

MEMORANDUM

Date: June 25, 2010

To: California State Lottery Commission

From: Joan M. Borucki

Director

Prepared By: Michael Brennan, Deputy Director

Sales & Marketing Division

Subject: Item 9(b) - Amendments to Regulations for Retailer Compensation and

Incentive Bonus

ISSUE

Should the California State Lottery Commission (Commission) adopt proposed amendments to the California State Lottery Regulations (Regulations) to reduce the current Scratchers retailer cashing bonus by one percent?

RECOMMENDATION

Staff recommends that the Commission adopt the proposed amendments. The amendments will become effective on August 1, 2010.

BACKGROUND

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

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DISCUSSION

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 new 13 percent cap on its administrative budget. These include renegotiating the contract with GTECH Corp., extending the Scientific Games ticket production and the UPS ticket delivery contracts with no increase in costs, terminating the unprofitable production of the Make Me a Millionaire TV Show and restructuring our investment portfolio. Despite these and other costs 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 within the 13 percent administrative budget.

The California Lottery offers the most generous retailer compensation package of any lottery in the nation. The biggest portion, or over 52 percent, of the Lottery's administrative budget is dedicated to retailer compensation. The Lottery's Fiscal Year (FY) 2009/10 budget for retailer compensation is over \$180 million for 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. This budget is based on projected FY 2009/10 sales of \$3.027 billion. If the Lottery continues to offer the same compensation package in FY 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 our retailer business partners. Each of the dozen or so components of the current retailer compensation package were evaluated as a part of this assessment. On June 3, 2010, staff convened a retailer advisory board comprised of representatives from both independent and major chain accounts to discuss various options and proposals for reducing retailer compensation. As a result of these efforts, staff recommends that the Commission approve amendments to Retailer Compensation and Incentive Bonus Regulations to reduce the cashing bonus the Lottery pays to retailers when they cash winning Scratchers tickets for prizes of \$1 to \$599 from two percent of the value of the prize to one percent of the value of the prize. The Lottery will also increase the Administrative Fees that retailers pay 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 will still offer the most generous retailer compensation package in the nation and total compensation paid to retailers will actually increase by over \$20 million in FY 2010/11 from what they will receive in this Fiscal Year.

The proposed amendments to the regulations are attached in their entirety.

¹ The Lottery's FY09/10 administrative budget is: 52.3% for retailer compensation; 22% for general administration; 13.9% for game operations; 11.3% for communications and .5% for spending reserve.

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^{*} Page numbers not included as they will be updated to conform with amendments, if approved.

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Employee Recognition

I. General Regulations sections A – O

were approved by the Commission on May 20, 2010.

II. Game Specific Regulations sections A – Iwere approved by the Commission on May 20, 2010.

III. Operational Regulations sections A – C(Reserve Prize Fund, Prize Assignment Regulations, and Retailer Regulations)

were approved by the Commission on May 20, 2010.

PROPOSED AMENDMENTS

III. Operational Regulations section D

(Retailer Compensation and Incentive Bonus Regulations)

D. RETAILER COMPENSATION AND INCENTIVE BONUS REGULATIONS

1. PURPOSE

These regulations are promulgated by the California State Lottery (Lottery) Commission to establish the compensation to be paid to game retailers.

COMPENSATION

a. Draw Games

- (1) The Lottery will compensate retailers for selling draw game tickets or shares as follows:
 - (a) 4½% of the retail sales price for each ticket issued from a self-service ticket dispensing machine.
 - (b) 6% of the retail sales price for each ticket issued from a retailer clerk terminal (RCT).
- (2) The retailer handling fee for issuing Fantasy 5 replay tickets will be \$.06 for each replay ticket issued from the retailer's draw game terminal, regardless of the type of terminal.

b. Scratchers®

- (1) Retailer compensation for selling Scratchers® tickets is 6% of the retail sales price for each ticket sold by the retailer at his/her authorized Lottery game retailer location.
- (2) The retailer handling fee for issuing free Scratchers® tickets is 6% of the retail sales price for each free Scratchers® ticket issued by the retailer in response to the redemption of a valid Scratchers® ticket with a "free ticket" prize.

3. INCENTIVE BONUS

a. The Lottery may pay an incentive bonus to retailers based on attainment of sales volume or other objectives as approved by the Lottery Director for any of the Lottery's games. Retailers who participate in and meet the objectives and requirements of an authorized incentive bonus program will receive a bonus payment according to these regulations and the terms and conditions of the program. b. Retailers will be paid an incentive bonus of .5% on prizes as specified below.

