

# CALIFORNIA STATE LOTTERY COMMISSION

Minutes – May 16, 2006

Sacramento, California

## **1. Call to Order**

Chairperson John Mass called the public meeting of the California State Lottery Commission to order at 10:03 a.m. at the California State Lottery Headquarters, 600 North 10<sup>th</sup> Street, Sacramento, California 95814.

## **2. Pledge of Allegiance**

John Mass led the Pledge of Allegiance.

## **3. Roll Call**

Mass asked Elisa Topete to call the roll.

### Commission Members Present:

Commissioner Rachel Montes  
Commissioner Manuel Ortega  
Commissioner Loretta Doon  
Chairman John Mass

### CSL Staff and presenters:

Joan M. Borucki, Executive Division  
Melissa M. Meith, Executive Division  
Jim Hasegawa, Marketing Division  
Bill Hertoghe, Security/Law Enforcement Division  
Pat Meroney, Finance Department  
Steve Pieri, Finance Department  
Susan Kossack, Marketing Division  
Elisa Topete, Assistant to the Commission  
Roberta Sherfey, Recording Secretary

## **4. Consider Approval of the Agenda**

Mass asked if any of the Commissioners wanted to make changes to the May 16, 2006 agenda as proposed. Doon moved to approve the agenda. Seconded by Montes. The motion passed unanimously (4-0).

## **5. Public Discussion**

Mass asked if anyone from the public had anything to discuss. No one had signed up prior to the meeting and no one came forward, so he proceeded to the next item on the agenda.

## **6. Approval of Minutes**

Mass asked if there were any additions or corrections to the March 15, 2006 minutes. Montes moved to approve the minutes. Seconded by Ortega. The motion passed unanimously (4-0).

## **7. Commission Liaison Reports**

### **Commissioner Montes :**

Montes was provided a year-to-date update on Lottery sales. Montes attended The Big Spin tapings in Burbank on March 26 and April 23, 2006.

### **Commissioner Doon:**

Doon was provided an update on Lottery sales and expenditures and indicated that it was going to be another good year at the Lottery. Staff continues to work on audits and Doon received a status on the SAM2000 audit report. Doon received an update on the Security Evaluations Solicitation process and the on-going internal audits from the district offices.

### **Commissioner Ortega:**

Ortega received an update on Lottery sales and expenditures. As the Security Liaison, Ortega was briefed by Security Director Bill Hertoghe on general security activities related to the Lottery's operations and specifically to the upcoming audit of security. Staff continues to brief Ortega on the GTECH merger with Lottomatica. Ortega and Hertoghe met with the District Sales Representatives from the Santa Fe Springs Office to discuss various Lottery security issues. For Legislative and Legal issues, staff has continuously updated Ortega on the MEGA Millions® litigation and on the amendment to the legal services contract.

### **Chairman Mass:**

Mass has been updated on Lottery sales and the MEGA Millions® litigation. As the Procurement Liaison, Mass was briefed on the legal services contract and the purchase order for Level 4 Networks for the Information Technology Services Division (ITSD), which is a contract being awarded to Honeywell International for the heat ventilation and air conditioning for ITSD. Mass was advised on the purchase orders for the purchase and installation of a new Automatic Transfer Switch System and removal and disposal of the old one, an award of the competitively bid contract to Electrical Reliability Services for service and repair of the diesel generator, and an amendment to the purchase order for Olson and Fielding Moving Services for the continuation of moving services at Lottery Headquarters. As the Marketing Liaison, Mass was updated by Jim Hasegawa on the marketing plans and promotions and the new radio strategy. Mass was updated and briefed on Item 10(a), the Scratchers® Game Profiles.

## **8. Staff Report**

Acting Director, Joan Borucki, thanked the Commissioners and staff for their warm welcome and helpfulness. Borucki attended the MEGA Millions® Director's Meeting in Boston. Borucki met other lottery directors. The discussions with other Director's

raised good ideas and identified best practices that the Lottery is now investigating. The directors elected new officers for the MEGA Millions® states for the coming year. Massachusetts Lottery Director Joe Sullivan will be incoming lead Director for the next year. The Massachusetts Lottery staff made a presentation about the different activities their lottery is doing with the sport franchises, such as the Red Sox. The Massachusetts Lottery has developed a recycling program because it was under criticism due to the fact that much of the litter was coming from the Scratchers® tickets.

**a. Review of or Current Year Sales & Budget**

Jim Hasegawa reported that in the first 10-months of this fiscal year, sales are up more than \$160 million or nearly 6%, compared to last fiscal year's first 10 months. The current sales pace is slightly short of the original budget goal of \$3.65 billion. The Lottery will probably reach close to the \$3.6 billion level, which will be a record level of sales. The Scratchers® category is up \$114 million over where sales were a year ago. The lotto category, which is comprised of both MEGA Millions® and SuperLOTTO Plus®, is up \$62 million relative to a year ago. The smaller product lines of Daily Games and Hot Spot show slight declines from last year.

