

CALIFORNIA STATE LOTTERY COMMISSION

Minutes – June 27, 2006

Sacramento, California

1. Call to Order

Chairperson John Mass called the public meeting of the California State Lottery Commission to order at 10:01 a.m. at the California State Lottery Headquarters, 600 North 10th 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
Pat Meroney, Finance Department
Susan Kossack, Marketing Division
Cathleen Dinubilo, Internal Audits
Elisa Topete, Assistant to the Commission
Mary Montelongo, Recording Secretary

4. Consider Approval of the Agenda

Mass asked if any of the Commissioners wanted to make changes to the June 27, 2006 agenda as proposed. Ortega 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 May 16, 2006 minutes. Montes moved to approve the minutes. Seconded by Doon. 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 and reported that there were \$25,000, \$100,000 and \$225,000 winners.

Commissioner Doon:

Doon was provided an update on Lottery sales and expenditures. Doon was briefed on the Lottery's internal and external audit activities. Audits are continuing for the District Offices as well as risk assessments for the next audit plan cycle. As Education Liaison, Doon is working with staff on Public Service Announcements which should be completed by the end of June and will be aired in the next quarter. There are about eight spots being produced in English and Spanish. Staff is collaborating with the California Teachers Associations on the production of the Public Service Announcements.

Commissioner Ortega:

Ortega was provided a year-to-date update on Lottery sales and expenditures. Ortega was briefed by Security Director Bill Hertoghe on general Lottery security activities which included the progress of the Security Guard Contract. Staff has continued to brief Ortega on the Lottomatica/GTECH merger and the investigation. Ortega was advised of a Strategic Planning Session which will be held in Southern California, under the direction of Linh Nguyen, Director of Business Planning. Ortega was also briefed on Legislative and legal issues related to the Lottery.

Chairman Mass:

Mass was provided an update on Lottery sales and the MEGA Millions® Litigation. Mass was briefed on the Cisco Maintenance Contract, a purchase order for the Core Network replacement, a renewal of the inter-agency agreement with the Justice Department, a release of the solicitation document for African American Advertising Agencies, and the issuance of a Request for Proposal to invite responses for qualified bidders to provide delivery services of Scratchers® tickets. Mass was informed of the upcoming Marketing plan of promotions as well as the Scratchers® game profiles, Item 10(b).

Mass presented on behalf of all the Commissioners, a Certificate of Recognition to retiring Chief Counsel Melissa Meith for her 21 years of state service and dedication to the Lottery.

8. Director's Report

a. Financial Statements for March 31, 2006

Joan Borucki went over the receipt of the March 31, 2006 Financial Statements as required by government code. The Lottery has prepared the quarterly reports and have been distributed to the Governor, Attorney General, State Controller's Office, State Treasurer, and California State Legislature. The Lottery requested a transfer of close to \$337 million to the Education Fund on May 15, 2006 for that quarter.

Borucki announced the departure of Communications Director Lezlie Puglia and introduced Rob McAndrews who was appointed by the Governor's Office as the Assistant Communications Director. Borucki advised the Commission of a Lottomatica/GTECH meeting in Chicago where the Grant Thornton Study is being presented to the various Lottery Directors. Steve Pieri, Finance Manager and Scott Ralston, Chief Lottery Agent, are attending the meeting on behalf of the California Lottery.

9. Consent Calendar

- a. Approval of Amendment to Interagency Agreement with the California Department of Technology Services
- b. Approval of Extension of Inter-Con Contract for Security Guard Services
- c. Approval of Amendment to Bank of America Contract for Electronic Fund Transfer Services

Ortega moved Consent Items 9(a), (b) and (c) for approval. Seconded by Montes. The motion passes unanimously (4-0).

10. Action Items

- a. Approval of the Business Plan and Budget for Fiscal Year 2006/07
Jim Hasegawa started by reviewing the Lottery's products, performance and the trends that are going on, not only in the lottery industry but the retailing industry as well. Staff looked at consumer data from a variety of market research sources, objectives for the organization, sales goals and strategies and tactics to achieve the objectives.

Hasegawa reported the Lottery had another record year with the largest sales in Lottery history at about \$3.56 billion, up \$200 million over last year's sales. It also was a record contribution for education at \$1.26 billion, up approximately \$85 million over last year's revenues to public schools. The contribution represents the sixth consecutive year that the Lottery has provided over \$1 billion to public schools. The retailers also had a record year, earning about \$251 million for selling Lottery products.

