

CALIFORNIA STATE LOTTERY COMMISSION

Minutes – October 22, 2009

Sacramento, California

1. Call to Order

Chairperson John Mass called the public meeting of the California State Lottery Commission to order at 9:06 a.m. at the California State Lottery Headquarters, 600 North 10th Street, Sacramento, CA 05911.

2. Pledge of Allegiance

John Mass led the Pledge of Allegiance.

3. Roll Call

Mass asked Elisa Topete to call the roll. Mass welcomed Sheriff Margaret Mims, a long-time member of the California Law Enforcement community, to the California State Lottery Commission.

Commission Members Present:

Commissioner Margaret Mims
Commissioner C.C. Yin (arrived at 9:57 a.m.)
Commissioner Cynthia Flores
Chairman Mass

CSL Staff and presenters:

Joan Borucki, Director
Sylvia Cates, Chief Legal Counsel
Linh Nguyen, Chief Deputy Director
Ed Fong, Chief of Product Development
Barbara Krabbenhoft, Deputy Director of Human Resources
Marilyn Wright, Assistant Deputy Director of Legislative Affairs & Outreach
Richard Woonacott, Acting Deputy Director of Security/Law Enforcement
Terry Murphy, Deputy Director of Operations
Richard Wheeler, Camelot Global
Elisa Topete, Assistant to the Commission
Stephanie Greenlee, Recording Secretary

4. Consider Approval of the Agenda

Mass asked if any of the Commissioners wanted to make changes to the October 22, 2009 agenda as proposed. Mims moved to approve the agenda. Seconded by Flores. The motion passed unanimously (3-0).

5. Approval of Minutes

Mass asked if there were any additions or corrections to the September 3, 2009 minutes. Flores moved to approve the September 3, 2009 minutes. Seconded by Mims. The motion passed unanimously (3-0).

6. Commission Liaison Reports

Commissioner Flores:

As Education Liaison, Flores reported that in September and October, updated memorandums were sent to the Lottery's stakeholders, including those in the education community. The information included: Sheriff Mim's appointment to the California Lottery Commission; Information on the NBC Dateline that highlighted the California State Lottery's (Lottery) Consumer Protection Program; The Lottery's Certificate of Achievement for Financial Reporting award from the Government Finance Officers Association for the third year in a row and; Information on the monthly Scratchers® for September.

Outreach updates included the Lottery sponsored "Chronicle in Education" for September and October which is a four-part instructional series. The San Francisco Chronicle created a non-profit program that provides news and information to 20,000 students everyday at no cost to the teachers. The Lottery partnered with Young Biz, who provided the instructional material free of cost. The Lottery hosted a delegation from the China Sports Bureau. The City of San Francisco invited the group to California and they requested a visit to the Lottery where they met with the Sales and Marketing Division.

On September 2, the California Lottery hosted Lottery retailers at a San Diego Padres vs. Washington Nationals game. On September 12, the Superintendent of Public Instruction Jack O'Connell and the Lottery hosted Orange County Teachers of the Year at an Anaheim Angels vs. Chicago White Socks game. Finally, on September 18, the Lottery hosted the Superintendent of Public Instruction and a local Superintendent at a Los Angeles Dodgers vs. San Francisco Giants game.

Chairman Mass:

Mass designated Commissioner Mims to be the Liaison for the Security/Law Enforcement Division. Mims will present a report at the next Commission Meeting. As Marketing Liaison, Mass was updated on the promotion and advertising for the California Replay Program which began September 8 and continues through October 25. As of October 5, there have been 234,399 registrants with 201,866 registrants who entered tickets and the total ticket codes entered are 7,634,439, which is an average of about 38 tickets per participant.

The NFL promotion with the Oakland Raiders, San Francisco 49ers, and the San Diego Chargers began September 8 and will run through October 25. The objective is to support the Replay Program with an NFL promotion and encourage playership

of Scratchers with the Replay logo by offering a second-chance to win experiential prizes from the three teams. The drawing is the week of October 26 and the winners will be announced the week of November 2. The winners will be able to use their prizes for the remainder of the season. The total number of people picking teams on NFL Bonus Blitz through October 5 is 25,121 and the total number of ticket codes entered is 892,510.