Pat Meroney advised the Commission of the Lottery's expenses which have been tracking at below budget - for both prizes and administrative expenses. Prizes are about two-tenths below the budget of 54.2% of sales and administrative expenses are about five-tenths below the budget of 11.8%. Staff had projected \$1.28 billion for education and if sales performance continues, revenues for education could be as high as \$1.26 billion, just \$20 million below the budget.

Hasegawa presented a review of the lottery industry's sales and performance. In terms of the industry comparison, California is ranked fifth in total sales, and 27 in per capita sales. Another important measure besides sales is the amount of dollars that a lottery delivers to its beneficiary. California's beneficiary is education and in terms of dollars going to the beneficiary, California ranked second. On a per capita basis, California ranks 27. Comparing per capita marketing budgets for the various state lotteries, California spent much less than most other lotteries. The New York Lottery spent about \$3.70 per person and California spent just under \$1 per person. California had its highest year in sales last year and the Lottery is poised to do the same this year, which will be the 8<sup>th</sup> time in the last 9 years where year over year sales have increased.

For total sales in the lottery industry, California ranks sixth in instant ticket sales. On a per capita basis, again California ranked 27<sup>th</sup>. The Lottery's instant games have increased 31% over last fiscal year, which is the 4<sup>th</sup> best in the United States. For California, 2006 will be the Lottery's biggest year ever for Scratchers® with just over \$1.9 billion in sales. Higher prize point games have driven sales. Through the first ten months of this fiscal year, over 55% of the Lottery's Scratchers® sales have been coming from the \$3 and \$5 games. The \$5 games sell well because of the higher prize payouts and players see the benefits of winning a good mid-tier prize. Prize payout for the \$5 games is about 66%, but there is a limit to what the Lottery

can afford. People buy a premium price product because it offers a better value and in the case of an instant ticket, a better chance of winning a meaningful prize. When the Lottery presented multiple \$5 games, sales were significantly higher. In terms of playership, the Scratchers® product has remained stable over the last five years.

Hasegawa provided information on the retailer network which showed California had 504 retailers for every million residents compared to Massachusetts, which has 1,300 retailers for every million residents. The average retailer in California sold \$3,495 worth of Lottery tickets in a given week. Certain trade channels do significantly better, such as Tea Rooms, which are selling at approximately \$10,000 a week. Other types of locations, such as bakeries, news stands, and mall kiosks also do extremely well.

**b. 2006/07 Business Plan Status**

Hasegawa stated that the Scratchers® sales came in at about \$100 million higher than the original Lottery budget. Some of the budget categories were under-spent this year as Meroney mentioned earlier. An example in the prize fund area deals with the amount of money needed to guarantee the SuperLOTTO Plus® jackpots. The jackpot starts out at \$7 million and then rolls to \$9 million, \$11 million and so forth. If there is a winner at one of those jackpot amounts, the Lottery may not have the sales to cover that jackpot amount, and utilizes the Special Prize fund to cover the difference. This current fiscal year however, there were no \$7 million hits and just two \$9 million winners and as a result, the Lottery had approximately \$11-\$12 million available in that prize fund to be applied towards Scratchers® prizes.

Sales of the \$5 Scratchers® could have been higher if more administrative dollars were available to permit the Lottery to offer multiple \$5 games concurrently. The Lotto category is critical because it accounts for all of the Lottery's administrative budget. Hasegawa explained the expenses associated with a Scratchers® ticket sale. About 59 cents will go to prizes; 34 cents goes to education; and 6 cents goes to the retailer in the form of commission along with an additional form of retailer cashing bonuses and incentives. Additional costs include ticket delivery and production. As a result, the cost for a \$1 sale is more than \$1.03. The 3 cents must be absorbed by the Lottery's administrative budget.

On the Lotto ticket side, prizes are about 50 cents, education receives 34 cents and administrative costs are about 8 cents for a total of 92 cents. The remaining 8 cents becomes available to use in the administrative budget which really funds all of the programs in the Lottery. As such, the balance between the Lotto and Scratchers® category sales is critical.

In terms of objectives for fiscal year 2006-07, the Lottery needs to make sure to maximize the sales from the games that deliver the most profit, which are the games that have prize payouts in the 50-55% range. MEGA Millions®, SuperLOTTO Plus® and the \$1 and \$2 Scratchers® games fall in that range.

