

REPORT ON THE NORTH DAKOTA LOTTERY

Prepared for
Judiciary Committee

by
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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.

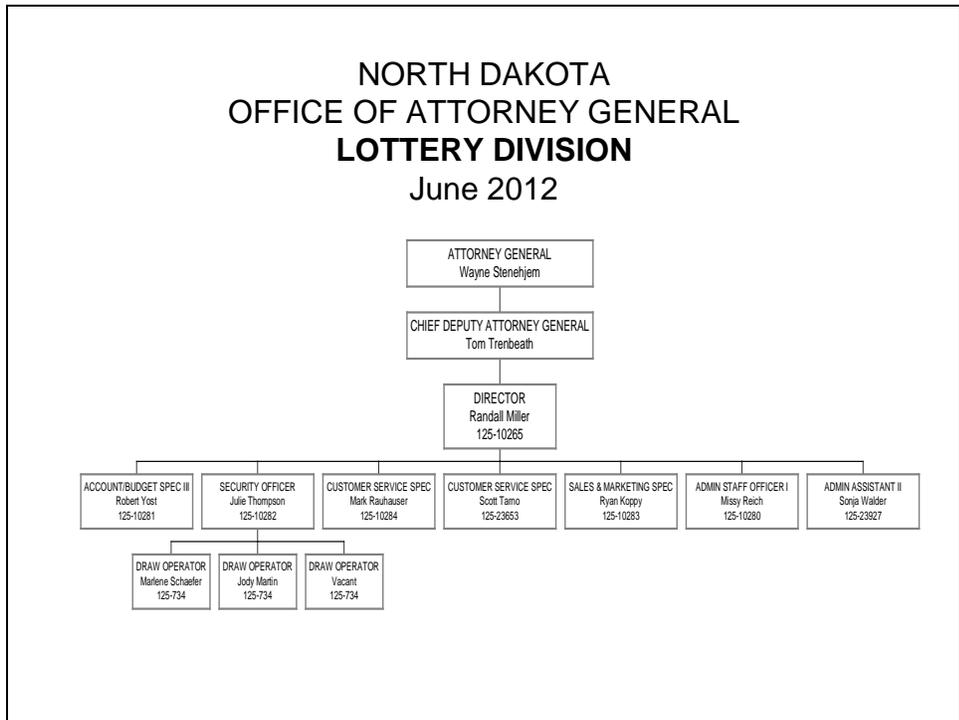
The Lottery processes license applications and collects application and license fees; selects eligible retailers for licensing; conducts criminal history record and credit checks; launches new games, develops point-of-sale promotional items; trains employees of retailers how to sell and redeem lottery 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 2013-15 biennium is \$1,537,944 for salaries and fringe benefits for 9.5 FTE's, and \$2,595,877 for operating expenses, totaling \$4,133,821. 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.

NOTE: Effective March 25, 2014, the Lottery contracted with Scientific Games International, Inc. (provides online gaming system and related services) for an additional 50 terminals (450 terminals total).

The numbers of retailers and sales percent, by type, for the period ending June 30, 2013 are:

<u>No.</u>	<u>Type</u>	<u>Sales %</u>
305	Convenience Store	73.5%
61	Grocery Store/Supermarket	22.0%
5	Gas/Service Station	.7%
17	Truck Stop/Plaza	2.6%
12	Other (i.e. Bar, Drug Store)	1.2%

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. 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 1:31.85.

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 2,246 subscribers and 2,845 subscriptions.

5. Financial Overview

Below is an overview of financial information for the 2011-13 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 29% of total revenues.

Operating Revenues:

Ticket Sales	\$ 53,881,132
Other Operating Revenue	<u>706,205</u>
Total Operating Revenues	54,587,337

Operating Expenses:

Prize Expense	27,623,901
Retailer Commissions	2,633,866
Retailer Bonuses	78,000
Contractual Services	5,048,619
Marketing	1,194,985
Salaries & Benefits	1,426,317
Operating	<u>585,548</u>
Total Operating Expenses	38,591,236

Operating Income 15,996,101

Nonoperating Revenues:

Interest Income	<u>7,289</u>
Net proceeds Before Transfers	\$ 16,003,390

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

NOTE: *The Lottery had back-to-back record setting ticket sales, net proceeds, and general fund transfers for fiscal years 2012 and 2013.

