

REPORT ON THE NORTH DAKOTA LOTTERY

Prepared for
Judiciary Committee

by
Randy Miller
Director, North Dakota Lottery

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NORTH DAKOTA LOTTERY

1. Organization

On November 5, 2002, North Dakota citizens approved a constitutional amendment by nearly two-thirds majority vote that enabled the state to participate in multi-state lottery games. The 2003 Legislative Assembly passed a law, effective April 4, 2003, that created the North Dakota Lottery as a division within the Office of Attorney General. The law restricts the Lottery to only conduct online games, while the Constitution restricts the Lottery to only conduct multi-state games. In-state lotto games, instant ticket games, video games, and pick 3 or 4 numbers games are prohibited.

The Lottery is responsible for administering, regulating, enforcing, and promoting the state's lottery. The Lottery's goal is to provide a service to the citizens of North Dakota and, while considering the sensitive nature of the Lottery, promote games, and ensure the integrity, security, and fairness of its operation. To accomplish this, the Lottery must offer attractive games that add value to its product mix, license retailers that are in convenient locations, create effective annual marketing plans, provide quality customer service to retailers and players, and control operating expenses.

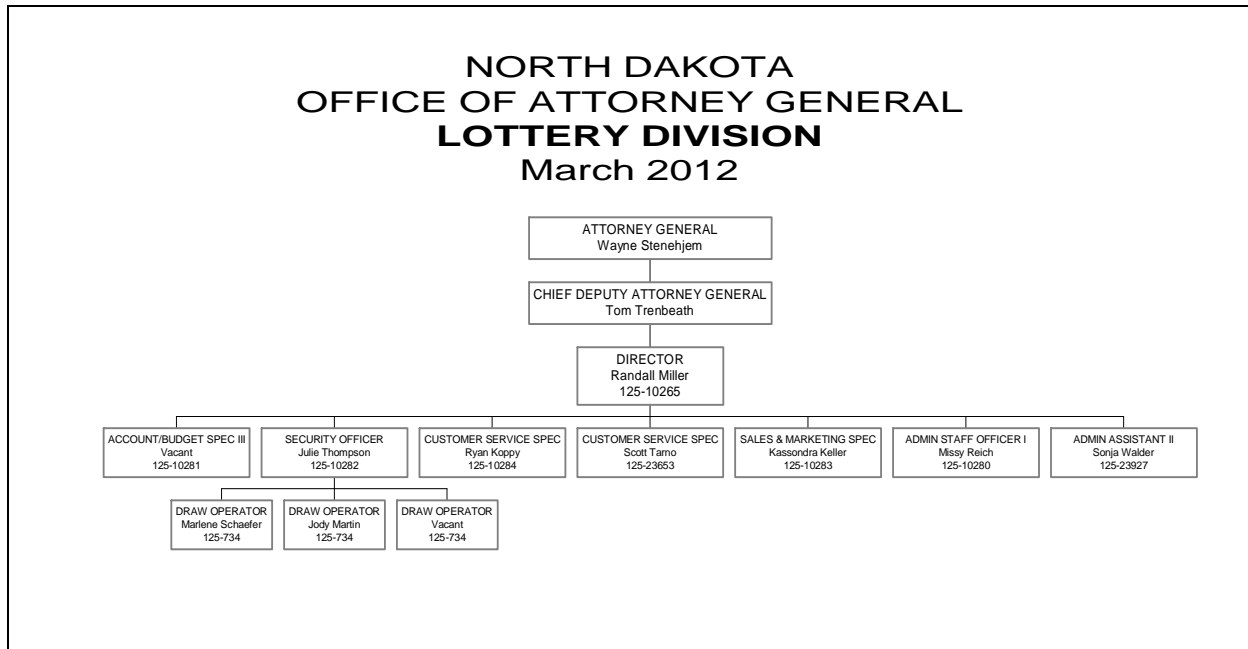
The Lottery processes license applications and collects application and license fees; selects eligible retailers for licensing; conducts criminal history record and credit checks; launches new games, develops point-of-sale promotional items; trains employees of retailers how to sell and redeem lottery tickets; assists retailers in promoting games; does electronic fund transfers of lottery money from retailers' bank accounts; completes debt setoff process; pays certain prizes to players; develops creative marketing, advertising, promotional, and educational programs; develops sales incentive promotions; issues news releases, quarterly retailer newsletters, and annual financial reports; develops administrative rules and proposes laws; ensures compliance with the lottery law and rules; works with the Lottery Advisory Commission, on-line system vendor, and ad agency; conducts draw procedures; forecasts revenue and net proceeds; develops and implements security policies and procedures to protect assets; complies with the Multi-State Lottery Association's (MUSL) computer gaming system and computer internal control system requirements, game security standards, system standards for new lottery implementations, and game rules; investigates allegations of unlawful activity; and provides full accountability to the public and Legislature.