As another objective, the organization needs to increase the availability and visibility of Lottery products through the retail network. The number of retailers will be looked at as well as the signage and the promotions that are done in the retail locations. The remaining business plan objectives are to build stronger connections with Californians and to bolster the Lottery's infrastructure to make sure staff delivers services in an efficient and effective manner.

Hasegawa advised the Commission that staff was recommending a \$3.6 billion sales goal. The Lottery needs to be prepared for \$7 million winners in SuperLOTTO Plus® and have that amount budgeted for that prize fund category. Staff will need to reduce the goals among the \$5 games, but increase sales from the \$1 and \$2 product lines. For SuperLOTTO Plus® and MEGA Millions®, the Lottery has a slightly higher sales goal number than the current year actuals because the products do show some increases and staff has accounted for that. With the slightly different mix of a small decrease in Scratchers® and a slight increase in the Lotto product line, the Lottery would reach about \$3.6 billion in sales with more than \$1.25 billion going to public education.

Mass asked if the 5 cents net per dollar that is left over could be used to increase the number of Scratchers® games, especially the \$5 games, so that the Lottery could then increase its contribution to education.

Hasegawa explained there is a limit to the number of \$5 games that can be introduced because of the prize payout being at the 65-66% level. The 5 cents is a net between the Scratchers® and the Lotto category and it depends on the sales levels. If Lotto doubled, more dollars could be available for the administrative budget so that the Scratchers® sales could grow. It is a balance between the products that has to be looked at and it is why most of the marketing resources are spent promoting the Lotto category versus the Scratchers®.

**c. Update on Merger of GTECH with Lottomatica**

Bill Hertoghe went over the procedures the Security and Law Enforcement Division went through with the background review of Lottomatica. Hertoghe assembled a team to travel to Italy in March and were joined by the Nebraska and Oregon Lotteries. The trip was coordinated by the State Department and staff was assisted by the field office of the FBI in Rome. The investigation is 90% complete and the Lottery has not found anything that disqualifies the officers or the directors of Lottomatica. Hertoghe will present a final report as soon as the disclosure information is received.

Steve Pieri has been monitoring the progress of the Lottomatica/GTECH merger-financial review. Grant Thornton, the contracted financial due diligence firm working through the North American Association of State and Provincial Lotteries (NASPL), on behalf of the California Lottery and 27 other state lotteries, continues its financial due diligence work. Grant Thornton is currently in Rhode Island performing financial reviews of GTECH and has set up two offices in Italy performing reviews. Grant

Thornton has completed an internal control review of Lottomatica and a financial internal control review of De Agostini. Lottomatica was following Italian GAAP and has changed to International Financial Reporting Standards. Representatives of the 27 lotteries that are working with NASPL will be meeting with Grant Thornton to discuss its findings.

### **9. Consent Calendar**

- a. Approval to Amend Contract with DLA Piper Rudnick Gray Cary US LLP to Extend Contract for Sixteen Months and to Add Funds

Ortega moved Consent Item 9(a) for approval. Seconded by Montes. The motion passes unanimously (4-0).

### **10. Action Items**

- a. Approval of Scratchers® Game Profiles for Games 479, 480, and 481

Susan Kossack presented the August Scratchers® game profiles for approval. Scratchers® game 479, "Red Hot 7's" is a \$1 game that has a key number match playstyle. Players can win the indicated amount by uncovering the seven in the play area and having a chance to win up to six times on a ticket. This game will be delivering \$6.8 million in prizes. Staff recommends a top prize of \$777 with overall odds of winning at 1 in 5.29.

Game 480 "Winner Take All," is a \$2 game that offers players the opportunity to win all the prizes on the ticket by matching the "Winner Take All" number. The game utilizes the key symbol match playstyle and the ability to win up to ten times on a ticket with two winning numbers. The top prize for this game is \$10,000 with overall odds of winning at 1 in 4.57.

Scratchers® game 481 is "Wild Bingo." The \$3 game will have a wild symbol where players are able to use it as another free space on any of the four Bingo "Your Card" areas, completing the winning pattern. The Bingo playstyle will incorporate the use of four Bingo cards, 25 caller card numbers and five bonus numbers. The recommended top prize is \$20,000 with odds of winning at 1 in 3.69.

Montes made the motion to approve Action Item 10(a). Seconded by Doon. The motion passed unanimously (4-0).

### **11. Commissioner General Discussion**

None

**12. Scheduling Next Meetings**

The next Commission meetings are scheduled for June 27, 2006, August 8 2006, and November 1, 2006, at the Lottery Headquarters in Sacramento. Times for the meetings will be determined.

**13. Closed Session**

The Commission convened in a closed session at 11:37 a.m. to confer with and receive advice from counsel regarding pending litigation California Coalition Against Gambling Expansion v. California Lottery Commission.

**14. Adjournment**

Meeting adjourned at 11:54 a.m.