

CALIFORNIA STATE LOTTERY COMMISSION

Minutes – June 26, 2010

Sacramento, 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 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.

Commission Members Present:

Commissioner Margaret Mims

Commissioner John Menchaca

Chairman John Mass

CSL Staff and presenters:

Joan Borucki, Director

Linh Nguyen, Chief Deputy Director

Lisa Hightower, Chief Legal Counsel

Michael Brennan, Deputy Director of Sales and Marketing

Michael Ota, Deputy Director of Finance

Marilyn Wright, Deputy Director of Legislation and Outreach

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 June 26, 2010 agenda as proposed. Director Joan Borucki stated that Consent Calendar Item 8(a), Contract(s) for Shredding of Lottery Confidential Documents and Unused Tickets, would be pulled from the agenda because both bids came in well below \$100,000 therefore Commission approval is not required. Mims moved to approve the adopted agenda. Seconded by Menchaca. The motion passed unanimously (3-0).

5. Approval of Minutes

Mass asked if there were any additions or corrections to the May 20, 2010 minutes. Menchaca moved to approve the May 20, 2010 minutes. Seconded by Mims. The motion passed (3-0).

6. Commission Liaison Reports

Commissioner Mims:

As the Liaison for Security/Law Enforcement (SLED), Mims was briefed and updated on the following issues: The first item is the Primm Valley Resort investigation. Investigators in the Inland Valley District Office recently concluded a year-long investigation into the embezzlement of \$620,000 in Lottery Scratchers® products. The suspect in the investigation was the store's manager, who was able to conceal the theft for over two years. The suspect was charged with embezzlement and grand theft and bail has been set at \$450,000. The second item is the East Bay Illegal Numbers Investigation. Investigators in the East Bay and San Francisco District Offices concluded their investigation with the arrest of seven people. All seven suspects were taken into custody and charged with felony book-making.

The third and last item is the Law Enforcement Outreach. Amber Bettar from the Special Investigations Unit gave the keynote speaker address at the Emerging Trend and Fraud Conference in Columbus, Ohio. The conference was sponsored by the Ohio State Auditor, and was attended by fraud-prevention specialists from all over the United States. Amber discussed the Latin Lotto fraud scams committed in California and the resources law enforcement has been utilizing to combat these particular scams.

Commissioner Menchaca:

Menchaca provided the Audit Liaison Report. From the State Controller's Office (SCO), the Second Quarter Transfer Report Analysis for Fiscal Year 2010's field work was completed in April 2010. No preliminary findings were noted. The final report is expected to be released in July 2010. The Third Quarter Transfer Report Analysis for Fiscal Year 2010's field work began May 2010 and is expected to last through July 2010. For the Annuity Investment Process Audit, the Lottery responded to the draft audit report in May 2010. The draft report noted one finding regarding a lack of formal procedures for the processing and monitoring of investment transactions. The final report is expected to be released in July 2010. The 3Ball Production Contract Audit's field work began in March 2010 and was completed in June 2010. The draft report is expected to be released in July 2010.

The KPMG Financial Statement Audit as of June 30, 2010's field work began June 2010. The final report is scheduled to be released by October 15, 2010. On the Draw Observation Reviews, KPMG continues to observe and report on the Lottery's daily draws. No significant findings to report. On the Lottery's internal audits, Contract and Procurement Service Audit's field work began in January, 2010 and is expected to last through the end of June 2010. As of today, no preliminary findings were noted. As for the Follow-up Audits, Internal Audits has completed its follow-up review of past audit findings. The results of this review will be shared with SCO for audit planning. Finally, the Audit Committee will meet following today's Commission meeting.

Chairman Mass:

As Marketing Liaison, Mass was updated on the In-Store Point of Sale (POS) with the retail theme, "Oh," and "Yeah." The POS is supporting millions in Scratchers and it reinforces the advertising campaign. The "Millions in Cash" Scratchers advertising began airing June 7 and will run through June 30 in the Los Angeles and San Francisco markets in particular. The TV campaign's message to consumers is becoming more of an instant millionaire. In the spirit of the Lottery's 25th anniversary, the game will feature 25 winners of \$1 million each. In addition, the game has a bonus replay draw of a million dollars, and awarded on the Lottery's anniversary of October 3 of this year.