The Warner Brothers Music instant ticket has been selling for about seven weeks. The ticket is intended to attract new and younger players and media support includes Point of Sale (POS), Radio, online ads, and Wild Postings. As of October 5, there have been 26,491 participants with a total of 121,527 ticket code entries. The Breeders' Cup Hot Spot® Promotion began October 21 and provides one entry into the drawing for every \$5 of Hot Spot purchased in a single transaction. The promotion is supported by POS, ePOS, Public website, ticket messaging, and email alerts to Jackpot Captains.

As Procurement Liaison, Mass was briefed by staff and requested approval to procure a new random number generation system to conduct daily, promotional, and raffle drawings. Staff recommends replacing the current RNG System with the new Origin System from Smartplay International. Staff also requested to amend the Electrical Reliability Services contract to extend the contract term, increase funding and update the contract managers. Their diesel generator provides emergency back-up power for critical operations at the Lottery's Sacramento Headquarters Facility.

7. Director's Report

a. Sales Update

Joan Borucki, Director, reported that fiscal year sales through the week ending October 3 were over \$820 million and at that pace, sales would exceed the Lottery's \$2.96 billion sales goal. This is fueled primarily by the large MEGA Millions® jackpot that occurred at the start of the fiscal year. At the last Commission Meeting, the impact of the furloughs on the Scratchers sales was discussed and staff has been projecting a possibly \$200 million shortfall off of the \$1.7 billion goal for Scratchers sales. Staff has instituted measures to try and mitigate the effects of the Scratchers distribution and have been somewhat successful. Scratchers sales this year are over \$440 million, however even with the various measures that the staff has put into place, the current pace indicates that Scratchers sales will probably end the year about \$100 million short of the goal.

For SuperLOTTO Plus® this fiscal year, there have been four jackpot winners and no draw has had a jackpot larger than \$32 million. SuperLOTTO Plus sales for the year are over \$120 million. Although at the current pace, sales will be shy of the \$490 million sales goal for the year. With the large jackpot sequence in August,

MEGA Millions sales for this fiscal year are more than \$140 million, which is more than \$60 million or 75 percent above sales for the comparable period last year. Sales of the Daily Games are over \$80 million so far this year, but are currently running about 7 percent behind the pace needed to meet their sales goal. Hot Spot sales this year are at \$30 million, which is where they need to be to meet the goals.

Discussion by Commissioners

b. NASPL Highlights

Borucki reported on the North American State and Provincial Lotteries Association's (NASPL) annual conference. At the start of the conference were a series of directors' meetings, both the MEGA Millions Directors and the Powerball Directors. The lottery directors from North America, the Caribbean, and Mexico met together to sit as a body and govern the association, but also share various information. The MEGA Millions and Powerball Directors together came to a tentative agreement to pursue looking at the ability to cross-sell each other's games without becoming members of each other's organizations. There is a small group of directors that have been put together to look at the legal game development and all the basic how-to issues that surround being able to do that. Eventually at some point, you could walk into a Powerball state and also purchase a MEGA Millions ticket, or vice versa. Research has shown that this could be a positive revenue enhancement for all the states that would participate in it.

As part of the agreement, there was a second tier that indicated that if the lotteries participate in cross selling, then everybody is going to work together on developing some kind of a national lottery game that everybody could participate in. There is another committee that is working on game development, which will be on a much longer time frame than cross-selling each other's games. Various states are looking at a wide range of alternatives and know that this game has to be new, unique, and different with the feel of a premium national game.

California will be participating in the committees and as far as eventually participating in either the cross-sell or the national game, that will be something for the Commissioners to decide in the future in the context of the overall new business plan that staff is developing, and how that fits in with the Lottery's strategy for draw-based games in California. The Lottery has not made a commitment one way or the other, but staff is making sure that they do not prevent anything us from not being able to participate. At the same time, we need to put into the context of the product plan what we want and desire and what will give us the best return on investment here in California, so the RENEW team will be looking at that.

