courier Service	85
	е.	Lottery Investment Policy and Strategy	88
	f.	Retail Sanctions Penalty Guidelines pos	tpone
	g.	Three-Month Extension of Draw Auditing and Review Services Contract	94
10.	Comm	nissioner General Discussion	95
11.	Sche	eduling Next Meetings	96
12.	Publ	ic Discussion	97
13.	Adjo	purnment	98
		000	

1	Thursday, February 23, 2012
2	Sacramento, California
3	000
4	CHAIR TAGAMI: I'm going to call this meeting
5	to order.
6	Good morning, everyone. My name is Phil
7	Tagami. On behalf of myself and Commissioners Smolin and
8	Kirtman, this is our maiden voyage, so to speak, in 2012,
9	with new director O'Neill.
10	So without further ado, we'll start with the
11	Pledge of Allegiance.
12	Please stand and join us.
13	(The Pledge of Allegiance was recited.)
14	CHAIR TAGAMI: Thank you.
15	Can the secretary call the roll, please?
16	MS. TOPETE: Commissioner Smolin?
17	COMMISSIONER SMOLIN: Here.
18	MS. TOPETE: Commissioner Kirtman?
19	COMMISSIONER KIRTMAN: Here.
20	MS. TOPETE: Commissioner Tagami?
21	CHAIR TAGAMI: Present.
22	As a tradition in other venues that I had
23	served, we had made it a practice to advance closed
24	session to the beginning of the meetings, to be able to
25	allow the Commission, if there was action that required

1 public notice or reporting out of actions in closed 2 session, that we do it at the beginning. 3 This is a test, so we're not sure if this is 4 always going to be the practice. But what we'll be doing 5 now is adjourning into closed session, and then coming 6 back to take up the regular agenda. 7 So with that, we'll adjourn into closed 8 session. 9 (The Lottery Commission met in closed 10 executive session.) 11 CHAIR TAGAMI: Okay, please let the record reflect at 9:29 we're going back into open session. 12 13 And with that, I'll ask our chief counsel, Ms. Hightower, to report any actions in closed session. 14 15 MS. HIGHTOWER: Thank you. During closed session, the Commission 16 17 authorized the Director to send appropriate instructions to the State Controller's Office regarding payment of 18 19 backpay with respect to the furloughs. And that will be 20 done later today. 21 CHAIR TAGAMI: Thank you. 22 With that, we'll move to the consideration of 23 this agenda for today. 24 Does anyone have any recommended changes or modifications to the agenda? 25

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                COMMISSIONER SMOLIN: Mr. Chairman, I'd like to
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     take Item 9.f off the agenda for today.
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                CHAIR TAGAMI: Okay. Any other comments or
4
     questions regarding the agenda, Commissioners?
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                COMMISSIONER SMOLIN: No.
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                CHAIR TAGAMI: Okay, so if I can accept a
7
     motion, please, to adopt the agenda, if someone will make
8
     it.
9
                COMMISSIONER SMOLIN: I'll make the motion.
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                CHAIR TAGAMI: Do you second that?
11
                COMMISSIONER KIRTMAN: Second.
12
                CHAIR TAGAMI: Okay, by consensus.
13
                Can we have the secretary call the roll?
14
                MS. TOPETE: Commission Smolin?
                COMMISSIONER SMOLIN: Yes.
15
                MS. TOPETE: Commissioner Kirtman?
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17
                COMMISSIONER KIRTMAN: Yes.
                MS. TOPETE: Commissioner Tagami?
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19
                CHAIR TAGAMI: Yes.
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                Okay, move on to approval of the minutes of the
     October 6<sup>th</sup>, 2011, Commission meeting.
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                As this Commission was not sitting at that
23
     time, normally, my practice would be to accept
24
     the minutes. But I think what we'll need to do is open
      this on the floor and see if there are any amendments or
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1 modifications being suggested by anyone. 2 Any corrections to the minutes? 3 (No response) 4 CHAIR TAGAMI: Okay, hearing no corrections to 5 the minutes, the minutes will stand as approved. Director's report, Mr. O'Neill? 6 7 MR. O'NEILL: Good morning, Commissioners. 8 I will go ahead and start off the Director's 9 report. And then after I speak, there will be a series 10 of presentations by various members of senior leadership 11 team. What I would like to do today is just briefly 12 13 kind of talk about my first couple months here as the new 14 director. I will talk about some of the actions I've taken to date. I'll give you some of my initial 15 perceptions on what I see as some of the issues facing 16 17 us. Talk about some of the major areas of focus I'm working with the leadership team on, going forward. And 18 19 then I'll also talk about some of the next steps I see in 20 the process working with the Commission to address some 21 of these areas we're working on. 22 As far as the actions to date, as I mentioned, 23 I've just been on the job for two months. It's been 24 quite challenging. It's been very busy. Sometimes, I've been drinking from a fire hose of information; but I'm 25

still standing here, so that's a good thing.

Basically, what I've been doing, working with the team, is taking a top-down look at the Lottery, starting with basics, like the legal mandates and requirements of the Lottery, looking at our major functions, how we are organizing staff to do business. Our various systems and processes, whether they be automated or manual systems. Just getting a sense of some of the inner workings of the Lottery. And then getting down into the weeds a little bit within headquarters and some of the various divisions, looking at the policies and procedures and practices that we have on a day-to-day basis, both Lottery-wide, as well as internally, within the various units.

We also met with the senior leadership team on numerous occasions and key staff, reviewing a whole series of documentation. Everything from strategic plans, to business plans, to audit reports, to project-management plans -- a variety of information regarding the current and past business of the Lottery, and how it's conducting itself, and what some of the major issues are that are currently confronting the Lottery, both internally, people bringing up, as well as external people, stakeholders looking at us. So just a lot of documentation.

And I've also done some walk-throughs of the individual units within the headquarters here. And starting this week, I'll be getting out to visit with each of the district offices, the nine district offices, as well as the two distribution centers and the Lottery's warehouse, just to get out to meet the people, to get a sense of how business is conducted, and just to see the general operations.

As far as my initial perceptions regarding the first couple months, just getting to know the organization, the functions, and the roles and responsibilities of folks within the Lottery, it has been a significant undertaking.

One of the things that I kind of looked at is, it's almost like a little bit of -- almost like a city, in terms of the stuff that the Lottery does. We have this huge, large sales and marketing organization on one side; but we also have some major, major functions, including law enforcement, a large information technology function, a huge audit function, and a pretty good-sized administrative and support function to help everything else out.

So there really is a lot of activity going on here, some of which is really different to the kind of typical public agency I've been exposed to in the past.

So it's a little bit different in terms of how we're organized and what we do just because of the nature of our mission.

As you know, we're midway through our three-year business plan. So what I've been taking a look at is kind of a mid-course look on how we're doing on that business plan. I think I've shared that plan with all of you; and it's a very detailed and aggressive plan. There was an awful lot in that plan in terms of commitments to do things.

Really taking a look now at what's been done to date, what has worked, what may have changed in the meantime, some of the things we probably thought about at that time, the world has passed them by and don't apply anymore. And then some of the areas where the Lottery made pretty large commitments in terms of what they wanted to do, and may not be keeping up with those commitments. So what we have to do if those issues are still valid, to do some mid-course corrections in terms of the business plan.

I really have found that it's been a very collaborative senior leadership team. It's a very seasoned group of professionals who know the Lottery business. They've been very open to me in terms of collaboration and a willingness to kind of work with me,

which has been very refreshing.

The one thing about the Lottery, from every person I've talked to, from top to bottom, in the organization, is the strong support for the mission and ownership of that mission. It's a pretty simple mission; I think it's one of the most straightforward missions in state government: You go out there and sell a lot of tickets, you do it efficiently, and you give as much money as you can to education. And I think everybody I talked to in this organization feels very comfortable getting behind that type of a mission.

So I think it's one of the strong things the Lottery has going for it, is the will of the people to stand behind that mission.

Also, there has been a willingness to revisit the way things have been done. I think everyone on the staff realizes that AB 142, which passed a year and a half ago, has been a real game-changer for the Lottery. It allows us much more flexibility in how we have our games and sell our tickets and the prize structure we can offer to the people out there. And I think our consumers are responding, as you'll see later on when Jim Hasegawa talks about the business-planning aspect and the sales aspect, our consumers responding to it. And we do see the opportunity for some really good growth in the

Lottery. And along with that growth is going to have to be change in the way things are done. And there's a willingness to do that on the part of staff.

And then also, just the openness to potential improvements and change. Having kicked around government a little bit over the last 30 years, I've seen a lot of differing, comparative situations regarding how things can be accomplished in different situations. And so I'm trying some of those on for size with senior staff and staff within the organization. And I do like the fact that people are open to considering: "Hey, let's take a different look at it. Things have changed, and maybe there's another way to do things." So that's been quite refreshing.

As far as, as I've been working on this, this kind of assessment on what is the current state of the Lottery: A number of major areas have stood out that I just want to talk a little bit about today.

First of all, is building capacity within

Lottery staff, retail recruitment and development. Also,
looking at various organizational efficiencies and
effectiveness opportunities. Focus on Lottery security
and risk management, as well as looking at product
development promotions.

The first area, building capacity within the

Lottery. A lot has happened the last couple years to the Lottery in terms of its staffing. We've had the furloughs issue, we've had the hiring freezes, considerable changes in management and leadership over the last few years. A lot of things have been going on which have affected the staffing of the Lottery.

Just, for example, at the beginning of February this year, 76 of our 644 positions were vacant. So we had basically 12 percent of our authorized positions vacant.

What the Lottery has done to basically make up for those vacancies, has been relying upon a large number of retired annuitants, a large number of intermittent people -- basically part-timers, to help fill the gaps where we don't have full-time staff to do the job.

The nice thing is, all that is off the table now. We have the ability to hire again. The hiring freeze is over. And so one of the things we're really going to do is focus on recruiting full-time staff to take those positions, and to do the daily business of the Lottery as opposed to using less-than-full-time staff.

Just to give you another perspective on this, in our sales force alone, which is really, I believe, the heartbeat of the Lottery in terms of getting things moving, last month we had 39 retired annuitants working,

and we had 68 temporary staff working. And I believe we're a full-time business, we need full-time staff to conduct our business activities. So that's going to be a major push for us.

Along with that, as part of that recruitment effort, there is going to become the need for training and development programs, particularly in the area of sales area. We're going to have a number of new staff coming in. We've done some restructuring in there.

We're adding more supervisory personnel, as well as our district sales representatives. So we see the need for a real focus on training the new staff to come in, and to equip them with the tools and knowledge to do those jobs.

And along with that is, we'll have a presentation later on this morning from our head of I.T., Ellen Ishimoto. We're doing a lot of with our technology systems, which is very good. We're getting into business information and business analytics. And the idea is to use that data, to get it down to the staff, to drive sales, and also hold people accountable for what they're doing in terms of sales.

So there's some nice, encouraging aspects of what we're doing in technology that you'll hear about a little later in the morning.

In terms of retail recruitment and development,

California significantly lags behind other lotteries in retailer penetration. This is older data. It's the most recent data available. But California ranks 40th out of 42 lotteries in our retailer penetration.

So we see the addition of retailers as a large potential opportunity for the Lottery in terms of trying to increase sales.