As Procurement Liaison, Mass was briefed by staff and requested approval of the following: Contract amendment to the Department of Technology Services (DTS). DTS provides ongoing operations support of the Lottery IBM mainframe applications, telecommunications services, and data storage. There is also a purchase order for BEAR Data Systems, Inc., which is the annual contract that is required for the Cisco local area network and wide area network. It includes the network application router, switches, and firewalls. Next, there is a contract amendment for Manatt, Phelps, and Phillips to continue the representation of the Lottery in the litigation connected with the imposition of furloughs for the Lottery and its employees. Lastly, there is a contract amendment with Union Bank of California for electronic fund transfer services. Electronic fund transfers are used for processing payments and distributing funds for the Lottery retailer accounts.

7. Director's Report

a. Sales Update

Director Borucki stated that the Lottery ticket sales update for year-end 2009-10 is anticipated to end the year at over \$3.04 billion, which represents an increase of more than \$85 million, or 3 percent over last year's sales of \$2.95 billion. As the fiscal year began, the original budget included a sales goal of \$2.96 billion. In April of 2010, staff brought a revised budget to the Commission for approval that included a higher goal of \$3.027 billion.

For the sales by product, MEGA Millions® represents the product with the largest year-over-year sales gain. Year-end sales should total about \$490 million, which represents an increase of \$142 million over last year's total and equates to a 41 percent increase in MEGA Millions sales. The gains can be attributed to two major factors that include the strong sales response to the recent MEGA Millions advertising campaigns in San Francisco and Los Angeles, and one more draw this year with a jackpot over \$200 million compared to last year.

The Scratchers product category will again be the number one Lottery product in terms of sales. It is anticipated that sales will end the fiscal year at over \$1.65 billion. Although sales were a little lower than anticipated for the last couple of

weeks, this year's sales will be more than \$35 million higher than last year's Scratchers sales, equating to more than a 2 percent gain. In the fall, staff reported that sales trends in this product line were down and were on pace to end the year by about \$200 million short of the sales goal for Scratchers. By quickly responding and instituting various changes through the RENEW Program, the shortfall was nearly eliminated. The year-over-year sales increase was remarkably accomplished despite a slightly lower prize payout in the current fiscal year.

For SuperLOTTO Plus®, sales for the year will be about \$465 million, which represents a decline of more than \$70 million, or 13 percent compared to last year. SuperLOTTO Plus has seen year-over-year declines for the past five fiscal years, which is why it is highlighted in the RENEW Program initiatives. Sales of the Daily Games will end the year at about \$316 million, which is down about 4 percent from last year's figures. Hot Spot® sales are anticipated around \$118 million, which is a decline of \$8 million, or 7 percent down from last year. All of these games are being looked at in the RENEW initiatives.

The overall ticket sales increase is remarkable considering the economic conditions confronting Californians, as well as the fact that staff at the California Lottery has had to conduct business with three few working days each month due to the furloughs. The sales gain also demonstrates the effectiveness of the quick-win initiatives from the RENEW Project. Once again, the Lottery will provide well over a billion dollars to public schools, which marks the tenth consecutive year that this milestone has been achieved. Borucki personally thanked the Commissioners for their guidance and the confidence and patience with the RENEW Project.

b. Lottery Report Card

Linh Nguyen, Chief Deputy Director, presented the Lottery's first Report Card. The premise behind the report is to provide an update to the Commission at every meeting on the Lottery's performance as well as project performance. It is in alignment with the staff's effort to increase accountability and performance of management within the organization. The documents presented at the Commission Meeting will also be available on the Lottery's public website for review by the public. In the binder presented to the Commissioners, is an updated Business Plan which is also posted on the Lottery's website. Also included is a Report Card, which has a Project Performance Summary with a few key headlines. As a result of the MEGA Millions campaign, sales statewide have increased \$39 million, which is a 37 percent increase over comparable jackpot levels.