Borucki had reported in the past about a small problem with credit card agencies that also flowed over into being able to use debit cards because of a federal law, the Unlawful Internet Gambling Expansion Act, UIGEA. This forced credit card companies to lump lottery in with all other types of gambling, even though the

Lottery was exempted from that federal act. New Hampshire announced at the meeting, that they had come to a deal with Visa where Visa was taking lottery out of the SIC code of gambling and putting them back into the government services SIC code. They are also now working with MasterCard so that the lottery industry is not be lumped in with gambling. Lastly, Borucki volunteered California to be considered as a host location for the 2012 joint World Lottery Association and NASPL Annual Conference.

Discussion by Commissioners

c. Workforce/Succession Plan

Barbara Krabbenhoft, Director of Human Resources (HR), provided an update on the workforce and succession plan. Staff has implemented many important recruitment and retention strategies since the last report in June. On June 24, staff conducted a health and safety fair at the Lottery's headquarters. Over 20 vendors offered information on a variety of health and safety issues and approximately 200 employees attended. During September, HR completed a resource assessment and exam plan which resulted in decisions to increase the use of continuous online Internet exams for recruitment purposes. There will be a greater utilization of the State Personnel Board's online exams for many Information Technology and Administrative classifications. Staff is also requesting Lottery-specific Internet exams for the Lottery Ticket Sales Specialist, Lottery Manager, Marketing Analyst I and II, and Marketing Specialist classifications.

In October, the new Employee Orientation Program was implemented. The program emphasizes effective on-boarding techniques, and includes a welcome letter from Director Borucki, a first-day supervisor checklist, a unit meet-and-greet, mentor assignment, and a meeting with the employee's HR representative. The new employee also attends a day-long training session focused on their role, the Lottery business, and the Lottery's benefits to education. Supervisory Training is scheduled for October 27.

Also on October 27 will be the annual recognition ceremony. Participating in the State Merit Award Program, the Lottery will give out awards to employees who have 25-year state service and will present superior and sustained superior accomplishment awards to individuals and teams. Staff will continue to develop formal training programs to enhance employee performance and transfer critical knowledge and skills. This will be done by developing a needs assessment survey to identify future training for all employees, conducting pre and post-assessments of training to measure knowledge attained, and offering a leadership academy. The academy is required training for all supervisors and managers. Staff continues to assist the Enterprise Project Management Office roll-out of the project management training and is in the process of revising the Lottery's Administrative Manual in conjunction with the Operations Division.

Discussion by Commissioners

d. Legislative and Outreach Updates

Marilyn Wright, Assistant Deputy Director of Legislative Affairs and Outreach, reported that on September 23, the Assembly Committee on Accountability and Administrative Review held an oversight hearing titled, "California Lottery Commission, Administrative Expenditures." The Chair of the committee, Assemblyman Hector De La Torre, held the hearing to examine the appropriateness of Lottery expenditures made by the Commission for various administrative and capital projects. The main focus of the meeting was the February 8 incident that occurred at the taping of the Make Me a Millionaire® game show. The nine players will get a second chance on October 25. Prior to the hearing Lottery staff met with the committee to discuss the upcoming hearing, go over the hearing agenda and corresponding documents that the staff had requested. At no time was the February 8 incident brought up by committee staff. The Lottery Director also met with committee staff prior to the hearing to answer any questions and go over the various documents that they had requested. Lottery staff also contacted all members of the committee in an effort to go over the agenda and answer any questions or concerns. Only one member accepted, Assemblywoman Audra Strickland.

The outcome of the hearing was somewhat positive in that the Lottery director was able to emphasize the importance of prize pay-out legislation. Several members expressed interest in learning more. The Lottery director provided several documents, explaining the importance of increasing prize pay-outs to the members; and staff is currently following up with the members and meeting with them one-on-one.

Finally, Senate Bill 831, the MEGA Millions Clean-up bill was signed on October 11. The bill is an urgency bill and went into effect upon the Governor's signature. At this time, there is no new information on the Barney Frank bill, HR 2267, Internet Gambling.

