

CALIFORNIA STATE LOTTERY COMMISSION

Minutes – January 28, 2009

Sacramento, California

1. Call to Order

Chairperson John Mass called the public meeting of the California State Lottery Commission to order at 10:31 a.m. at the California State Lottery Headquarters, 600 North 10th Street, Sacramento, CA 95811.

2. Pledge of Allegiance

John Mass led the Pledge of Allegiance.

3. Roll Call

Mass asked Elisa Topete to call the roll. Mass publicly thanked Manuel Ortega for his years of service as Commissioner and support of the California State Lottery. Mass introduced and welcomed C. C. Yin as the new Commissioner. Yin is an owner and operator of McDonald's franchises in Northern California.

Commission Members Present:

Commissioner C. C. Yin
Commissioner Cynthia Flores
Chairman John Mass

CSL Staff and presenters:

Joan Borucki, Director
Sylvia Cates, Chief Legal Counsel
Richard Woonacott, Deputy Director of Legislative Affairs & Outreach
Bill Hertoghe, Deputy Director of Security/Law Enforcement
Michael Brennan, Deputy Director of Sales/Marketing
Susan Kossack, Deputy Director of Marketing
Jim Hasegawa, Deputy Director of Business Planning
Terry Murphy, Deputy Director of Operations
Jose Bodipo-Memba, CEQA/NEPA PBS&J
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 January 28, 2009 agenda as proposed. Joan Borucki, Director, postponed Item 9(a), Revised Sales Projections and Amended Fiscal Year 2008/09 Budget until the March 28 Commission Meeting. Flores moved to approve the amended agenda. Seconded by Yin. The motion passed unanimously (3-0).

5. Approval of Minutes

Mass asked if there were any additions or corrections to the October 15, 2008 and December 3, 2008 minutes. Flores moved to approve the October 15 and December 3, 2008 minutes. Seconded by Yin. The motion passed unanimously (3-0).

6. Commission Liaison Reports

Commissioner Flores:

As Audit Liaison, staff updated Flores on the State Controller's Office (SCO) six open audits: Work began on the Visa CAL-Card in April 2008 and finished in December 2008. The audit disclosed three findings of non-compliance and the Lottery agreed with the findings and will implement corrective action. Staff is awaiting final release of the report. Fleet Management work began in July 2008 and finished in December 2008. The draft report and findings are pending final review. Once received, the Lottery will have 15 days to respond. The GTECH Contract Audit work began in July 2008 and is estimated for completion in January 2009 and the target date for the draft report is February 2009. Work began on the First Quarter Transfer of Lottery Funds to Education in November 2008 and is estimated for completion in January 2009. The target date for the draft report is January 2009.

Recently completed audits include: The Office Revolving fund, which began in February 2008 and finished in October 2008. The final report was issued on December 17, 2008 and the audit disclosed four findings of non-compliance. The Lottery agreed with the findings and will implement corrective action. The Draw Observation Contract began in May 2008 and finished in October 2008. The final report was issued on December 31, 2008. The audit disclosed one finding of non-compliance and the Lottery agreed with the finding and will implement corrective action. The Lottery's Internal Audit staff will follow up on corrective actions at the Lottery.

For the Lottery's internal audits, per Lottery Act section 8880.46, the Lottery is required to engage an independent firm to conduct a biennial security evaluation of all aspects of security in the operation of the Lottery. Internal Audits is scheduled to award the Security Audit Contract in February 2009. The audit is expected to last several months. Flores provided an update on the newly created Audit Committee. The Audit Committee was established at the December Commission meeting and staff is awaiting the appointments of the committee members. The new members will have an orientation, develop and approve an Audit Committee Charter and calendar for 2009.