The Retailer Pilot also kicked off in June, which is the pilot in San Francisco where staff is implementing the best practices to increase sales. It involves six District Sales Representatives (DSRs) and one of the main components completed is to come up with an ideal presentation model for Scratchers. In the past, the DSRs and retailers would place Scratchers in the displays based on how they felt would be best. However now through data and analysis, there are certain setups that work

better and those setups will be implemented as part of the pilot. Staff plans to begin the roll-out statewide in November for those things items that are believed to pay dividends. Staff has revised and completed the Scratchers game plan and the 2010-11 marketing plan, which are critical elements for growth in the next fiscal year.

Staff has delivered several briefing sessions on the communications front: one to the sales conference and there has been four separate sessions at Lottery Headquarters to share the Business Plan with staff. The new headquarters building project is on schedule and is well within budget. Finally, the investment restructure program has achieved its goal of \$45 million from portfolio restructuring.

The Projects in Exception is where staff will report on projects that are in the "red" and as of now, there are not any projects in the red. Projects that are in the "yellow" include the headquarters staff visits, which have been postponed due to timing concerns. There are other projects that need to be completed first before the visits can be done. Next is the completion of the retailer makeovers. Staff is holding off on further expansion of the program pending a Return on Investment (ROI) analysis of the completed makeovers. Staff is also putting a hold on the addition of further sponsorships of retailer events pending an ROI analysis.

Nguyen stated that the World Lottery Association Certification for Responsible Gaming was a project that was previously in critical status. There are only two accepted submission dates and unfortunately, staff missed the date because the initial product was unsatisfactory to Nguyen and Borucki. Staff has been asked to do some further work on it to meet the next deadline which is November 30.

The Financial Performance Category is in the early stages of implementation so most of the projects have not yet reached the stage where the benefits can be measured. Nguyen reported that the Scratchers have increased sales by \$60 million with the quick-win efforts. The Road Map has been updated and the Commissioners can track how the Lottery is doing against the timelines. The new Web site Project has already had its kickoff meeting with the vendor. The Enterprise Resource Planning Project also had a kickoff meeting. Finally, the policies for the Lottery Administrative Manual are complete.

c. Legislative and Outreach Updates

Marilyn Wright, Deputy Director of Legislation and Outreach, gave a brief update on two events the Director and staff attended in the month of June. On June 4, the Director and staff, joined by Chairman Mass, attended the Distinguished Schools Award Ceremony. The Lottery has sponsored the ceremony for many years and this year, there were over 400 elementary schools chosen. At the Lottery's sponsorship level, staff provided a prerecorded video congratulating the schools. The Lottery also did a special recognition to Superintendent O'Connell, as this is his last year in office.

The Director and staff attended the National Council of Legislators for Gaming States (NCLGS) conference in June. The conference began with a roundtable discussion on Lotteries. Director Borucki spoke first on Lottery revenue bonds, higher prized games, and how lotteries can maximize revenues. Other roundtable discussions were on pari-mutuels, responsible gaming, and Internet gaming, including intrastate and Internet poker.

Wright played a video that was submitted by the Lottery to the North American Association of State and Provincial Lotteries (NASPL) for their Batches awards that will be presented during the fall NASPL conference. The awards are given to best TV, radio, and print advertising, and corporate beneficiary video. The Lottery worked with California Life to create a piece that highlights the Lottery's contribution to public education and sponsorships for education programs (video played).

Discussion by Commissioners.

8. Consent Calendar

- b. Van Nuys District Office Lease Extension and Amendment
- c. Scratchers® Game Profiles for Games 661, 662, 663, 664, 665, 666, 667, 668, and 669

Mims made the motion to approve Consent Calendar Items 8(b), and (c).
Seconded by Menchaca. The motion passed unanimously (3-0).

