

CALIFORNIA STATE LOTTERY COMMISSION

Minutes – October 16, 2007

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 10th Street, Sacramento, California 95811.

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

Chairman John Mass

CSL Staff and presenters:

Joan Borucki, Director

Linh Nguyen, Chief Deputy Director

Kate Killeen, Acting Chief Legal Counsel

Heather Lambert, Acting Deputy Director of Communications

Bill Hertoghe, Deputy Director of Security and Law Enforcement

Susan Kossack, Product Development Manager

Michael Brennan, Deputy Director of Sales & Marketing

Patt Eberhart, Deputy Director of Finance & Administration

Elisa Topete, Assistant to the Commission

Joyce Crandall, Recording Secretary

4. Consider Approval of the Agenda

Mass asked if any of the Commissioners wanted to make changes to the October 16, 2007 agenda as proposed. Ortega moved to approve the amended agenda. Seconded by Montes. The motion passed unanimously (3-0).

5. Approval of Minutes

Mass asked if there were any additions or corrections to the August 15, 2007 minutes. Montes moved to approve the minutes. Seconded by Ortega. The motion passed unanimously (3-0).

6. Commission Liaison Reports

Commissioner Montes:

Montes attended The Big Spin® tapings on August 26 and September 30.

Commissioner Ortega:

Ortega was updated by the Security and Law Enforcement Division on a Roseville 7/Eleven Grand Theft case and a bomb threat received by the Van Nuys District Office. Ortega was also briefed on two cases in the San Bernadino area regarding altered tickets.

Chairman Mass:

As Procurement Liaison, staff briefed and requested approval on the following items: a contract award with Union Bank as a result of an Invitation of Bid (IFB) #2686 for Electronic Fund Transfer Service to process payments from retailers for the sale of Lottery Tickets, a contract award with Contract Marketing Resources (CMR) as a result of an IFB for Modular Furniture Systems Services to provide installation, reconfiguration and maintenance of modular furniture for the Lottery, and an approval for the purchase of Security Communications Equipment (two-way radios, and related software) for the Security and Law Enforcement Division.

As Marketing Liaison, Mass was briefed by staff that the Sales and Marketing Division began hosting events at various Sears Stores and shopping malls and the Hot Spot® “Mystery Doubler” promotion started on October 1. In-store point of sale and merchandising materials for the Lottery’s 2007 Holiday effort are being produced. The gift cards are being manufactured through GTECH and store displays have been designed and are in production by Alcone Marketing. Staff conducted two very successful holiday sell-in kickoff meetings, one in Anaheim and one in Sacramento. The meetings covered November and December Scratchers®, Gift Cards, Raffle, and holiday marketing programs. Mass was also briefed on Item 9(a), the Scratchers® Game Profiles.

7. Director’s Report

Joan Borucki, Director, went over recent Lottery personnel changes which included the loss of the Chief of Internal Audits, the announcement of Kate Killeen, who is now acting Chief Counsel and new employee Terry Murphy, Deputy Director of Special Projects. Borucki also announced that Jim Hasegawa is now Deputy Director of Business Planning and Susan Kossack will oversee the combined Game Development and Marketing Units.

a. Estimated Sales Through 09-30

Borucki reported on the state of the budget and at the current pace, the Lottery is expected to come in at \$3.25 billion for sales. The pace of sales would put the Lottery at about \$157 million short of the budgeted goal, however the sale pace is about 5%

ahead of where it was last fiscal year at this time. SuperLOTTO Plus® and MEGA Millions® are both over budget: SuperLOTTO Plus® by 14% and MEGA Millions® by 24%. Sales for both are on pace with where they were last fiscal year.

Scratchers® had been estimated in the budget to achieve at least \$1.8 billion, however currently it is about 16% off on the sales pace. The sales are similar to where it was last year at this time and at the end of the year, Scratchers® did come in with the estimated budget amount. Prizes are running high on the prize pay-outs. Staff had budgeted 57.5%, but it is running at 57.89%. Staff is currently doing analysis to figure out why it is higher.

