

CALIFORNIA STATE LOTTERY COMMISSION

Minutes – March 19, 2008

Pasadena, California

1. Call to Order

Chairperson John Mass called the public meeting of the California State Lottery Commission to order at 10:00 a.m. at the Pasadena City Hall Chambers, 100 Garfield Ave., Pasadena, CA 91109.

2. Pledge of Allegiance

John Mass led the Pledge of Allegiance.

3. Roll Call

Mass asked Elisa Topete to call the roll. Mass welcomed Cynthia Flores as the newest Commissioner to the California State Lottery and wished Commissioner Ortega a Happy Birthday.

Commission Members Present:

Commissioner Rachel Montes
Commissioner Manuel Ortega
Commissioner Cynthia Flores
Chairman John Mass

CSL Staff and presenters:

Joan Borucki, Director
Kate Killeen, Acting Chief Legal Counsel
Jim Hasegawa, Deputy Director of Business Planning
Michael Brennan, Deputy Director of Sales/Marketing
Heather Lambert, Deputy Director of Communications
Bill Hertoghe, Deputy Director of Security and Law Enforcement
Susan Kossack, Deputy Director of Marketing
Roberto Zavala, Chief of 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 March 19, 2008 agenda as proposed. Joan Borucki, Director, announced that Action Item 9b was being pulled from the agenda and would be brought up at the May Commission Meeting. Ortega moved to approve the amended agenda. Seconded by Montes. The motion passed unanimously (4-0).

5. Approval of Minutes

Mass asked if there were any additions or corrections to the January 9, 2008 minutes. Montes moved to approve the minutes. Seconded by Flores. The motion passed unanimously (4-0).

6. Commission Liaison Reports

Commissioner Montes:

Montes had nothing to report.

Commissioner Ortega:

Ortega was advised that Lottery investigators teamed up with members of the San Francisco-San Rafael Police Departments to solve a series of burglaries in the City of San Francisco. A Modesto Lottery retailer was the victim of a nighttime burglary involving several packs of Scratchers®. Two suspects were captured and the stolen Scratchers® were recovered.

Lottery Investigators in the Fresno District Office developed information that led to the identity of an armed robbery suspect who might have been responsible for several robberies, most of which involved the theft of Lottery products. Ortega concluded that on February 26, Special Agents from the Department of Justice (DOJ) served a search warrant on a Bell Gardens gas station/market following a month-long investigation of an illegal lottery. DOJ believes the suspect may have cleared \$80,000-\$100,000 on each "lottery."

Commissioner Flores:

Flores has not yet been assigned Liaison duties.

Chairman Mass:

As Procurement Liaison, Mass stated that staff briefed and requested approval on several projects: The first was the approval to award a contract to TG Page Design to provide the Corporate Communications Division with graphic design layouts and creative design services; the approval for a contract with Sun Ridge Systems to purchase, install and provide training for RIMS Records Management software for the Security/Law Enforcement Division; the approval of an agreement with Human Factors International (HFI) for consulting services for Phase 2 of the Lottery Public Website redesign; the approval of a purchase order with Trius Technologies for telecommunications and network services for Lottery Headquarters and various statewide district offices; the approval of a purchase order for the procurement of poly film bags from R. G. Graphics to be used for shipping Scratchers® tickets; the approval to release a competitive solicitation to procure a contract to provide Tracking Study Services. Section 8880.41 of the Lottery Act requires the Lottery to "engage an independent firm experienced in demographic analysis to conduct a special study which ascertains the demographics characteristics of the players of each Lottery Game."; and finally the approval of a purchase order for the procurement of switches for two Network Access Closets for Lottery Headquarters.

As Marketing Liaison, Mass was briefed on the newest \$5 game, California Millionaire, which launched on December 31, 2007. It is a strong performer with 20-\$1 million top prizes to be awarded and five \$1 million prizes to be awarded via second chance draws. The SuperLOTTO Plus® TV and radio campaign ran January 14 through March 8 and encouraged consumers to play at all jackpot levels by reinforcing "Isn't any jackpot worth playing for?" Marketing is working with its advertising firms to develop the "State of Winning/SuperLOTTO Plus®" promotion campaign for April and the advertising support for the Daily 4 launch in May/June. The Request for Proposal (RFP) process continues for a new TV Game Show production company. Five bidders have been identified as finalists and will be making their finalist's presentations to the Lottery in April.