2. Appropriation

The Lottery's fixed appropriation for the 2011-13 biennium is \$1,454,365 for salaries and fringe benefits for 9.5 FTE's, and \$2,245,877 for operating expenses, totaling \$3,700,242. The Lottery has a continuing appropriation for variable expenses of prizes, retailer commissions, online gaming system vendor fees, and MUSL game group dues which have a direct incremental relationship to sales and cannot be budgeted.

The appropriation funds 8 FTE positions in the Lottery Division, 1 FTE position in the Information Technology Division, and .5 FTE position in the Finance and Administration Division. Also, the appropriation funds 3 part-time draw operators.

Organization Chart



3. Retailers

The Lottery selects and annually licenses 400 businesses as lottery retailers. There is approximately one lottery terminal for each 1,600 residents.

The numbers of retailers and sales percent, by type, for the period ending June 30, 2011 are:

<u>No.</u>	<u>Type</u>	<u>Sales %</u>
300	Convenience Store	71.7%
61	Grocery Store/Supermarket	23.1%
7	Gas/Service Station	.7%
18	Truck Stop/Plaza	3.0%
14	Other (i.e. Bar, Drug Store)	1.5%

4. Products

The Lottery conducts five multi-state games: Powerball, Hot Lotto, Wild Card 2, 2by2, and Mega Millions. The Powerball game was launched on March 25, 2004; Hot Lotto on June 24, 2004; Wild Card 2 on September 23, 2004; 2by2 on February 2, 2006; and Mega Millions on January 31, 2010. The games of Powerball, Hot Lotto, and 2by2 have

been re-launched with enhanced features. These games have a range of minimum jackpots of \$22,000 to \$40 million, and a range of overall odds of winning a prize of 1:3.59 to 1:39.89.

The Lottery's Give-A-Gift service provides players an opportunity to purchase lottery gift certificates in values of \$1, \$5, \$10, and \$20 to give as gifts to family members and friends for special occasions. The certificates are printed on Lottery terminals. The certificates may be redeemed for lottery tickets at any Lottery retailer and have no expiration date.

The Lottery's subscription service provides players an opportunity to prepay and be automatically entered into draws for 13, 26, or 52 weeks. The service is available for the games of Powerball, Hot Lotto, Wild Card 2, 2by2, and Mega Millions. Subscriptions are a convenience for players who cannot always get to a Lottery retailer before every drawing, for players who travel to another state on vacation during winter months, or as gifts. Currently there are 2,426 subscribers and 3,032 subscriptions.

5. Financial Overview

Below is an overview of financial information for the 2009-11 biennium. The Lottery's operating expenses are minimized because the Lottery blueprinted its organizational structure, functions, and gaming system features to optimize efficiency. The Lottery's net proceeds (actual profit) are 26% of total revenues.

Operating Revenues:

Ticket Sales	\$ 47,425,326
Other Operating Revenue	<u>158,904</u>
Total Operating Revenues	47,584,230

Operating Expenses:

Prize Expense	24,584,890
Retailer Commissions	2,320,297
Retailer Bonuses	111,000
Contractual Services	4,998,361
Marketing	1,160,798
Salaries & Benefits	1,328,389
Operating	<u>742,815</u>
Total Operating Expenses	35,246,550

Operating Income	12,337,680
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Nonoperating Revenues:

Interest Income	<u>18,824</u>
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Net proceeds Before Transfers	\$ 12,356,504
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For the 2009-2011 biennium, the Lottery projected sales of \$46,453,880 and net proceeds of \$12.4 million (\$11.155 million - state general fund; \$400,000 - Compulsive Gambling Prevention and Treatment Fund; and \$845,000 - Multi-Jurisdictional Drug

Task Force Grant Fund). Sales and net proceeds for the biennium were above projections at \$47,425,326 and \$12,356,504, respectively.