As Education Liaison, Flores stated that the first quarter and cumulative totals contributed to education in FY 2008/09 have become available. The transmittal is under review in the Directorate, after which it will be mailed to the Lottery's stakeholders. The Lottery joined with GTECH and Superintendent of Public Instruction, Jack O'Connell to dedicate a new computer lab donated by GTECH to the West Fresno Elementary School in mid-December. The launch of GTECH's ninth computer lab in California was a tremendously successful and heartwarming event.

Chairman Mass:

Mass provided an update on the newly established Audit Committee. In accordance with the AICPA guidelines for the governmental organization, Mass appointed Commissioner Yin as Chair, and Commissioner Flores and Chief Counsel Sylvia Cates as members of the Audit Committee. Once the Committee Charter and Calendar have been established, an update on these items will be provided at the March Commission Meeting.

As Procurement Liaison, Mass was briefed by staff and requested approval on the following items: To release a competitive solicitation to procure a contractor to provide Asian Advertising Services to the Lottery. A successful solicitation will result in a contract to a contractor capable of meeting the Lottery's Asian advertising needs for the next three to six years; A purchase order with Natoma Technologies allowing the first phase of the Business Intelligence project, formerly called "Dashboard Reporting," to be completed in accordance with the approved Lottery Business Action Plan for FY 2007-08. The amendment will increase the dollar value by \$40,000 for a total expenditure authority of \$216,840, and extend the term by three months to March 31, 2009; Amend an existing contract with SenData, which provides statistical consulting services. The amendment is to increase the expenditure authority by \$25,000 for a total value of \$225,000, and language will be amended allowing the contractor to be reimbursed for travel; Amend Trius Technologies purchase order to extend its term by one year and add additional funding in the amount of \$56,800. They provide telecommunications and network services required to install, maintain, and service the existing voice, data, and video systems for the Lottery Headquarters complex and various District Offices statewide.

As Marketing Liaison, Mass was updated on the following: Holiday Bonus second-chance Web site promotion and the winter "Let it Dough" promotion at top retail locations; The Make Me a Millionaire® program, including the retail promotion, point-of-sale, advertising and station promotions, and the new TV show, which debuted on January 17; Upcoming Scratchers® and the 2009 retailer calendars, including the Chinese New Year logo, featuring the Year of the Ox, and the new logo calendar. Additional information will be provided in the Director's Report.

7. Director's Report

Joan Borucki, Director, introduced the Lottery's new Chief Counsel, Sylvia Cates and Barbara Krabbenhoft, the new Deputy Director of Human Resources. Borucki also announced that Scott Gunn of GTECH will be going to Rhode Island as a Senior Vice President and Derrick Gwaltney will be replacing Chris Shaban, who will also be returning to Rhode Island, as General Manager.

a. Sales Update

Jim Hasegawa, Deputy Director of Business Planning, stated that at the last Commission Meeting, staff had reported on sales through the first four months of the fiscal year, and sales were down 10 percent, versus the year-ago figures. Sales for the

first six months of this fiscal year through December 31, are over \$1.46 billion, compared to last fiscal year at \$1.56 billion, representing a 6.7 percent decline. Nearly all of the \$105 million difference can be attributed to the jackpot games of SuperLOTTO Plus® and MEGA Millions®. SuperLOTTO Plus® is down just over \$46 million, an approximate decline of 15 percent over year ago figures. MEGA Millions® is down about 24 percent. In terms of jackpots, the largest SuperLOTTO Plus® jackpot had been \$53 million through the first six months of the fiscal year, compared to last year where the Lottery had a \$93 million jackpot during the early part of the fiscal year. Currently, the jackpot is at \$62 million, which represents the largest jackpot since February 20 and is helping sales most recently. The Lottery had only one jackpot over \$50 million from July through December, compared to nine in the first six months of last fiscal year. The largest MEGA Millions® jackpot for the first six months of this year was \$207 million. Last fiscal year during the first six months, the largest jackpot was \$330 million.