7. Director's Report

a. Financial Statements for December 31, 2007

The financial statements for the first six months of this fiscal year ended December 31, 2007. Pursuant to Government Code section 8880.22, the statements were submitted to the Governor, Attorney General, State Controller, State Treasurer, and the California State Legislature. The statements resulted in a transfer of \$265,807,000 to the education fund on February 21. The transfer for the second quarter was budgeted at a higher amount. It had been budgeted originally at \$301 million, which is below budget, as a result of draw-game and Scratchers® sales. Because of the significant amount of savings in the administrative budget, the Lottery was over budget in the transfer for the first quarter of this year by \$9 million. The overall transfer to education is only under budget by about \$27 million for the second quarter.

b. Sales and Budget Updates

Total sales are slightly fluctuating and efforts in marketing and advertising are going on in the draw game sales, which is part of the overall business and marketing plan for the year. Staff is seeing very positive impact from it, sometimes double-digit growth in the draw game sales. Week-over-week sales are in the ten percent range for the draw games at the lower jackpot levels, which is significant because the Lottery is trying to shift from the paradigm of people only playing when it gets to a certain level of Lottery jackpots. There has been a decline in the instant ticket sales and staff is assessing the cause to possibly be lower prize pay-outs when the budget was adopted because higher levels could not be afforded. Staff will perform some analysis and proposals that will be brought back to the Commission.

Discussion by Commissioners

c. Business Plan Update

Jim Hasegawa, Deputy Director of Business Planning, provided a status report on key projects that were outlined in the 2007-2010 Business Plan. Hasegawa went over the initiatives that support the overall strategies of the Plan: Improve Brand Image, Shift the Jackpot Paradigm, and Modernize Operations. Areas for improving the brand image

will include the marketing campaigns for proceeds and winner awareness, improve and fully leverage The Big Spin® television show, redesign of the Lottery's Public Website, and ways to improve the Problem Gambling Program.

Hasegawa presented some strategies to shift the jackpot paradigm to get consumers to purchase Lottery tickets not only in periods of really big jackpots. Some of the strategies will involve potential changes to the game designs and others are involved with the marketing of the Lottery's products. Between the combination of the marketing effort, including the advertising campaign, recent retailer promotions for SuperLOTTO Plus® and the addition of many retailers to the network over the last month, staff is definitely seeing higher sales with jackpots in the lower levels. Some of the tactics or projects associated with this strategy are implementing a raffle game and researching other draw game opportunities, such as the Daily 4 game which will be launched in May 2008. It offers a game where the top prize will average around \$10,000, fitting into the strategy of shifting the jackpot paradigm.

The third of the key strategies, modernizing internal operations, has a number of projects associated with it such as improving the Lottery's Back Office Systems. Grant Thornton has been hired to review accounting policies, procedures and processes to make recommendations for improvements. Improving the Management Information System by identifying data requirements that are needed, this is currently underway and will be completed before the end of the fiscal year. Improving the Investigative Case Management System, this manages all the cases being investigated by the Security/Law Enforcement Division (SLED). The new system will improve the ability of the Lottery's Law Enforcement officials to conduct a greater number of investigations and more thorough inquiries.

The Gaming System is an integral part of the Lottery. In order to capitalize on opportunities and react to changes in consumer preferences in the marketplace in general, the Lottery needs a gaming system that can be flexible and allow for new games and new promotions or new ideas to be implemented as quickly as possible. The goal is to institute changes by both GTECH and the Lottery to enable major gaming system modifications four separate times during the calendar year in 2009.

A Ticket Ordering System was upgraded in September 2007 with a suggested order for a Lottery ticket specialist for the managing and distribution of products such as Scratchers®. It aids in the accuracy and speed of creating orders for Lottery retailers. An automated system of tracking point-of-sale materials began in November and the first phase tracks when it leaves the warehouse and goes to a District Sales Representative (DSR). The second phase will begin at the end of April where the DSR will be recording a point-of-sale piece when the actual item is placed at a retail location. The system will allow staff to better manage inventories and make sure there is adequate supply of merchandising materials for Lottery retailers.