Ticket Sales and Transfers

Fiscal Year	Ticket Sales	Net Proceeds Before Transfers	General Fund Transfers	Compulsive Gambling Transfers	Drug Task Force Transfers
2004	\$ 5,768,602	\$ 1,665,952	\$ 1,431,000	\$ 139,511	\$
2005	19,127,290	6,464,895	5,838,005	260,489	
2006	22,328,353	6,922,984	6,300,000	200,000	
2007	22,641,454	6,801,454	6,300,000	200,000	
2008	22,123,185	6,077,843	5,300,000	200,000	422,500
2009	21,724,891	5,730,624	5,755,000	200,000	422,500
2010	24,422,716	6,332,198	5,100,000	200,000	422,500
2011	<u>23,002,610</u>	<u>6,024,306</u>	<u>5,300,000</u>	<u>200,000</u>	<u>422,500</u>
Totals	\$161,139,101	\$ 46,020,256	\$ 41,324,005	\$ 1,600,000	\$ 1,690,000
2012 (thru 12/2011 unaudited)	\$ 11,507,209	\$ 3,000,000 (estimated)	\$ 0	\$ 100,000	\$ 211,250

For the 2011-2013 biennium, the Lottery projected sales of \$46,500,000 and net proceeds of \$12,245,000 (\$11 million - state general fund; \$400,000 - Compulsive Gambling Prevention and Treatment Fund; and \$845,000 - Multi-Jurisdictional Drug Task Force Grant Fund).

Unaudited ticket sales through December 2011 (first 6 months of the fiscal year) are \$11,507,209. This reflects a \$357,000 increase in sales or 3% increase compared to the same period last year. The Lottery is on track to meet projected sales of \$23,250,000 and net proceeds of \$6,122,500 for the first year of the biennium.

- Once a year, the Lottery transfers its net proceeds to the State Treasurer for deposit in the state's general fund.

Prize Expense

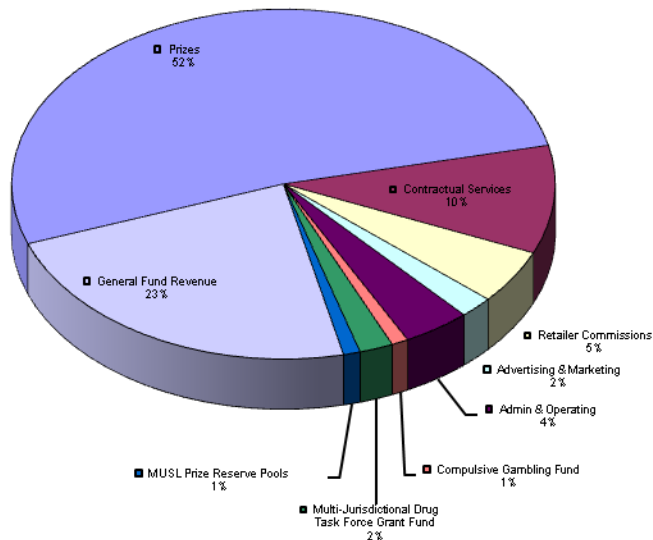
<u>Fiscal Year</u>	<u>Total ND Prize Expense</u>	<u>Total MUSL Prize Pools</u>	<u>Expired ND Prizes</u>	<u>Net Prize Expense</u>
2004	\$ 1,216,192	\$ 1,574,206	\$	\$ 2,790,398
2005	4,401,786	5,011,990	(328,225)	9,085,551
2006	10,045,820	1,350,731	(352,329)	11,044,222
2007	6,603,548	5,078,807	(392,789)	11,289,566
2008	9,003,827	2,692,339	(331,960)	11,364,206
2009	7,197,208	4,442,163	(324,408)	11,314,963
2010	10,547,330	2,439,589	(343,287)	12,643,632
2011	<u>9,847,909</u>	<u>2,423,974</u>	<u>(330,625)</u>	<u>11,941,258</u>
Totals	\$ 58,863,620 70.2%	\$ 25,013,799 29.8%	(\$ 2,403,623)	\$ 81,473,796
2012 (thru 12/2011 Unaudited)	\$ 3,627,718 58.6%	\$ 2,565,791 41.4%	(\$ 191,480)	\$ 6,002,029

Through June 30, 2011, \$58.8 million or 70.2% of the prize expenses were payable to North Dakota players and \$25 million or 29.8% were payable to MUSL to fund prizes.

