

CALIFORNIA STATE LOTTERY COMMISSION

Minutes – May 26, 2011
Sacramento, California

1. Call to Order

Chairperson John Mass called the public meeting of the California State Lottery Commission to order at 9:37 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 John Menchaca
Commissioner Alex Fortunati
Chairman John Mass

CSL Staff and presenters:

Linh Nguyen, Acting Director
Lisa Hightower, Chief Legal Counsel
Ed Fong, Chief of Product Development
Jim Hasegawa, Deputy Director of Business Planning
Michael Brennan, Deputy Director of Sales/Marketing
Liz Furtado, Sr. Marketing Specialist
Elisa Topete, Assistant to the Commission
Glenda Lewis, Recording Secretary

4. Consider Approval of the Agenda

Mass asked if any of the Commissioners wanted to make changes to the May 26, 2011 agenda as proposed. Acting Director Linh Nguyen removed Director's Report 7(b), Consumer Compliance and Protection Program. Menchaca moved to approve the amended agenda. Seconded by Fortunati. The motion passed unanimously (3-0).

5. Approval of Minutes

Mass asked if there were any additions or corrections to the April 14, 2011 minutes. Menchaca moved to approve the April 14, 2011 minutes. Seconded by Fortunati. The motion passed unanimously (3-0).

6. Commission Liaison Reports

Commissioner Menchaca:

Menchaca reported on the Security Liaison and staff briefed him on the following: In early April 2011, all Lottery Investigators successfully completed the certified "Advanced

Officer Training” course mandated every two years by the California Commission on Peace Officers Standards and Training (POST). On May 27, all Lottery Investigators will be attending a mandatory one-day Risk Management course at the California Highway Patrol’s headquarters. The training course is certified by the California Commission on Peace Officers Standards Training.

The California State Controller’s Office and the Franchise Tax Board’s Interagency Intercept Collections Unit has agreed to provide greater access to the Lottery’s investigative staff for accessing “offset” (tax withholding) information for its investigations. Offset information identifies persons who owe back taxes, child support, court ordered judgments, tax liens, etc. During the week of April 25, 2011, a Dateline news film crew rode along with Lottery Investigators during the Retailer Compliance Program in San Francisco and Bakersfield. Undercover Lottery Investigators, using decoy winning tickets, entered retailer stores to determine if the clerks would steal the winning ticket from the unsuspecting players. The stores selected for the compliance program were retailers that Lottery players had previously complained about.

Menchaca provided the Audit Liaison Report. The following is a status of the State Controller’s Office (SCO) audits: A report was issued in May 2011 and had two findings on the Fourth Quarter Transfer Report Fiscal Year (FY) 2010. A report was issued in May 2011 and had no findings on the Alcone Marketing Group Contract. No findings were found in the First Quarter Transfer Report FY 2011 and the Second Quarter Transfer Report FY 2011. The Lottery took corrective actions on five findings that were noted in the report for the 3 Ball Production Contract. On the implementation of past SCO audit recommendations, the Lottery responded to the draft audit report on May 16, 2011 and took corrective actions on five findings that were noted.

Field work has been completed and is under review of the Otto Construction Contract. Six findings will be noted once the draft report is issued. Field work is complete and is under review for the LPA Sacramento Inc. Contract. One issue will be noted once the draft report is issued. Field work is expected to last through the end of May 2011 on the Samuel Ramirez & Co. Contract. There are no preliminary issues. Field work is expected to last through the end of July 2011 on the Budget Process. There are six preliminary issues. Field work is expected to last through the end of May 2011 on the Risk Assessment and there are no preliminary issues. Field work began on May 16, 2011 on the Retailer Network and is expected to last through July 2011. Field work began on May 17, 2011 on the Casanova Pendrill Publicada Inc. Marketing Contract and is expected to last through July 2011.