Hasegawa reported that Scratchers® were slightly higher for the first six months of the year at \$806 million in sales, approximately 1 percent higher than last year. Daily 3® and Daily 4 sales came in at \$87 million. With the addition of the Daily 4 product, sales in this category are up about 13 percent. Fantasy 5 and Daily Derby® sales have declined about 10 percent relative to last fiscal year at over \$77 million for the first six months of this year. Hot Spot® sales are at \$62 million, which is a 9 percent decline relative to last year.

Staff found that the number of transactions, meaning the number of purchase occasions, is the biggest source of the decline in SuperLOTTO Plus® sales, roughly a 20 percent drop since fiscal 2005-06. The size of the transaction, the amount spent per purchase occasion, has declined only 6 percent.

Staff is not only looking at the transaction information, but also where sales are coming from in terms of the types of retailers that sell Lottery products. Sales declines are steeper in liquor stores compared to some of the other key trade channels such as convenience stores, which generate the most dollars for the Lottery. In terms of geography, the Los Angeles market has declined by the largest percentage between 2006 and 2008. SuperLOTTO Plus® experienced a 24 percent decline in sales in that media market. In summary, the biggest issue that staff needs to work on will be trying to increase the number of purchase occasions by people.

Discussion by Commissioners.

b. 2008 Comprehensive Annual Financial Report (CAFR)

Borucki gave a special recognition to the Accounting staff that puts the CAFR together every year and has received a Certificate of Achievement from the Government Finance Officers Association. The report goes out to all the Lottery's stakeholders and the Legislature.

c. Financial Statements for 1st Quarter 2008-09

The Lottery requested the State Controller's Office to transfer in excess of \$260 million for the Lottery Education Fund on November 19, 2008.

d. Legislative and Outreach Updates

Richard Woonacott, Deputy Director of Legislative Affairs and Outreach, stated that staff attended the National Council of Legislators of Gaming States January 9-11. The Teachers of the Year dinner will be on February 9 and the Lottery will be participating in the statewide National Problem Gambling Awareness Week, March 1-7. Staff will be attending the California Police Chief's Association Conference, March 1-5 and the Charter Schools Association, March 11-12. Woonacott advised the Commissioner of several meetings the Director will have with numerous new members of the Assembly and Commissioner Cynthia Flores' Confirmation was going to take place the afternoon of January 28.

Bill introduction deadlines are February 27 and staff has not identified any that are impacting the Lottery's operations at this point in time. A Federal Stimulus Plan will be voted on in the House and it is about \$14 billion in direct budget relief that could possibly come to California. It would be a one-time cash infusion that cannot be applied to any permanent cost beyond anything that would be paid beyond 2010. Much of the money, about \$10 billion, would go to ease pains in the schools and would be able to be used for construction, special education, and supporting low-income students. Commissioner Yin requested a list of the legislators who have interest or leadership in the State regarding regulations towards the Lottery.

e. Consumer Protection Update

Bill Hertoghe, Deputy Director of Security/Law Enforcement (S/LED), presented the Commission with a two-year comparison of Retailer Sanctions. There has been an increase in monitored probations and a major increase in monitored probation inspections. Because of the new Probation Sanction, S/LED is sending investigators into those stores for the monitoring of the conditions of probation. With a new case-management system, staff is now able to collect and analyze data so that statistics can now be captured. Hertoghe stated that the department has done 512 undercover operations from June 2008-December 2008 and S/LED has opened and investigated 2,016 cases.

Approximately 1,220 claims have been referred to S/LED. Some of the criteria for the referred claims can be altered play and claimant areas or multiple name situations. In these cases, staff will have to go out and interview claimants, which takes time. The most notable criteria for referrals are the Retailer, Retailer Employee, and Retailer related claim investigations. The Lottery's new claim form requires that claimants specify if they are a retailer, related to a retailer, or an employee of a retailer. These numbers have dramatically increased because staff is now scrutinizing those types of claims.