Through December 2011 (first 6 months of the fiscal year), \$3.6 million or 58.6% of the prize expenses were payable to North Dakota players and \$2.5 million or 41.4% were payable to MUSL to fund prizes.

Below is a pie chart of a "Percent Allocation of Lottery Ticket Sales" for the fiscal year ended June 30, 2011.

Percent Allocation of Lottery Ticket Sales



6. Compulsive Gambling Prevention and Treatment Fund

By law, \$400,000 is transferred to the State Treasurer each biennium for deposit in the Compulsive Gambling Prevention and Treatment Fund. The Department of Human Services utilizes the \$400,000 appropriation for treatment services, media/awareness, and certification training for counselors. (Transfers are made on a quarterly basis.)

The Lottery is sensitive to problem gambling and encourages players to play responsibly through messages in its media ads, point-of-sale items, and on its website.

7. Multi-Jurisdictional Drug Task Force Grant Fund

By law, \$845,000 is transferred to the State Treasurer each biennium for deposit in the Multi-Jurisdictional Drug Task Force Grant Fund. The Attorney General utilizes the funds for defraying the expenses and operating costs incurred by the multi-jurisdictional drug task force. (Transfers are made on a quarterly basis.)

8. Plans for the 2011-2013 Biennium

To sustain sales and net proceeds each year the Lottery must be innovative, energetic, and offer exciting and attractive games that add value to the Lottery's product mix for players to play, license retailers which are in convenient locations to sell tickets, develop

attractive point-of-sale items, creative marketing promotions, and responsive retailer outreach program, provide quality customer service to retailers and players, and control operating expenses. Attractive games must include a broad range of player odds and minimum jackpot prizes.

Total sales of a game are highly affected by the size of the game's jackpot. Larger jackpots generate higher sales. However, large jackpots cannot be predicted or counted upon. Therefore, a variety of games with varying jackpots and odds of winning a prize are necessary to consistently attract players.

During the 2011-2013 biennium, the Lottery plans to:

- Generate net proceeds of \$12,245,000
- Replace the \$1 Powerball game with a \$2 Powerball game that will include new features which add strong value propositions to make it more exciting and attractive to players. The \$2 game will augment our product mix of online games by offering players diversity in price point, starting jackpots, and odds – done
- Re-launch the game of Wild Card 2 – researching
- Develop and conduct innovative marketing promotions and public awareness campaigns – on-going
- Implement a retailer sales enhancement pilot program to introduce new point-of-sale items that actively promote the sale of Lottery tickets – in progress
- Upgrade terminal software to allow retailers to print subscription applications forms with discounted prices during special promotions – done
- Redesign our website to make it more innovative, user-friendly, and helpful – in progress
- Expand social media contact through Facebook, Twitter, and text messaging – on-going
- Complete Request for Proposal process for a marketing vendor and issue contract – in-progress
- Enhance security features to ensure the integrity and fairness of its operation – on-going
- Strategically reposition its brand to bring about change and refresh our look – in-progress

9. Multi-State Lottery Association (MUSL)

The Lottery is a member of the MUSL that administers games on behalf of its members. The Lottery is authorized to conduct games of Powerball, Mega Millions, Hot Lotto, Wild Card 2, and 2by2. Drawings for Powerball, Hot Lotto, and Wild Card 2 are held each Wednesday and Saturday evenings. Drawings for Mega Millions are held each Tuesday and Friday evenings. Drawings for 2by2 are held 7 evenings a week, Sunday through Saturday.

Each member lottery of MUSL sells lottery tickets through its retailers and makes weekly wire transfers to MUSL in an amount equal to the member lottery's share of the prize liability. If this is a negative amount due to the member lottery having prizes in state which exceed the normal game's prize allocation, the MUSL transfers funds to the member lottery. Pooling the lotteries' prize money to fund prizes reflects the multi-state concept and is very effective. Each member lottery pays prizes directly to winning players.

