

CALIFORNIA STATE LOTTERY COMMISSION

Minutes – May 24, 2007

Pasadena, California

1. Call to Order

Chairperson John Mass called the public meeting of the California State Lottery Commission to order at 10:04 a.m. at the Pasadena City Hall Council Chambers, Pasadena California 91105.

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, Executive Division

Linh Nguyen, Executive Division

Don Currier, Executive Division

Heather Lambert, Executive Division

Susan Kossack, Executive Division

Scott Ralston, Security/Law Enforcement Division

Elisa Topete, Assistant to the Commission

Stacy Matsunami, Recording Secretary

4. Consider Approval of the Agenda

Mass asked if any of the Commissioners wanted to make changes to the May 24, 2007 agenda as proposed. Joan Borucki, Director, advised the Commission that staff wanted to remove Action Item 9(d) because there was no longer an action to take up. Ortega moved to approve the 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 February 28, 2007 minutes. Ortega moved to approve the minutes. Seconded by Montes. The motion passed unanimously (3-0).

6. Commission Liaison Reports

Commissioner Ortega :

Ortega mentioned that he was not able to attend the Lottery's American Idol Grand Finale on May 23, 2007. Ortega was briefed on the GTECH/Lottomatica investigation in Rhode Island, Boston and Italy. Staff briefed Ortega on the Underage Gaming Enforcement and Education Program, with the pilot beginning on June 1, and was briefed on the acquisition of OGT by Scientific Games and the pending disclosure investigation.

Commissioner Montes:

Montes attended The Big Spin® tapings of March 11, April 15 and May 20. Montes attended the Lottery's American Idol Grand Finale Event on May 23 and publicly thanked Director Borucki for the outstanding job done by the Lottery staff.

Chairman Mass:

Mass was updated on Lottery sales and as Procurement Liaison, staff briefed and requested approval on the following items: Non-competitive Contract with Cambria Solutions to provide consulting services for a best practice and organization assessment of the Lottery; a purchase order to Ross Clark Material Handling for a new pallet rack storage system for the Sacramento Supply Warehouse; a Interagency Agreement with the Department of Justice to conduct criminal history checks; and the release of a competitive bid solicitation to procure the services of a contractor to provide small parcel delivery service.

As Marketing Liaison, Mass was updated by staff on the American Idol Scratchers® and sweepstakes, as well as the ongoing Major League Baseball Scratchers® advertising promotions and Item 9(a), the Scratchers® Game Profiles.

7. Director's Report

a. Financial Statements for December 31, 2006 Update

Borucki advised the Commission that pursuant to Government Code section 8880.22, the Lottery is required to make quarterly reports on operations. Staff has prepared the statements and has requested the transfer of \$286 million on February 27, 2007. The money transferred to the State Controller's Office will be transferred to education for the quarter.

b. Update on Final Distribution Network Evaluation

As mentioned in previous meetings, the Lottery hired a consultant to come in and do an assessment of the Lottery's basic business model for ticket distribution and point-of-sale materials distribution. Studley, Inc. was brought in to also review the Lottery's ticket order generation and processing practices, with a focus on opportunities for more efficient order processing and to provide recommendations for the design and geographic placement of future warehouses. Studley's findings were that the Lottery's business model that was being used for ticket distribution was

appropriate and was fairly efficient, but could use some improvement. Studley felt that the Lottery's contract with UPS for ticket delivery was well managed and cost-effective. It was recommended that the Lottery keep the function in-house, rather than outsourcing it or having a third party come in and manage it.

The significant recommendation that the Lottery is moving on is the consolidating of all point-of-sale materials, warehousing, inventory control and shipping, and moving it to the Southern Distribution Center, where the majority of the business is. It is currently being housed in a separate facility in Northern California. Staff is also putting in a racking system, to get more space efficiency and also help the workers with safety concerns. To improve ticket order processing efficiency, the Lottery is looking at a special "Pick to Light" automation system to make it easier for employees to pack ticket orders for shipment. A more efficient process for applying shipping labels should be implemented with Lottery staff applying the labels at the time of order packing.

As mentioned before, the Lottery is also in the process of looking for new warehouse space, both in Northern and Southern California. Staff will be bringing the actions back to the Commission once suitable space is found.

Discussion by Commissioners.

c. GTECH / Lottomatica Disclosure Update

Scott Ralston, Chief Lottery Agent, advised the Commission that in March 2007, an updated disclosure investigation of Lottomatica and GTECH was conducted by the Security/Law Enforcement Division. During the investigation, Lottery staff met with Italian authorities, the U.S. Embassy, the Federal Bureau of Investigation, and Italian law enforcement agencies, to run a check on the individual officers or directors. During the investigation, the Lottery found no adverse or disqualifying information on the company or any individual.