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	23,002,610	6,024,306	5,300,000	200,000	422,500
2012*	26,043,816	7,714,953	7,000,000	200,000	422,500
2013*	27,837,316	8,288,437	7,300,000	200,000	422,500
Totals	\$215,020,233	\$ 62,023,646	\$ 55,624,005	\$ 2,000,000	\$ 2,535,000
2014 (thru 3/2014 unaudited)	\$ 20,840,158	\$ 6,000,000 (estimated)	\$ 0	\$ 150,000	\$ 316,875

For the 2013-2015 biennium, the Lottery projected sales of \$47,000,000 and transfers 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 March 2014 (first 9 months of the fiscal year) are \$20,840,158. This reflects a \$631,000 increase in sales or 3% increase compared to the same period last year.

NOTE: The Lottery is on track to exceed projected sales and transfers (now projecting sales of \$26.8 million and transfers of \$6,786,500); \$6,164,000 - state general fund; \$200,000 - Compulsive Gambling Prevention and Treatment Fund; and \$422,500 - Multi-Jurisdictional Drug Task Force Grant Fund) 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.

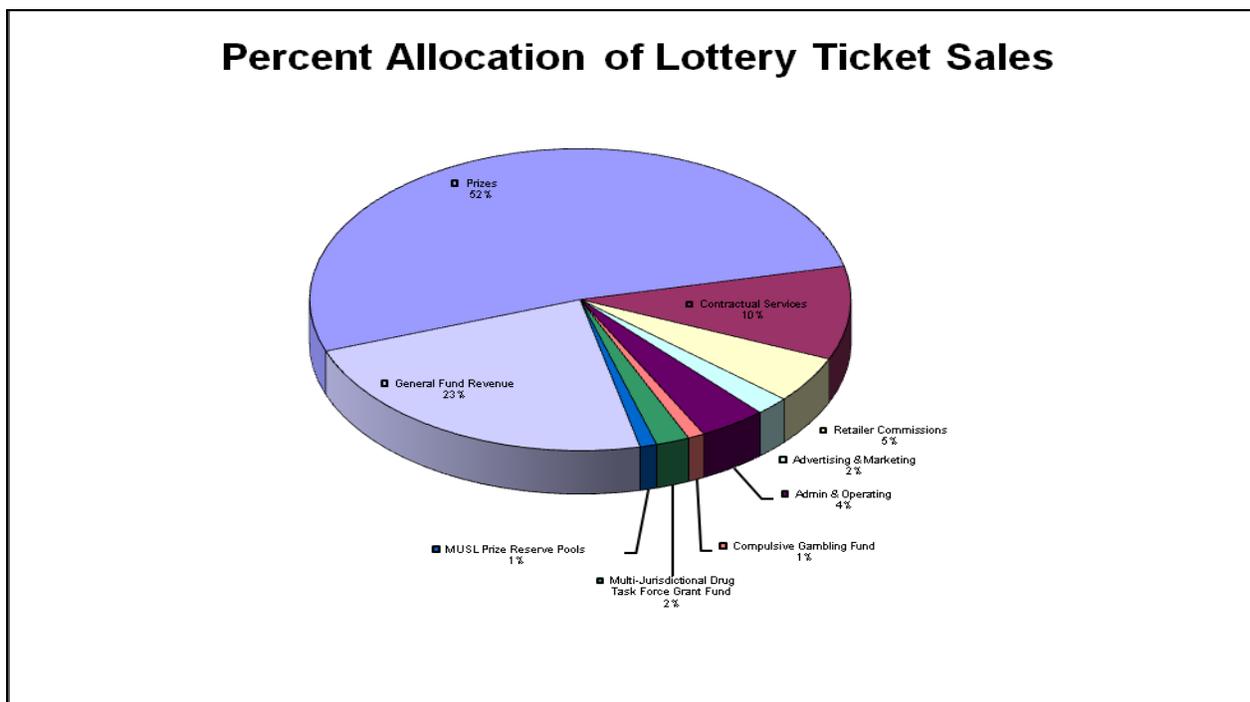
Prize Expense

Fiscal Year	Total ND Prize Expense	Total MUSL Prize Pools	Expired ND Prizes	Net Prize Expense
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	9,847,909	2,423,974	(330,625)	11,941,258
2012	7,026,034	6,741,052	(359,817)	13,407,269
2013	<u>7,567,690</u>	<u>7,089,117</u>	<u>(440,175)</u>	<u>14,216,632</u>
Totals	\$ 73,457,344 65.4%	\$ 38,843,968 34.6%	(\$ 3,203,615)	\$ 109,097,697
2014 (thru 3/2014 Unaudited)	\$ 6,452,107 58.3%	\$ 4,610,855 41.7%	(\$ 334,988)	\$ 10,727,974