In terms of optimizing the retailer network, about 6,000 retailers have had multimedia screens (e-pos) installed at their locations by mid-March and another 800 are already scheduled for deployment. The screens are an electronic point-of-sale device that will deliver Lottery specific messages in terms of promoting products or delivering other Lottery news such as the Problem Gambling Program. For recruiting non-traditional retailers that are in other trade channels a recruitment plan has been completed and is in the review stage. Staff is working with GTECH for additional software applications to give the gaming system a little more flexibility to handle alternative business models.

To improve district office operations and services, a recent study is nearing completion to determine if the nine current locations are adequate to service the growing population of California. To optimize the sales force, a revised classification schematic, which includes one new job classification for sales representatives, was approved by the Department of Personnel Administration (DPA) in November 2007. The next step is to meet and confer with the unions, followed by a final approval by DPA. Another tactic is to use on-site marketing teams like demonstration events, particularly at locations where the Lottery has self-service devices that players may not be either comfortable or knowledgeable of how to operate the machines. This project was completed during the fall of 2007 at Sears Locations and at pilot CVS retail sites.

Hasegawa stated that a project on staff-succession planning is ongoing. The scope of the project was enlarged compared to what was in the original document; it is now a Lottery-wide succession plan, not just for S/LED. The plan involves the recruitment, development, motivation, and retention of talented staff. The project is scheduled to finish the plan and start implementation by June 2008.

Borucki stated that there are over 20,000 Lottery retailers in the State of California and the Lottery is now the largest purveyor of electronic point-of-sale in the country. Borucki also pointed out that the new consumer protection feature, the check-a-ticket machine, is popular with retailers as well as Lottery customers because players can check tickets themselves. It empowers the consumer with more information and stems off some of the retailer fraud issues that players encounter when trying to collect winnings.

Discussion by Commissioners

d. Marketing Plan Update

Michael Brennan, Deputy Director of Sales/Marketing, presented an overview of the three-year Marketing Plan, specifically the improvement of the brand image and shifting the paradigm. To improve the Lottery's brand image, staff will introduce new and exciting games and in the fall the Lottery's new logo will be introduced. Staff wants to emphasize that people do win the Lottery and that money does go to public schools. The Lottery wants to reduce any barriers to play, increase current playership, and leverage a strong brand to more easily introduce new products. Brennan went over the month by month marketing components.

The Lottery will improve its processes and procedures for retailers and will make playing the games more relevant and accessible to Lottery players. Staff will develop effective consumer protection programs and increase spending on problem gambling information. The changing of the paradigm effort has been successful as staff is seeing higher sales at lower jackpot levels, both at MEGA Millions® and SuperLOTTO Plus®. Various advertising strategies were presented to the Commission and Brennan went over the various products and promotions for 2008, and Marketing components for 2009-2010. Borucki stated that strategies between now and next September-October will raise some awareness that there is something new and different about the Lottery. It will look different in the media, both earned and purchased.

e. Consumer Protection

Hertoghe went over some of the scam letters that S/LED has received, some from the field and others from local law enforcement. The letters are sent to people by mail or via email. Some letters use the MEGA Millions® logo while others will use Lottery letterhead. Scam letters will occasionally use Lottery employee names to add some authenticity to them. S/LED has dedicated a subject matter expert or an investigator who is responsible for these types of scams and the expertise that goes with learning all about the scams. With the new RIMS system that will launch in June, staff will be able to have a database for keeping track of these types of cases. Many of the scams originate in Africa, British Columbia, Canada, and Jamaica. S/LED works with local law enforcement, the U.S. Postal Service and the Federal Bureau of Investigation. Borucki stated that the Lottery's Communication Division is trying to work with the media to send out consumer alerts as well as updating the Lottery's website under the Consumer Protection portion. Hertoghe stated that most of the scams will ask for a prepayment in order to win.

Hertoghe went over the "Discounting" phenomenon where the customer has a winning Scratchers® ticket and will go into a retailer asking it to be validated. The retailer will advise them that they are a winner and the consumer will seek advice on what to do. The retailer will advise them to file a claim with the Lottery and if the consumer doesn't want to wait for that process to complete, the retailer will advise them that they will pay them half of what they won in exchange for the ticket. The retailer will then file the claim on the winning ticket. S/LED has advised retailers that it is not acceptable and it violates the Lottery Act and it violates the retailer's contract and that contract will be in jeopardy. When S/LED receives a claim from a retailer, it is subject to an investigation. If the retailer is caught "Discounting," they are subject to sanctions up to termination, and may be put on probation. Over the last six months, S/LED has seen \$200,000 in denied claims, which goes back to education and staff are seeing a lot more compliance by the retailers.