And to put that in perspective, in terms of increasing sales, this is where California stands based on 2011 data, compared to the U.S. median and to some of the other lotteries we compare ourselves to.

Basically, we're \$58 below the median sales per capita of the U.S. median. That includes lotteries like, you know, Idaho and Nebraska and Arkansas. So it's not exactly a high standard in terms of who we're comparing ourselves against size-wise. So we really lag in sales.

And as I mentioned, AB 142 did provide a game-changer in terms of our sales. And you'll hear more about that from Jim later on. But we think there's a large opportunity to increase these figures.

In addition to just overall sales, one of the aspects of that is, the Lottery needs to increase retailer penetration. If you take a look at the U.S. median here of the residents per total retailers, it's about 1,500, while we're at about 1,775 residents per

retailers.

To put this in perspective, we have about 21,000 retailers right now. We would have to add another 4,000 retailers just to get up to the U.S. median in terms of the penetration, on average, of what the other lotteries are doing.

So it shows the size of the task ahead of us. We don't want to just go out and add retailers for retailers' sake. But we think there is a real good opportunity to add the right retailers, who are selling our products in the right places, to do a good debt in terms of some of the sales bogey we see that we've got to make up.

Not only do we need more retailers, we also need to do better with the retailers we have. Basically, California is about 25 percent below the U.S. median when it comes to how much product we're selling per week at our retailers. So along with adding the right retailers, we've got to work with our staff to get out there and work with our retailers, to make sure that we have the product out there, make sure that the retailers are knowledgeable about how to position that product in their store, and then to help them and coach them in terms of how to get more product out the door.

So, once again, not enough retailers, not

enough sales per retailer, and, overall, that puts us behind in terms of what's happening with other lotteries in the country.

The third area I want to take a look at is the overall organizational efficiency and effectiveness. As I mentioned, we're taking this top-down look at how things are operating.

One of the things I'm looking at is the grouping of the major functions within the Lottery: Are there other opportunities to consolidate some of these functions, which are very similar, and save some of the administrative expenses? And then focus those savings on our sales and marketing side, to do more with our sales and marketing force.

So we're taking a look at these functions, we're taking a look at the number of layers of management, the ratio of managers to staff. Just a basic analysis you would do of an administrative operation as we go forward, with the idea of making more efficient, more effective; and any savings we free up, to direct those to our sales force, where we need to grow.

Another area we're looking at is our project management. At any given time, there's numerous projects going on at the Lottery, whether they be large I.T. products or smaller projects within individual divisions.

We've got a very fledgling project management system; and I want to improve that system. We devote a lot of resources towards project management; and I want to see that become more efficient and effective.

A major review we're going to undertake this next year, hopefully, is taking a look at our distribution systems and practices. Not just the lottery industry, but all industry, in terms of their supply chain management, have done dramatic things in the last few years. If you take a look at the Amazons of the world, the Walmarts of the world, they're much more efficient in how they get product out to market, with speed and efficient practices. We want to do the same: Take a look at the Lottery, and see what can be done in that area to really enhance our supply chain.

It's taken us about three days to get product, from the time it's ordered, to our retailers. And that's just too slow in this day and age, when, typically, you can get a Zappos shoe, you know, delivered the next day at your house, in 24 hours.

So we want to take a look at what we can do to kind of expedite that process, make it more efficient, so that we have the product we need on the retailer's shelf the next day.

Another area is contract management. We've had

a couple of audits in the past year or two which have criticized our contract-management practices. We want to take a look at that. There may be some opportunities there also to do some consolidation. It's kind of a decentralized process throughout the organization. So we will be doing a contract-management review.

We also have two call centers within the Lottery. There's two different call centers. There may be some opportunity here, we believe, to consolidate some of these functions and to free up some savings, as well as to make the operations more efficient. So we're looking at that one.

Another area where we have an ongoing project currently is asset management. Again, we've had an audit which has brought up our asset-management practices. The staff is actively working on the project to address this right now. Basically, we're reviewing our policies and procedures. We're putting in a new system. We're going to populate that system with our assets, and get our inventory squared away, with the idea that we can then track -- manage that asset inventory in a much better fashion.

And then finally, the Governor's office has come out with a series of executive orders which talk to just basic efficiencies since he has been in office. And

we are complying with those orders. They relate to cell phones, vehicle usage, take-home permits, that type of thing.

The fourth area is Lottery security and risk management. Currently, we have a continuing project that's going on to enhance our Security and Law Enforcement Division operating policies, procedures, and practices. Basically, what we're doing is making sure that we adhere to industry standards, and that we do the training and the refresher of the standards that people need to keep current, and to make sure we're up-to-date in terms of how we are conducting our business operations. And that's been an ongoing project.

Another area we're taking a look at is just reviewing our risk management practices within the organization.

One of the areas, for example, is just insurance: Insurance on this building, insurance for our vehicles, that type of thing. Just very simple things. But also, taking a look at other aspects of risk management: Everything from physical security, to operational practices, to our financial practices, to even our reputational security and risk management efforts. So a lot of different things in that area in terms of risk management.

We are just beginning, right now, an information technology security audit. We're required in our regulations every two years to have one of these. Taking a look at what's happening in the industry right now, the number of people encroaching upon people's data, the number of people, you know, who are targeting different organizations for some type of, you know, penetration. We are making sure this audit this year is a very comprehensive audit, everything from penetration testing to I.T. policies with our personnel, to access controls, that type of thing. So that's an area we've just started this audit this year.

We've just hired a new ISO, information security officer, and he'll be intimately involved in that particular activity.

And finally, really, in light of this new building we're in right now, we're taking a look and revisiting our business continuity and disaster recovery plans. Just in terms of the thoroughness, the completeness of those plans, making them up-to-date, to be consistent with the environment that we're currently in right now, we're taking a look at those plans, and making sure that we're doing everything we can in case of any type of calamity happening.

And then lastly, I want to talk about product

development promotions. We are developing aggressive product development plans for next year, both in the Scratchers® and in the draw areas.

In one of the subsequent presentations, you're going to hear from Liz Furtado and Ed Fong regarding what we're doing in those areas in terms of some of the things we're doing right now, as well as what we're thinking of for next year, as we start the business-planning process for the July 1st start of the fiscal year.

Also, one of the areas we're looking at is promotions across all levels: What can we do to get the retailers incented to sell more tickets, Lottery players, and even sales staff. We offer sales staff bonuses right now; but are there other things we can do to invigorate our sales staff, and really, at all levels, try to promote better and more aggressive sales.

One of the areas we're exploring also is expanding the use of the Internet as a sales channel. There are many opportunities relating to social networking, social media that are out there right now. We're seeing all different things exploding across the industry right now.

We need to take and consider some of those, and look at some of those, and see if they fit our business model; and is there a way that we can use them to enhance

our sales and expand our reach of our sales programs? So that's going to be in the mix going forward.

And then lastly, looking at our Players' Club and Loyalty Program. We want to communicate better with our players. We want them to feel some involvement with the Lottery. And we want to basically expand these programs as a way of trying to get the connection with them, to understand what we're doing, to play our games, and to enjoy the experience and keep coming back.

And the emphasis there is getting more people to play. Not having them play, necessarily, a lot; but a lot of people play at a certain little level which we think is the appropriate social thing for the Lottery to do.

As far as next steps, continuing the top-down look at things: Continue to work with leadership to address these issues we identify, and initiatives to address them. We are working as a team to come forward to you with a business plan suggested for next year. And over the next couple months, we intend to work with you, to talk about these initiatives, and to finalize this business plan, and have a plan which we all can get behind in terms of the sales goals and objectives for next year, and how we're going to conduct that and work with you to get that done by the June 30th date, when --

1 before the start of the fiscal year. 2 So that's a brief capsule of what I've been 3 doing, what some of the focus areas that I've been 4 working with the senior leadership team on, and some of 5 the initiatives we see going forward. It's not, you 6 know, a complete look, but I wanted to give you a sense 7 of kind of what we had in mind, and some of the areas of 8 focus that I had already identified in my brief tenure 9 thus far as the new director. 10 CHAIR TAGAMI: Thank you. 11 COMMISSIONER SMOLIN: Thank you. 12 MR. O'NEILL: Any questions on that or ...? 13 COMMISSIONER SMOLIN: No. CHAIR TAGAMI: Commissioner Smolin? No? 14 15 COMMISSIONER SMOLIN: Thank you, Director. None for me. 16 17 MR. O'NEILL: Okay. 18 CHAIR TAGAMI: Mr. O'Neill, before we roll into 19 the financial statements, I want to thank you for your 20 report. 21 It's clearly a broad and thorough report, 22 though you referred to it as "brief." 23 I would tell you that there are a lot of 24 concurrent tasks that we see there in your report. And as we look at the alignment, I think that's also in 25

alignment with what the Commission is charged with by way of its regulations, to make sure that, in essence, we stay not only in compliance, but we evolve to meet the challenges of the day.

So I would say that we need to find the most constructive way that we can support those efforts. I think that we often hear the phrase "you have to think outside the box." But I think sometimes what we have to do is think inside the box first. So I think your evaluation shows that you've exercised that diligence.

So I think, rightfully so, what I would make a recommendation, that we could maybe address it at our next or future meeting from the Commission's side, is looking at how we can align some of our work to make sure that we meet at a very positive place to take the Lottery forward.

So with that, what I would suggest is, if you could, at our next meeting, provide some of a timetable of some of these actions that you've proposed in your ongoing work so, in essence, we could have a follow-up report, letting us know how that's tracking. And as we start to look at any of the current framework -- if you want to call it the constraints, or what the rules are that we currently govern the Lottery by, we would then be able to do some forward planning to set a policy on a

1 broad basis instead of a case-by-case basis. 2 MR. O'NEILL: I appreciate your comments. 3 There is a lot going on, I agree with that. 4 And I think right now, the best thing would be, our 5 leadership team is currently in our budget-prep process. We're all identifying major initiatives. We haven't 6 7 fleshed them all out yet, but we're basically identifying 8 major initiatives we want to go forward with for the next 9 year. 10 So what I'd like to be able to do, maybe at the 11 next meeting, would be to present you just with an 12 outline, roughly, of those initiatives, and maybe the 13 rough timing of those and sequencing of those in terms 14 of priorities, to make sure that those align with your 15 priorities. And along the way, if we do see any impediments in terms of our current regulations, or even 16 17 potentially legal changes down the road, I would be glad to bring those up to you for consideration. 18 19 CHAIR TAGAMI: Thank you. 20 And with that, the fiscal 2010-2011 --21 MR. O'NEILL: As a former auditor, this is 22 always the height of the event. 23 Every year --24 CHAIR TAGAMI: You and Commissioner Smolin. 25 MR. O'NEILL: Yes, every year people look

forward with bated breath.

The only thing better than this is the auditor's Christmas on April $15^{\rm th}$.

But basically, by state law, we're required to have an independent audit every year.

KPMG audited the financial statements this year. Basically, we got a clean bill of health.

Basically, it's a clean opinion regarding how we conduct our financial operations. And there was a few topics in a management letter which were minor, but we'll talk to those. But the financial opinion on our financial statements was clean.

Just a couple noteworthy things: It shows that in fiscal year 2010-11 we transferred 1.12 billion dollars' worth of money to California's public schools and colleges. Also, though, we also paid out \$1.9 billion to prize winners, and we gave \$233 million to retailers out there in the field. There is a lot of economic activity which comes out of what the Lottery does, and we think that's very helpful for California.