(1) Draw Games

- (a) A retailer who sells a valid winning Fantasy 5 five of five ticket or a valid winning Daily Derby grand prize ticket will receive a bonus payment equal to .5% of the value of the player's winnings.
- (b) A retailer who sells a valid winning SuperLOTTO Plus® jackpot prize ticket will receive a bonus payment equal to .5% of the annuitized jackpot value of the player's winnings, regardless of the payment option indicated on the winning ticket.
- (c) A retailer who sells a valid winning Mega Millions® grand/jackpot prize ticket will receive a bonus payment equal to .5%, up to a maximum of \$1 million, of the annuitized grand/jackpot value of the player's winnings.
- (d) A retailer who sells a valid \$1 million winning Raffle grand prize ticket will receive a bonus payment equal to .5% which is \$5,000 per winning ticket.
- (e) The determination of what constitutes a valid winning ticket will be made solely by the Lottery in accordance with applicable law and Lottery regulations and procedures.

(2) Scratchers®

- (a) A retailer who sells a valid Scratchers® ticket resulting in a player's spinning the Big Spin® prize wheel will receive a bonus payment equal to .5% of the value of the prize won at the wheel.
- (b) A retailer who sells a valid Scratchers® ticket resulting in the payment of an instant prize of \$1 million or more will receive a bonus payment equal to .5% of the value of that prize.
- (c) The determination of what constitutes a valid winning ticket will be made solely by the Lottery in accordance with applicable law and Lottery regulations and procedures.

(3) Promotions

- (a) This section applies to promotions for any Lottery game or games and/or the California Lottery television show.
- (b) A retailer who sells a Lottery game ticket in connection with an authorized Lottery promotion that results in a participant winning a promotional prize of \$1 million or more will receive a bonus payment of .5% of the value of the promotional prize.
- (c) A retailer who sells a Lottery game ticket in connection with an authorized Lottery promotion that results in a participant's eligibility to spin the prize wheel on the Big Spin® TV show will receive a bonus payment of .5% of the value of the resulting prize.
- (d) Bonus payments provided in this section are subject to the Director's approval of each promotion, and are subject to official promotion rules.

c. Payment of Incentive Bonus

Any incentive bonus payment is contingent upon and subject to the following:

- (1) The prize winner must have complied with all rules and regulations for the applicable game or promotion, and his/her ticket or entry must be determined a valid winning ticket or a valid winning promotion entry by the Lottery.
- (2) The retailer must be current (i.e., not delinquent) in any payments(s) that he/she owes to the Lottery. If a retailer is delinquent in payments to the Lottery, the Lottery may deduct the total amount of the delinquency from any bonus payment.

4. CASHING BONUS

- a. For Scratchers®, retailers will be paid a cashing bonus of 21% of the value of the prizes the retailer pays to players for cashing valid winning tickets with prize amounts of \$1 to \$599 on a single ticket.
- b. For draw games, retailers will be paid a cashing bonus of 3% of the value of each prize paid to players for cashing valid winning tickets with aggregate prize amounts from \$99 to \$599.

c. The determination of what constitutes a valid winning ticket will be made solely by the Lottery in accordance with applicable law and Lottery regulations and procedures.

5. PAYMENT WHEN A GAME OR INCENTIVE BONUS PROGRAM IS TERMINATED

- a. Termination of a Game or Promotion
 - (1) The Director may, at any time, announce a termination date for a Lottery game, games, or promotion after which date no further tickets or shares may be sold.
 - (2) If the Lottery terminates a game, games, or promotion, retailers will be paid compensation and/or bonuses earned up to and including the last day of sale for the terminated game, games, or promotion.
- b. Termination of an Incentive Bonus Program
 - (1) The Director may, at his or her discretion, terminate an incentive bonus program at any time.
 - (2) If the Director terminates an incentive program, retailers will receive any bonus payment owing, as provided in these regulations and in the terms and conditions for the incentive bonus program, through the termination date.

6. PILOT ALTERNATIVE COMPENSATION AGREEMENTS

The Director may enter into alternative compensation agreements with Lottery retailers to accommodate pilot testing new business models aimed at the retention and recruitment of existing and new chain accounts and trade styles. The Director shall notify the Chair of the Commission prior to entering into such pilot alternative compensation agreements. Such pilot alternative compensation agreements can be used to pay retailers different sales commissions, incentive bonuses and cashing bonuses than those specified in Sections 2, 3, 4 and 5 of the Retailer Compensation section of these regulations.

7. ALTERNATIVE COMPENSATION AGREEMENTS

The Commission finds there is a need to develop alternative business models to engage in partnerships with certain retailers.

If the model results in an overall compensation plan to the retailer that is less than 5% of tickets or shares sold, then the Lottery Director is delegated discretionary authority under California Government Code §8880.51 to negotiate and enter into such business compensation structures, upon consent of the Commission Chairperson.

8. GOVERNING LAW

These regulations are governed by the California State Lottery Act (Gov. Code sec. 8880.00, et seq.), state and federal law, Lottery regulations, procedures, directives, decisions, and instructions and the terms and conditions of the Lottery game retailer contract.

III. Operational Regulations sections E – F(Competitive Bidding Procedures and Employee Recognition)were approved by the Commission on May 20, 2010.