

CALIFORNIA STATE LOTTERY COMMISSION

Minutes – March 15, 2006

Sacramento, California

1. Call to Order

Chairperson John Mass called the public meeting of the California State Lottery Commission to order at 10:05 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:

Melissa M. Meith, Executive Division
Jim Hasegawa, Marketing Division
Tricia Metzger, Sales Division
Pat Meroney, Finance Department
Cassandra Lichnock, Human Resources Department
Bill Hertoghe, Security/Law Enforcement Division
Susan Kossack, Marketing Division
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 March 15, 2006 agenda as proposed. Ortega moved to approve the agenda. Seconded by Doon. 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 January 25, 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. She attended the Governor and First Lady's Conference on Women and Families on October 27, 2005, in Long Beach. On November 5, 2005, Montes attended the American GI Forum in Sacramento. She was at the press conference for California's first MEGA Millions® Jackpot winner on November 18, at the Santa Fe Springs District Office, and she was present at The Big Spin tapings in Burbank on January 29 and February 26, 2006.

Commissioner Doon:

Doon was provided an update on Lottery sales and expenditures and was extensively briefed on the contribution to education for the current year. Doon was briefed on the internal and external audit activities for the Commission, particularly on an agenda item with respect to the draw audit services provided by an outside accounting firm. Doon has been working on Public Service Announcements with the California Teachers Association and the Lottery. She is also working with the Communications Department on sponsorship opportunities.

Commissioner Ortega:

Ortega was provided an update on Lottery sales and expenditures. He has been in frequent contact with Bill Hertoghe, Director of Security, regarding the background investigations on people from whom the Lottery plans to lease properties. He also continues to be briefed on the GTECH merger with Lottomatica. Ortega has received weekly updates from staff on legislative and legal issues.

Chairman Mass:

Mass has been updated on Lottery sales and the pending MEGA Millions litigation. As Procurement Liaison, he has been briefed on the Legal Services Contract and the request for approval of Security Services solicitation. Mass was also briefed on Item 9b - Approval of the Riverside District Lease Agreement, 9d – All Steel Contract for Modular Furniture for the offices, and 10a – an addition to General Regulations regarding Real Property Transactions. As the Marketing Liaison, he was briefed on upcoming marketing promotional plans. Mass was also briefed on Item 9c – Approval of Technical Amendments of Lotto regulations and the pre-payment, pre-selection of SuperLOTTO Plus®, and he was given an update on the Scratchers® game profiles.

8. Staff Report

a. Review of Sales & Budget

Hasegawa updated the Commission on Lottery sales through the end of February. Sales are up nearly \$150 million over the first eight months of the last fiscal year.

The Lottery is at about \$2.36 billion compared to last fiscal year's first eight months at \$2.21 billion, which is \$148 million increase, or 6.7%. Hasegawa advised that at the current pace, the Lottery may fall slightly short of the budgeted goal of \$3.65 billion, but with four months left in the fiscal year and with big jackpot games such as MEGA Millions and SuperLOTTO Plus, a lot will depend on what types of rolls will come. The Scratchers games are up about \$100 million over sales from last fiscal year and Lotto (MEGA Millions and SuperLOTTO Plus combined) is up approximately \$60 million. The Daily Games and Hot Spot show very slight decreases over last year's levels.

Since November, with the current advertising campaign and since the Lottery had its first big MEGA Millions jackpot winners, sales have been trending up. This is also evident for jackpots under \$20 million. The general public tends to only play when the jackpots get really big. For jackpots in the \$100-\$150 million range, sales were up about 55% over sales for the same jackpot levels prior to November. Jackpots of \$150-\$200 million saw sales nearly twice as high as similar jackpots in November. Jackpots between \$200-\$250 million more than doubled in sales for a similar size jackpot earlier in the fiscal year. The playership has grown for these larger jackpots as consumers become not only familiar with MEGA Millions, but also have become more involved with the brand and have a stronger attitude towards the product.

Pat Meroney advised the Commission that staff does not propose any adjustments to the 2005/2006 budget for this fiscal year at this time. Sales are tracking at slightly below the budgeted level, but expenses are also tracking below the budgeted level. Based on information through February, expenses are tracking at about 11.5% of sales and the budgeted goal for the year is 11.8% of sales. The prize expenses are tracking at about 54% of sales, and the budgeted prize expense is about 54.2%. If the sales performances continue, revenues for education will be over \$1.2 billion, perhaps as high as \$1.25 billion. This is about \$75 million above last year's performance and the contribution to education would be the highest in the 20-year history of the Lottery.

At the last Commission Meeting, Mass asked staff to research the Lottery's overhead and expenses for the lower selling games. Hasegawa informed the Chairman that since the launch of the daily games and Hot Spot, there have been very few expenses incurred to support any of these games. Consumer messages on the Hot Spot game are done through the monitors that are at retailer locations. Every few years the Lottery allocates a modest amount of money to buy in-store signage for Hot Spot. There are no extra expenses required to operate the daily games. The cost of the gaming system, the play slips that consumers use, and the ticket stock is part of the GTECH contract, which is based on a flat percentage of sales. The Lottery's cost for these games came when the games were first developed and introduced.

b. Presentation: A Day in the Life of a District Sales Representative

Metzger advised the Commission that there are nine district offices and the Lottery has approximately 132 District Sales Representatives (DSRs) that cover the entire state. The DSRs average anywhere from 120 to 170 retailers that they visit on a bi-weekly basis. The variance is due to the geographic territory assigned to the DSR. Some of the DSRs travel more than two hours to their district office to pick up supplies and another two hours back to their territories to service the retailers.