And I didn't want to go too much more into that unless you wanted to take a look at the detailed financial statements.

CHAIR TAGAMI: Commissioner Smolin?

COMMISSIONER SMOLIN: No, I have -- I've

reviewed them pretty thoroughly. I think they look 1 2 I have to concur with KPMG there. great. 3 CHAIR TAGAMI: Good. COMMISSIONER KIRTMAN: I agree. 4 5 CHAIR TAGAMI: Okay. 6 If I could, just one quick comment, and then we 7 can move on. 8 The actual direct and indirect employment 9 benefit created by this economic through-put would be, 10 I think, some good statistics, just to understand. And 11 that might be already in hand. I don't know if, from an 12 economist's perspective, if the Lottery is been using 13 IMPLAN or anything similar, so we can understand what our 14 direct and indirect is. It would be just helpful for the 15 future. MR. O'NEILL: I think it would be very easy to 16 17 use the IMPLAN statistics to generate some analysis like 18 that, just to give a rough sense of also where we are 19 today. But if we grow the Lottery, we'd have some kind 20 of -- I'm an old hockey player, so I talk about 21 hockey-stick growth. But basically, if we could do some 22 of these hockey-stick growth, what the impact of the 23 increasing sales would do on jobs in California, and 24 economic benefits. So I think that makes sense. 25 CHAIR TAGAMI: Okay, thank you.

MR. O'NEILL: Okay, with that, I'd like to introduce Jim Hasegawa from our Business Planning area.

MR. HASEGAWA: Good morning, Commissioners.

My name is Jim Hasegawa, and I'm currently the deputy director over the Business Planning and Research Office.

I've been with the California Lottery since

1989 -- a little over 22 years -- in a variety of

positions. Actually, primarily in the Sales and

Marketing division.

In addition to myself, there are a total of eight staff in the unit. And we're responsible for -- kind of, this is our role. We're responsible for these things: Analyzing trends in our sales data, the buying behavior of our players, attitudes among consumers, and sales in other Lottery jurisdictions.

With this information, we identify strategic opportunities for increasing Lottery sales. And we manage the planning process by working with all the other divisions here at the Lottery and, of course, the Director, and compose the actual business plan.

We monitor the performance of the business plan to various metrics. The number of metrics that we're able to track has grown, as you'll hear later this morning, through a presentation by Ellen on our

business -- information business analytics.

And we provide general market research services for the Lottery. For example, we conduct market research studies that pretest Scratchers® game concepts. When the Product Development group has an idea, we actually test it with our players, to try and estimate what the sales potential of that game is.

And we also conduct other studies, for example, to pretest advertising campaign ideas before they're actually produced into television commercials; again, to understand how players would perceive those and how likely they are to motivate people to purchase Lottery products.

So now for an update on Lottery sales. And this is through February 4th. And it covers the first 31 weeks of our current fiscal year. At over \$2.34 billion, total sales are more than 19 percent ahead of sales last fiscal year, through the same time period. And importantly, we're meeting our sales goal -- our year-to-date sales goal. In other words, we're exactly where we anticipated being through the first 31 weeks of this fiscal year.

Looking at other lotteries, our sales are growing at the fastest rate. For example, in calendar 2011, our sales were 22 percent higher in 2011 than they

were in calendar year 2010. And that's the highest percentage growth of any lottery in the country.

Now, the most recent quarter for October through December, our sales were 32 percent higher than the same quarter last year; and that, again, is the biggest percentage gain in the U.S.

I should point out, however, that even with all of this news, California ranks just fifth in total lottery sales, even though it has the largest population. The New York Lottery actually had the largest sales during the calendar year 2011 at \$6.8 billion. And our sales for that time period totaled over \$3.8 billion.

Now, we're going to look at sales and some game history, to give some background to you for each of our product categories.

And we're going to start with MEGA Millions®.

In terms of sales, it's our second biggest product behind Scratchers®. And this is a game that's played in multiple U.S. states. What happens is that a portion of all sales goes towards the top prize or the jackpot. And with a large population base, the jackpot can get rather large.

We joined, in June of 2005, and became the twelfth state in the MEGA Millions® group. And we joined, really, to help counter some lagging sales in our

own game, SuperLOTTO Plus®.

And you should know, for information, there is another multistate game called "Powerball."

In terms of the history of the game, you can kind of see, it's had its ups and downs. But since 2010 -- fiscal year 2010, we have really seen sales grow.

And last fiscal year, MEGA Millions® became the second largest -- in 2010, excuse me -- MEGA Millions® became the second largest product in our portfolio. And in 2011, it had its largest year for us.

Now, this game is now sold in all lottery jurisdictions in the U.S. except Florida. So there's a total of 44. And the largest jackpot to date is \$380 million. And that draw occurred back in January of 2011. It created quite a bit of sales and quite a bit of -- a lot of publicity.

But what really drives the sales in MEGA Millions®, as seen by this chart, is a really big jackpot. You know, when there is no ticket that matches all the winning numbers, the funds in the top prize roll over to the next draw. And when that happens over several weeks, the jackpot ends up getting into the hundreds of millions of dollars.

And you can see that, from the chart at the top there, sales really begin to increase as it approaches a

hundred million dollars, and really takes off once it gets to the \$200 million level. And those sales are the sales just in California. So you can really see that the large jackpots really drive the draw sales. But not just the sales for an individual draw, but the number of these big jackpots that occurred during a fiscal year, that greatly impacts what the sales will be for MEGA Millions® in that fiscal year.

So, for example, last fiscal year, as you can see at kind of the bottom table there, we had two draws where the jackpot exceeded \$300 million. And in addition to that, we had four other jackpots that were between \$200 million and \$299 million. And because of so many occurrences of these big jackpots, we had our largest sales ever for MEGA Millions®.

Now, through February 4th, MEGA Millions® sales have totaled \$288 million. And this year, we have only had one jackpot over \$200 million. It was actually a \$206 million jackpot. And that's the reason why sales are down 12 percent this current fiscal year, to date, through last year, the same time period.

And we currently also stand at just 93 percent of our yearly -- year-to-date sales goal. That's primarily because of the lack of large jackpots.

And since we can't predict when the big

jackpots will occur, because they're all based on random chance, the annual sales goal in this case is just divided up by 52 weeks. So it's just taking the annual goal and dividing it. And, again, that's why we stand at just 93 percent, because we haven't had any large number of large jackpots yet.

Now, while we've only experienced one jackpot in excess of \$200 million this year, in the past, we've averaged about five of that size for each of the last four fiscal years. And this year, we budgeted four occurrences.

In terms of some positive news for MEGA Millions®, because of changes in our advertising strategies, this fiscal year and also in fiscal year 2011, we're seeing bigger sales for moderate and large jackpots.

In this chart, you can see that the purple bars representing fiscal year 2011 and the yellow bars representing the current fiscal year are much taller than those in prior years, because our sales are much higher now when we get to jackpots approaching a hundred million dollars, and larger jackpots, like \$200 million.

The reason why the yellow bar in the far right, the \$200-million-and-up category is shorter, is because

this year, the largest jackpot we have had was \$206 million. And you're comparing that to last year, where we did have jackpots that were significantly larger than \$200 million.

But what we've done with this advertising strategy is, when jackpots get above, like, \$50 million, we've increased draw sales anywhere from 40 percent to 80 percent over the last three years. The larger numbers tend to be where the jackpots are larger. The 40 percent is when the jackpots are more in the 50- to 75-, 100-million-dollar range.

And it my understanding that at the next commission meeting, our presentation, our advertising program will occur, and you'll be able to see how these advertising strategies have increased the MEGA Millions® sales.

Moving on to SuperLOTTO Plus®, this game started in October of 1986. It's been around a long time. But it has evolved because the game design has actually been changed three times during the course of its history.

At times, this was our number-one selling product. And the largest jackpot in SuperLOTTO Plus® history is \$193 million, and that was just only played within California. And that occurred back in February of

2002.

As you can see, the game has had its ups and downs over the years. It is responsive to game changes. You can see in the mid-nineties, there were sales gains, when the game design was changed, and then again around in 2001 and 2002, when the game came to its current design matrix.

For SuperLOTTO Plus®, as you see, we've had years of decline after the launch of MEGA Millions®, because the games ended up competing against each other as large jackpot games. And also, consumers really didn't have a clear brand identification with one game or the other. But after years of decline, the sales have stabilized.

Sales through the first 31 weeks of this fiscal year stand at \$256 million. That is down 3 percent, compared to the same time last year. However, we are above our goal, and that's because this decline is much lower than originally anticipated, when we were projecting declines on the same -- kind of the straight line that you see there. And as a result, since our declines have really stabilized, we are actually ahead of our pace for the goal.

This game now has really changed. It used to be a much more jackpot-driven game, much like MEGA

Millions®. Today's sales are much more stable. They do not rise as much during large jackpots. But, actually, when we're at very low jackpots, the SuperLOTTO Plus® game actually sells more than the MEGA Millions® game, even though the MEGA Millions® would have a larger jackpot. MEGA Millions® really takes off, once again, when it gets like the \$100 million, \$200 million mark.

Our Daily Games, as a category, it's composed of four games: Daily 3, Daily 4, Fantasy 5, and Daily Derby. And for this category, sales are at \$201 million through February 4th. And that's up about 3 percent compared to the same time last year. And, again, we are ahead of goal, so we're doing pretty well in that game.

Fantasy 5 and Daily 3 are the main reasons for this increase. Those games are up, versus last year. We've seen some migration from Daily 4, back to the Daily 3 game.

And Fantasy 5 has increased sales because of some in-store LED signage that showcases the top prize.

And so we do see when the top prize is getting promoted -- it's a much smaller prize than Lotto, but it's a game that's much more winnable -- players respond.

All of the Daily Games have a very small player base. There isn't as many people playing these products

as compared to SuperLOTTO Plus®, MEGA Millions®, and Scratchers®.

For Hot Spot, although you'll be hearing more about Hot Spot in the next presentation from the Product Development group, I want to discuss a little bit about the recent sales.

After many years of declining sales, last fiscal year saw Hot Spot sales increase by 10 percent due to promotions. And that was the first increase we've seen in a while. And this year, sales are at \$77 million; and that is also up from last year's sales pace through the same time period.

Currently, the game is just short of its year-to-date sales goal. It's about \$1 million short right now. But Hot Spot sales this year are up due to some changes to the basic game, even though there are actually fewer promotional days this year than last year. So that bodes well for the product.

Now, for the biggest news -- the product with the biggest news. I decided to save that for last, and that's on our Scratchers® product line.

Now, Scratchers® -- this is the game that debuted when the Lottery first started in October of 1985, although I think -- back then, I was actually a Lottery player; and it looks much different now than it

did back then in 1985.

As you can see, it's the game that has had the most dramatic rollercoaster ride in terms of sales, and that's because Scratchers® are very responsive to product enhancements. For example, when the product was first launched, and for many years thereafter, there was just one single Scratchers® game sold at a time. There wasn't any multiple games, variety, and so forth. And then sales started to decline after the novelty wore off.

If you notice in the early nineteen-nineties, sales started to gain; and that's when multiple

Scratchers® were first introduced, so that players had variety and choices, actually, in the marketplace. And they responded by buying more products.