MUSL prize reserve funds serve as a contingency reserve to protect MUSL from unforeseen prize liabilities. The prize reserve fund monies are refundable to member lotteries if MUSL disbands or if a member leaves MUSL. Any prize reserve fund monies remaining at the end of a game are carried forward to a replacement game. The MUSL's Prize Reserve Pools' account balance and the Lottery's share of that balance are:

	<u>6/30/2011</u>
MUSL Prize Reserve Pools' account balance	\$ 140,262,107
ND Lottery's share of the account balance	\$ 1,128,087

10. Line of Credit

The Lottery has a short-term line of credit with the Bank of North Dakota. The law provides that the line of credit be limited to the amount of each prize of \$100,000 or more that relates to prize funds known to be due and forthcoming to the Lottery from other government-authorized lotteries through the MUSL. The line of credit may not exceed \$1 million in the aggregate. To date, no advances have been requested.

11. Debt Setoff Program

In accordance with law, the Lottery established a debt setoff program in which a lottery prize of \$600 or more is used to setoff a delinquent debt owed to any state agency or collected through a state agency on behalf of a third party. These 25 agencies participate in the debt setoff program:

- Barley Council
- Department of Commerce
- Department of Human Services
- Department of Transportation
- Geological Survey
- Housing Finance Administration
- Job Service North Dakota
- Lake Region State University
- Mayville State University
- Mill and Elevator
- Minot State University
- Minot State University Bottineau
- North Dakota State University

- Office of Adjutant General
- Office of Management & Budget
- Office of State Tax Commissioner
- Parks and Recreation
- Parole and Probation
- Student Loans North Dakota
- Student Loan Service Center, ND University System
- Supreme Court
- University of North Dakota
- Veterans Affairs
- Veterans Home
- Workforce Safety & Insurance

12. Major Contracts

The Lottery has major contracts with:

1. Scientific Games International, Inc. of Alpharetta, Georgia. The vendor provides an online lottery gaming system and related services through March 24, 2014. Payments for fiscal years ended June 30, 2011, 2010, 2009, 2008, 2007, 2006, 2005, and 2004 totaled \$2,419,516, \$2,578,845, \$2,285,574, \$2,348,570, \$2,376,779, \$2,366,279, \$1,973,152, and \$606,060, respectively. The Lottery's obligation through March 24, 2012 was based on 10.63% of ticket sales and the current obligation effective March 25, 2012 through March 24, 2014 is 8.8761% of ticket sales. There is no minimum fee or retainer fee.
2. H2M of Fargo, North Dakota. The vendor provides marketing and related services through June 30, 2012. Payments to H2M for fiscal years ended June 30, 2011, 2010, 2009, 2008, 2007, 2006, 2005, and 2004 totaled \$394,550, \$454,157, \$481,746, \$467,139, \$394,547, \$331,564, \$175,188, and \$237,418, respectively. The Lottery's obligation is based on actual services requested. There is no minimum fee or retainer fee.

13. Online Gaming System

Scientific Games International, Inc. provides the Lottery with online and secondary online gaming systems hardware, games management system software (GMS), retailer telecommunications network, 400 lottery terminals, electronic scrolling and logo backlit signs, primary and secondary internal control systems (ICS), and five field technicians to provide service to lottery retailers. The Lottery does not own this equipment. The GMS manages retailers and tracks and controls the sale of tickets, validation of winning tickets, and payments on winning tickets. The ICS's are independent databases of all retailer sales transactions that are controlled only by the Lottery, and are used for each draw to determine the number of winning tickets, by prize value, and other confidential data. The telecommunications network that connects retailers to the computer data center is 99% satellite based.

The Lottery's online and secondary online gaming systems are co-located with the primary and secondary online gaming systems of the Oklahoma Lottery at a Scientific Games owned computer data center in Oklahoma City, Oklahoma.

14. Americans with Disabilities Act (ADA)

The State of North Dakota is obligated under Title II (State and Local Government Services) of the ADA to make its government services - lottery tickets - accessible to individuals with disabilities. The Lottery meets its obligation, in part, through the license renewal process.

Most retail sites, as places of public accommodation, have a responsibility under Title III (Public Accommodations) of the ADA to be accessible to individuals with disabilities, a responsibility that can be enforced by the United States Department of Justice or through private lawsuits. The North Dakota Human Rights Act also prohibits discrimination on public accommodations based on a disability.