Yin asked Hertoghe for some data on S/LED's goals and targets for the various violations and if there were statistics on whether the violations were going up or down.

f. Marketing Update

Michael Brennan, Deputy Director of Sales/Marketing, went over the Holiday Bonus program where there were four games that were eligible for participation in a drawing for the chance to be on the new Lottery TV game show, "Make Me a Millionaire®." The Scratchers® games were "Let it Dough Doubler," Jingle Bucks," Candy Cane Crossword," and "Make Me a Millionaire." There were 1,174,711 registrants and of those, ten contestants became eligible to go on the game show. The program was supported with radio, in-store POS, the e-POS animation, ticket messages, monitor messages, and mall screens. Also as part of the holiday program, there were 31 statewide events from November-December where contestants who spent \$20 in Lottery products got to enter the Snow Bubble. Players get to grab prizes such as holiday Scratchers® and SuperLOTTO Plus® coupons. The retail promotion ran from November 9-January 3 and for every pack settled of Make Me a Millionaire Scratchers®, the retailer earned an entry into a drawing. In that time period, the Lottery settled 25,626 packs, which is very good.

Make Me a Millionaire® TV show aired for the first time on January 17. The overall ratings for the first two shows are higher than the six-month average for The Big Spin®. Staff will continue to monitor the ratings and will report back to the Commission. The host of the show, Mark Wahlberg, has done numerous radio and TV interviews around the State. The Lottery had Make Me a Millionaire® mall tours and the events were very popular and in some cases, there were two-hour lines waiting to win prizes such as Scratchers® and gift cards. Players also had a chance to get in the drawing to make it to the television show.

Upcoming promotions include the sponsorship of a float in the 2009 Southwest Airlines Chinese New Year Festival and Parade in San Francisco and the Lottery will also have a booth. Another promotion is the Hot Spot® Bulls-Eye Top Prize 4X. A player must purchase at least \$6 on any single Hot Spot® transaction and if a bulls-eye is purchased during the promotion, there is a chance to win four times the typical prize amount.

Brennan provided examples of upcoming Scratchers® that include Instant Hot Spot®, Instant Daily 4 and Super Instant Daily 4. Later in 2009, staff will introduce the Lottery's first Scratchers® that will give a free draw game as part of the prize. It will be a Fantasy 5 instant ticket which will give the player the ability to play a Fantasy 5 Quick Pick® draw game. With the help of the Information Technology and Security/Law Enforcement Divisions, staff is pleased to launch the new PDF 417. This new barcode is larger and gives the ability to give the exact dollar amounts when it is run under the Check-a-Ticket. Brennan provided examples of new graphics and themes with an updated fresh perspective, reflecting a modern age of the Lottery, full of excitement and energy, integrated with tried and true successful practices. "Rockin 7's" is a Guitar Hero/Hard Rock Café cool contemporary type of look and "X" word which is a fast-

paced, futuristic modern look. The Lottery is also introducing more ways to win on one ticket such as "Twice the Action" which has two games at the \$1 price point and "Double Match" which offers two different playstyles.

Brennan stated that there will be seasonal tickets offered, such as "Hearts and Cash" in February, "Pot of Luck" in March, and to celebrate the Chinese New Years, "Year of the Ox." For the first time, the Lottery will be offering all cash prizes, meaning no free tickets and increasing low-tiered prizes. The "Bedazzled" Scratchers® features a new extended playstyle and offers color graphics under print: it looks equally dazzling before and after scratching. Brennan showed samples of the new Chinese New Year calendar as well as the retailer calendar. During this time period, staff has spent a majority of the Lottery's advertising funds for the budget, through the end of the fiscal year. The small amount of money left will go to some radio promotions that are planned for the spring.

Discussion by Commissioners.

g. Audit Committee Update

(Item covered under Liaison Reports)

8. Consent Calendar

There were no items on the Consent Calendar.

9. Action Items

- a. Revised Sales Projections and Amended Fiscal Year 2008/09 Budget
Item pulled from the agenda.