(End of Tape 1-A. Start of Tape 1-B.)

MR. HASEGAWA: -- category is our number-one product, and accounts for about 65 percent of total sales this year.

Now, I've talked about how our Lottery sales have been growing at record paces within the U.S. Lottery industry, and it's because of our Scratchers® games.

Our Scratchers® games have been growing at tremendous rates. And those are the fastest rates in the U.S. lotteries. For example, in calendar year 2011, Scratchers® sales are 35 percent higher than they were

in 2010. And that's the largest percentage gain in the nation. And to see the difference, if you go to the next states down, they're growing at percentages of about 16 percent, compared to our 35 percent. And those states are South Dakota and Illinois.

And as before, despite all of these gains, we want to point out that right now, we are only ranking fifth in terms of sales, in terms of the dollar basis.

We sold \$2.37 billion in calendar year 2011; and New York ranked first at \$3.5 billion.

And looking at sales at a per capita basis, as you saw from some earlier charts, for Scratchers® sales, California ranks 29th in the calendar year 2011.

Massachusetts is ranked first, and it sells at a rate of about seven times ours. So every man and woman in Massachusetts is buying about seven times the amount of Scratchers® instant tickets, in terms of dollars, than they do here in California.

Through the first 30 weeks of this -- 31 weeks of this fiscal year, Scratchers® sales are at \$1.52 billion. And this is 38 percent ahead of last year, the same time period.

Scratchers® are right on pace to meet their sales goals. And the large gains over last year can really be attributed to three major areas: First, the

product, things like increasing the prize pay-out in the \$5 and \$10 games; retail initiatives that you'll hear more about later this morning, which results in more retailers offering the newest and top-selling games for sale to our consumers; and periodic advertising campaigns in select markets.

The real dominant factor over time that's been growing our Scratchers® sales is really the rise of higher price-point Scratchers® games. And you can see that not only in the recent history, but in the last ten years or so, the rise of \$3 games, and then finally now, the rise of \$5 games; and in our most recent quarter, the rise of the \$10 games. That's really what's been accounting for our sales growth. The sales from the \$1 and \$2 games, albeit a bit smaller than they once were in the late nineteen-nineties. But you can see the total sales are dramatically higher.

Now, while I've been showing you sales through the first seven months of this fiscal year, I now want to provide you with some estimates on what our sales will look like come June $30^{\rm th}$ -- or at least our best estimates at this time of what they'll look like on June $30^{\rm th}$.

So, first, I want to go over some of the assumptions that go into that model.

On the Scratchers® product, right now, since sales are on pace at their current levels, we still believe that sales -- average weekly sales will rise from the levels seen in Quarter 2 at about \$54 million a week, to get up to the \$57 million a week in Quarter 4.

We've actually seen weeks get as high as \$60 million, even in this quarter.

The \$10 game will continue to sell well above our original projections.

And we'll continue to see sales gains from advertising flights that are planned, and continual improvement in retail key-performance indicators.

For MEGA Millions®, this estimate is based on just one more sequence, having a jackpot of \$200 million or more. And that's actually below what we originally projected in our budget.

And then for our other games, those sales estimates are pretty much just based on current trend analysis.

So with that, let me show you the numbers.

In terms of Scratchers®, we see that sales will end the year at about just slightly above the original goal. They'll be about \$2.705 billion. And that will represent a 35 percent increase over last fiscal year's sales of just over \$2 billion.

For MEGA Millions®, we're projecting about \$510 million for the year. While that is a decrease of 5 percent from last year, it's due to the fact that we are having fewer -- we're projecting fewer big jackpots this fiscal year.

Obviously, if there's rollover luck and we see the average number of large jackpots, that number will go up significantly, particularly because our response to jackpots has gotten much stronger, as I showed you with some earlier charts.

And again, this is based on an assumption of just having two, over the course of the whole fiscal year, compared to what we budgeted at four.

For SuperLOTTO Plus®, \$417 million is what is anticipated. That is up from our original goal.

However, it is representing a 4 percent decline from last fiscal year. This decline of 4 percent is about half the decline seen last fiscal year. We've been seeing about an 8 to 10 to 12 percent decline year over year; and now this game has definitely been stabilized.

Daily games, sales are up a few million this year compared to last year. It's about an increase of 2 percent. Hot Spot will see sales finishing the year around \$139 million. That will be \$9 million over last year.

And as such, total sales will go from \$3.4 billion last fiscal year, to just over \$4.1 billion this fiscal year, an increase of 20 percent. And this estimate is about \$20 million higher than the original budget approved by the Commission back in June of 2011.

And, obviously, what is -- ultimately, what's most important is the bottom line, the dollars that we deliver to public schools throughout the state of California. This fiscal year, it's currently estimated at \$1.17 billion. And while it will be at least \$40 million over last year and \$120 million over fiscal year 2008-2009, which is designated in AB 142 as kind of our base year of comparisons, it is a bit lower than the goal of \$1.19 billion. That was presented and adopted by the Commission back in June of 2011.

The key reason for this slight decline is the tremendous strength of our \$10 Scratchers® game. This game has a higher prize pay-out than other Scratchers® games, resulting in the overall prize pay-out to be higher than what was originally budgeted.

And, obviously, these numbers also don't reflect anything that our Finance division right now is working on, going -- working with all the various divisions on their expenditures, and monitoring those expenditures, and seeing what expenditures are going to

1 continue for the current fiscal year or not. So we will 2 be able to provide even a clearer view in a subsequent report at our next commission meeting. 3 4 MR. O'NEILL: If I could on that, Jim, just to 5 add to that. 6 Basically, we feel confident we're going to 7 make our top-line goal. And now, because of the fact of 8 the mix of games this year, as well as the lack of the 9 big -- you know, big prize games, we're going to look at 10 administrative efficiencies, and see if we can squeeze to 11 make the goal also for making the amount of money for education we had committed to at the beginning of the 12 year. So that's part of the equation we're playing with 13 14 in the next five months. 15 CHAIR TAGAMI: Commissioners, any questions for 16 Mr. Hasegawa? 17 COMMISSIONER SMOLIN: Not at all. Thank you. 18 COMMISSIONER KIRTMAN: Thank you. 19 CHAIR TAGAMI: Thank you. 20 A report from Ms. Furtado and Mr. Fong on 21 Product Development. 22 MR. FONG: Good morning, Commissioners. 23 My name is Ed Fong. I'm currently chief of 24 Product Development in the Sales and Marketing division. To my right is Liz Furtado, who manages the 25

Scratchers® product line. And you'll hear more about the Scratchers® product line after my presentation here.

Some background on myself: I've been managing this unit for about four years right now. I graduated from San José State University in about 1983 -- it shows my age -- with a B.A. degree in advertising.

Prior to joining the Lottery in 1985, I was employed by two different ad agencies in the Bay Area. So my entire work experience has been in the sales, marketing, and advertising arena.

Now, a little background on the Lottery's

Product Development unit. When we say "create and launch
the Lottery gaming product," that means every Scratchers®
game and draw game that you see in the marketplace either
originated from this unit, or this unit was instrumental
in the development and launch of those games and
programs.

Product Development staff designs the tickets and game graphics, and develops the prize structures, and even created some of the promotional extensions that you might have seen, such as the second-chance drawings for Scratchers®.

Our team is comprised of two different areas, the first being draw games, which includes the jackpot games like MEGA Millions®, SuperLOTTO Plus®, our Daily

Games like Fantasy 5, Daily 3, Daily 4, and our monitor game Hot Spot, which is played like keno.

The other team is Scratchers®, or sometimes referred to as "instant games," which Liz will get into later.

Now, let's take a look at some of the major draw-game initiatives.

The first is our Lotto game analysis. Based on directions approved at the 2011 October Commission meeting, staff is taking a wait-and-see approach; but we're still actively gathering data on the impact of adding a \$2 Powerball game to our product mix. And we should have our analysis completed by July of 2012.

For SuperLOTTO Plus®, like Jim was mentioning, this is the first major draw game introduced by the Lottery back in 1986. Since then, SuperLOTTO Plus® has gone through many iterations over the years. And it may not be such a jackpot-driven game anymore, but sales have stabilized and we are ahead of goal, which leads us to look at ways to drive transactions and purchase and increased frequency of play with our players. This has a very strong player base, or loyalty.

The tactic that we're recommending is to provide a value-add incentive to players. This value-add incentive is a second-chance program. They utilize the

program abilities for a new public Web site. Players will have an opportunity to register their entries online for a chance to win prizes throughout the year. We anticipate this program launching the first quarter of next fiscal year.

For monitor games, we have Hot Spot. This game has also gone through some major changes since its beginnings in 1992. Last fiscal year, though, we thoroughly analyzed this game, and determined that several ongoing tactics are required to move this game forward.

First, we need to identify the optimum base prize pay-out level. We need to continue running promotions with varying pay-outs and prize-structure configurations to determine what that optimum prize pay-out should be. We have also identified some other potential prize pay-out designs, and will run these concepts this fiscal year to fine-tune that potential new prize structure for this game. We expect to have a recommendation to commissioners early next fiscal year on this.

The second, is develop a new monitor-type game and/or features to freshen up this product category. It creates a better product, and a possibility of recruiting new retailers. This is also an opportunity to generate

some positive retail chatter to sell the benefits of this game to other retailers.

Which brings us to the third point: Servicing these retailers more effectively. We are taking steps right now to create a better product. And having a more impactful service plan is essential to maximizing this investment.

The good news for Hot Spot, though: Our sales are running slightly ahead of last year. With this, some of these subtle changes are making some positive strides. We're adding more spots to include a complete 10-spot game. We slightly raised the base pay-outs already. And we are reinforcing the type of prizes that players can win on the monitors. The monitors actually display the actual games so they can watch while they're winning.

We're also adding some winner-awareness messages on those monitors, too.

So basically, the attention that we're giving to this game is working.

For MEGA Millions®, like Jim stated, this game is the second highest-selling game in our game portfolio, and continues to be a jackpot-driven game. The main reason why we're experiencing a sales decline, of course, is the lack of large jackpots compared to last year. However, recent research studies, our players don't have

that strong emotional connection with this game. In fact, most players don't really associate themselves positively with MEGA Millions®. So the appeal and strength of MEGA Millions® is really the large jackpots that this game can generate.

To change this type of behavior, though, we need to build an emotional connection for this game with our players through a more focused communication effort, which Leticia Saldivar, our chief of Consumer Marketing and Advertising, will provide to the Commissioners in next month's meeting.

That, in a nutshell, concludes the major initiatives for draw games.

Are there any questions?

CHAIR TAGAMI: Commissioners?

COMMISSIONER SMOLIN: None. Thank you.

MR. O'NEILL: If I could just add one thing in terms of what's coming up in the near future, is the \$2 Powerball. As you've seen across the country right now, it took off because it had a huge jackpot, most recently. And the commissioners will have, in the next few months coming before them, the most recent, you know, analysis, estimates coming down the pike in terms of what Powerball could do.