Discussion by Commissioners

e. Consumer Protection Update

Richard Woonacott, Acting Deputy Director of Security/Law Enforcement (SLED), provided a brief background of the Lottery's Security/Law Enforcement Division to the Commissioners. Woonacott stated that the number of criminal investigations, which includes ticket thefts as well as other types of fraudulent activity such as embezzlements, is dropping. The Administrative Investigations, which includes backgrounds, lost tickets, and retailer inspections are also down. The decline in the Retailer Complaint Investigations is due to the Lottery's approach through public information, education, outreach, and enforcement.

Discussion by Commissioners

f. Business Plan/RENEW Project Update

Linh Nguyen, Chief Deputy Director, stated that staff has finished the first phase of the RENEW Project and have done a lot of data-gathering and information sharing. Nguyen introduced Richard Wheeler, Camelot's Project Manager, who presented Camelot's assessment of the Lottery business as it stands today and some preliminary conclusions. Wheeler stated that Stage Zero began around July and August with a mobilization ramp-up phase which included the Camelot project team, both in the United States and the United Kingdom, and the Lottery's team. Stage I is the As-is assessment phase which sets the basis for everything else staff is doing for the business plan, and enables the teams to move into analysis of options proposals. Finally, the teams will move into the decision-making phase where the business plan will be finalized. The implementation phase will kick off next year. Along with the stakeholder engagement and management control activities, there will be some quick win activities the teams will identify sooner that will help with the performance of the Lottery this year as opposed to waiting until 2010.

A Strategic Plan was attempted in 2006 in an organization that never had a long range strategic plan since inception, and was accustomed to Director's lasting only a year or two. Management deserves credit for creating a long term plan that contained content and real merit that supported the state of the business at that time. The organization has lacked the training, experience and best practices to accomplish successful implementation of a strategic plan.

Wheeler spoke about the California Lottery within the context of the U.S. market overall. There is an overall steady growth trend of the US lottery industry that California is not part of. The Lottery has been significantly underperforming against its peers in terms of growth and per capita performance, since inception. California has the highest percentage, but not dollar, returns to education and lowest prize payout of the top 15 states. The percentage constraints around net returns (34 percent), means that California does not have the same levels to stimulate growth and sustain performance as other lotteries. If California were to perform at the average level of the top 15 states, the California Lottery would be a \$7.9 billion a year lottery, returning \$2.4 billion to schools. Discussion by Commissioners.

Wheeler presented a total revenue breakdown of the entire Lottery product range. Aside from the 6/53 matrix change in the early 90's, Lotto (SuperLOTTO Plus and MEGA Millions combined) has been successfully stabilized when changes have been made to it. Daily games, numbers games, and Hot Spot are small, but still a very stable part of the portfolio. Despite the launch of MEGA Millions in 2005, the combined sales for MEGA Millions and SuperLOTTO Plus today are less than SuperLOTTO Plus alone in 2004. SuperLOTTO Plus and MEGA Millions are high profit margin games and are critical to the financial health of the business by supporting products that players really want. Although Scratchers are relatively strong, they alone are not profitable enough to sustain returns to the 34 percent commitment level. The decline of SuperLOTTO Plus in particular, needs to be

immediately understood and addressed. SuperLOTTO Plus and MEGA Millions are high margin games relative to the rest of the portfolio. The strength in these games will give the Lottery the right to be able to sell and grow the Scratchers business. Discussion by Commissioners.

Next, information on California Lottery Consumers was presented that included a demographic forecast, a corporate Lottery consumer image, the percentage of adults that have played in the past month, and what a player spends on average. The existing strategy to target a new, younger demographic in an effort to retain these players as they age has real credit in the situation so the Lottery can have a stable, vibrant, and growing business. People are playing less on SuperLOTTO Plus, but are playing about the same on Scratchers. People are spending less on SuperLOTTO Plus, but are spending more on Scratchers. Nearly three million people have stopped playing the Lottery since 2002, and a further two million are likely to leave by 2012 if the current trend continues. Although there are a number of credible hypotheses that explain the decline in player penetration, staff will need to perform further analysis to determine what can be done. The RENEW Project is a decision-making project to assist the management team and the Commissioners take the right decisions to arrest the decline. The team will conduct further analyses and quantify the effects in order to understand exactly what is happening from a player perspective. Discussion by Commissioners.