KPMG continues to observe and report on the Lottery’s daily draws. No significant issues were noted since the last Commission Meeting. KPMG began field work on the Annual Financial Statement Audit for fiscal year 2010/2011 and field work is expected to last through October 2011. The final report is scheduled to be released on October 14, 2011.

For the Lottery's internal audits: the draft report was issued in May 2011 on the Camelot Contract. Two findings and one observation was noted in the draft report and the final report will be issued in June 2011. Field work is completed and is under review on the Asset Management. The draft report is pending and six preliminary findings are noted. Field work is expected to last through the end of May 2011 on the Scratchers® Ticket Activation and there are no preliminary findings. Field work is expected to last through the end of May 2011 on the Travel Program. There are no preliminary findings. Finally, the Audit Committee will be meeting following today's Commission Meeting.

Commissioner Fortunati:

Fortunati reported on the Education and Community Relations Liaison Report. The Lottery has sent its application for the Level 3 Certification by the World Lottery Association for Responsible Gaming. The application requires information on all Lottery programs that encourages players to engage in responsible gaming. If the Lottery secures the Level 3 Certification, it will be the only lottery in the nation with such a high level of recognition for promoting responsible gaming. Staff will be notified if the application is approved this summer.

The Lottery is moving ahead with a program to display art pieces throughout the year at the new Lottery Headquarters building. The first installment will feature 36 award-winning pieces of art from Elk Grove High School. The art will be displayed in July, August, and September.

Chairman Mass:

As Marketing Liaison, Mass was updated on the following: The Lottery launched advertising for the "Red Hot 7's" Scratchers at the \$5 price point offering 16 chances to win. The ticket featured an advertising campaign that included separate commercials for General Market television and radio, and Spanish language television and radio. The campaign began on April 11 and ran through May 1. Marketing is not on the air at this time with advertising. Staff is planning for the next round which is planned for August and will focus on "Set for Life" and then will follow with the introduction of the \$10 Scratchers game. Advertising for that game will air at the end of October.

As Procurement Liaison, Mass was briefed by staff and requested approval of the following: A contract amendment for Wilson Sonsini Goodrich & Rosati. Wilson Sonsini provides assistance to the Lottery's in-house legal staff on specialized intellectual property legal advice. Staff will release an Invitation for Bid to invite solicitation to procure a contractor to provide security guard services that includes: monitoring and controlling access to Lottery facilities, responding to alarms, escorting visitors, providing security services at special events, and protecting Lottery assets throughout the State.

There will be a purchase order to Epicore Software Corporation for annual maintenance and support of the Lottery's accounting system from June 1, 2011 to May 31, 2012. Staff will procure an interagency agreement with the California Department of Alcohol

and Drug Programs, Office of Problem Gambling for maintenance services to the Lottery's problem gambling helpline and other services.

As Budget Liaison, staff updated Mass on the 2010-11 Budget. Staff continues to monitor expenses against sales goals. The most recent sales projections indicate the Lottery is on track to meet the budget goal of \$1.1 billion to public education this fiscal year. Development of the 2011-12 Budget is well under way. A key step in the process is Commission approval of the 2011-12 Business Plan that will be presented at today's meeting. Staff is schedule to present the proposed 2011-12 Budget to the Commission at the June meeting. Staff will be providing an overview of the budget development process to Commissioners Menchaca and Fortunati prior to the June Commission meeting.

Mass presented the Legislative/Legal Liaison Report and stated that the Lottery is following two Legislative bills that would amend the Lottery Act. Assembly Bill (AB) 363 changes the reporting dates for the State Controller to make specified reports to the Legislature from September 1 and December 31 of one year to January 1, and April 1 of the following year, respectively, for each of five specified full fiscal years regarding the Lottery's efforts under AB 142 to boost income for public education. It also extends operation of AB 142 and restoration of the prior law from December 31 of one year to April 1 of the following year, if the Controller notifies the Legislature and the Governor that specified events relating to the total net revenues allocated to the benefit of public education have occurred. Senate Bill 939 makes several technical non-substantive corrections to the Lottery Act.