So I do think, in the near future, in the next

1 few months, the Commissioners are going to have to take a 2 real look at the \$2 Powerball game, and to see if 3 California wants to play. 4 CHAIR TAGAMI: Thank you, Mr. Fong. 5 Ms. Furtado? MS. FURTADO: Good morning, Commissioners. 6 7 Liz Furtado. 8 Let me get to the next screen here. 9 I work in Sales and Marketing, and I'm the 10 Scratchers® product manager. 11 I've been with the Lottery over 25 years, and 15 of those years specifically working on Scratchers®. 12 13 So primary responsibilities include the creation of the 14 annual Scratchers® product plan for all game launches, 15 price points, pay-outs, and themes. I also direct and manage all Scratchers® games and track sales performance 16 17 for each game. And we typically launch between 48 to 50 games a year. 18 19 I also provide marketing direction to the sales 20 team on an ongoing basis. 21 So some of this year's initiatives included the 22 focus on growing the \$5 games. We increased the overall 23 number of \$5 games launched from three, back in fiscal 24 year 2009-10, to the current nine games that we offer

25

this year.

We also expended our \$5 game offerings by launching our first \$5 Mega Crossword game, and this game has remained a best seller since its launch.

Increasing our \$5 game ticket size from 5-by-4 to 6-by-4 provided that extra space for additional play value, with extra chances to win. And this is an important feature for our \$5 players.

Another big initiative, of course, was launching our long-awaited first \$10 game. \$250 million Cash Spectacular focuses on the total number -- or total amount of prizes contained in the entire game, or all the tickets that were printed. It's our largest ticket, measuring 8-by-4, and has the highest pay-out currently offered at 73 percent. This game also includes lots of \$100 prizes, which players at this price point deemed very important, as concluded in our research findings.

This game also has 31 \$1 million top prizes, which are not annuitized, so they are paid in one lump sum after taxes.

The special holographic paper also adds to the unique look and appeal of this game, and definitely stands out at retail.

We also revamped our prize structures to ensure that prize levels were being maximized. For example, by replacing a \$12 prize with a \$10, we were able to

reinvest the extra \$2 in other prizes to create more wins and improve the overall odds of the game. Improving pay-outs in the \$5 and \$2 games also allowed us to create more wins and target specific prizes and odds.

Another initiative that we undertook was to improve our game-development process and make it more efficient. We created price structure templates, also known as "core profile templates," that are used multiple times for games rather than creating a unique price structure for each and every game. These templates have been approved by the Commission over the last year, and contain prize levels, price points, and pay-outs.

Staff matches the template ID to the type of game being launched, and the other components of the development process continues from there.

As a result, this one change has strongly improved our process, allowing staff to be able to be more productive.

Another component of our game-development process is the ongoing game-concept research that Jim mentioned, prior to launch. This has proven very beneficial, and has limited our liability in the area of launching underperforming games substantially.

Planning for next year is still underway.

However, here are some of the areas that we are focusing

on.

And, of course, continuing the growth of our \$5 games is a very important strategy for next year as well; and we looked to add more \$5 games to the number of games being carried by retailers, possibly increasing this from five to six. And we're considering launching another -- or a total of ten \$5 games next year, which is our all-time high to date.

In addition, we're researching which \$3 game themes lend themselves to players playing \$5 games with the same theme. Recently conducted research has already shown that introducing a \$5 game instead of a \$3, with that same, specific theme, could provide a sales increase overall.

Our \$10 games will also be an important part of generating more sales. We expect to launch another \$10 game next year; and research is already underway to provide us with more direction in this area.

We will also consider the number of \$10 games in market. Currently, we only offer one. However, player demand and possibly changing the dispenser layout could mean that we're able to offer more than one at a time.

Knowing players want the most fun and excitement for their money, we are also looking to add

	Camorina State Lottery Commission Meeting 1 cortain 25, 2012
1	more play value to all prize points in order to keep our
2	loyal players and also attract new players into the mix.
3	This will be achieved by adding extra chances to win,
4	more bonus areas and quick wins or fast-spots on our
5	upcoming game.
6	This concludes my presentation.
7	Are there any comments or questions at this
8	time?
9	CHAIR TAGAMI: Commissioners?
10	COMMISSIONER SMOLIN: Thank you, Liz.
11	COMMISSIONER KIRTMAN: Thank you.
12	CHAIR TAGAMI: Well, it must be fun to be the
13	team working on the number-one revenue generator. So
14	keep up the good work.
15	MR. O'NEILL: In the country.
16	CHAIR TAGAMI: In the country? Whoo.
17	MS. FURTADO: Yes, thank you.
18	CHAIR TAGAMI: That's right.
19	That's well said.
20	With that, Sales and Marketing from Michele
21	Tong?
22	Good morning, Michele.
23	MS. TONG: Good morning.
24	Well, you've heard from the, I call it, the
25	tangible half of marketing; and I'm going to talk about

the front-liners and sales. The next Commission meeting, you'll get a presentation from Leticia Saldivar on the consumer advertising and player promotions.

So a little bit about myself: I've been with the Lottery since start-up in 1985. I started as sales representative. Moved over to key accounts. Went up to headquarters in regards to doing work with the retail marketing and merchandising side, then stepped into the sales management in the field. Field operations chief. And, lucky me, now I'm the deputy director of Sales.

I feel, with my background, I serve as a technical resource for field and retailer networking for all of senior staff to ask me questions.

The role of the salespeople is very key. They take everything that you've heard and bring it to market. And it's really important on the education piece, not only to themselves, but to the retailers, because we are teaching them about enjoying being part of the Lottery family.

So our public mandate there, our mission statement is very critical. And we review it often, because we have to have heart in what we sell. And so we do raise sales -- that's our number-one thing. But we have to look at our bottom line. Because if we don't kick back money to public education, we aren't going to

be here.

So with some of our programs, we are striving to reach the high numbers, and yet remain extremely profitable.

The role of Sales is to develop and service the Lottery's retailer network. And with that, we have four very distinct but separate coordinating units.

The first one is our largest. With over 300 staff in sales, 75 percent of them are in our field operations unit. We have a northern and a southern section. And with that, there are nine district offices, as Bob said, who handle the over 21,000 retailers. And they are responsible for managing the network in regards to delivering the point-of-sale materials and helping retailers understand how to sell the product, merchandise the product, and how to improve the image of the Lottery by making sure they point out the features of the games and why it's beneficial for the public to buy it.

Key accounts is the next segment. And they work directly with corporate chain executives, such as 7-Eleven, Chevron, Safeway, Vons Supermarkets. And they also develop programs and sales-building activities through the chain offices, and they work them down the line.

Retail network and also key accounts does trade

relations. And they work with our various retailer trade groups, such as the California Independent Grocers

Association and the 7-Eleven Owners Association. Very large groups.

The retail network management is sort of the back-office area that deal with all the maintenance of our retailer master file, the application processing, the actual installation of our equipment, coordinating with GTECH. And then also doing the promotions and incentives, development and analysis.

We also have two distribution centers that fall into that network management unit: A northern and a southern, who are responsible for distributing all the Scratchers® products that Product Development creates.

And finally, our Scratchers® inventory management unit, that actually creates and manages the inventory levels at retail.

Current sales activities that we're working on:
We have five, and that's an important number for sales -and I'll explain later on -- five key programs are
running.

The first one is our Scratchers® Inventory

Management center pilot. And that, we refer to, as our

SIM center. What they're working on is developing

improved order processing. And we are going to it go

through a network change in regards to our gaming system. So that's going to be a challenge for us. But we see some great improvements in getting the right product, at the right time, to the right retailers.

The next project we have is a Scratchers® distribution assessment. And it is a real critical time for us. As we move forward with rapid sales growth, we have to keep up the pace in order to make sure we deliver the products to them. And so we are assessing, with our two distribution centers now, cost optimizing and how much we can max out, and what we need to do in order to get to our sales objectives, which are reaching up to the \$5 billion mark.

The third one, Scratchers® equipment optimization. Here is what we're looking at, number one, our remaining pieces of Lottery equipment, both Scratchers® and draw; and seeing where to best place them, not only within retail, but within our network.

Finally, the key account services in communication project. And here's where we've evolved how we service these large chain accounts. We've focused on the top 11. And using a form of sales philosophy, Ex\$ell, which I'll explain in a minute, have actually changed the business for them. They're focusing on the same priorities that the Lottery has, which has been very

different for many, many years.

And, actually, finally, retail communications. We have a lot of mediums that we present information to retailers. And we are trying to make it where it's one voice: That they're all delivering the same message with good timing.

So Ex\$ell, which I had mentioned before, it's a sales philosophy. And over 20 years of being a state agency, we have a lot of procedures and programs that are kind of viewed by our retailer network as very bureaucratic, and most importantly, by our sales staff, as "Is it really needed? How does that really bring in sales?"

And so in the last two years, we have taken a look at the way we do business. And we have actually reformatted our thinking, our philosophy, to focus in on the sales-building activities.

So if it doesn't generate revenues, we ask questions: What does it do? And if we can't answer successfully that it does do something in that positive note, we let it go. And we have let go many, many reports, many things that we thought were necessary. But in reality, if we haven't done it in two years, guess what? Don't need to do it.

What we have them do, though, is focus on some

key priorities that meet our business objectives.

The first thing is keeping the bins full, or the Scratchers® facings at retail. If you can't see it, you're not going to buy it.

After that, the next move is maximizing Scratchers® activations. It's really key that we introduce new games every month. We are still working on retailer education; but the faster we can get our retailers to activate the new games, studies have shown, players go in to buy new games. So it's speeding up as soon as they receive it, activate it, and put it on display: A challenge that we take on every month to improve our key performance indicators, our numbers.

And we're talking about bottom-line revenue. By golly, we're focusing on the \$5 games. The \$10 game is absolutely phenomenal. We outdid everything we ever thought we could do. And we were scared when we first started, saying, are we going to be able to do it? But guess what? We did.

And now, we're working on making sure our bottom line is on par. And so the \$5 price point is very valuable to retailers because they know players have, for years, been asking for \$5 games. We have introduced one, and then we wait a year, introduce another. Because we couldn't afford it. And now that we can afford multiple

\$5 games, that's the one we're focusing on, a meat-and-potatoes version.

So right now, five \$5 games is what we're hoping every retailer will have faced.

With that, every quarter, we have a great advertising campaign. And so focusing on external POS is absolutely vital. Why? Because after they see the advertising, they hear the radio, they're going to say, "Okay, that sounds good." Well, we have to make it easier for our players because Scratchers® is very impulse-related. You have to point out where you got to go buy them. So we have to make sure our logo is front and forward, so they can easily have that message.

And right now, we're introducing the fifth component, and that is really talking about our equipment. We have to pay more attention about where it's placed in retail. You know, we're still testing under the counter, on top of the counter, behind the counter. It varies, depending on the trade style. So finding the right merchandising technique for the trade style and for that particular retailer's selling personality is what we're focusing on.

Now, to get all that done, not an easy task. It's been two and a half years. What we found key is, we tested a lot of these concepts. In a three-month

test, in one district office, the Bay Area, San Francisco.

And as usual, we try to put so many items that we try to make work. And what we found, that of all the things we've tested, there were some key principles, which I just went through on that circle of life there. But the one thing that made it work is, we dedicated all of our resources in that one office to make it work. And what we found? The answer. We need additional supervisors is the classification. But I like to refer to them as coaches.