The final section covered the sources of decline at the product level over the last few years. The major sources of decline are in Scratchers, SuperLOTTO Plus and MEGA Millions. Rollover performance for SuperLOTTO Plus has collapsed sharply since 2004, with an accompanying decline in base sales. SuperLOTTO Plus is exhibiting signs of being an unhealthy game and a key turn-around lies in a change to the game itself; possibly rather than any specific marketing efforts only. Scratchers performance is hampered by the availability of high price point products that players really want, such as the \$5 games. Too many Scratchers in the market for too long tend to have a number of negative downstream consequences. Discussion by Commissioners.

In conclusion, there has been a significant decline in high profit draw-based games for the last three years. The decline is not well understood, not being addressed, and showing no signs of abating which means there is no effective platform from which to grow other games. Scratchers are operating well below their potential and the ability to maximize sales of products through the retailers is restricted. In order to address the issues through the RENEW Project, the conclusions are being turned into a long list of key strategic imperatives and initiative options. A long list of potential initiatives, including quick win, has already been identified by the project workstreams. The workstreams are well structured to conduct analysis of the options so that the initial analysis can be completed by early November. Workstreams will be making a recommendation on the short-list of initiatives to be

considered for further feasibility assessment by the end of November. Discussion by Commissioners.

Wheeler stated that critical elements around the mission and goals for the Lottery include correction of strategy, implementation tactics and performance measurement, and accountability for those performance measures. The Commissioners will engage more actively in the future generation of the mission and goals and strategic intents for the Lottery. On November 16, the Commissioners will participate in an all-day Strategic Planning Session. Borucki stated that this is one of the most critical functions and reasons that the Lottery Commission exists. The Commissioners will participate and set the direction and goals for the Lottery to be used to guide the development of the next 3-year Business Plan.

8. Consent Calendar

There were no items on the Consent Calendar

9. Action Items

a. Contract Extension for Security Guard Services

Woonacott requested a two-year extension of the current security guard contract with Andrews International. The Lottery has used contracted security guard services since its inception in 1985. The current contract was awarded through a competitive bidding process in 2006, and expires in December 2009. The extension would take the term of the contract through the beginning of December 2011; and would take the Lottery through the construction and new Headquarters Building. Although the original contract was awarded to HMI, the Lottery amended the contract in March 2000 to reflect the consolidation of services with Andrews International, which had been disclosed through initial investigation.

The security guard services are vital to the operation of the Lottery, and the 37 guards that are employed with the Lottery. The presence of uniformed guards at key Lottery facilities provides a measure of deterrence against unwanted activities, thereby promulgating safety and security in all aspects of the Lottery's appearance to both the public as well as Lottery employees. If the extension is not approved, other options would include using the master service agreement that is administered by the CHP or going out to bid. However, significant staff resources would be utilized with either of these options; and any new staff would have to be fully trained on Lottery-specific security policies and procedures, another function that could only be performed by Security and Law Enforcement personnel. With the construction of the Lottery's new Headquarters building, it is recommended by staff that the continuity of services to avoid any additional disruptions be given paramount consideration.

Discussion by Commissioners.

Mass asked if anyone from the audience had any questions on Action Item 9(a). Dave Hancock of SEIU, United Service Workers West, expressed his concerns for the contract. Mass proceeded to the motion of approval.

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

b. Scratchers® Game Profiles and Alternates for Games 624, 625, 626, 627, 628, 629, 630, and 631.

Ed Fong, Chief of Product Development, presented the game profiles for February and March, 2010. Staff developed two profiles for each proposed game: A version with a standard prize payout and a version with higher prize payouts, should sustained payout relief become an option soon.

Game 624 was developed to increase playership among 18-34 year olds, especially males because it is a tattoo-theme game. It is a \$1 game with a Key Number Match playstyle with a specific variant. If players uncover the specified symbol, the prize is automatically doubled. The game has a \$1,000 top prize and overall odds of winning are 1 in 5.03. Game 625 has a seasonal/heart theme. It is a \$2 game with a Key Symbol Match playstyle with two specific variants. Players who uncover a specified symbol automatically win that prize while revealing another specified symbol doubles their win. The top prize is \$14,000 with overall odds of winning at 1 in 3.82.

