

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 Lottery launched its first game on March 25, 2004. The law restricts the Lottery to only conduct online games, while the Constitution restricts the Lottery to only conduct multi-state games.

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 advertising 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.

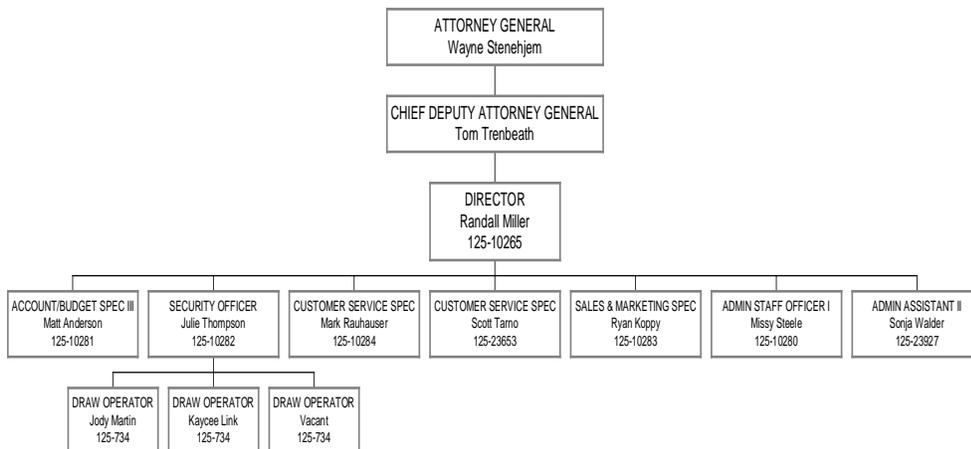
2. Appropriation

The Lottery's appropriation for the 2015-17 biennium is \$1,753,083 for salaries and fringe benefits for 9.5 FTE's, and \$3,529,695 for operating expenses, totaling \$5,282,778. 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

**NORTH DAKOTA
OFFICE OF ATTORNEY GENERAL
LOTTERY DIVISION
June 2015**



3. Retailers

The Lottery selects and annually licenses 450 businesses as lottery retailers. There is approximately one lottery terminal for each 1,640 residents.

The numbers of retailers and sales percent, by type, for the period ending June 30, 2015 are:

<u>No.</u>	<u>Type</u>	<u>Sales %</u>
338	Convenience Store	72.7%
68	Grocery Store/Supermarket	22.3%
6	Gas/Service Station	.5%
23	Truck Stop/Plaza	3.5%
10	Other (i.e. Bar, Drug Store)	1%

4. Products

The Lottery conducts five multi-state games: Powerball, Hot Lotto, 2by2, Mega Millions, and Lucky for Life. The Powerball game was launched on March 25, 2004; Hot Lotto on June 24, 2004; 2by2 on February 2, 2006; Mega Millions on January 31, 2010; and Lucky for Life on January 31, 2016. 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 1:24.87. The Wild Card 2 game ended February 24, 2016.

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 a single draw or up to 52 weeks. The service is available for the games of Powerball, Hot Lotto, 2by2, Mega Millions, and Lucky for Life. Subscriptions are a convenience for players who cannot always get to a Lottery retailer before every drawing or for players who travel to another state on vacation during winter months. Currently there are 1,052 subscribers and 2,677 subscriptions.

The Lottery's Players Club is a rewards program that provides players an opportunity to earn points by becoming registered members and submitting valid tickets at club.lottery.nd.gov. Players can redeem their points for items at the Points for Prizes store at store.lottery.nd.gov. In addition, players can use their points to enter into special promotional drawings in the Points for Drawings program.

5. Financial Overview

Below is an overview of financial information for the 2013-15 biennium. The Lottery's net proceeds (actual profit) are 27% of total revenues.

Operating Revenues:

Ticket Sales	\$ 53,909,663
Other Operating Revenue	<u>323,568</u>
Total Operating Revenues	54,233,231

Operating Expenses:

Prize Expense	27,742,062
Retailer Commissions	2,642,732
Retailer Bonuses	75,300
Contractual Services	5,211,869
Marketing	1,234,788
Salaries & Benefits	1,596,643
Operating	<u>1,084,888</u>
Total Operating Expenses	39,588,282

Operating Income 14,644,949

Nonoperating Revenues:

Interest Income	<u>5,366</u>
Net proceeds Before Transfers	\$ 14,650,315

For the 2013-2015 biennium, the Lottery projected sales of \$47,000,000 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).

Ticket Sales and Transfers

Fiscal Year	Ticket Sales	Net Proceeds Before Transfers	General Fund Transfers	Compulsive Gambling Transfers	Drug Task Force Transfers
2014	\$ 26,899,400	\$ 7,795,722	\$ 7,200,000	\$ 200,000	\$ 422,500
2015	27,010,263	6,854,593	6,100,000	200,000	422,500
Totals (Since Lottery Began March 2004)	\$268,929,896	\$ 76,673,961	\$ 68,924,005	\$ 2,400,000	\$ 3,380,000
2016 (thru 2/2016 Unaudited)	\$ 25,309,792	\$ 7,300,000 (estimated)	\$ 0	\$ 240,000	\$ 316,875

For the 2015-2017 biennium, the Lottery projected sales of \$59,620,000 and transfers of \$16,985,000 (\$15.5 million - state general fund; \$640,000 - Compulsive Gambling Prevention and Treatment Fund; and \$845,000 - Multi-Jurisdictional Drug Task Force Grant Fund).