Our salespeople, for so many years, are out there, literally representing the Lottery, and becoming one-person armies. And with the supervisor, or the coach following them, they help identify things that they might have missed, pointing out, "Hmm. I think we have an opportunity. Where do you see that we could increase the number of games carried? How could you convince the retailer to activate this or merchandise that?"

And the coach is just the additional eyes and ears to help drive the message at each and every call, because we need to be more disciplined on that; and also to help our salespeople realize that they're going to have to speed up some of their calls on lower performers, and take more time on calls that are with the higher

revenue generation locations.

So on that, thanks to the lottery gods, we are able to have additional supervisors come into our network. We are so excited about it.

Number one, you know a lot of them are going to come up through the ranks, the sales representatives who have proven that they got what it takes but also, they're willing to share that information.

We're also going to get some brand-new people into our network who have absolutely no clue about Lottery, but have the techniques that make good supervisors.

Then, from the DSRs, we will have some vacancies. And we've been given a blessing to fill in those vacancies of those vital salespeople with the next level, which is our route sales representatives, who might move up the rank.

What does that do? It leaves us vacancies in the route sales area. So we'll probably have some new staff coming in at that rate, too.

So those simple 13 positions equate to a lot of impact. And what's vitally important to make that program work is to train and develop this staff, because they're coming in not only from the outside, but they're coming up through the ranks, and they could be the future

people that you're going to see standing up here.

Future projects, after all that, that we have down the pike, are "five." "Five" is very important to sales: Five dollars, five facings, five programs.

The first one is the retailer servicing visitation refinements. And I mentioned that briefly. We have to focus on, number one, the people who are doing the business for us; and identifying those who are the most potential for improving.

Next, is the retailer incentives and in-store promotions. Well, I spoke a lot about our salespeople. We also have to focus on our retailers. It's a 6 percent commission. It used to start at 5 percent. It doesn't sound real exciting when you do that because you have to work the numbers differently. If you have to say, "Well, if you do this kind of volume, here's what you take home."

There are more things than just focusing on the percent. It's the opportunities of making the Lottery fun and exciting, not only for our players, but our retailers. So we're going to provide them incentives in the very near future that will have them be part of the excitement.

Expansion of successful SIMs pilot elements: What we did before, in testing in that one district

1 office, we want to roll out the successful components to 2 the rest of the state, just like we did with Ex\$ell. 3 Next is the network optimization. And this is 4 one where, again, we're going to be focusing on where we 5 are, where we need to be. And that's moving our equipment to the right retail locations throughout the 6 7 state. 8 Which brings us to our final, which is the 9 retailer recruitment on-boarding, where, like our sales 10 staff coming on board, we have retailers coming on board. 11 We need to get them up to speed, and fast, so that the sooner they are generating the kind of revenues they're 12 13 expecting, and continue to succeed in the right area, 14 they'll tell their friends. And we'll have better 15 retailers and more of them. Because, as Bob says, we're ready to go. 16 17 And that concludes my presentation. 18 If you have any questions? 19 CHAIR TAGAMI: Commissioners? 20 COMMISSIONER SMOLIN: No. 21 Thank you. 22 COMMISSIONER KIRTMAN: Thank you, Michele. 23 CHAIR TAGAMI: Thank you. 24 Michele, that was energetic, and I'm ready -just, I don't know, I'm ready to go do something now. 25

1 You've got me all fired up. 2 MS. TONG: Thank you. 3 CHAIR TAGAMI: Okay, Ellen Ishimoto? 4 MS. ISHIMOTO: Good morning, Commissioners. 5 I'm Ellen Ishimoto. I'm the deputy director of 6 Information Technology. 7 I have here my handy assistant -- no, John 8 Reilly. He is over Online Marketing. He'll be joining 9 me in the presentation in a moment. Okay. 10 Okay, a little background on me. I've been 11 with the Lottery for a whole six and a half years, but I've been with the state for 26 years. I've been in 12 13 I.T. for over 21 years. 14 I.T., Information Technology Services Division, we are responsible for all the technology here, whether 15 or not it affects our players, our retailers, or Lottery 16 17 employees. So we are the invisible people, too, that supports all the other people that presented today. 18 We are split up into two different offices. We 19 20 have application services, which supports our business 21 applications; and naturally, we have a vendor-management 22 group as well. And those people are the ones that help 23 support and work with those vendors that provide external 24 support for these applications -- or, actually, are providing these applications to us. 25

Infrastructure is really more internal facing. It's within the Lottery district offices and the data centers. And here at headquarters, it's providing desktops, phones, things like that to the Lottery staff, as well as all the network and servers and the behind-the-scenes infrastructure for Lottery internal operations.

Today, I'm just going to touch on three major initiatives that we've been working on in I.T., along with our business partners.

Business Intelligence and Business Analytics, as Bob had mentioned, we call it "BIBA." We have been partnering with Jim Hasegawa's Business Planning and Research group.

The gaming system upgrade is a project that affects the majority of the divisions in the Lottery that we've been working with.

And the new public Web site, we've been working very closely with Online Marketing.

So BIBA. Simply -- not so simply, I guess -- we're saying, it's really a set of tools and processes that really helps us organize Lottery data. It allows easy access to that information, so we can enable real efficient decision-making. And it really transforms that data into actions. And so we're really excited to see

how sales is using this; and it really is turning things into a real tangible actions that are taking place in the field.

Right now, we currently have -- we offer reporting analysis for all product sales and distribution. So this includes all our product portfolio. It's Scratchers® tickets and draw games.

We are focused on supporting headquarters, specifically sales and marketing and research planning -- business plan and research, excuse me.

The future, as Bob mentioned, is we're going to be getting information out to the sales staff, so they can make those decisions out in the field.

The other thing that we're going to be doing, is really expanding the system to have more data besides just the gaming-system data; but also financial systems. The goal, the vision at one point, is to actually use this as the source for doing all types of reporting and analysis across the Lottery for all our systems.

Gaming system upgrade: First, I should explain what the gaming system is. It really is an integrated system that includes the core system, which is really what the retailers are using. When players are actually wagering, we actually are using this core system to do that. It also is made up of administrative systems.

It's all these back-office systems that the Lottery uses to manage gaming-related operations.

The real benefit of doing the upgrade -- and we've talked a lot about our increased sales growth. We knew that was coming. We knew that we needed to have a more robust gaming platform, to be able to support that increased sales growth, as well as, really, to enable us to add in functionality.

STECH is the one that actually runs our gaming system. And we have been -- there are a lot of functionality that we'd like to add into our system; but we have an older version of the system. So we wanted to get to the latest and greatest because we wanted to be able to make sure we could handle all the sales volume. Our launch date for that is going to be April 1st, 2012.

Okay, last but not least, our new public

Web site. We're excited about this. The design of it is

to be very player centric. We wanted to engage players;

make it exciting, optimistic, fun to come visit us at the

Web site. We want people to actually then play and

purchase Lottery products.

We also wanted to build a technical architecture that's going to be able to allow the Lottery to really start incorporating new functionality quicker than we can in our current Web site.

We are working on our final preparation steps to launch the Web site. Our future plans is going to be really developing a second-chance program for draw games. It's something that in the Product Development Group, we'd really like to see us create on the Web site.

We are going to be delivering the next real phase of player loyalty that Bob was also mentioning. We're also going to be looking at, really, integrating some robust mobile applications, to offer even more functionality to our players.

I'm going to then turn it over to John, to actually have him show us the public Web site.

MR. REILLY: So, "Player-centric public Web site," what that means is, when we went through the design and development process, we used the point of view of the player in all our decision-making: What were the players' desires? What were they try to do, and how could we fulfill those wants and needs?

We know the main reason for visiting the Web site is for winning numbers. Depending on a jackpot scenario, we have anywhere from eight to twelve million visits a month. So because we know that players come in there, want to see the winning numbers, and then move out, and to make it a positive experience, we provided several sources for players to find those winning

numbers.

We all don't think the same way. We're not intuitively trained the same way. So there's lots of different ways to find those types of numbers.

Secondly, what we've done is, we've created a system where it's levels of information. High level of information, and then an easy process to start drilling down if the player wants additional information.

So let's go over the site just rather quickly. Being player-centric, the main navigation is all about playing the Lottery, engaging with the Lottery, and what the Lottery is all about.

So the first area, which contains most of the content, is our gaming or playing area. And as you can see, when you roll over the "PLAY" navigation bar, a fly-out comes out and gives you a quick snapshot of all the content that's in that area. And as you can see, draw games, all our Scratchers® are there -- our traditional games; and then we have our non-traditional games: Second-Chance, Replay, and Fantasy 5 Bonus Bucks.

We also have other ways to play. Our Jackpot Captain program which is pools of individuals getting together to buy tickets.

And one new feature we have is a game-finder. Based on your mood, you can go in and make some

selections. And that system will bring back a game that's probably right for you, and may be lucky for you to win today.

The next area is the "WIN" area. And this is all about winning. What happens if I win? What do I do? Winner stories. The winner's handbook is here. How to claim prizes is here. That type of information.

The next area is the "HAPPENINGS" area. And this is the way to engage with the Lottery, without playing the Lottery. So here, we have a lot of video content, which we call our "Lottery TV." This is where we also put up our events. We go out into the marketplace at different fairs and festivals and engage with the consumers. And this is where we list that activity.

The "GIVING BACK" area. This is all about education. This is a big section for Russ and his group. This is where we talk about where the money goes, how the money is used, how the Lottery is making a difference; and different partnerships we have with educational communities, and how we engage with those communities.

The next area is -- we call it "LUCKY RETAILERS" because we want some traffic in this channel. We do have lucky retailers, those retailers that have sold multiple-

million dollars tickets. But essentially, this area is our retailer locator. And the functionality being, it has Google maps associated. The player can put in the address of where they're at. It will provide them the nearest Lottery retailers that they can go make purchases.

One of the best changes to the new Web site is a single sign-on functionality. Our current system was somewhat awkward, in that when you wanted to go into our Second-Chance portal, you had to essentially surf away to a subsite. Multiple sign-in systems to get to the different games: Replay, Fantasy 5, Jackpot Captains, those type of things.

We now have single sign-on. Very easy for the player to come in and sign on.

That main bar, navigation bar is on every page. So signing on can be accomplished on every page.

We talked about "Winning Numbers." One of the better features on the new site is, we have a "Winning Numbers" tab. And that essentially provides a one quick-glance look for our players on draw-game activity and results. So we show jackpot amounts and we show winning numbers in a glance.

Let's get out of that.

Another area is our games bar area.

I'll scroll down here.

And here, we have our entire portfolio available to our players. And, again, in kind of a single glance away, but more of a selector to where the player can determine which game they are interested in, and make that choice. This also includes our Scratchers® game portfolio. And what we display when a player selects that, is our hottest-selling Scratchers®. And they can -- right from there, we talked about levels of information. They can go to the Scratchers® area in particular, where we have a promotion for the Hot Streak game. But we have the entire Scratchers® portfolio here. And a new feature on this site is that the player can select, by play style or newest games, or games ending soon, of which games they would particularly like to see and read about.

And, again, I won't go into it, but another level of information, as you roll over these games, we give them a quick synopsis of the game, they click on that game there, and it takes them to an actual detail page, which shows them all the prizes available, odds, and that type of thing.

So let me get back out of this.