The De Agostini Group formed a holding company to layer the corporate structure of the ownership called B and D Holdings. With that restructure, staff conducted an updated investigation, along with a detective with the Oregon State Police and an investigator with the Nebraska Department of Revenue. Staff again went to the same contacts as before, met with the Italian Stock Exchange authorities, and once again, found no adverse or disqualifying information. Staff traveled to Boston to meet with the Security and Exchange Commission to discuss any findings on the investigation of GTECH concerning Brazil. The Lottery was assured that there was no adverse information and nothing to indicate that anything would disqualify GTECH, Lottomatica, or De Agostini. There is an open investigation and facts are continuing to be gathered.

d. Scientific Games Acquisition of Oberthur Gaming Technology

Ralston advised the Commission that on May 1, 2007, Scientific Games (SGI) purchased Oberthur Gaming Technologies (OGT). Both companies are under

contract with the California Lottery and both have been qualified by the division with current disclosure investigations. The Lottery has had longstanding relationships with both companies and staff has done a background on both companies' corporate officers, directors and shareholders and once again, no adverse or disqualifying information. With the acquisition, the Lottery has sent a letter to SGI, along with disclosure documents, to update the investigation and in the process the Lottery will meet with the California Department of Justice for the antitrust to make sure there are no issues. At this time, it is an open investigation.

Discussion by Commissioners.

e. Legislative and Outreach Updates

Heather Lambert, Deputy Director of Legislation and Community Outreach, reported on the continued meetings between Joan Borucki and the new legislative members. Lambert has heard good feedback from the members and there is a fair amount of information that has been shared in laying a good foundation for an understanding about the day to day work being done at the Lottery. In addition, Borucki has also met with both the Superintendent of Public Instruction and the State Controller.

Lambert went over some bills that are priorities to the Lottery. Assembly Bill 1251 is the bill to resolve the issue with the MEGA Millions® time frame. The bill passed on the Assembly Governmental Organization Committee as well as the Assembly Appropriations Committee, both unanimously and is scheduled to be heard on the Assembly floor May 24. Assembly Bill 1339 deals with problem gambling and is sponsored by the Chair of the Assembly Governmental Organization Committee. The Chair is aiming to formalize a problem gambling advisory group. The bill is in the Assembly Appropriations Committee, awaiting some amendments to revise the number of people that are part of the group. Finally, Senate Bill 440, which is the Florez bill, would prohibit the Lottery from joining or running an international or Internet-run lottery. The bill has passed through both committees and the Senate, and is over on the Assembly side.

Lambert reported that staff has started monthly communications with the Legislative offices by sending copies of games that are being introduced monthly, some high points of the office and what is going on at the Lottery. The offices are being sent voided Scratchers® tickets to experience first hand what player's experience. Staff is also spearheading a project to identify jackpot winners and significant 5 of 5 winners as well as retailers that sold the tickets to notify the legislative offices whose districts those people reside in.

Staff has set up exhibitor booths at a number of conferences, including California Charter Schools Association, California Association of School Business Officials, California Parent-Teacher's Association and a small conference with the Sacramento Chamber of Commerce. The booths were designed to answer questions and reach out to the various stakeholder groups and communities. The

National Teacher of the Year was named in April and although the teacher from California was not chosen, the representative was able to travel to Washington D.C. to take part in the ceremony. National Teacher Appreciation Week was in the beginning of May. The Lottery printed information about it on its *instant tickets, as well as a segment done on The Big Spin® show. (*staff meant to report draw tickets)

The Lottery attended the Distinguished Schools Ceremony on May 18. Staff is going to be working with the Superintendent's Office and some of the schools in the regions where the Lottery has Major League Baseball sponsorships, to honor the distinguished schools at various events throughout the year. During the game, the teachers will be honored either on the field or using monitors within the field. Lambert advised Commissioner Montes that the Commissioners would be receiving revised brochures that list the Lottery's contributions to public education.

f. Oberthur Gaming Technology Update

Don Currier, Chief Legal Counsel, gave an update on the visit to the Oberthur Gaming Technologies (OGT) plant in San Antonio in March, by him and the Security/Law Enforcement Deputy Director, Bill Hertoghe. The trip was to ensure OGT had taken remedial actions after the last ticket misprint incident. OGT concluded that the last misprint was caused by an OGT employee's lack of response to an audible alarm while using the dual pass print system. After closely examining the printing machines that use the dual pass system it was concluded that the Lottery will continue to use OGT for printing that does not require the use of the dual pass system. Currier and Hertoghe toured the facility to look at quality control and automation and OGT's processes in all other respects are at industry standard or above.