Fantasy 5® and Daily 3® are both on target with budget estimates. Daily Derby® is over 104% which might be due to the fact that the current jackpot is at \$903,000. The Hot Spot® game is currently in a promotional period which started October 1 and ends November 2. Hot Spot® overall is running about 13% behind last year's pace. The Lottery's estimated expenses through September are 11.3%. Last fiscal year it was about 11.8% at this time.

Discussion by Commissioners.

b. NASPL / MEGA Millions® Meeting

Borucki reported that she and several Deputy Directors attended the annual North American Association of State and Provincial Lotteries (NASPL) Conference in Louisville, Kentucky. The conference was done jointly with the World Lottery Association so there were lotteries from all over the world. Staff brought back ideas on potential games and potential marketing. A MEGA Millions® Director's Meeting was held at the conference as well. The directors discussed marketing and press coordination as well as other promotional things that could be done jointly between the 12 states.

c. Retailer Actions

Bill Hertoghe, Deputy Director of the Security and Law Enforcement Division (SLED), presented a background on the function of the Retailer Sanction Unit followed by statistics of sanction activity between July 1 and September 30, 2007. The Retailer Sanctions Unit reports to the Chief Lottery Agent of Headquarters who coordinates with field operations to conduct retailer sanction investigations in the field when necessary. An update of sanction activity will be presented at each subsequent Commission meeting. (PowerPoint presentation attached)

Discussion by Commissioners.

d. Legislative and Outreach Updates

Heather Lambert, Deputy Director of Communications, advised the Commission of a hearing on October 17 with the Senate Governmental Organization (GO) Committee regarding the true value of the Lottery. The committee will be exploring some of the deals that have been put forward and will look to Joan for some information on how the

Lottery is currently run. Lambert reported that the bill-signing season is over and the bills that staff is monitoring have turned into two-year bills. Assembly Bill 1339 which has to do with problem gambling, ultimately formalized an advisory group that currently exists. It slightly expanded the membership and the Governor saw fit to veto the bill, believing that the initiatives and ideology of the bill was currently being executed within the California Office of Problem Gambling. Assembly Bill 1251 is also being monitored by staff because it is the Lottery's bill to resolve the time frame with the MEGA Millions® game.

The Business Plan was released and outreach was done to various education and business groups and statewide organizations that the Lottery deals with. Lambert has been planning National Problem Gambling Awareness Week, which will be in March, 2008. Staff is working with an advisory group of various state and local entities.

Major League Baseball wrapped up after attending every Major League Baseball park with Superintendent of Public Instruction Jack O'Connell. Local distinguished schools were honored at each of the games. The Teachers of the Year recipients will attend The Big Spin® Show and the Women's Conference.

Lambert reported on the various conferences that were attended as well as future conferences. Staff attended the California Hispanic Chamber, California Black Chamber and the League of California Cities, had successful exhibits and enjoyed meeting with local elected officials and local business owners. Future conferences include; the Women's Conference and the California Science Teachers Conference in October. In November staff will attend; the Association of California School Administrators Conference; the California State Association of Counties; the Peace Officer Research Association of California; the Women in Law Enforcement; and the California School Boards Association. Lambert is working with SLED to make sure that local law enforcement is aware of the Lottery's public safety division.

e. Holiday Promotions and Products

Michael Brennan, Deputy Director of Sales & Marketing, went over the Lottery's holiday promotions and products. Brennan went over details for the New Years Raffle which begins November 19. "It's the best odds to win a million dollars" is the tag line and it is a single prize point with one drawing and is an easy gift-giving idea. Brennan went over the prizes and odds of winning. The sale will end on December 30 or sooner if it sells out. The drawing will be on December 31 and the results will be available on the terminal winning numbers report on both the Lottery's public and business web sites as well as an 800 number.

Brennan introduced the Lottery gift cards, which is the first of its kind in the nation. Retailers are excited about it and it will be a great way to encourage additional sales, repeat play, and allow the Lottery to spread its presence throughout the retail environment. The cards will be available to the retailers and players can purchase both scratch and draw game tickets. The cards can be activated at the Altura or Quick Terminals. There is no activation fee, maintenance or reload fee or expiration date.