7. Director's Report

Nguyen stated that the sales report will be presented as part of the Business Plan under Action Item 9(b).

a. Lottery Report Card

Ed Fong, Chief of Product Development, presented an update on the RENEW Initiatives. Staff finalized a Retailer Incentive Program that focuses on pack activations for the \$5 Mega Crossword May game. The incentive should motivate retailers to activate and display the packs. The incentive will run from June 6 through September 6 and the retailer prizes range from \$100 to \$10,000. Staff will roll out the Scratchers Inventory and Distribution Program which will maximize efficiencies on how games are distributed, on June 6. For Ex\$ell, Retail Optimization, and Retail Communications: staff has either finalized or approved the new charters for these programs. Staff has fine-tuned the product plan to quickly seize the benefits of an earlier \$10 game launch. The prize structures are constantly being refined to create the optimum prize awards within the templates.

For draw and jackpot games, the Lottery is on pace to re-launch Hot Spot® on August 1, 2011, with additional spot plays which is the first step in strengthening the product line. For possible improvements to SuperLOTTO Plus® the mechanics are being

finalized for a brainstorming session that will lead to ways to differentiate and identify value-added programs. The session is currently scheduled for mid July. For Marketing/Communications, staff has announced the three finalists for the Hispanic Advertising Services Request for Proposal (RFP).

Staff is refining the 2011-12 Advertising Plan to accommodate such tactics as supporting an earlier \$10 game launch. The Lottery has been very successful in identifying and realigning internal resources to assist in the efforts of the digital communications and the public Web site. Staff is also looking at programs that would have immediate sales impact, such as Web-based second-chance draw programs for draw games. Finally, one of the key initiatives under "Business Optimization," is developing a market response analytics for media buys. Staff is refining the model and the target is to have the initial model completed by early June 2011.

c. Upcoming Marketing and Promotions

Michael Brennan, Deputy Director of Sales and Marketing, provided an overview of last year's marketing efforts and the upcoming year's advertising promotions and marketing plan including the product. Last year, the Lottery introduced advertising for Scratchers including the holiday advertising, advertising for the \$5 "Set for Life" ticket and finishing with "Red Hot 7's" last month. In August, staff will refresh the "Set for Life" advertising (video shown).

In 2010-11, staff accelerated distribution of Lottery tickets, going from three tickets every four weeks, to four games every three weeks, with the goal of having at least 17 of the 24 tickets in retail faced by the end of September. The goal was to get an overall payout of between 61 and 62 percent from the previous average which was 57.7 percent. After accomplishing that in September, the first phase of advertising began with the statement that the Lottery had more prizes and more ability to win. From that point in time, there as been a steady gain in sales throughout the year. The Lottery has also been able to maintain at least five \$5 games in retail throughout the year. Brennan went over the May Scratchers including two facings of the Tripling Crossword which are performing at \$5 million a week.

The Lottery's promotion with Viejas Casino in San Diego County ran from February 1 through March 1. The promotion was a second-chance entry to win \$5,000 from the Lottery and players received one second-chance entry code for every \$5 spent per transaction. In addition, players also received promotional messaging, directing them to the Viejas Casino to join its loyalty club. Upon joining, players would receive a free Scratchers game, a free play at the Viejas Casino's kiosk game, and free entry into the casino's weekly drawing, which had a prize of about \$10,000. A micro-site was developed and had more than 800,000 visits in February, with approximately 650,000 of those being unique, and had more than 14,000 players sign up to participate in the promotion by entering Web entry codes.