9. Action Items

- a. Termination of Lottery Contract with 3Ball Productions, LLC/Milestone Entertainment and Applicable Amendments to Game Regulations
Michael Brennan, Deputy Director of Sales and Marketing, stated that on June 25, 2008, the Commission approved the award of a four-year contract with 3Ball for the production of a new Lottery television show. The contract commenced on August 1, 2008 and the new game show, "Make Me a Millionaire®" began airing on January 17, 2009. On February 25, 2010, staff completed an in-depth assessment of the Return on Investment (ROI) from the Make Me a Millionaire (MMaM) TV show, and recommended that the Lottery stop producing the show at the end of the current fiscal year and redirect administrative and prize expense savings to generate a more robust ROI.

On April 30, 2010, the Lottery notified 3Ball that contingent upon Commission approval, the Lottery intended to terminate its contract effective August 15, 2010. Current regulations contain provisions related to conducting TV show drawings, contestant eligibility requirements, et cetera, as well as provisions related to the Fantasy 5 coupon game feature which no longer will be relevant or necessary with the cancellation of the MMaM show. Staff is requesting that the Commission approve both the termination of the 3Ball contract, as

well as applicable changes to regulations, to remove references to a TV show and the Fantasy 5 coupon feature.

Finally, staff recommends that the Commission authorize the Director to award TV show prizes to those claimants who become eligible to win those prizes during the 180-day claim period at the end of the MMaM Scratchers game and at the end of the Fantasy 5 coupon feature. The Lottery will end the MMaM Scratchers game on June 25, 2010 and will end the Fantasy 5 coupon feature on July 4, 2010. Players will have 180 days from the above dates to claim TV show prizes. The Director must have the authority to award these prizes after July 1, the effective date of the proposed amendments to the regulations.

The Lottery is always looking for ways to maximize revenues for public education by operating as efficiently as possible. It has become even more important with the passage of Assembly Bill 142, which reduced the Lottery's administrative budget from 16 percent to 13 percent of revenues. A recent cost/benefit analysis of the TV show revealed that the show's ROI is not sufficient to justify its continuation because the benefits the Lottery received are significantly less than the costs associated with producing the show.

Most of the expenses associated with the MMaM TV show are the \$19 million allocated to pay prizes awarded on the show. Direct costs associated with producing the TV show are just over \$3.2 million, plus \$57,000 for auditors and staff overtime and travel, and just over \$400,000 in advertising guarantees to the stations that air the show. Given the current environment where prize money and administrative funds are at a premium, it appears that the funds used for the show could generate more sales and profit to education if applied to other purposes.

Reallocating the funds used to support the TV show is consistent with the Business Plan's strategic imperative to get the most out of the Lottery's marketing dollar. Staff is developing marketing, advertising, and product plans to maximize the ROI with these dollars. Staff has been coordinating the many tasks associated with the MMaM show to ensure that there is minimal impact on both 3Ball and the TV show contestants. All of the shows for broadcast have already been produced and the last show is scheduled to air on July 3, 2010. Staff has also developed a replacement for the Fantasy 5 coupon called Fantasy 5 Bonus Bucks. The new promotion will offer players a second-chance entry number for each purchase of \$5 or more on a single ticket; and players will have the opportunity to enter the numbers on the Lottery's website for a chance to win twelve \$1,000 prizes and three \$10,000 prizes each week.

Brennan asked the Commission to approve the termination of the California State Lottery contract with 3Ball Productions, LLC/Milestone Entertainment, and adopt applicable amendments to the regulations that become effective July 1 2010. Brennan also recommended the Commission authorize the Director to award TV show prizes to players who become eligible to win these prizes after the effective date of the amendments to the regulations.

Mass commended 3Ball and Milestone for the outstanding production value the Lottery received from the game show. Mass asked how much time went into the evaluation of the show and the ROI. Brennan stated that staff spent several months of time and effort on the analysis and evaluation followed by a presentation to the Director and Chief Deputy Director.

Mass asked if anyone from the audience had any questions on Action Item 9(a). Randy Katz of Milestone Entertainment and Gary Dawson of 3Ball Communications expressed their concerns over the termination of the contract.