So let me go back to the homepage and show you one more item. I know time is tight. And this is new to

1	Camorina State Lottery Commission Wieeting – February 25, 2012
1	this site as well. Again, all about information, all
2	about task efficiency.
3	We have a super-footer down at the bottom.
4	It's a series of "I" and "Me" type statements: What am
5	I looking for? Who am I? Show me. And with quick
6	links, they can get to the information they want very
7	quickly. And, again, task efficiency, move in and out of
8	the white Web site as they desire.
9	Any questions at all?
10	CHAIR TAGAMI: Commissioners?
11	COMMISSIONER SMOLIN: None from me. Thank you.
12	CHAIR TAGAMI: Thank you very much.
13	COMMISSIONER KIRTMAN: That was great.
14	MS. ISHIMOTO: Thank you.
15	CHAIR TAGAMI: Director O'Neill, did you want
16	to provide us any wrap-up or summary on all those reports
17	or should we just roll right into our consent?
18	MR. O'NEILL: No, I think what we were trying
19	to do today, was start to give you a feel for some of the
20	major divisions within the Lottery.
21	Next month, we
22	(End of Tape 1-B. Start of Tape 2-A.)
23	MS. ISHIMOTO: the business.
24	CHAIR TAGAMI: Thank you.
25	With that, there are no items currently on the

1	consent calendar. So we're going to go to the action
2	items.
3	And is it tradition to have the secretary read
4	the item for the record, or do we just want to roll into
5	it?
6	MR. O'NEILL: I think we're just going to roll
7	into it. But I think we've given you the binders in
8	advance and the information has been on the table.
9	I've asked each of the presenters to basically
10	just summarize the item for you. And then if you wanted
11	to ask any questions.
12	A number of these are ratifications of prior
13	actions because the Commission has not met since last
14	October. So these are actions that had to be taken in
15	the interim, and which the Director can take the actions.
16	But we wanted to present them to you briefly.
17	CHAIR TAGAMI: Mr. Murphy?
18	MR. MURPHY: Good morning. My name is Terry
19	Murphy. I'm deputy director of Operations.
20	I'll have the first two items on your agenda
21	today for action. They are both ratifications.
22	The first item is the San Diego District office
23	lease extension and amendment. Basically, the Lottery
24	has nine district offices statewide. Eight of those are
25	leased. We have been renewing those leases as

appropriate.

Most recently, negotiations have focused on basically taking care of the market rates we have available to us right now. And secondly, providing ourselves an out in the leases, if you will. There is some question, looking forward, how will these offices be organized, where will they be? Will they be? So we're providing that out in the leases, so that if we need to midway, we can get out of them.

We were successful on both accounts in San Diego. We took great advantage of the current market. Got a good reduction, and we were happy with it.

CHAIR TAGAMI: Okay. Commissioners, any comments or questions?

COMMISSIONER SMOLIN: No.

CHAIR TAGAMI: Just for clarification, is the Lottery following a DGS standard form of lease, or does the Department of General Services provide any support?

Or you're a complete stand-alone on procuring the --

MR. MURPHY: A complete stand-alone. We certainly utilize information that the Department of General Services has available, and we use it when it helps us.

CHAIR TAGAMI: On a representation basis then, does the Lottery go out to, like, RFQ, RFP for

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1
     representation services, or do we self-represent?
2
               MS. MURPHY: We self-represent.
3
               CHAIR TAGAMI: Okay.
               MR. O'NEILL: We need to ask for a motion on
4
5
     each of these and a vote for ratification.
               CHAIR TAGAMI: Certainly, yes.
6
7
                I just had a couple questions I wanted to --
8
                COMMISSIONER SMOLIN: And I'll make a motion to
9
     ratify the contract.
10
                COMMISSIONER KIRTMAN: Second.
11
               CHAIR TAGAMI: By consensus?
               MS. HIGHTOWER: We'll need to have --
12
13
               CHAIR TAGAMI: Voice vote?
14
               MS. HIGHTOWER: -- open it for potential --
15
               CHAIR TAGAMI: Oh, certainly.
               MS. HIGHTOWER: -- public comment also.
16
17
               CHAIR TAGAMI: Well, do we have any public
     speakers?
18
19
                (No response)
20
                CHAIR TAGAMI: Seeing none, we'll call for a
21
     voice vote.
22
               MS. TOPETE: Commissioner Smolin?
23
               COMMISSIONER SMOLIN: Yes.
               MS. TOPETE: Commissioner Kirtman?
24
               COMMISSIONER KIRTMAN: Yes.
25
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1
                MS. TOPETE: Commissioner Tagami?
2
                CHAIR TAGAMI: Yes.
3
                The next item, please?
4
               MR. MURPHY: The second item that I have for
5
     you is the ratification request for BroadSpec,
     Incorporated, contract amendment. BroadSpec was the
6
7
     inspector of record and billing official on this new
8
     headquarters project.
9
                We are still wrapping up some things.
10
     Basically, the need for their services went a little
11
     longer, in that we were wrapping up items on the
     building. They also were providing some assistance with
12
13
     reconciliation of all the books of the auto-invoicing.
14
     That was critical. They were the ones that were
15
     specifically looking at the work that was occurring and
     what we were paying for. So those additional services
16
17
     were needed.
18
               We've had a very good relationship with
19
     BroadSpec. I believe they've done the Lottery well. And
20
     this was approved last year.
21
               And we're looking for your ratification to add
22
     the dollars for the contract.
23
                CHAIR TAGAMI: Thank you.
24
                Any comments or questions?
25
                (No response)
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1
                CHAIR TAGAMI: Any public speakers on this
2
     item?
3
               MS. HIGHTOWER: We need somebody to ask -- you
4
     need to request a motion.
5
                CHAIR TAGAMI: That's okay. I just wanted to
     see if there were any public speakers first on this item.
6
7
                (No response)
8
                CHAIR TAGAMI: None? Okay.
9
                Is there a motion on the floor?
10
               COMMISSIONER SMOLIN: I'll make a motion to
11
     ratify that contract as well.
12
               COMMISSIONER KIRTMAN: Second.
13
                CHAIR TAGAMI: Seeing none, by consensus -- or
14
     anyone, a voice vote on this?
15
               MS. HIGHTOWER: Voice vote.
               MS. TOPETE: Commissioner Smolin?
16
17
               COMMISSIONER SMOLIN: Yes.
18
               MS. TOPETE: Commissioner Kirtman?
19
               COMMISSIONER KIRTMAN: Yes.
20
               MS. TOPETE: Commissioner Tagami?
21
               CHAIR TAGAMI: Yes.
22
               The next item, please?
23
               This is Ms. Ishimoto.
24
               MS. ISHIMOTO: Okay, as I mentioned earlier,
     we have a -- ITSD actually supports a computer network
25
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1	for headquarters district office and distribution
2	centers. We have around 200 network devices that we need
3	software support and maintenance, that provides us with
4	software updates, technical support, and hardware
5	replacement.
6	In late 2011, the Lottery engaged in a
7	competitive process, and selected Century Link as the
8	resaler for our Juniper network software and support
9	maintenance for three years, beginning in December 2011.
10	We're asking the Commission to ratify the approval of the
11	purchase order with Century Link.
12	CHAIR TAGAMI: Okay, thank you.
13	MS. ISHIMOTO: Okay.
14	CHAIR TAGAMI: Any comments or questions?
15	(No response)
16	CHAIR TAGAMI: Consider a motion from anyone?
17	COMMISSIONER SMOLIN: I'll make a motion to
18	accept the new contract.
19	COMMISSIONER KIRTMAN: Second.
20	CHAIR TAGAMI: Any public speakers?
21	(No response)
22	CHAIR TAGAMI: Seeing none, call the question.
23	MS. TOPETE: Commissioner Smolin?
24	COMMISSIONER SMOLIN: Yes.
25	MS. TOPETE: Commissioner Kirtman?