The Lotto games (MEGA Millions® and SuperLOTTO Plus® combined) were about \$70 million higher in sales than last year when the Lottery had

SuperLOTTO Plus® alone. There were nine different occurrences where the jackpot achieved either \$200 million or more during this past fiscal year. Scratchers® sales are up about \$170 million over last fiscal year as the Lottery had some additional dollars to fund higher prize payout games. All of the games have payouts higher than 50%, but the Lottery was able to introduce four \$5 games, which have payouts around 66%, which makes the game very popular.

Some objectives for the year are: to maximize sales from games with the greatest profit potential, to increase the availability and the visibility of the Lottery's product, to build stronger connections with the public, and to bolster the Lottery's infrastructure.

Hasegawa went over the Lottery's product and marketing plan and the sales goals by product. The Lotto games sales goal for next fiscal year is \$1,245,000,000, which represents a 5% increase over the current year. Staff anticipates the growth in the Lotto games category will come from the MEGA Millions® product because it is a new game and for any new product, it is still in its growth cycle.

Hasegawa went over the various advertising efforts for the Lotto games which include television, radio and new media vehicles such as in-stadium exposure. Through the Lottery's sponsorship with the Los Angeles Dodgers, the SuperLOTTO Plus® jackpot amount would be on display for the fans at the stadiums and would close with the tag line, "Imagine what a buck could do." Other efforts to promote big jackpots are part of the Marketing plan such as showcasing the amount on the tops of taxis or having radio personalities chatter about the jackpot and what they would do if they won.

A consumer promotion is being proposed. A player would buy seven MEGA Millions® or SuperLOTTO Plus® games on one ticket and would receive a free SuperLOTTO Plus® play. This provides an incentive to get players who might be buying \$5 worth of the product, to increase their purchase up to the \$7 level. A sampling program is also being proposed. The Lottery would give out coupons for free plays of SuperLOTTO Plus® and MEGA Millions®, through the additional event marketing activities that are being proposed or through radio station promotions.

Hasegawa advised the Commission that the higher prize payouts in the Scratchers® games, particularly the \$3 and \$5 games, have dramatically increased sales. Staff is recommending to continue the higher prize payout strategy, however there is a budget constraint on prize money which will mean that the \$1,880,000,000 sales goal is actually lower than actual sales this current fiscal year. This year, it will be over \$1.9 billion and it's a function of additional prize money available out of the Lottery's budget. Staff is also working closely with retailers to promote the \$1 and \$2 games by making them more visible and giving them premium locations. Staff is planning to start promoting \$1 and \$2

Scratchers® Game with a campaign for the \$1 Big Spin Scratchers® game because The Big Spin® is very well known to players, and has high and appealing top prize.

In terms of the retailer network, the Lottery is currently undergoing a saturation study in Los Angeles and Orange County and staff will be analyzing the results of the study to see the impact on sales and the increase in costs. Depending on the results of the study, the Lottery could potentially be expanding the network in the rest of the state.

The Lottery plans to continue developing products to keep the consumers satisfied and excited and staff will be testing a number of possible games for both the consumer's appeal as well as an estimate on what staff thinks the sales will come in at. Product development is included in the marketing plan and budget.

Doon asked Hasegawa what the Lottery was doing with respect to enhancing the education of responsible gambling.

Hasegawa advised Doon of the hotline for individuals who want to seek advice and assistance for problem gambling. The hotline number is printed on all tickets and point of sale materials. There are also brochures at all retail locations and the Lottery is also doing Public Service Announcements during "National Problem Gambling Awareness Week."

Pat Meroney, Finance Department Chief, discussed next year's budget sales target of \$3.6 billion, which would be \$40 million more than this year. This year, the Lottery expects to come in at \$3.56 billion. For the upcoming budget, the overall prize expense is 53.9%, which is made up of 50% for statutory prizes and another 3.9% for promotional prizes. The Scratchers® prizes are budgeted at 59.1%, with nearly all of the promotional money going towards the Scratchers® product. The total administrative expenses for this year are proposed at \$435 million, about 12.1% of revenue. The largest expense in this category is retail commissions, which is at about 7.1%. It includes cash and bonuses and incentives for the next year. There are no changes in the current retailer compensation program and is based on Commission approved regulations and driven directly by sales.

The game operations portion of the budget is all cost directly associated with operating the gaming systems, both draw games and Scratchers®. The budget totals \$60 million and is largely based on sales levels. A few changes in this area of the budget include the new Scratchers® ticket printing contract, which resulted in a significant reduction in ticket printing costs as a percent of sales, about a \$6.5 million budget savings.