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

- b. Amendments to Regulations for Retailer Compensation and Incentive Bonus
Brennan proposed the amendments of the California State Lottery regulations to reduce the current Scratchers retailer cashing bonus by 1 percent. The passage of Assembly Bill (AB) 142 reduced the California State Lottery's administrative budget from 16 to 13 percent of revenue. As a result, the Lottery must now operate more efficiently than it has before, and must seek out all available sources of funding to support mission-critical marketing initiatives while staying within the 13 percent cap on spending. Staff therefore recommends that the Commission adopt amendments to reduce the bonus that the Lottery currently pays to retailers for cashing winning Scratchers tickets from 2 percent of the value of prizes from \$1 to \$599, to 1 percent of the value of these prizes.

Since the passage of AB 142, the Lottery has identified and implemented a variety of strategies for reducing administrative costs in an effort to stay within the 13 percent cap on its administrative budget. These include renegotiating the contract with GTECH, extending the Scientific Games ticket production, and the UPS ticket-delivery contracts with no increasing costs, terminating the production of the Make Me a Millionaire® TV show, and restructuring the Lottery's investment portfolio.

Despite the other cost-reduction efforts, the Lottery will be unable to fully fund marketing initiatives that are vital to the success of next fiscal year's business plan objectives without identifying other sources of funding from the 13

percent administrative budget. The Lottery offers the most generous retailer compensation package of any lottery in the nation. Over 52 percent of the Lottery's administrative budget is dedicated to retailer compensation.

The Lottery's fiscal year 2009-10 budget for retailer compensation is over \$180 million of sales commissions, over \$10 million for special handling fees, almost \$3 million for incentives, and over \$21 million for cashing bonuses, for a total of over \$214 million. The budget is based on the projected 2009-10 sales of \$3.027 billion. If the Lottery continues the same compensation package in fiscal year 2010-11, retailer compensation costs will increase from \$214 million to over \$252 million based on projected sales of \$3.519 billion.

Staff assessed several options for reducing retailer compensation costs in an effort to identify a funding source for key marketing initiatives while minimizing the financial impact on retailer business partnerships. Each of the dozen or so components of the current retailer compensation packages were evaluated as part of this assessment. On June 3, 2010, staff convened a Retailer Advisory Board comprised of representatives both from independent and major chain accounts to discuss various options and proposals for reducing retailer compensation.

The Lottery will also increase administrative fees that retailers pay to the Lottery each week for the first time in over 20 years to further improve efficiency and support mission-critical marketing initiatives. It is important to note that even with these changes, the Lottery still offers the most generous retailer compensation package in the nation; and total compensation paid to retailers will actually increase by over \$20 million in fiscal year 2010-11 from what retailers received this fiscal year. Staff recommends that the Commission adopt the proposed amendments and the amendments will become effective on August 1, 2010.

Mims asked if any retailers expressed concern over the changes. Brennan stated that the Retailer Advisory Board, which is made up of major chains and independent retailers, came up with the final recommendation. DSRs will also visit the retailers to explain the amendments. Menchaca asked if we received outside consultants' input on whether the Lottery actually did have the most generous retailer compensation package in the nation. Brennan stated that an analysis was received from both the Lottery's vendor partners and from Camelot.

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.

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

c. Amendments to MEGA Millions® Regulations

Michael Ota, Deputy Director of Finance, brought forth the recommendation to approve amendments to bring Lottery regulations, in conformance with changes to California law and rule changes to the multi-state MEGA Millions game. The first regulation change is to clarify the prize-claiming period, to state that Grand Prize winners of multi-state lottery games have up to one year to claim their prize money. The change will align Lottery regulations with the multi-state MEGA Millions game rules.

Recently, the MEGA Millions consortium entered into a cross-selling agreement with the Multi-State Lottery Association (MUSL). The agreement was necessary to allow the 12 MEGA Millions states to begin selling Powerball tickets and the 33 MUSL states to begin selling MEGA Millions tickets. As part of implementing cross-selling, changes are required to the MEGA Millions rules to bring consistency to the Grand Prize jackpot structure of MEGA Millions and Powerball.