If a retailer or the Lottery determines that the retailer is not accessible to individuals with disabilities, the Lottery requires the retailer to advise the Lottery of the steps the retailer is taking to become accessible and the expected timeline. The Lottery also provides information on the retailer to the Protection and Advocacy Project so the Project may assist the retailer to become compliant.

If necessary, the Lottery will issue a conditional license to a retailer to prompt the retailer to become compliant and may use ADA compliancy as a factor in renewing or not renewing the license.

15. Debit Card vs. Credit Card

The lottery rules allow retailers to accept cash, checks and debit cards as payment for lottery tickets, but prohibit retailers from accepting credit cards. Although the rules do not allow players to purchase tickets from lottery retailers by credit card, the rules do authorize players to purchase subscriptions from the Lottery by credit card. Credit cards are authorized for subscriptions for these reasons:

- A purchase of a subscription is different than a purchase of a lottery ticket. Through a subscription, a player purchases one play for each draw of the subscription period.
- A player cannot suddenly chase high jackpots by spending a large amount of money on many plays for a specific draw.
- The Lottery created a subscription service as a supplemental distribution channel for sales, particularly in response to the growing popularity of e-commerce. The subscription service is no different than other businesses using online services to sell a product in which credit cards are accepted.

16. Potential Factors Affecting Future Operations

The Lottery must partner with one or more other government-authorized lotteries to conduct a game. This restriction generally limits the Lottery to games sponsored by the MUSL. The MUSL may not have a broad range of games available to fulfill the Lottery's desired product mix. Should the MUSL disband, although it is not anticipated, the Lottery may not have a source of games to operate.

17. Disaster Recovery Plan

The Lottery has a Disaster Recovery Plan and necessary equipment in place should its control center that is located in a secure room at the Lottery's main office at 1050 East Interstate Avenue become temporarily inoperable for a short or long-term basis. There would be no downtime. The Lottery has a third Internal Control System in place with ready access to its Game Management System at its disaster recovery site located at Scientific Games International, Inc. computer data center in Oklahoma City, Oklahoma. The Lottery staff's operation of the lottery from Oklahoma City would be transparent to retailers and players.

18. Lottery Advisory Commission

A five-member Lottery Advisory Commission serves as a policy advisor to the Attorney General and Director of the Lottery and as the Audit Committee of the Lottery. The Commission provides an independent perspective on issues and operation of the Lottery and presents ideas and recommends solutions while it represents the best interests of the state, public, and lottery industry. It meets at least on a quarterly basis. The Attorney General and Director consult with the Commission on policies, plans, issues, contracts, timelines, and activities of the Lottery, including:

- Selecting retailers
- Proposing new games
- Proposing laws and rules
- Drafting legislative reports
- Recruiting a lottery director
- Proposing surveys or studies
- Developing a mission statement, logo, and slogan
- Developing point-of-sale decals, brochures, banners, and posters
- Developing the organization structure and employing key employees
- Proposing ceremonial launches of games or celebrated anniversaries
- Selecting vendors for the on-line gaming system and marketing services
- Proposing advertising, marketing, promotional, and educational campaigns
- Proposing policies on monetary fines, license suspensions and revocations, and sales incentive programs

The members of the Commission are appointed by the chairman of the Legislative Council and Attorney General. The members are:

Mr. Mike Rud - Chairman
Representative Lois Delmore
Representative Dwight Wrangham
Senator Lonnie Laffen
Mr. Laurel Thoreson

19. Critical Success Factors

To evaluate the performance of the Lottery, these critical success factors are applied:

- Being sensitive to problem gambling
- Educating the public on how to play the games
- Maintaining an image of public trust and confidence
- Providing quality customer service to retailers and players
- Exercise of due diligence managing and promoting the Lottery
- Selection of promising retailers and effective training of retailers
- Developing effective marketing plans to support the Lottery's product mix
- Amount of actual annual gross sales compared to projected annual gross sales
- Amount of weekly and annual per capita sales in North Dakota compared to amount of weekly and annual per capita sales of other state lotteries that are similar demographically and geographically to North Dakota
- Amount of actual annual state general fund revenue compared to projected annual state general fund revenue
- Audit reports issued by the Office of the State Auditor