g. Major League Baseball Scratchers® Update

Borucki advised the Commission that the Major League Scratchers® are doing very well. Staff did a heavy coordinated advertising promotion and Public Relations campaign at the start of the initial first week of sale. The Marketing group used the Internet heavily with Yahoo.com, the Fantasy Baseball pages, and the different web sites of the five California Major League Baseball teams. The Lottery was also in the e-mail newsletters that the Giants and the Dodgers sent out. Staff also did "Wild Postings" in only Los Angeles, San Francisco, and San Diego which consisted of ads posted on boards surrounding construction sites. Staff is trying to coordinate with the different sponsorships and different packages that are obtained, to use towards emphasizing and rewarding the Lottery's beneficiary.

h. American Idol Update

Borucki reported that on May 23, staff along with the Lottery's vendor, MDI, organized a Lottery VIP viewing party in Hollywood for 90 American Idol Scratchers® winners and their guests. Staff received excellent feedback from the winners who were very excited and enjoyed the evening. The America Idol

Scratchers® ticket continues to sell, although not as strong as staff would have liked, but is holding its own.

i. Fiscal Year Sales Update

Borucki provided a sales report for Super LOTTO Plus®. Sales through April 30 are \$540 million. If the Lottery remains at the current sales pace, sales should be approximately \$635 million at year end. For MEGA Millions®, the revised budget was \$355 million. Sales through April 30 are \$339 million. At the current sales pace, sales should be approximately \$400 million at year end. Sales estimates for the fiscal year significantly exceed the revised budget due to the largest North American jackpot of \$390 million. The Scratchers® had a revised budget of \$1.760 billion. Sales through April 30 are \$1.527 billion. At the current pace, sales should be approximately \$1.850 billion at year end, however with the introduction of the \$5 game, sales could exceed the original budget of \$1.880 billion. The revised budget for the Lottery's other draw games such as Hot Spot, Fantasy 5®, Daily 3®, Daily Derby® and Raffle will be \$480 million. Sales through April 30 are \$394 million and at the current sales pace, sales for the fiscal year are estimated at \$469 million. When added up, the Lottery is now estimating that it will be close to \$3.4 billion at year-end, which is about \$200 million over the revised budget sales goal.

To conclude her Director's Report, Borucki introduced new staff member Michael Brennan, Deputy Director of Sales and Marketing.

8. Consent Calendar

There were no items on the Consent Calendar.

9. Action Items

- a. Approval of Scratchers® Game Profiles for Games 522, 523, 524, and 525 with Revisions to Previously Approved Games 516, 517, 518, 519, and 521 Profiles
Susan Kossack, Chief of Product and Development, brought forth the August and September game portfolios. Kossack first mentioned the "100,000 Club" Scratchers game coming in July. The \$5 game will have a top prize of \$100,000.

Games 516, 517, 518, 519, and 521 were approved at the January 17 and February 28, 2007 Commission Meetings. Since that time, staff has revised the Scratchers® product plan to better optimize profitability from the Scratchers® game portfolio. Staff recommends revising these game profiles to include renumbering of the games only.

For the month of August, Game 519, "Straight 8's" will have a Tic-Tac-Toe playstyle and uses "8" as the main visual. The \$1 game will have a prize structure that can deliver over \$1.2 million in prizes of \$25 to \$100. The recommended top prize for this game is \$888, with overall odds of winning 1 in 5.28. Game 521 is a \$2 game that will replace the existing "Multi-Money" game that was offered last year. Players can automatically win multiple prizes of five

times the amount shown on the game. The Key Number Match playstyle game will have a top prize of \$25,000 with odds of winning at 1 in 4.64. The last game for August is Game 522, "Doubling Star Crossword." Game 522 is a \$3 game with a top prize of \$20,000 and overall odds of winning at 1 in 3.27.

For September, Game 523 will be a \$1 game with a Key Number Match playstyle. The popular "7"s theme game will have a top prize of \$777, with overall odds of winning at 1 in 5.40. Game 524 is called "Super Match 3" and is a \$2 game with a Match 3 playstyle. It will have a \$10,000 top prize with overall odds of winning at 1 in 3.40. The final game for September is Game 525. It is a \$3 poker themed game with a \$50,000 top prize and overall odds of winning at 1 in 3.73.

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 to Amend the Contract with HSM Electronic Services, Inc. to Extend for Two Years and Add Additional Funds for Security System

Ralston advised the Commission that in August of 2004, the Lottery entered into a three-year contract with Honeywell International to provide security system services. The contract was valued at \$2 million and contained an option to extend for two years at the end of the initial three years.