Next year, the Lottery plans to continue efforts to recruit new retailers and the budget includes the cost associated with that effort, including new additional

gaming equipment. The category also includes the cost of additional programming dollars for GTECH for software support of the gaming system and for the terminal memory upgrade. The budget anticipates a small increase in maintenance for instant ticket vending machines, and for new machines that are going to be installed in new retailer locations. Game operations total \$60 million, 1.7% of the budget.

Communications include advertising, broadcast, point of sale materials, retailer commissions and retailer and consumer promotions. A total of \$36 million has been budgeted for this area of the budget. On top of a base budget, incremental funding has been added for additional retailer merchandising, including additional play centers and customized signs. The communications budget is about the same as it is for the current year.

The remaining portion of the budget is for general administration and contains what could be considered the Lottery's housekeeping costs at a total of \$76 million. It includes personnel costs, operating expenses such as telephone supplies and facilities, contracts and consultant services, and depreciation charges for capitalized purchases that were made in prior years. For this year's budget, the Lottery plans to reduce 30 positions, bringing the total position count to 620. In addition, the Lottery is including funding for a 5.5% general salary increase. The unions have agreed to new contracts that have to be ratified by the union membership and approved by the Legislature before they take effect. The budget maintains an estimate for vacancies of 5% and includes updated estimates for state funding and retirement costs and other staff benefits including an adjustment to the Workman's Compensation cost.

Overall, the remainder of the general administration budget represents a continuation of spending levels approved in last year's budget and is essentially unchanged. Staff is recommending a reserve of \$8 million which provides protection against unanticipated expenses. If it is not spent by the end of the year, it will go directly to education. The budget projects education revenues at \$1,245,000,000, 34% of sales. When combined with interest income and unclaimed prizes, there is a total of \$1.27 billion that will go to education, roughly 35.3% of sales.

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

b. Approval of Scratchers® Game Profiles for Games 482, 483, 484, 485, 486, 487, and 488

Susan Kossack advised the Commission that the Lottery has seven games being brought forward for September and October. The first game for September is a \$1 game called "Ace in the Hole." Also in September is Game 483, "Find the 9's" which is a tic-tac-toe playstyle, giving the player three games on a \$2 ticket.

Game 484 is a \$2 game called "10X the Money" and is the last game for September.

October will begin with Game 485, which is a \$1 money themed game with a key number match playstyle. Game 486 is "Super Match 3," a \$1 game with an opportunity to win a prize in each of the three different games. The top prize for the game is \$1,000 with overall winning odds of 1 in 5.3. Also in October is Game 487, "Sizzling 7's" which is a popular 7's theme with a top prize of \$7,777. Finally, "Struck by Luck" is Game 488 and is a \$2 game with a key number match playstyle.

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

c. Approval of Contract with Getronics for Security Evaluation Services

Cathleen Dinubilo, Chief of Internal Audits, gave the Commission a background of the contract with Getronics for Security Evaluation Services. Required by the government code, the Lottery is supposed to engage an independent firm experienced in security procedures, including but not limited to computer security and system security to conduct a comprehensive study and evaluation of all aspects of security in the operation of the Lottery. The goal of the evaluation is to provide the public, appropriate state officials and the Legislature with assurances as to the security, integrity and fairness of the Lottery's products, operations and gaming activities. The Lottery has had an independent security evaluation on a biennial basis since inception. In the past, the Lottery used a Request for Proposal (RFP) and included only one biennial period per audit. The purpose for going with a longer term is to decrease cost and save time so it will include two biennial audits with the option for an extension to include an additional audit period. Dinubilo went over the RFP process and Getronics was recommended to be awarded the contract. Getronics offered a more customized and specific work plan along with excellent staffing and overall firm experience, and the pricing was the lowest overall. The contract is scheduled to begin July 1, 2006 and expire on December 30, 2008, with the option to extend for an additional two years. The total contract expenditure authority is \$282,000 for the two audit periods.

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

11. Commissioner General Discussion

Ortega congratulated Security Director Bill Hertoghe on the Ventura County case that the Security Division was working on concerning a clerk at one of the retailers who had cheated a MEGA Millions® winner. The case was coming to a close and a warrant had been issued for the clerk.

Ortega brought up an issue that was discussed several months ago concerning positions that were going to be eliminated from the Lottery, due to vacancies that were not going to be filled. At the time, Ortega requested a list of the positions that were being considered for elimination and advised Borucki that no list had been provided to him as of yet. Ortega would like a response back for the next Commission Meeting.

12. Scheduling Next Meetings

The next Commission meetings are scheduled for August 9, 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 11:55 a.m.