Through June 30, 2013, \$73.4 million or 65.4% of the prize expenses were payable to North Dakota players and \$38.8 million or 34.6% were payable to MUSL to fund prizes.

Through March 2014 (first 9 months of the fiscal year), \$6.4 million or 58.3% of the prize expenses were payable to North Dakota players and \$4.6 million or 41.7% 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, 2013.



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 2013-2015 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 2013-2015 biennium, the Lottery plans to:

- Update lottery equipment at retailer locations; including new terminals, self-service ticket checkers, jackpot signs, and LCD monitors - done
- Implement an automated subscription process and Players Club that will provide an easy way for players to manage their subscriptions and reward players for their continued patronage – in-progress
- Implement 50 self-service lottery terminals to our retailer base allowing players to purchase and check lottery products without utilizing a retailer clerk – in-progress
- Celebrate Lottery's 10th Anniversary – in-progress
- Conduct re-branding campaign to bring an exciting and refreshing look to the Lottery – on-going
- Re-launch Mega Millions with changes that will provide better odds, more winners, and larger jackpots – done

- Return the random Power Play multiplier to Powerball – done
- Add a new online game that will complement our product mix - researching
- Develop and conduct innovative marketing promotions and public awareness campaigns – on-going
- Redesign our website to make it more innovative and user-friendly – done
- Enhance security features to ensure the integrity and fairness of its operation – on-going

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>6/30/2013</u>
MUSL Prize Reserve Pools’ account balance	\$ 150,737,031
ND Lottery’s share of the account balance	\$ 1,185,655

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 July 5, 2014. Payments for fiscal years ended June 30, 2013, 2012, 2011, 2010, 2009, 2008, 2007, 2006, 2005, and 2004 totaled \$2,442,356, \$2,606,263, \$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 July 5, 2014 is 8.8761% of ticket sales. There is no minimum fee or retainer fee.

Scientific Games International was awarded a new contract effective July 6, 2014. The contract runs through June 30, 2022. The Lottery's obligation effective July 6, 2014 through June 30, 2022 is 10.473% of ticket sales. In addition, Scientific Games International is eligible to earn a contractor incentive payment (CIP) of 8% of all incremental annual sales exceeding the prior 3-year rolling sales average. Payment of the CIP will not begin until end of contract year 4.

2. KK Bold of Bismarck began providing marketing and related services to the Lottery on July 1, 2012. The contract runs through June 30, 2015. Payments for the fiscal years ended June 30, 2013, and 2012, totaled \$323,389 and \$405,578, respectively. The Lottery's obligation is based on actual services requested. There is no minimum fee or retainer fee.

13. Online Gaming System

The new contract with Scientific Games International, Inc. provides the Lottery with online and secondary online gaming systems hardware, games management system software (GMS), and retailer telecommunications network; 450 lottery terminals, self-service ticket checkers, jackpot signs, Lottery InMotion monitors, and customer display units; 50 self-service lottery terminals; primary and secondary internal control systems (ICS); and four field technicians and one field service supervisor 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 primarily cellular based.

The Lottery's primary data center will be moved from Oklahoma City, Oklahoma to Scientific Games International national data center in Alpharetta, Georgia. In addition, Scientific Games International will provide a testing facility in Bismarck, North Dakota.

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.

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. Currently, 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.

With the new contract, the Lottery would access its Game Management System at its testing facility in Bismarck, North Dakota. If the Bismarck site is inoperable, a hot backup site in Atlanta, Georgia would be utilized.

The Lottery staff's operation of the lottery from the disaster recovery site 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 Joe Heilman
Senator Lonnie Laffen
Mr. Russ Hanson

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