Since the contract execution, Honeywell has been sold at least twice and the current owner of the company is called Stanley Works. Stanley Works operates under the name HMS Electronic Protection Services. Although the contract has been amended several times to reflect the ownership change, the terms and conditions remain the same and the contract is set to expire on August 31, 2007. The majority of the initial funding for the contract has been expended. On August 31, the Lottery will have a balance of approximately \$450,000 left. The monies have already been allocated for several existing proposed projects, including the relocation of the Lottery's Southern and Northern Distribution Centers, the proposed relocation of the Sacramento District Office, with the purchase of a backup Digital Video Manager (DVM) server at the Lottery's operation recovery sight.

Staff is asking to extend the contract for the additional two years and to add funds of \$600,000, of which \$409,000 will be allocated for monthly maintenance, \$100,000 for additional projects, and \$91,000 set aside for unexpected system repairs and modifications. Because of the complex state-of-the-art security systems in the district offices, the Lottery has been an example for other state agencies to come and view for demonstrations because of its capabilities.

If the extension is not approved, the Lottery would have to seek bids for a new contract knowing only two vendors are currently authorized to service the EBI software. The costs associated in procuring a new security system would greatly exceed the cost of extending the contract. Additional costs would also be incurred by GTECH as its contract requires it to interface with the Lottery's security system.

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.

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

c. Approval of Recommendations for Fleet Management

Borucki reported that the Lottery approached Mercury and Associates, an outside consulting firm, to evaluate current fleet management functions. Lottery staff worked with Mercury to identify issues, develop better policies, practices, and establish goals to ensure that the Lottery manages its fleet in accordance with best practices. The Lottery currently has a fleet of 222 vehicles and today, drivers schedule most of the service on assigned vehicles on an as needed basis. Pool vehicles are scheduled for service by either the District Office Manager or the Lottery's Fleet Manager. The study also discovered the lack of information regarding vehicle operations, including repair and cost history. Mercury's recommendation was that the Lottery hire an actual fleet manager to take on this type of operation. Based on the Lottery's financial analysis, Mercury also confirmed the Lottery's decision to purchase new vehicles instead of leasing replacement vehicles.

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.

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

d. Approval of Purchase of Property

Item removed.

e. Approval of the Business Plan

Linh Nguyen, Chief Deputy Director, presented the Commission the Lottery's Business Plan so that staff may begin allocating funding for specific initiatives. The development of the strategies is the result of a year-long process that began in May 2006. The effort consisted of holding strategic planning session with staff,

consulting industry leaders, other lotteries, marketing and advertising firms, vendors and consultants, gathering and analyzing data, conducting research studies, reviewing the history of the organization and assessing industry trends and best practices.

After the analysis and consideration of the options available to the Lottery, staff believes the proposed strategies represent the most effective way to increase contributions to our beneficiary. The essential elements of the strategy are: 1) focus on long term planning, 2) improve brand image, 3) shift the jackpot paradigm, and 4) modernize operations.

Approval of the strategies allows staff to begin the process of tying specific initiatives to the 2007/08 fiscal year budget and become the basis for the 2007/08 long range business plan. The proposed strategic direction will increase revenue in the short term and establish a strong foundation for long term growth. The final 2007/08 long range business plan and 2007/08 budget will be presented for approval at the June 2007 Commission Meeting. (See attached slides for reference)

Discussion by Commissioners.

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.

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

10. Commissioner General Discussion

Montes publicly thanked the Mayor and Council Members from the City of Pasadena for allowing the Lottery to hold the Commission Meeting in Pasadena's City Hall. Ortega mentioned the Governor's proposal of the privatization of the California State Lottery and his concern for staff. Ortega thanked Borucki for bringing some positive changes, specifically in the Business Plan. Ortega would also like staff to explore having a Commission Meeting, at least once a year in Southern California.

11. Scheduling Next Meetings

The next Commission meetings are tentatively scheduled for June 27, August 15 and November 7, 2007 at the Lottery Headquarters in Sacramento. The times for the meetings will be determined.

12. Public Discussion

The following individuals all spoke in regards to the issues between the Glendale Hilton and union supporters:

John Steele – Deacon of Holy Family Church

Triny Ramirez – Glendale Hilton, Housekeeping Department

Mark Westerberg – Glendale Hilton Employee

Joan Harper – Office of Justice and Peace for the Arch Diocese of Los Angeles

13. Closed Session (This item was taken out of order, immediately following Item 11 – Scheduling Next Meetings, before Item 12 – Public Discussion)

The Commission convened in a closed session at 12:05 p.m. to confer with and receive advice from counsel regarding pending litigation: California Coalition Against Gambling Expansion, et al. v. California State Lottery Commission; Lee v. California State Lottery Commission; Glendale Hilton Contract; Board of Equalization Decision

14. Adjournment

Meeting adjourned at 12:40 p.m.