A van is needed to pick up supplies that will last up to two weeks before the DSR will be back in the district office to gather more supplies.

The DSRs merchandise the Lottery's point of sale from the banners that are seen at the retailers to the free-standing signs. The DSRs deliver and install ticket dispensers which are kept at the various district office warehouses. A warehouse is needed to store all of these items so that they are ready and available to the DSRs.

The DSRs are responsible for managing the retailers' inventory and for picking up tickets at the end of a game. The DSRs train all of the retailers and their clerks on the promotions of new games, how to load the vending machines and service the self-service terminals.

The DSRs work with the Lottery's Revenue and Collection section to help the retailers who have payment problems. DSRs work with the retailer to establish an in-store accounting process, so that the retailers have an understanding of the Lottery's billing cycles and how to best manage their tickets and ticket inventory. The DSRs use the retailers' own sales information to analyze the trend at the retailers and to encourage the retailers on how they can sell more games by better in-store promotion. Metzger presented a slide show of photographs to the Commissioners describing "A Day in the Life of a District Sales Representative."

c. Organizational Review of Vacancies and Position Allocations

Cassandra Lichnock presented the organizational review to the Commission. Human Resources staff first met with Division Directors to identify non-essential processes and functions that could be eliminated. Overtime usage was assessed and eliminated for non-critical needs. Comparing the same seven months of the 04-05 and 05-06 fiscal years, the Lottery reduced overtime usage by over \$100,000. With the exception of the Security Division, which has taken on additional responsibilities for the MEGA Millions Draws, all divisions significantly reduced overtime.

Temporary help usage was reviewed to determine if the Lottery was substituting temporary workers for full-time staff. Temporary help includes intermittent employees and retired annuitants. The Sales Division utilizes 70% of our temporary help funds due to positions such as DSRs and warehouse workers in the Lottery's distribution warehouses. The increase in the use of temporary help indicates that

the Lottery is relying more on intermittent employees and retired annuitants to address workload created by vacancies.

Staff also looked at the organizational structure in relation to changing conditions. The Customer Service Division was consolidated into the Finance & Administration Division and renamed Claims and Player Services Department. Customer Service has been moved into the newly formed Corporate Communications Division. Staff consolidated all communications to optimize effectiveness of communications between the Lottery and the education community, the legislature, players, retailers, and members of the public.

Staff looked at the Marketing Division and found that there is much more complexity in the game development process. New techniques for promotions and advertising have come into existence and when the division was last reorganized in the early 1990's, additional functions should be incorporated into the Marketing Division. Another organizational consideration that affects staffing is the addition of 1,250 new retailers.

In recent years, Lottery sales have steadily increased while the staffing level has remained constant at 650 budgeted positions. The Lottery is currently operating with a vacancy rate of approximately 115 positions. Staff believes that it can comfortably eliminate 30 vacant positions from the 06-07 fiscal year budget and still maintain over a 7% vacancy rate through general staff turnover.

d. Update on Merger of GTECH with Lottomatica

Melissa Meith explained to the Commission the two phases of a background review that is taking place because of the merger of GTECH with Lottomatica. The first is the criminal history background review required by law that the Security staff is performing right now. Staff went through the process of collecting information and is now in Italy going through police records, since there is no database here in the United States.

Second, staff is looking at a forensic investigation into the economics of this new entity. A total of 27 lotteries in the United States have joined together through the North American Association of State & Provincial Lotteries (NASPL). NASPL sent out a Request for Proposal (RFP) looking for a company that could do an economic review. The selected company is Grant Thornton, an accounting and management consulting firm with a specialty in forensic investigations of this type. The firm will conclude its report in about 45 days.

Bill Hertoghe said that the Security staff is in Italy and is being assisted by the FBI, both in Milan and in Rome. The Lottery is also joined by the Nebraska and Oregon state lotteries. Staff had excellent support from GTECH in retrieving disclosure documents and personal history statements on almost 20 owners and officers. The disclosures are needed in order to run background checks and criminal history

checks. Hertoghe is receiving daily reports via email and everything is progressing well.

9. Consent Calendar

- a. Approval to Amend Audit Contract with KPMG to Extend for Two Years and Add Funds
- b. Approval of Lease Agreement for Riverside District Office
- c. Approval of Technical Amendments to Lotto Regulations and Removal of Payment Pre-Selection (SuperLOTTO Plus®)
- d. Approval of Amendment to All Steel, Inc. Contract for Modular Furniture Reconfiguration

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

10. Action Items

- a. Approval of Addition to General Regulations Regarding Real Property Transactions

Meith advised the Commission that Item 10(a) was a follow-up to an item that was discussed at the last meeting. Staff would like to adopt a regulation that talks about the Lottery's standards for leasing property. There are nine leased properties, eight for the district offices and a warehouse in Southern California. Staff feels some standards are needed to articulate the Lottery's real estate needs.