The cards can be reloaded at \$10 increments, not to exceed \$200. The card will have no value until it is activated, so it is safe out on display. Retailers must provide a receipt displaying the gift card value to the buyer and it is the first time that Lottery employees may be able to buy the card and give it as a gift. There are three types of gift cards, the standard Lottery gift card, the Jackpot Captain's card and a promotional card that will be used throughout the season.

Brennan went over the November and December Scratchers® and stated that the holiday gift packs are returning and will be sold in mall locations and select chain retailers. The "Golden Goose" is a \$1 game with a pay out of 53½% and the "Double It" Game is a \$2 game with a 56.97% pay out. There is a gift tag Scratchers® \$1 game which will have 12 scenes to match three with a quick \$10 spot and a top prize of \$1,000 with a 53.4% pay out. "Holiday Bingo" is a \$3 game with a 60% pay out and odds of winning at 1 in 3.79. The "Hot Spot" Scratchers® game will come with a new color mark technology. It will be a \$3 game with odds at 1 in 59.4%. "Gold 7's" is a \$2 game with a pay out of 56.2%. Finally, "Mad Money" is a \$1 Scratchers® game that was put together in partnership with Overture Films. It is a film that will premier in January and the premier experience is one of the second chance prizes that Overture is offering. Additionally, there will be other drawings that will include a future walk-on role in an upcoming movie, tickets, copies of DVD's posters and local screenings.
(PowerPoint presentation attached)

f. Business Plan Action Items Update

Linh Nguyen, Chief Deputy Director, gave a briefing on several major projects that staff is working on from the Business Plan. He went over the overall marketing and branding campaign which is the largest initiative of the Business Plan. Staff has been doing some creative work with the Lottery's creative work with the advertising agencies and other partners. The Lottery is settling on a brand message, then developing an 18 to 24 month calendar and laying out a very comprehensive marketing plan. The marketing plan will not only include an advertising TV and radio campaign; it will also include player promotions, the Lottery's website, retailer recruitment, new game offerings, internal communications as well as outreach, and point-of-sale materials. In January, there will also be 10-15 second television and radio spots that encourage Lotto play at lower jackpot levels.

Another item of the Business Plan is the "Suite of Daily Games." Several game options have been researched and the best option for the Lottery would be to offer a traditional Daily 4 game, which has been successful in other states. The daily games would now include a Daily 3®, Daily 4 and Fantasy 5 Game.

Staff has been researching a new Lotto game and has developed a game based on what Lottery players have been wanting for a long time. The Lottery is looking at five potential Lotto games designed to offer \$1 million to ten different people as opposed to \$10 million to one person. The Lotto game would be positioned separate and apart

from MEGA Millions® or SuperLOTTO Plus®, which are jackpot-driven games. Early testing on the Internet has been promising and staff is also doing some field testing using the District Sales Supervisors, who are getting research from players in the field.

Nguyen reported on the public website redesign so that the new marketing and branding effort can be communicated. The Lottery hired Human Factors International to evaluate the current website, interview personnel and conduct user-centered research to determine needs and customer segmentation. Human Factors will then develop a navigation structure and an information architecture to develop a future website. The analysis will take into consideration consumer convenience, expansion of the Jackpot Captains Program, and the implementation of a player loyalty program.

Discussion by Commissioners.

8. Consent Calendar

There were no items on the Consent Calendar.

9. Action Items

a. Approval of Scratchers® Game Profiles for Games 540, 541, 542, 543, 544, 545, and 546 Profiles

Susan Kossack, Chief of Product Development, presented the proposed games for January and February, 2008. Game 540 is a \$5 Key Number Match playstyle with a Multiple Win variant, allowing players the chance to multiply their prizes 10 or 20 times. In addition to the opportunity to win one of 15 distinctive \$1 million top prizes, players will have another chance to win one of five \$1 million prizes by entering their non-winning tickets into second chance drawings. The overall odds of winning are 1 in 3.82. Game 541 is a \$1 game with a Match 3 playstyle. When three lucky-themed symbols are matched, a prize is won and if a specified symbol is revealed, the prize shown is tripled. The top prize for the game is \$3,000 and the odds of winning are 1 in 4.97.