Unaudited ticket sales through February 2016 (first 8 months of the fiscal year) are \$25.3 million. This reflects a \$6.47 million increase in sales or 34% increase compared to the same period last year.

NOTE: The Lottery is on track to exceed projected sales and transfers (now projecting sales of \$33 million and transfers of \$9,242,500); \$8.5 million - state general fund; \$320,000 - 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

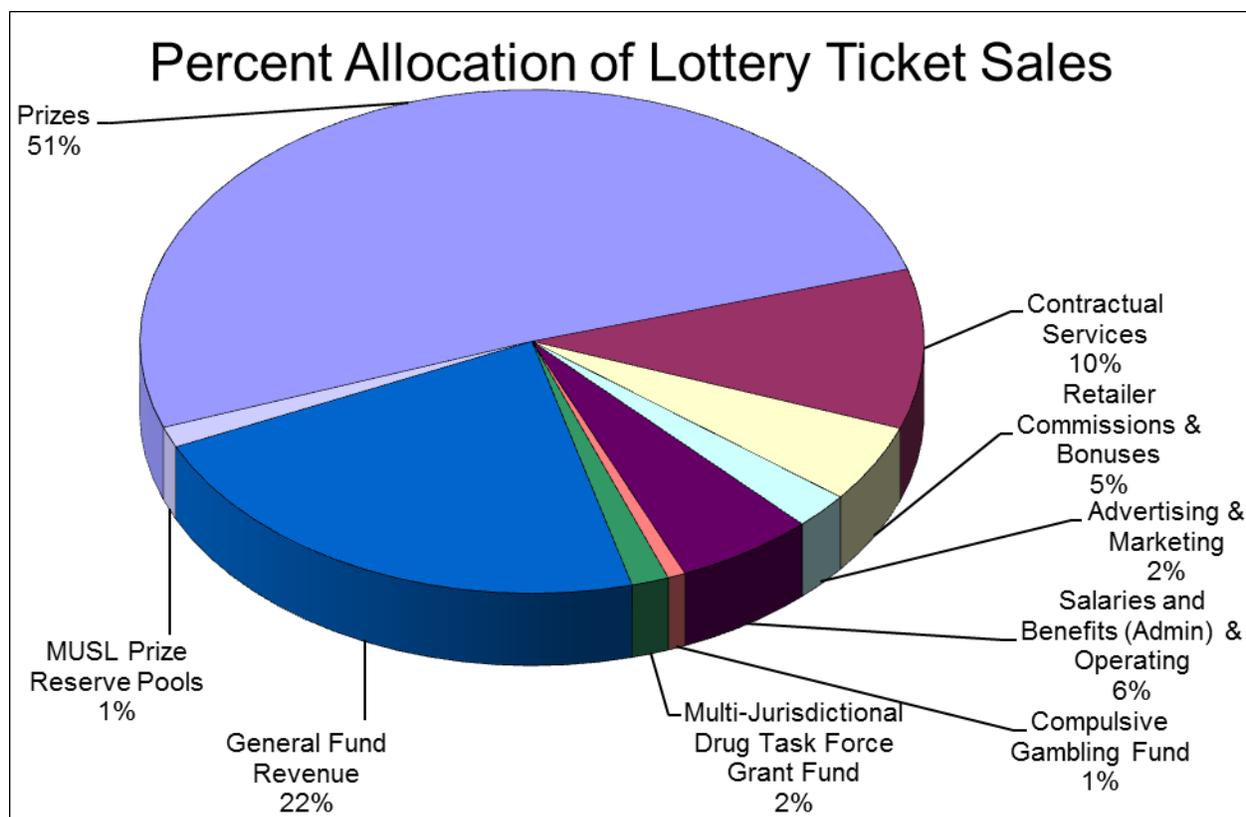
Fiscal Year	Total ND Prize Expense	Total MUSL Prize Expense	Expired ND Prizes	Net Prize Expense
2014	\$ 8,014,298	\$ 6,213,350	\$ (464,403)	\$ 13,763,245
2015	8,147,582	6,215,658	(384,422)	13,978,818
Totals (Since Lottery Began March 2004)	\$ 89,619,224	\$ 51,272,976	(\$ 4,052,440)	\$ 136,839,760
% of Gross Prizes (Since Lottery Began March 2004)	63.6%	36.4%		

2016 (thru 2/2016 Unaudited)	\$ 7,567,690 51.6%	\$ 7,089,116 48.4%	(\$ 440,175)	\$ 14,216,631
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Since the Lottery began through June 30, 2015: \$89.6 million or 63.6% of the prize expenses were payable to North Dakota players and \$51.2 million or 36.4% were payable to MUSL to fund prizes.