Discussion by Commissioners

f. Legislative and Outreach Updates

Heather Lambert, Deputy Director of Communications, advised the Commission that staff attended the California Charter Schools conference, which is a new group that has

been receiving Lottery funds for the past three years. Staff will be attending the California Association of School Business Officials and the California PTA Association conferences. National Problem Gambling Awareness Week was March 9-15 and the Lottery presented a new Public Service Announcement. The Lottery has also inserted language into press releases to advise players and the media that "you shouldn't play beyond your means." The Problem Gambling community has appreciated all of the information that the Lottery has put out.

National Teacher Appreciation Week will be coming in May and staff is looking at options on how the Lottery can utilize some of the marketing materials to raise awareness about its beneficiary. Lambert advised that the National Council of Problem Gambling Conference will be in California this year and the Lottery will be sponsoring the conference with approximately \$25,000. The conference will be held in Long Beach and the Lottery will be part of the planning committee.

Each year, the Lottery sponsors the California Teachers of the Year, a program that has been celebrated by the Superintendent of Public Instruction's Office. To raise awareness, Lottery staff utilizes a lot of its existing marketing agreements with sports entities to celebrate the teachers and their communities. Recognitions have taken place at a Clippers game and will continue through the Major League Baseball season.

Lambert went over legislation which included Assembly Bill 1251. The bill has been running since last year and is a two-year bill that would resolve the time frame issue with MEGA Millions® that was raised by the Court. The bill passed the Senate Governmental Organization Committee and through appropriations it is on the Senate floor. Once the Legislature reconvenes, staff anticipates it will be heard almost immediately and then head to the Governor's desk for signature. Assembly Bill 2462 would require schools to report on their website, how Lottery funds are spent. Senator Florez amended Senate Bill 440, which allows the Legislature to give spending authority to the Department of Finance to hire an advisor to assess options for the Lottery. The Options include whether to lease the Lottery, key revenue bonds or how to structure some things to improve the Lottery and/or move it on. Senate Bill 1679 is a Lottery Best Practices bill that Senator Florez introduced to address some of the issues that were raised in the Lottery's Business Plan. The bill is due in committee on April 8 and staff will be watching it closely to offer technical support.

Borucki gave a brief update concerning the Lottery's headquarters facility. Last August, the Commission gave spending authority to the Lottery to go out and contract with a consultant to evaluate the headquarters facility. At that time, staff advised the Commission that a consultant came in and looked at alternatives concerning staying on the property, move, lease or build. The decision came back to build new on the existing property. The analysis of the existing property concluded that the costs of maintenance and repairs to the existing facility would be substantial. The Lottery owns 13 acres which consists of approximately four buildings, three that are attached and one independent. The Lottery has contracted with a consultant and has been moving along for the first phase which is the site planning. The planning consists of what to do with

the 13 acres, what is the highest and best use, and what is the most advantageous to the Lottery, both from an employee-productivity standpoint as well as a financial standpoint. There is an employee advisory counsel that is assisting Terry Murphy, Deputy Director of Special Projects. The counsel is working with the consultants, which is the Richards Boulevard Partnership, and the architectural firm of LPA.

In addition, the consultants are supporting the Lottery in getting us through the land-entitlement process with the City of Sacramento. The City of Sacramento would like the Lottery to remain at its current site because of the importance of the redevelopment district.

8. Consent Calendar

There were no items on the Consent Calendar

9. Action Items

a. Approval of Scratchers® Game Profiles for Games 553, 554, 555, 556, 557, 558, 559, and 562 Profiles

Susan Kossack, Deputy Director of Marketing, introduced the Scratchers® games for June, July and August. Game 553 is a \$1 money-themed game with a Key Number Match playstyle. There are six chances to win, including a \$2,000 top prize and overall odds of winning are 1 in 5.17. Game 554 is the Instant Daily 4 \$2 game that will give eight chances to win. The top prize will be \$5,000 and has over \$18 million in cash prizes. The odds of winning any prize are 1 in 4.64.