The Marketing Plan for 2011-12 will involve awarding a new contract for the Hispanic marketing services, utilizing the econometric ROI modeling for choosing the Lottery's marketing mix. Supporting jackpot draw-based games in the market year-round is afforded, and aligning marketing initiatives to support the Scratchers product plan. Additional second-chance promotions will provide services on the Lottery's Web site. Staff will continue with the Fantasy 5 Bonus Bucks \$5 purchase incentive to generate awareness of the Daily Games. Staff will include Daily 4 and the top prizes through Lottery-owned devices such as LEDs and ePOS. The Daily 3® jackpot information was just added in the last three months and there has been an increase in sales. Staff is also looking at adding a mid-day draw to the Daily 4.

Staff reviewed the Hot Spot® business and found that players are seeking some new elements of the game. In August, the Lottery will offer the 10-spot Hot Spot with Bull's-Eye as opposed to the five. A Bull's-Eye wage will be offered on every spot and the highest prize could potentially reach up to \$300,000. Jackpot games will continue advertising MEGA Millions® in key areas such as Los Angeles and San Francisco, with jackpot alerts at thresholds between \$70 million and \$100 million.

SuperLOTTO Plus has been evaluated and promotional concepts have been developed and will be implemented in 2011 to make the product more exciting, with some value-added incentives. One incentive will include a Web-based second-chance program. Staff is also monitoring the possibility of a national game that is being developed by both MUSL and the MEGA Millions states. The new public Web site will launch in the summer of 2011 and will possibly have a Check-a-Ticket online, integration with the second-chance programs, a new rewards program, and casual games. Staff is looking at the possibility of a claims-tracking process and the supporting advertising campaigns. Future iterations may include improved mobile applications for communication with the players.

Staff will continue to use advertising, both brand and game-specific; continue to communicate with Lottery retailers through the revised monthly retailer product plan, which will include the new game mix; and those games that are to be ended and pulled out of retail. Monthly game, vending, and counter displays will be provided to ensure that the right games are being displayed. The Lottery will launch 45 to 48 games with an average payout of 64 percent and the \$5 games will go from 66 percent to 68 percent payout. The \$10 game, "\$250 Million Cash Spectacular" is scheduled to have a payout of 73 percent and will be the largest ticket from the Lottery.

There will also be events and promotions that will all be tied to a purchase, so there will be not be non-purchase events for the year. The events will include 13 fairs and festivals throughout California, and retailer events including the popular Snow Globe Tour.

8. Consent Calendar

There were no items on the consent calendar.

9. Action Items

a. Regulations for Implementation of Draw Test Games

Ed Fong, Chief of Product Development, provided the proposal on improving amendments to the regulations for the implementation of the draw test games. The amendments provide the Lottery with the ability to run controlled live draw test games. It also lays the foundation to provide staff with the ability to thoroughly investigate, design, and complete the basic framework that is needed to run the test games. Staff needs the flexibility to test different games, as long as it adheres to guidelines that meet validation requirements and overall gaming integrity.

The goal in developing new products is offering products that meet the wants, needs, and desires of Lottery's players. Findings from research studies are critical and provide important key player insight into the development of key programs. The test system is entirely independent from the Lottery's host gaming system, which allows for self-sufficient deployment. GTECH has developed a secure wireless test system that communicates separately from the retailers' existing gaming system. Players can only purchase a test game from a test system terminal. Players can view the test game's actual draw and results on a separate monitor or other types of communication device. At that point, players can experience the winning and non-winning experiences that are important to understand exactly how the player perceived that particular game.

Players will also be able to validate their test game tickets and collect winnings as they normally would for any type of draw games. But the claiming of any of these test game prizes has to specifically be from the test-game system. Wagering can also be enabled and suppressed at certain times of the day. The Lottery will have full control in determining when it starts and when it ends. The key benefits of approving regulations for draw test games would allow the Lottery to obtain real-world data as a result of the live environment testing. If approved, staff would like to build the test game framework to run live test games next fiscal year.