- b. Scratchers® Game Profiles for Games 590, 593, 594, and 595
Susan Kossack, Deputy Director of Marketing, presented the recommended Scratchers® games to be launched in June 2009. Game 590, "Make Me a Millionaire®" is a \$1 game with graphics that reflect the look and feel of the Lottery's new television show. Staff will be updating the prize structure to allow the Lottery to generate twice as many contestants than before. The top cash prize will be \$500 with the overall top prize as a chance to be a contestant on the new game show. Overall odds of winning are 1 in 5.45. Game 593 is a \$1 8-themed game with a Match 3 playstyle and specific variant. Reinforcing the lucky number theme is an \$888 top prize. The overall odds of winning any prize are 1 in 5.29.

In an effort to increase sales by bridging Scratchers® players to our draw games and draw game players to Scratchers® products, staff has successfully launched several cross-marketing themed Scratchers® games including Instant Daily 3®, Instant Hot Spot®, Instant Daily 4, and even Super Instant Daily 4. Staff now recommends leveraging the equity of another draw game, Fantasy 5. It will be the first Scratchers® to offer draw game Quick Picks® as an instant prize:

Fantasy 5 Quick Picks®. The \$2 game features a Key Number Match playstyle; players match their numbers to five draw numbers to win the prize indicated. Like the Fantasy 5 draw game, players who match at least two out of the five numbers will win a prize, including the change to win a top prize of \$20,000. The overall odds of winning are 1 in 4.98. Game 595 will be a \$3 game and will combine two popular themes: sevens and Bingo. Like traditional Bingo, players match "Callers Card" numbers to numbers on "Your Cards." Within each card, not only can players win in the traditional Bingo manner, they can also win if their numbers are revealed within a highlighted "7" pattern. The top prize is \$20,000 and the overall odds of winning are 1 in 3.80.

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 Flores. The motion passed unanimously (3-0).

c. Public Hearing and Certification of the Mitigated Negative Declaration for the California State Lottery Complex

Terry Murphy, Deputy Director of Operations, stated that the Lottery contracted with Richards Boulevard Joint Venture to first provide an overall site plan for the headquarters campus. Second, was to do a preliminary design of a new headquarters for the Lottery. The final action was to perform the environmental process for the entire campus. The first two items have been completed and today's meeting represents the end of the final process, which is the environmental. Jose Bodip-Memba from Richards Boulevard Joint Venture, presented the Mitigated Negative Declaration (MND). The purpose of the hearing, in accordance with the California Environmental Quality Act (CEQA) is: to allow the adoption of the document and to allow the Commissioners and the public to hear a summary of the project; consider the MND combined with any public comments received on the document; and provide the Commissioners the opportunity to make a determination regarding the adoption of the document.

The project that was evaluated involved the construction of a 484,000 square-foot office complex on this facility. It involves the demolition of the existing facility and the construction of the complex, with three six-story buildings and a six-story parking garage. As part of the evaluation, staff took into account what has been currently developed and what is planned for development within the City of Sacramento with reasonably foreseeable development. The intent of the environmental document is primarily to identify the opportunity to evaluate environmental impacts associated with construction and operation of the proposed project and to offer mitigation measures or opportunities to improve on those potential impacts associated with development operations. Bodip-Memba

explained the process staff went through to evaluate all the issues according to the CEQA checklist (see attached handout).

The findings and the mitigation monitoring program have to do with the revised mitigation language for the traffic analysis. The City of Sacramento recommended that the language be changed, to change the timing of the payment into a fee program for Interstate 5. The language has no substantive change on any of the evaluation made and the new language will part of the written finding. The Commission must adopt the written finding first before making any determination regarding the MND. The mitigation monitoring reporting program identifies all of the mitigation measures and provides a monitoring process, to make sure those mitigation measures are put into place. The next step would be to file a notice of determination with the County Clerk and with the Office of Planning and Research, within five days of the adoption.

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.