The proposed regulation points provide that the Security Director may conduct background investigations on landlords as with contractors.

The question at the last Commission Meeting was, "when should the director sign a lease prior to Commission approval?" The proposed regulation provides that leases will be approved by the Commission because leases generally over \$250,000, except in those instances where a favorable deal may be lost if staff wait for the next Commission meeting. If the Chair agrees, the Director can commit to signing the lease so that the Lottery can take advantage of that opportunity. The lease agreement would be reported at the next Commission meeting.

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

- b. Approval of Scratchers® Game Profiles for Games 473, 474, 475, 476, 477, and 478

Hasegawa reported that the Scratchers games that the Commission approved at its October meeting were the first games printed under the new contract with Scientific Games, the Lottery's primary instant ticket provider. The transition was

smooth with the efforts of not only Scientific Games, but also GTECH and the Lottery staff communicating specifications and the need to test the tickets to make sure that the tickets be read by our gaming system and meet the Lottery's security standards. Hasegawa introduced Mike Chambrello, President and CEO of Scientific Games, who provided background information on the company.

Kossack went over the Game Profiles for Scratchers Games 473, 474, 475, 476, 477, and 478 for June and July. Game 473, "In the Chips" is a \$1 game with a key number match playstyle with a specific variant. Players can automatically double their prize by uncovering a 2x in the play area. Players can win up to five times on a single ticket, with a top prize of \$5,000 and overall odds of winning at 1 in 5.28.

Game 474 is a \$2 game with a key symbol match playstyle. Players can win a prize by uncovering "money bags," "pot of gold," "gold coin," and/or the dollar symbol on a ticket. The more money bags revealed on the ticket, the larger the prize won by the player. Players can also win a prize by uncovering a pot of gold (\$5), a gold coin (\$50), or the double dollar symbol (\$250). The unique feature for this game is the ability to deliver over \$50 million dollars in prizes to players. The top prize for this game is \$20,000 and overall odds of winning are 1 in 4.73.

The final game for June is Game 475, which is a poker themed game. This game is a \$3 game focusing on the use of cards, with a "Yours Beats Theirs" popular playstyle. In this game, there are six straight poker hands where the player will try to beat the dealer's hand. The top prize on this game is \$50,000, with overall odds of 1 in 4.

In July, Game 476 is a \$1 game with an animal theme. It will feature a popular match 3 playstyle and players can win \$20 automatically by uncovering the special symbol in the quick spot. The top prize in this game is \$2,000 and the overall odds of winning are 1 in 5.3.

Game 477, "Spicy Hot Cash" is a \$2 game utilizing a key symbol match playstyle with a specific variant and the ability to win up to ten times on one ticket. Players can also triple their indicated prize by uncovering a "chili pepper" symbol. The top prize for this game is \$10,000 and the overall odds of winning are 1 in 4.74.

Game 478 is called "Emerald Green 7's." It is a \$3 key symbol match playstyle and has a feature that allows players to win up to 12 times on a ticket, possess the ability to multiply the prize seven times in the indicated prize amounts shown by uncovering a green seven symbol and to automatically win a prize by uncovering a black seven in the play area. Players can also win \$1,000 by uncovering a green emerald symbol. The top prize for this game is \$47,777, with overall odds of 1 in 4.06. This game was attached for the Commissioners information, as no approval is required because it is materially similar to Game

458, "Sapphire Blue 7's" which was approved at the October 2005 Commission Meeting.

Doon stated that since Game 478 did not need Commission approval, it should be excluded as an Action Item. Montes approved the omission of Game 478 as an Action Item. Seconded by Mass. The motion passed unanimously (4-0).

Doon moved Action Item 10(b) for Game Profiles 473-477 for approval. Seconded by Ortega. The motion passed unanimously (4-0).

11. Commissioner General Discussion

Montes congratulated Ortega on his confirmation. Ortega spoke of his meeting with Nettie Sabelhaus, Appointments Director for the Senate Rules Committee, and her concern with problem gambling. Ortega proposed that staff look into the possibility of some type of presentation or short video that would be shared at the high school level, particularly graduating seniors, on the issues of problem gambling. This would show the Rules Committee and Legislators that the Lottery shares their concern about problem gambling.

Meith stated that Lezlie Puglia, Communications Director, is reviewing the Lottery's problem gambling program. She is looking at ways to discourage youth gambling in a way that supports our beneficiary by working with school affiliated organizations. The Lottery supports a problem gambling hot line and is the first organization in this state to do so. Hasegawa mentioned that the month of March was National Problem Gambling Awareness week and the Lottery aired Anti-Problem Gambling Public Service Announcements for the entire month.

12. Scheduling Next Meetings

The next Commission meetings are scheduled for May 16 2006, and June 27, 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 11:53 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 12:25 p.m.