Game 542 is called "Blazing 8's" and is a Key Number Match playstyle with two specific variants for the western-themed game. The overall odds of this game are 1 in 4.30 and the top prize is \$8,888. Game 543 is a \$3 game called "Solitaire." As a fresh addition to the current extended-play game portfolio, staff recommends the re-introduction of Solitaire. Players have four chances to win and the top prize is \$25,000. The overall odds of winning are 1 in 4.27.

Game 544 is a \$1 game with a Match 3 playstyle and a Quick Spot in which players can win a \$7 prize instantly. The top prize is \$777 and the overall odds of winning are 1 in 5.24. Game 545 is called "Diamond Dazzler." The \$2 game will utilize a Match 3 playstyle with two specific variants, a Multiplier and Auto-win. The top prize is \$10,000 and the overall odds of winning are 1 in 4.66. Game 546 is a \$3 "3-D" game with cubic-inspired graphics that offer three tic-tac-

toe games on one ticket. Players win a prize by finding three like symbols in a horizontal or vertical row. The top prize is \$20,000 and the overall odds of winning are 1 in 3.65.

Mass asked if anyone from the audience had any questions on Action Item 9(a). No one came forward so he proceeded to the motion of approval.

Ortega made the motion to approve Action Item 9(a). Seconded by Montes. The motion passed unanimously (3-0).

b. Approval of Contract for Small Business Parcel Delivery to United Parcel Services

Patt Eberhart, Deputy Director of Operations, requested approval of a contract with United Parcel Service (UPS) for small business parcel delivery. The contract is for two years, with an option for four one-year extensions and a cost not to exceed \$250,000. The Invitation for Bid (IFB) was released in May and 39 potential vendors were retrieved from the database. It was advertised on the Lottery's website and also Department of General Services' State Contracts Register.

The proposals received from FedEx and UPS both passed mandatory evaluation. FedEx proposed the lowest rate and was announced the apparent successful vendor. However, the FedEx submittal contained incorporated directions and questions to the IFB. The conditions were not reviewed during the evaluation process. The contractor administrator learned that FedEx hires independent contractors to perform its pickups and deliveries. For security reasons, the IFB specifically requires employees to perform the delivery. FedEx was asked to clarify and respond to the administrator that the contractors were going to be performing the pickups and deliveries. For this reason, the Lottery disqualified FedEx for not meeting the scope of services. UPS was announced the apparent successful bidder.

Discussion by Commissioners.

Mass asked if anyone from the audience had any questions on Action Item 9(b). No one came forward so he proceeded to the motion of approval.

Montes made the motion to approve Action Item 9(b). Seconded by Ortega. The motion passed unanimously (3-0).

c. Approval to Hire Project Management Consultant

Borucki asked the Commission for approval to hire a project management consultant to develop the planning and design of a new Headquarters facility and manage its construction. With approval, Borucki will begin negotiations with a firm to arrive at a final scope and price. Three different bids have been solicited

for the Headquarters facility from three different firms, with two of the bids being very qualified. Staff is looking at a cost not to exceed \$6.3 million and that cost is a very inclusive price tag which includes things such as permits, fees, environmental process, architectural and engineering drawings and will take it through construction and project management as well, for three years. It does not include the actual building construction costs which will range anywhere from \$40 million to \$60 million.

The Lottery has been in this facility since day one and it was initially leased, than later purchased. Several buildings were added on to this facility, however it no longer meets the Lottery's needs. The biggest concern is that there are close to \$20 million in improvements that are needed and the building is being carried as a \$22 million asset.

The building was initially designed for a staffing level of 1,600 employees. The Lottery's current staffing level is 400 employees. It would not be such a concern if there was better leasing opportunities, but because of security concerns and the improvements that are needed, the Lottery is not able to take advantage of that so the recommendation is to replace the facility.