Game 555 is a poker themed \$3 game with over \$6 million in prizes. The prizes range from \$50 to \$1,000 with a top prize of \$50,000 and overall odds of winning are 1 in 3.45. Game 556 is called "Stars and Stripes." It is a \$5 game and is a red, white, and blue themed, Key Number Match game. Players have a chance to win five, ten, and even 20 times the prize revealed and if a "50" is revealed in the "Fast Spot," players automatically win \$50. There is a \$100,000 top prize and odds of winning are 1 in 3.59.

Game 557 is a \$1 animal-themed game with a Match 3 playstyle with a quick spot. The top prize is \$1,000 and overall odds of winning are 1 in 4.82. Game 558 is a \$2 Key Number Match playstyle with a specific variant. The game offers \$18 million in prizes with a top prize of \$10,000. The overall odds of winning are 1 in 4.48.

Game 559 is called "Magnificent 7's" and is a \$3 game using the number seven as the main visual with art-deco inspired graphics. It offers five different play areas with different play styles on one ticket, including Tic-Tac-Toe, Key Number Match, and Yours Beats Theirs. With 12 chances to win, the game offers a top prize of \$4,777 and overall odds of 1 in 3.85. Game 562 is \$3 "California

Crossword". The crossword game has a \$20,000 top prize featuring words and graphics associated with California and overall odds of winning are 1 in 3.38.

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.

Flores made the motion to approve Action Item 9(a). Seconded by Montes. The motion passed unanimously (4-0).

- c. Approval to Extend the KPMG Contract for Draw Auditing and Review Services
Roberto Zavala, Chief of Internal Audits, recommended the Commission approve Amendment 3 on the draw auditing review services. According to Government Code section 8080.3, the California State Lottery is required to ensure that drawings are witnessed by an independent contractor and that they report back on the procedures for the draws on a daily basis. KPMG was awarded the contract back in July 2003, for \$1,116,000. The contract was awarded for three years, with an option for two years as well as an additional six months at the Lottery's discretion. The contract was amended the first time in November 2003 for just invoicing terms. No expiration or additional funding was included. The contract was amended again a second time in May 2006, which exercised the two-year option. The Lottery added \$200,000 and the total came up to be \$1,316,000. The current expiration date is June 30, 2008. The present amendment will allow time for the processing of an RFP that will allow staff to make some changes in KPMG's agreement with California and Georgia, which allows KPMG to witness MEGA Millions® draws in Georgia on the Lottery's behalf. Amendment 3 would increase the amount to \$1,466,000, an increase of \$150,000 and add six months. The Lottery has been satisfied with the performance of KPMG throughout the term of the contract and KPMG is agreeable to the final six-month contract extension.

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 (4-0).

- d. Approval to Purchase Replacement Vehicles
Borucki advised the Commission that vehicle replacements were discussed last year as part of the first part of changing how the Lottery does fleet management. The fleet is used primarily by the District Sales Representatives as well as the Security/Law Enforcement Division. Because the Lottery is at a point where the entire fleet will have to be turned over, a consultant was brought in to help staff put in place a better management process for the fleet. The fleet will be on a more routine depreciation/replacement schedule. Rather than having very large purchases, it will be put on a smaller purchase and rotational cycle. The fleet

manager in Headquarters is doing a very good job and one of the potential process improvements is to go to the Department of General Services to use their master contract for the purchase of vehicles. Staff could also use the County of Sacramento's master contract as well, subject to a few other legal and regulation clarifications. It affords the Lottery a greater variety of price and type of vehicles to choose from. Borucki requested the ability to purchase 37 cargo vans, three sedans, and 13 law enforcement vehicles for an estimated total cost of \$1,345,000.

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 Flores. The motion passed unanimously (4-0).

10. Commissioner General Discussion

Commissioner Montes thanked the City of Pasadena and Mayor Bill Bogaard for the use of the City Hall Chambers.

11. Scheduling Next Meetings

The next Commission meetings for 2008 are tentatively scheduled for 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 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.

13. Closed Session

The Commission convened in a closed session at 12:02 p.m. to confer and receive advice from legal counsel regarding pending litigation (including adjudicatory proceedings, potential litigation exposure or initiation): California Coalition Against Gambling Expansion, et al. v. California State Lottery Commission; Dana Lee v. California State Lottery Commission; sales/use taxes.

14. Adjournment

Meeting adjourned at 12:42 p.m.