Through February 2016 (first 8 months of the fiscal year): \$7.56 million or 51.6% of the prize expenses were payable to North Dakota players and \$7.08 million or 48.4% 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, 2015.



6. Compulsive Gambling Prevention and Treatment Fund

By law effective July 1, 2015, \$640,000 (prior to that was \$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 \$640,000 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 Office of Attorney General utilizes the funds for defraying the expenses and operating costs incurred by the nine regional narcotics task forces, including rent, equipment, travel, fuel, and other costs associated with the undercover operations. (Transfers are made on a quarterly basis.)

8. Plans for the 2015-2017 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 2015-2017 biennium, the Lottery plans to:

- Implement 50 self-service lottery terminals to our retailer base allowing players to purchase and check lottery products without utilizing a retailer clerk – done
- Re-launch the Powerball game with better overall odds, more winners, and bigger jackpots - done
- Add a new online game that will complement our product mix – done
- Develop and conduct innovative promotional and public awareness campaigns that will attract new players as well as strengthen the current player/lottery relationship
- Build membership in the Players Club that rewards players for their continued patronage
- Increase awareness of the subscription service
- Continue to monitor security policies and procedures to ensure the integrity and fairness of its operation
- Research the opportunity to introduce a mobile application

9. Multi-State Lottery Association

The Lottery is a member of the Multi-State Lottery Association (MUSL) that administers games on behalf of its members. The Lottery is authorized to conduct games of Powerball, Hot Lotto, Mega Millions and 2by2. Drawings for Powerball and Hot Lotto 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 or refunded to the member lotteries. The MUSL's Prize Reserve Pools' account balance and the Lottery's share of that balance are:

	<u>6/30/2015</u>
MUSL Prize Reserve Pools' account balance	\$ 155,643,044
ND Lottery's share of the account balance	\$ 1,033,486

10. Lucky for Life Game Group

The New England Lotteries (CT, ME, MA, NH, RI, and VT) offer the Lucky for Life game. In addition to the New England Lotteries, other government authorized lotteries may join the multi-jurisdictional game. The North Dakota Lottery began selling the game on January 31, 2016. Drawings for Lucky for Life are held each Monday and Thursday evenings. There are twenty lotteries offering the Lucky for Life game. Game related services are provided by MUSL through a contract with the lotteries selling the Lucky for Life game.

11. 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.

12. 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. Twenty-five agencies participate in the debt setoff program.

The Lottery has conducted 1,337 debt setoffs. 53 claims have been identified as delinquent debts with the Lottery collecting \$46,723.

13. 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 June 30, 2022. Payments for the fiscal years ended June 30, 2015 and 2014 totaled \$2,812,101 and \$2,399,768 based on 10.473% and 8.8761% of ticket sales, respectively. The Lottery's future obligation through June 30, 2022 is 10.473% of ticket sales. There is an annual fee of \$325,000 to fund the Player's Club Points for Prizes and Points for Drawings programs. In addition, Scientific Games International, Inc. is eligible to earn a contractor incentive payment (CIP) of 8% of all incremental annual sales exceeding the prior three-year rolling sales average. Payment of the CIP will not begin until end of contract year four.
2. KK Bold of Bismarck, North Dakota. The vendor provides marketing and related services through June 30, 2016. Payments for the fiscal years ended June 30, 2015, and 2014 totaled \$475,387 and \$399,764, respectively. The Lottery's future obligation is for actual services requested. There is no minimum fee or retainer fee. The contract can be extended by the state by written notice no later than 30 days prior to the expiration of the original contract.

14. Online Gaming System

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); four field technicians and one field service supervisor to provide service to lottery retailers; and one computer operator at the test facility. 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.

15. 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. The Protection and Advocacy Project assists 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.

16. 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. The rules do authorize players to use automated clearinghouse, credit card, or debit card to purchase a lottery subscription.

17. 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 an adequate number of games to continue operations.

18. Disaster Recovery Plan

The Lottery has a Disaster Recovery Plan for the ICS and connectivity to the GMS in the event of a natural or man-made disaster. The Lottery would utilize its secondary ICS system located at its test facility in Bismarck, North Dakota. The Lottery would also

have remote access to the production GMS system, located in Alpharetta, Georgia, from the test facility. The use of the secondary site for operating the Lottery would be transparent to the Lottery retailers and players.

19. 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 other activities of the Lottery.

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

Mr. Mike Rud - Chairman
Representative Lois Delmore
Representative Thomas Beadle
Senator Nicole Poolman
Mr. Russ Hanson

20. Critical Success Factors

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

- Maintaining an image of public trust and confidence - transparency
- Exercising due diligence managing and promoting the Lottery
- Being sensitive to problem gambling and encouraging responsible play
- Audit report recommendations issued by the Office of the State Auditor
- Selecting promising retailers and effective training of retailers
- Providing quality customer service to retailers and players
- Educating the public on how to play the games
- Developing and conducting effective marketing campaigns
- 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