Alfa Tech Cambridge was brought in to look at the different options for the Lottery from going to a turn-key operation off site, building new on the existing site or rehabbing this particular building. Staff is recommending to remain on-site, with a new building on-site. Borucki would like to structure a contract with a project-management consultant to take the Lottery to a point, through land entitlements and 30% design, to allow staff to have a better cost estimate to bring back to the Commission for review.

Discussion by Commissioners.

Mass asked if anyone from the audience had any questions on Action Item 9(c). No one came forward so he proceeded to the motion of approval.

Ortega made the motion to approve Action Item 9(c). Seconded by Montes. The motion passed unanimously (3-0).

d. Approval to Hire Consultant to Review Business Processes

Eberhart requested the approval of a contract with Grant Thornton, LLP, for a review of business processes. The contract would be executed with the costs not to exceed \$330,000.

Over the past decade, the Lottery has undergone many changes without an in-depth review of its business policies and processes. Changes have included implementation of new games, new gaming system and will include additional

games, new retailer business models, recruitment of new retailers and other trade styles. Because of staff resource constraints, knowledge lost by retiring staff and ongoing business changes, staff is requesting to hire a consultant to assess business operations and make recommendations to improve policies, processes and systems.

To minimize costs and reduce staff time, staff is recommending a consultant with extensive Lottery experience and Grant Thornton has the knowledge and expertise. Grant Thornton has assembled a well-qualified team which includes a former New York Lottery Director, to assess the Lottery's back office systems and provide recommendations.

Mass asked if anyone from the audience had any questions on Action Item 9(d). No one came forward so he proceeded to the motion of approval.

Montes made the motion to approve Action Item 9(d). Seconded by Ortega. The motion passed unanimously (3-0).

e. Approval to Add Funds to Research Contract

Linh Nguyen, Chief Deputy Director, advised the Commission that the Lottery Act requires the Director to "make an ongoing study" of "the reaction of citizens of the State to existing or proposed features in Lottery Games." The Lottery Act requires the Director to "engage an independent firm experienced in demographic analysis to conduct a special study which shall ascertain the demographic characteristics of the players of each Lottery Game." The Lottery satisfies the requirements through a contract with Synovate, Inc. Nguyen requested expenditure augmentation of \$300,000 to the Synovate Research contract. The contract began on June 2002 and at that time, the Commission authorized the contract expenditure of \$2.1 million, with the contract term ending on June 30, 2008. Over the course of the contract, staff has made augmentation requests such as additional questions to the survey. Such augmentation requests are an additional cost to the Lottery. The funding for the \$300,000 is budgeted and staff is requesting approval for the expenditure authority.

Mass asked if anyone from the audience had any questions on Action Item 9(e). No one came forward so he proceeded to the motion of approval.

Ortega made the motion to approve Action Item 9(e). Seconded by Montes. The motion passed unanimously (3-0).

10. Commissioner General Discussion

Montes asked Tricia Metzger, Deputy Director of Sales, about specifics concerning the L.A. County Fair. Metzger advised the Commission that 416,395 tickets were sold in 18 days. Approximately 81% of the sales were Scratchers® tickets. There were about

1,365,000 people in attendance, which was up about 5% and sales were up almost 13%. George Safar of Lone Hill Liquor was the retailer.

11. Scheduling Next Meetings

The next Commission meetings for 2008 are tentatively scheduled for January 9, March 19, May 21, June 25, August 20 and October 15 at the Lottery Headquarters in Sacramento. The times for the meetings will be determined.

12. Public Discussion

Mass stated that Aaron Wilson from Alfa Tech Cambridge Group had signed up to speak. Mr. Wilson no longer wanted to address the Commission. Mass asked if anyone else from the public had anything to discuss. No one came forward, so he proceeded to the next item on the agenda.

13. Closed Session

The Commission moved the Closed Session to follow the Consent Calendar and convened at 11:05 a.m. to confer with and receive advice from counsel regarding pending litigation: California Coalition Against Gambling Expansion, et al. v. California State Lottery Commission; technology patents, use taxes, and headquarters facility issues. The Commission reconvened at 11:45 a.m. and continued with the Action Items.

14. Adjournment

Meeting adjourned at 12:12 a.m.