Currently, the annuity value of the MEGA Millions jackpot is guaranteed for each draw. However, the jackpot winner has the option to choose a lump sum payment of the estimated cash equivalent of the guaranteed prize. Under current regulations, if a California player wins the Grand Prize, the Lottery would initiate the purchase of US Treasury bonds the next business day following the winning draw to minimize investment risk inherent under the current regulations. The US Treasury bonds would fund a series of 26 annual payments to the prize winner that would equal the guaranteed prize amount.

A Grand Prize winner has 60 days after the date they are verified as the winner to select either annuity payments or a lump sum cash payment. If the grand prize winner came in at the end of July and elected to receive the lump sum cash payment, the value of the US Treasury Bonds might have changed from the time of purchase in late June and time of sale in late July. The sale of the US Treasury bonds could net more than or less than the estimated cash value that was advertised in late June. Currently, the cash equivalent of the guaranteed annuity prize is advertised as “estimated.”

The MEGA Millions multi-state rule changes that are scheduled to take effect August 31 will amend the Grand Prize structure. The rule changes will guarantee the advertised cash value of the Grand Prize and convert the annuity value of the prize to an estimated amount. The change will make the Grand Prize structure consistent for the MEGA Millions and Powerball games. The Lottery would no longer initiate the purchase of US Treasury bonds the next business day after the winning draw. If the Grand Prize winner comes in and chooses the annuity option, the Lottery would take the estimate cash value and purchase the US Treasury bonds that would provide the 26 annual

payments to the prize winner. The annuity prize amount would become an “estimated” amount under the proposed regulation changes.

The only exception to the process involves the first jackpot following a MEGA Millions jackpot win. Under MEGA Millions rules, \$12 million is the starting annuity jackpot level after a win therefore the starting annuity jackpot level will remain guaranteed. If a California player wins the \$12 million jackpot, the current process of purchasing US Treasury bonds following the winning draw and then awaiting the winner to come forward and select their payment option would continue. The adopted regulations do not change the basic prize structure or odds of winning prizes in the MEGA Millions game. Staff supports the changes to the MEGA Millions game rules regarding the structure because it eliminates the current practice of purchasing US Treasury bonds every time there is a California Grand Prize winner. Nearly all winners choose the cash option so it eliminates the need to turn around and sell those US Treasury bonds to determine the cash value of the prize.

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.

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

d. Fiscal Year 2010-11 Budget

Ota presented the budget that will result in \$1.1 billion to public education, which is the eleventh consecutive year the Lottery surpasses the \$1 billion mark. The \$1.1 billion is a \$34 million increase over the budgeted contribution to education for this year. It is a landmark budget that includes the first full year of implementation of the Lottery’s 2010-13 Business Plan, and implementation of business strategies resulting from the passage of Assembly Bill (AB) 142.

Ota went over key elements of the budget starting with revenues. The largest increase in projected sales is in the Scratchers product line. Sales are expected to grow \$482 million, to a total of \$2.2 billion. The growth is fueled by business plan initiatives, specifically for Scratchers games, and a Scratchers product line that incorporates higher prize payout. Sales for SuperLOTTO Plus are projected to continue on a downward trend. Addressing the health of this game is one of the key business plan initiatives in the upcoming year. The budget does not include any assumptions regarding modifications to or replacement of SuperLOTTO Plus.

Sales for MEGA Millions are projected to increase \$51 million. The increase will be from investing in marketing efforts for MEGA Millions, a strategy supported by the success of advertising efforts that were tested during the

later part of this fiscal year. Daily Games and Hot Spot have sales goals that are slightly above the levels expected for the current year. The \$18 million increase for Hot Spot is based on the projected outcomes of both business plan initiatives for Hot Spot as well as prize payouts for the game.

The proposed budget does not include additional resources from a restructuring of the Lottery's investment portfolio. Staff was successful in completing a plan to capitalize on the opportunity to reduce investment costs and generate additional funds for education. The effort started at the end of fiscal year 2008-09 and was completed this year. In a little more than one year, staff was able to generate a total of \$61 million in investment proceeds to augment sales revenue and no additional investment restructuring activity is planned for the upcoming fiscal year.