Flores made the motion to approve Action Item 9(c) - the adoption of the written finding allowing for the text change to mitigation measure 6a-2, as shown in the Mitigated Negative Declaration. Seconded by Yin. The motion passed unanimously (3-0). Flores made the motion to approve Action Item 9(c) – the adoption of the Mitigated Negative Declaration prepared for the California State Lottery complex project, as well as the supporting mitigation monitoring and reporting program. Seconded by Yin. The motion passed unanimously (3-0).

d. Design Contract for California State Lottery Offices

Murphy stated that in May 2008, the Commission approved the advertisement of the final design contract. The Lottery received proposals from five firms. Following best-value analysis, the Lottery selected LPA Sacramento as the potential successful candidate and asked to approve the contract award to LPA Sacramento to perform the final design of the Lottery's new headquarters facility.

Discussion by Commissioners.

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.

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

e. Amendment to South San Francisco District Office Lease

Murphy advised the Commission that the lease is a revisit of a prior-approved lease amendment however since the approval, there has been a new landowner and a subsequent new property manager for the site. The property manager has reevaluated the property and essentially recognized that the Lottery was getting

a good deal in the past on the lease rates and in bringing us in line with market rates, has slightly increased the amount the Lottery is paying. Staff reviewed comparable rates in the area and found the new proposed rate was within what was reasonable in the area. Staff also looked into the vacancy rate in South San Francisco in the industrial-type property that the office is in and found there was a 5 percent vacancy rate, which is a reasonable explanation for why the new owner is seeking a slightly increased rent.

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.

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

f. Amendment to Lottery Waste Disposal, Recycling, and Mobile Shredding Contract

Murphy stated that with the move to the West Sacramento warehouse last year, it consolidated a couple of warehouses in Sacramento: One on-site and one right next door. The move caused staff to look at records retention among other things. The process of doing so has essentially caused the Lottery to run more expenditure on this contract than anticipated. The contract takes care of shredding and other type activities of old documents. Additionally, the Lottery has changed the logo which has also increased some of the items staff is getting rid of. The contract amendment is to add dollars for the additional disposal. Yin asked Murphy if a process and procedures system could be put in place on how to handle these types of issues regarding disposals and shredding on a regular basis.

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

Yin made the motion to approve Action Item 9(f). Seconded by Flores. The motion passed unanimously (3-0).

g. Annuity Investment Policy

Borucki stated that there was a change in the Lottery's annuity investment policy which is the annuities that are purchased to ensure that the Lottery continues to pay its prize winners who win annuities or choose annuities as their prize selection. In the past, the Commission set the priority of purchasing those annuities to be very risk-free or as close to zero risk as possible. In line with that, the Lottery would like to expand on the number of instruments that are available in our portfolio from just U.S. Treasuries, which is what is currently in place, to also include other types of municipal bonds. In the past, U.S. Treasuries would have brought in a better yield, however the Lottery

can get a better yield at less cost at the municipal bond market. Borucki asked for approval to amend the Lottery's annuity investment policy and expand it to include those municipal bonds as well as the Treasury bonds.

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

Yin made the motion to approve Action Item 9(g). Seconded by Flores. The motion passed unanimously (3-0).

10. Commissioner General Discussion

Yin is honored to be part of the Lottery's effort to help the State and the schools and thanked the Commissioners and the Lottery's management team for their good work in the past. Flores thanked her daughter Becky, for lending her support as she goes through the Confirmation process and also thanked Lottery staff for their help in preparing her for the hearing. Flores also feels very strongly in helping education as much as possible. Mass again welcomed Barbara Krabbenhoft, Sylvia Cates and C. C. Yin to the Lottery and congratulated the GTECH staff on their new positions.

11. Scheduling Next Meetings

The next Commission meetings for 2009 are tentatively scheduled for March 25, May 20, June 24, August 19, October 21, and December 3 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. Adjournment

Meeting adjourned at 12:01 p.m.