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

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

b. Fiscal Year 2011-12 Business Plan

Jim Hasegawa, Deputy Director of Business Planning, reported that sales are at about 97 percent of the Lottery's goal and about 13 percent ahead of last year and provide public schools about \$1.1 billion. The increase is about \$400 million higher than sales of the prior fiscal year and will be the largest dollar gain that the

Lottery has seen in about 18 years. NASPL released sales figures from other jurisdictions for the first quarter of this calendar year and for the second consecutive quarter California is again the fastest growing Lottery in the United States. Sales were about 30 percent higher in January through March of 2011 than they were in the same quarter in 2010.

Hasegawa stated that the development of the plan and its initiatives was a team effort that involved Lottery staff through the various RENEW work streams, as well as discussions and presentations from the Lottery's key business partners. The business plan revolves around the four "P's" of marketing: product, place, promotions and price. The same strategic imperatives from the three-year business plan still form the cornerstone of the foundation for this year's plan.

There are two main product categories; the Scratchers game category and the draw games. The two enhancements to the Scratchers product is the introduction of the \$10 game and the continued refinements in product planning for Scratchers. Because of AB 142, the Lottery has been able to launch multiple \$5 games therefore sales have gone from \$3 million a week in the first quarter of 2010 to over \$11 million a year later. The share of sales coming from the \$5 product line has gone from 10 percent of Scratchers sales to 28 percent of Scratchers sales. A \$10 game has been a key strategy for most jurisdictions that have been very successful with Scratchers and all other states do have a \$10 product. Research has shown that players are already primarily purchasing \$5 games because they see the benefit of winning higher prizes. The \$10 game has been tested both qualitatively through focus groups, as well as quantitative through the Replay database.

Over the last 18 months, there have been dramatic changes in the Scratchers that have led to dramatically better-selling games, such as the prize structure changes; not only the prize payout percentage, but also where the prizes are and what people are actually winning. There have been a reduced number of games that has being distributed to retailers, from 70 different games to 28 games to ensure that retailers are carrying the best-selling games. It has caused the number of individual Scratchers games that are selling more than \$2 million to dramatically increase. Hasegawa reported a record-breaking 11 different Scratchers games that sold \$2 million or more. Staff is also looking into increasing the payout of the \$5 games. Staff will be having quarterly Scratchers review meetings to be able to look into the games that have been introduced recently, explore their sales, how players have reacted to it, and determine what features were very strong for those games.

In the draw games area, new features and promotions for Hot Spot and SuperLOTTO Plus will be evaluated for a potential national lottery game. This year will mark the first time in many years that Hot Spot will show an increase in sales from the prior fiscal year; approximately an 11 percent gain. As part of the

RENEW effort, one of the key findings was the fact that Hot Spot behaves differently in California compared to how successful games in other lottery jurisdictions behave. The Lottery generates a much lower share of the sales from social venues like bars, restaurants and taverns; the Lottery does not have all ten spots, and there is a lower prize payout.

In the RENEW effort on the jackpot games, various SuperLOTTO Plus options were analyzed last year and at this time, no game change is being recommended. What is being recommended is to launch a promotional feature and Product Development will make sure it helps brand the game better so that it becomes more unique in its positioning from the MEGA Millions product. Research will be conducted on players to really understand their perception about SuperLOTTO Plus versus MEGA Millions.

In terms of evaluating the potential national game, the recommendation was not to join the \$1 Powerball game at this time. According to the Virginia Lottery analysis, all the other MEGA Millions states that joined Powerball saw only an 8 percent gain in their combined MEGA Millions and Powerball game sales compared to just MEGA Millions before. It is based on the first 52 weeks after that cross-selling effort began. Lottery staff will conduct a similar research and analysis to assess whether any potential national lottery games that are being developed will really create more sales and more to the bottom line for public schools before making a recommendation to the Commission.