Ota provided an overview of expenses which included two major categories: prize expense and administrative expense and AB 142 figures prominently in both categories. The growth in sales is supported by an increase in prize payouts for the Scratchers product line and the Hot Spot game. As a result, prize expenses are budgeted to increase from \$1.6 billion to almost \$2 billion. The aggregate change in prize payouts goes from 53 percent of sales this year to 56 percent of sales in 2010-11.

AB 142 also has a major impact on administrative expenses. Prior to AB 142, the Lottery Act required that no more than 16 percent of total revenues could be allocated for administrative expenses to 13 percent of annual revenues. Retailer compensation accounts for more than half of the administrative expense budget. In the current year, the budget for retailer compensation is \$213 million, which is 52 percent of the administrative expense budget. The proposed budget assumes the Commission adopt the amendments and the Lottery regulations for retailer compensation and retailer administrative fees.

Even with the amendments, the expected growth in sales will result in a \$27 million increase in retailer compensation and will represent 52 percent of the total administrative expense budget. The remaining administrative expense budget increases \$23 million. Nearly half of the increase has been allocated to communications; which is the Lottery's advertising and marketing efforts. The remaining expense is primarily in Game Operations which includes gaming contract costs that are directly tied to the increase in sales and operating costs tied to the increase in Scratchers ticket sales.

The General Administration category includes the Lottery's personnel costs. The budget includes funding for 644 permanent positions, which is an increase of four positions over current year levels. Three of the positions are required in the prize payment area. The Lottery's claim forms advise players to expect payments on winning tickets within six weeks. Based on the

projected increase in Scratchers sales, staff looked at workload measures for processing payments and determined that an additional three positions will be necessary to maintain the six-week turnaround time for payments. Staff requests that the added positions be authorized effective October 2010 to coincide with the increase in workload. The Lottery also recognizes the potential for technology improvements that will streamline the payment process therefore staff requests these positions be approved as 3-year limited term positions.

One additional position is being proposed for the Security and Law Enforcement Division. It is necessary to support the security systems at the Lottery facilities and to manage contracted security services for the Lottery. Currently, one position is budgeted for this activity, but workload is required to provide additional support with a Retired Annuitant. The additional position will eliminate the need for reliance on the Retired Annuitant to adequately staff this activity and the position is being requested effective July 2010.

In addition to the personnel costs, the general administration category also includes funding for information technology projects in the business plan. The Business Intelligence Project and the Public Web site project include the sales and marketing initiatives and the business plan, exams and training that are in the Lottery's Workforce and Succession Plan, and funding for the preparation of the move into the new building. Finally, the budget continues the long-standing practice of providing an Administrative Reserve as a safeguard against future uncertainties. The proposed reserve is set at a conservative \$2 million. The budget provides the foundation for sustainable growth in revenues, and further enables the Lottery to carry out the commitment of enhancing education and supporting local communities.

Commissioner Menchaca asked how the Lottery would handle the situation of revenue goals not being met or if additional staffing was required in different areas. Ota explained that the approved budget is the Lottery's performance measure therefore staff would be monitoring the budget throughout the fiscal year, looking for deviations in sales or expenses. If there was a need to come forward to make an amendment to the budget, staff would come to the Commission and propose the amendment. Menchaca asked what the basis was in reducing the Administrative Reserve in half. Ota explained that the initial 2009-10 budget had a \$2 million reserve. When the revised budget was presented to the Commission in April, the Lottery had higher sales at that time therefore raising the reserve to \$4 million. The proposed reserve is equal to what the Lottery started last fiscal year.

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.

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

10. Commissioner General Discussion

Chairman Mass commended staff on the terrific year and the budget that was presented. The 14.6 percent increase in revenue, and raising revenue to \$3.5 billion is an incredible increase to public education for next year.

11. Scheduling Next Meetings

The next Commission Meetings are tentatively scheduled for December 9, 2010 in Sacramento.

12. Public Discussion

Mass asked if anyone from the public had anything to discuss. Ray Cormier Jr. was pleased that the Fantasy 5 drawings are now online.

13. Adjournment

Meeting adjourned at 11:27 a.m.