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COMMISSIONER KIRTMAN: Yes.
 1
2
                MS. TOPETE: Commissioner Tagami?
3
                CHAIR TAGAMI: Yes.
4
                MS. ISHIMOTO: Thank you.
5
                CHAIR TAGAMI: The next item?
6
                I think that brings us to Ms. Tong?
7
                MS. TONG: Sure. Finance is ready to go, to
8
     talk about money.
9
                CHAIR TAGAMI: This is the ratification request
10
     of Scratchers® daily ticket delivery courier service;
11
     correct?
12
                MS. TONG: Correct.
13
                Our old contract was with the United Parcel
      Service, and it expired on February 19th of 2012. So our
14
     director, Robert O'Neill, had to approve it because we
15
     had no commission meeting in time for that. So I'm
16
17
     asking ratification approval for it.
                The new contract is, again, recommended vendor
18
19
     with the United Parcel Service. The term is for five
20
     years, with an option to extend two one-year periods,
      starting February 20th this year, all the way to
21
     February 19<sup>th</sup> of 2017.
22
23
                The contract amount for the five years is
24
      $20 million.
25
                To summarize the process, so you have that, the
```

RFP for this was posted on the Web site of October 6th on 2011. We had eight potential bidders attend the mandatory job site visit on October 12th. Proposals were due November 29th. We had three bidders submitting proposals, one of which was the United States Postal Service; but, unfortunately, we had to reject their bid because there were no attachments that were required for the mandatory submissions.

The review team then reviewed the final two bids, and they were evaluated on five key points:

Experience and ability to deliver Scratchers® tickets, commercial fleet capability, successful deliveries to appropriate locations, tracking capability, and finally, the shipping labels.

For the valid bidders, United Parcel Service gave a bid for the five years, which equaled about \$5.11 average. And Colma Drayage, which was the other bidder, submitted one, and it averaged out at \$5.62.

And so we felt that the United Parcel Service was the only bidder to achieve not only the overall rating of "Exceeds," but also provided the best value for the California Lottery.

With this new pricing, we feel we would save approximately \$1.9 million over the course of the five-year contract.

1 CHAIR TAGAMI: Thank you. 2 Do I have any public speakers on this item? 3 (No response) 4 CHAIR TAGAMI: Any comments or questions from 5 the Commission? COMMISSIONER SMOLIN: I just have one question. 6 7 I apologize for not addressing this in the briefing. Was 8 there any explanation for why the United States Postal 9 Service was unable to provide the mandatory documentation 10 with their bid? 11 MS. TONG: Good question. I'd actually like to call Dave Merrill, who was 12 13 the contract manager on that. MR. MERRILL: Thank you, Michele. 14 Good morning, Commissioners. 15 The United States Post Office didn't submit a 16 17 price bid quote. They wanted the business. We were actually somewhat eager to look at them as a potential 18 19 vendor for us. And they submitted a bid without any of 20 the mandatory requirements, other than to say, "At some 21 point in our lives, we would like to bid on this 22 contract." But right now, because of how they're 23 structured -- you know, they have the three size boxes 24 that will ship anywhere in the world, we require a single flat-rate pricing for all of our deliveries, regardless 25

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of the size of the order or where they go. And at this
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2
     time, they couldn't adjust their pricing to meet our
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     requirements.
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                COMMISSIONER SMOLIN: Okay, thank you.
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               MR. MERRILL: Thank you.
                CHAIR TAGAMI: Any further questions?
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7
                (No response)
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                CHAIR TAGAMI: A motion?
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                COMMISSIONER SMOLIN: I'll make a motion to
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     ratify the contract to UPS.
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                COMMISSIONER KIRTMAN: Second.
               MS. TOPETE: Commissioner Smolin?
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                COMMISSIONER SMOLIN: Yes.
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               MS. TOPETE: Commissioner Kirtman?
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                COMMISSIONER KIRTMAN: Yes.
               MS. TOPETE: Commissioner Tagami?
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               CHAIR TAGAMI: Yes.
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                That takes us to Item E, Lottery Investment
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     Policy and Strategy.
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               Mike -- Michele?
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               MR. O'NEILL: No, it's not Michele. I'm sorry.
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                CHAIR TAGAMI: Michael Ota, sorry.
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               MR. OTA: I think I want to bring Michele up
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     here to kind of add some excitement to this, anyway.
25
               Michael Ota, Deputy Director of Finance.
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Compared some of the other speakers that have talked, I'm a relative newbie to the Lottery. I've been here for three and a half years.

Today, we're going to talk about the Lottery's investment strategy and investment policy.

The Lottery's investment policy requires that our investment strategy and policy be reviewed and approved by the Commission annually.

But before I get into that, I'd like to provide a little bit of background about our investments.

Prior to December 2009, the Lottery's investment policy was very simple. The policy was to purchase U.S. Treasury Bonds to provide a cash flow for our annuity prize winners.

An example of a game with annuity prizes are \$5 Set For Life Scratchers® game that offers grand prizes of \$100,000 a year for 20 years. We purchased U.S. Treasury bonds with a maturity schedule, to time the maturity with the payments for those prizes.

By December 2009, the Lottery's investment portfolio had grown to over a billion dollars, and was comprised exclusively of U.S. Treasury bonds.

But during fiscal year 2008-09, the Lottery saw an opportunity to leverage our investment portfolio to generate additional resources for public education.

The opportunity arose because at this time, the financial market was in turmoil, and investors were searching for safe and secure instruments to invest in.

Our strategy was to sell a portion of the U.S. Treasury bonds and purchase other higher-yielding, high-quality agency and municipal bonds, generating additional resources, what we described as net proceeds.

Per the Lottery Act at that time, 34 percent of these net proceeds would go directly to public education, and the remainder would be reinvested in the business to drive higher sales.

The Lottery's investment restructuring activities spanned two fiscal years: From May 2009 through June 2010. And during those 14 months, we generated \$61 million. 34 percent of those dollars went straight to public education, and the remainder was used to increase prize pay-outs, fund marketing efforts, and business plan initiatives.

The end result was that the proceeds from investment restructuring allowed the Lottery to generate greater contributions to education in those two fiscal years.

Our investment restructuring strategy was always intended to be a short-term effort, and it focused on taking advantage of the market at that time.

The restructuring efforts were performed under the guiding principles for prudent investment of public funds; and these guiding principles are documented in a comprehensive investment policy that the Commission had approved in December 2009. Again, that policy requires that our investment strategy and policy be reviewed annually by the Commission and approved.

So starting with the investment strategy for 2011-12. As I mentioned earlier, the restructuring effort, short-term planning, was completed in June of 2010 for fiscal year 2011 just recently completed. The strategy was more of a maintenance activity. And "maintenance" meaning, business-as-usual purchase of U.S. Treasury bonds for new annuity winners, and also monitoring and/or managing our investment portfolio to mitigate risk.

We are requesting that the Commission approve continuance of that maintenance strategy for the upcoming fiscal year.

The second part of this is about the investment policy. We have conducted our annual review of the investment policy, and reaffirmed that the guidelines specified by that policy are consistent with standards for investment of funds managed by a public entity.

Lotteries have also confirmed that the

investments in the Lottery's portfolio are in compliance with our policy. Therefore, no substantive revisions to the investment policy are being proposed; however, we are recommending a couple of minor revisions to the policy. The revisions basically replace reference to investment portfolio restructuring, with broader language that reflects the Lottery's current maintenance investment strategy.

One of the proposed revisions is to change the title of the report that is required to be submitted to the Commission annually. That report provides information about the investment portfolio and our risk mitigation activities.

Pending Commission approval of the revisions today, we intend to submit that annual report to the Commission for the March meeting.

In conclusion, we are requesting that the Commission approve the Lottery's proposed investment strategy for 2012, and the proposed revisions to the investment policy.

That concludes my presentation.

I'd be happy to answer any questions.

CHAIR TAGAMI: Thank you, Mr. Ota.

Any specific comments or questions?

COMMISSIONER KIRTMAN: No.

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CHAIR TAGAMI: Commissioner Smolin?
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                COMMISSIONER SMOLIN: No. Thank you.
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                CHAIR TAGAMI: Do we have any public speakers
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     on this item?
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                (No response)
                CHAIR TAGAMI: I just want to highlight, I
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7
     think it's important to underscore that if anything, you
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     know, under the permitted investments provision, really
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     underscoring the risk management comments you made and
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     highlighting the guidelines to keep this very narrow --
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     and I use -- you know, this is safer than widows and
     orphans level of consideration. And I think that's
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13
     appropriate under the circumstances.
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                So I appreciate your report and your thoughtful
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     approach to this.
                So with that, call a vote -- motion, sorry.
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                COMMISSIONER SMOLIN: I'll make a motion to
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     approve the investment strategy as submitted.
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               COMMISSIONER KIRTMAN: Second.
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               MS. TOPETE: Commissioner Smolin?
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               COMMISSIONER SMOLIN: Yes.
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               MS. TOPETE: Commissioner Kirtman?
               COMMISSIONER KIRTMAN: Yes.
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               MS. TOPETE: Commissioner Tagami?
25
                CHAIR TAGAMI: Yes.
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1 COMMISSIONER SMOLIN: And another motion to 2 approve the amendments to the investment policy. 3 COMMISSIONER KIRTMAN: Second. 4 MS. TOPETE: Commissioner Smolin? 5 COMMISSIONER SMOLIN: Yes. MS. TOPETE: Commissioner Kirtman? 6 7 COMMISSIONER KIRTMAN: Yes. 8 MS. TOPETE: Commissioner Tagami? 9 CHAIR TAGAMI: Yes. Okay. 10 Item F was removed from the agenda. So we 11 will go to G, which was the three-month extension of draw auditing and review services contract. 12 13 MR. ZAVALA: Good morning, Commissioners. My 14 name is Roberto Zavala. I'm the chief auditor at the 15 California Lottery. And I'm presenting to you an action to extend our draw services contract. 16 Just to give you some background on this draw 17 services contract, it's a requirement by the Lottery to 18 19 have all of our draws witnessed by an independent 20 individual as determined by the regulations. 21 Currently, right now, our contract is with 22 They've had it since 2009. And it's for \$788,000. 23 We're asking for a three-month extension to 24 give us the opportunity to go ahead and complete our RFP 25 process.

	Cantorna State Lottery Commission Meeting 1 cortain 25, 2012
1	Right now, we are looking at an ending date of
2	June 12 th to execute a new contract. This will give us
3	no gap in service. This is a mission-critical service
4	that we have to have someone witness every single draw
5	365 days of the year. And by giving us this extension,
6	it will give us the opportunity to not have any missed
7	witnessing of the draws.
8	So I appreciate your consideration on this.
9	CHAIR TAGAMI: Thank you.
10	Any comments or questions from the Commission?
11	COMMISSIONER SMOLIN: No.
12	CHAIR TAGAMI: Seeing do we have any
13	speakers on this item? No?
14	(No response)
15	CHAIR TAGAMI: Seeing none, a motion?
16	COMMISSIONER SMOLIN: I'll make a motion to
17	ratify the extension with KPMG.
18	COMMISSIONER KIRTMAN: Second.
19	MS. TOPETE: Commissioner Smolin?
20	COMMISSIONER SMOLIN: Yes.
21	MS. TOPETE: Commissioner Kirtman?
22	COMMISSIONER KIRTMAN: Yes.
23	MS. TOPETE: Commissioner Tagami?
24	CHAIR TAGAMI: Yes.
25	Okay, it's going to take us to our Commissioner
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general discussion provision of the agenda.

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Commissioners, is there anything you'd like to bring to the floor for comment?

COMMISSIONER SMOLIN: I'd just like to thank the presenters for their reports. It was very helpful.

COMMISSIONER KIRTMAN: Absolutely. Thank you. I look forward to working with you.

CHAIR TAGAMI: Who could not support that statement? I think it was wonderful. Very efficient.

I believe we had some scheduling proposed for future meetings. And in concert with that -- and I'll kind of group these into the general discussion -- would like to -- I would like to ask -- and if my colleagues are in support -- ask the director to afford a letter to the Governor's office, informing them of our March 22nd meeting; and then if convenient, if we could coordinate, between now and that meeting, some forward dates for other commission meetings; and then make a request of the Governor's office for the timeliness of filling the two remaining appointment positions, respectful of everyone's calendar. We just want to maintain a quorum, and be there to make sure we can support Director O'Neill and his team on meeting the Lottery's mission. And so I think that would be important.

And perhaps when we're fully -- you know, one

1 of our -- everyone is appointed, we will be able to then 2 turn our task to looking at how the Commission can best 3 organize itself to support the Lottery's mission. 4 I think there has been a history of some 5 committee work. Right now, I think it's probably the committee of the whole, because it's a quorum to act and 6 7 to work on things. But perhaps when we are fully filled 8 out, we'll be able to ask some of our colleagues to take 9 on specific tasks to work with the Director and his team 10 to advance the Lottery's business. And then maybe a 11 retreat with senior management -- publicly noticed, of course -- would be appropriate to help work on further 12 13 alignment, and moving the organization forward. 14 So if the Director would be willing -- and I'd look for my colleagues' consent -- if that's something 15 that you would be in support of to do that? 16 17 COMMISSIONER SMOLIN: Agreed. 18 CHAIR TAGAMI: And then -- thank you. 19 And then with that, any public speakers? 20 guess open-forum portion of our meeting. 21 Secretary, do we have anyone signed up besides Ms. McClaflin? 22 23 MS. TOPETE: No. No one else signed up. 24 CHAIR TAGAMI: Okay, so Ms. McClaflin, if 25 you're available.

1	MS. McCLAFLIN: I just wanted to introduce
2	myself. I am Karen McClaflin, Executive Director of the
3	California Automobile Museum. We're one of the newest
4	retailers here locally. And we are also a new trade
5	style, as you will. I'm learning the lingo, in that
6	we're a museum.
7	So we are hoping to generate some revenue to
8	help promote our educational programs, as well as support
9	the Lottery in their support of our public schools.
10	So in particular, we're hoping to train some
11	of our volunteers to be able to take the trailers out to
12	some of the larger car events in our community and
13	beyond. So we hope it's a good partnership.
14	So it's great to partner with you. And just
15	wanted to meet all of you and put a face to the name.
16	CHAIR TAGAMI: Thank you for coming.
17	MS. McCLAFLIN: Thank you.
18	COMMISSIONER SMOLIN: Thank you.
19	CHAIR TAGAMI: Any other public speakers?
20	(No response)
21	CHAIR TAGAMI: Seeing none, at the hour of
22	11:23, I guess, we can say that we stand adjourned.
23	Thank you. Thank you all very much.
24	(End of audio recording and end of meeting)
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2	TRANSCRIBER'S CERTIFICATE
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4	This is to certify that: I transcribed to the
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