There are a number of initiatives being proposed on improvements of where the Lottery sells its products. Phase II of the Ex\$ell program is going to focus on the efforts in the field for specific retail locations that have the greatest potential to grow Lottery sales and increase the visitations. It will also concentrate the District Sales Representatives' time there versus areas or stores where a visit would not produce as much in terms of sales growth. The corporate-owned locations are different than the independent locations. The focus of the corporate locations will be to reduce empty Scratchers bins to make sure there is always a full complement of Scratchers games available for the players and improving game activation levels. Other drivers include increasing the number of \$5 games sold and staff would like the retailers to be carrying all five of them. Installing ePOS equipment at the retail locations is a great communication device that definitely increases sales and increases profits based on the cost of those ePOS devices for the Lottery. Increasing the actual number of chain locations in the Lottery's network is a real critical project to accommodate all the growth that is being planning for Scratchers to ensure a supply chain is effective and efficient.

The Network Optimization Project will recommend potential areas that either need more retail locations or perhaps fewer locations selling Lottery products. It is done in two different ways: One is geographically to show areas of the state

regarding trends and population; and the other is the type of retailer establishments. Other retailer initiatives include improving retailer communications. The retailer is the driving force behind the selling of Lottery products so if something can streamline a retailer's effort it reduces the amount of time they have to spend on the Lottery's product which will make them more likely to want to sell Lottery products. The final initiative in the retail area is developing the recruitment plan for Hot Spot locations to successfully get new accounts.

Jackpot levels have been higher over the last couple of quarters compared to earlier sales due to the advertising efforts by Marketing. Based on advertising analysis done in the Los Angeles and San Francisco areas since March of 2010, an additional \$65 million in sales has been reported in those areas compared to what the Lottery would have expected if there were no advertising being done. The analytics model will allow staff to enhance the impact of the advertising because of the media vehicles being optimized as well as the different jackpot amounts and when is the best ROI to do those jackpot alerts. Advertising has also increased top-of-mind awareness in MEGA Millions and has driven more people into the stores to purchase the product. Scratchers advertising has definitely increased sales and awareness is higher. For future growth in the Scratchers product line, the Lottery needs to increase the size of the player base. One of the long-term initiatives will be to develop strategies that will allow advertising to reach new players and get them to play Scratchers in the future.

The gaming system upgrade will allow the Lottery to have new functionality and will enable staff to bring new products to market faster. Business Intelligence will be expanded to include draw games and other areas as well as KPI's. Succession planning will ensure that the projects can live beyond the time that the Lottery baby-boomers would be entering into retirement years. Finally, documenting and reviewing Lottery processes will allow staff to follow them in an orderly way. The financial highlights of the business plan will deliver record sales. The plan will deliver increased profits to schools in the range of about \$100 million more in the coming fiscal year and will represent the 12th consecutive year that the Lottery has provided more than a billion dollars to public education. Approving the plan will allow staff to develop the details and develop the budget that will be presented at the June Commission meeting.

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

c. Core Scratchers® Game Profile Templates

Liz Furtado, Sr. Marketing Specialist, stated that the Commission modified regulations to streamline the new game approval process by having the Commission review and approve Scratchers core game profile templates instead of approving individual game profiles for each Scratchers game. As part of the Scratchers RENEW Initiatives, the templates were based on improved prize structures for every price point that incorporated higher payouts and maximized winning opportunities.

The new templates include mainly \$5 games and staff recommended increasing the \$5 game payout from 66 percent to 68 percent, with prizes being improved mainly at the \$15 and \$20 levels. The Lottery is also increasing some of the top prizes on those games, from \$100,000 to \$500,000 which is especially important once the \$10 game is launched in order to provide more significant wins that will reward the Lottery's established and loyal \$5 player base.

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.

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

10. Commissioner General Discussion

Mass thanked Barbara Krabbenhoft, Deputy Director of Human Resources, for her incredible effort and value that she brought to the Lottery.

11. Scheduling Next Meetings

The next Commission Meetings are tentatively scheduled for June 23, September 8, October 27, and December 8, 2011 in Sacramento.

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 10:55 a.m.