Game 626 is a \$2 crossword themed game which is the first \$2 game to offer this type of play action. The game will offer a \$10,000 top prize and overall odds of 1 in 4.89. Game 627 is a \$5 game that will appeal to players seeking a large, life-changing prize. This game has a \$2 million top prize, which is the largest top prize ever, to be paid out in annuitized yearly payments. The game will feature a Key Symbol Match playstyle with two specific variants to maintain player interest and excitement. If a specified symbol is revealed, the prize is multiplied by 10 and if another specified symbol is revealed, the prize is multiplied by 20. The overall odds of winning are 1 in 3.52.

Game 628 is a \$1 game with a Match 3 playstyle with a specific variant utilizing a popular 7's theme. If a special symbol is revealed in the "Quick Spot," the player will automatically win \$7. The top prize is \$777 and the overall odds of winning are 1 in 5.31. Game 629 is a \$2 luck-themed game featuring lucky symbols/icons for a March 2010 launch. The game features a Key Symbol Match playstyle and two specific variants with a lucky top prize of \$17,000. If a specified symbol is uncovered, players win triple the prize shown. In addition, if another specified symbol is revealed, players will automatically win that prize. The overall odds of winning are 1 in 4.83.

Game 630 is a \$2 game with a Key Number Match playstyle with two specific variants and a top prize of \$10,000. If a specific symbol is revealed, players will automatically win four times the prize shown and if another specific symbol is revealed, the players will automatically win that prize. The overall odds of winning are 1 in 4.13. Game 631 is a \$3 Crossword game with a brand new feature. The game includes the traditional way of playing but will also feature two "Bonus" words which will offer players two additional chances to win prizes. The top prize is \$20,000 and the overall odds of winning are 1 in 3.15.

Fong presented the same games with an alternate game profile that has higher prize payouts. The only change to the game profiles are the overall odds of winning a prize, which are improved to the higher prize payouts. Game 624 odds are 1 in 4.53; Game 625 odds are 1 in 3.35; Game 626 odds are 1 in 4.47; Game 627 odds are 1 in 3.38; Game 628 odds are 1 in 4.34; Game 629 odds are 1 in 3.80; Game 630 odds are 1 in 3.95 and; Game 631 odds are 1 in 3.33.

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.

Yin made the motion to approve Action Item 9(b). Seconded by Mims. The motion passed unanimously (4-0).

c. Extend Term and Add Funds to Honeywell International Contract for HVAC Maintenance and Repair

Terry Murphy, Deputy Director of Operations, requested to extend the term for two years and add \$185,000 in funds to the Honeywell International contract for heating, ventilation, and air-conditioning service and maintenance to the Headquarters Office, Sacramento District Office, and Distribution Warehouse. The contract was competitively bid three years ago and Honeywell was the successful bidder to provide the maintenance and service on the Lottery's HVAC units. Service has been very good by Honeywell, and the system performance has improved because the Lottery has experienced a significant decline in HVAC downtime and cold/hot calls. The original contract term was for three years, with an option to extend up to two additional years if the Lottery was satisfied with services, cost, and overall contractor performance.

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.

Yin made the motion to approve Action Item 9(c). Seconded by Mims. The motion passed unanimously (4-0).

10. Commissioner General Discussion

Flores and Mass stated they looked forward to working with Commissioner Mims. Commissioner Mims thanked Director Borucki and staff for the Commission preparation and warm welcome and thanked the Governor for the appointment.

11. Scheduling Next Meetings

The next Commission Meetings are tentatively scheduled for December 2, 2009, January 20, March 17, May 5, June 16, August 18, October 20, and December 8, 2010.

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 to a closed session at 11:30 a.m. to confer and received advice from legal counsel regarding litigation (including adjudicatory proceedings, potential litigation exposure or initiation): CASE v. Schwarzenegger et al.; SEIU v. Scharwzenegger et al.; Moorefield Construction, Inc. v. California Lottery Commission; sales and use tax issues 2. Discussion of personnel matters pursuant to Government Code section 11126(a).

14. Adjournment

Meeting adjourned at 12:50 p.m.