

NATIONAL COUNCIL OF LEGISLATORS FROM GAMING STATES
COMMITTEE ON LOTTERIES
ATLANTIC CITY, NEW JERSEY
FRIDAY, JUNE 12, 2015
11:00 A.M. – 12:00 P.M.
DRAFT MINUTES

The Committee on Lotteries of the National Council of Legislators from Gaming States (NCLGS) met at The Water Club at Borgata in Atlantic City, New Jersey, on Friday, June 12, at 11:00 a.m.

Rep. Kevin Ryan of Connecticut, committee chair, presided.

Other legislators present included:

Rep. Helene Keeley, DE
Sen. Bill Cowsert, GA
Sen. Ben Kleckhefer, NV
Rep. Lois Delmore, ND
Rep. Marvin Abney, RI
Del. Eric Nelson, Jr., WV

Others present were:

Susan Nolan, Nolan Associates, NCLGS Executive Director
Candace Thorson, Nolan Associates

MINUTES

The Committee accepted the minutes of its last meeting on January 9, 2015, in Las Vegas, Nevada.

IMPACT OF CASINOS ON LOTTERY SALES

Steven Geller of Greenspoon Marder P.A. said there are a number of studies on whether casinos affect lottery sales and that the results have been mixed. He noted, as an example, a study conducted in Oklahoma on whether or not Indian casinos would affect lottery sales and said the study concluded that there was no effect. He stated that a study done in Maryland concluded that there was a huge impact, while a study in New York found that impacts were uncertain.

Mr. Geller said that when lottery sales start rising after a decline, the bar has typically been reset at a lower level, indicating some sort of impact on lottery sales. He noted that studies don't quantify whether or not there have been other outside impacts. He said that historically when lottery sales increase year-after-year, there is pressure on those states to increase sales. Mr. Geller explained that this is done by offering new games and new products. He said this could mean that there's no long-term impact or it could mean that you have shaken up the lottery with these new offerings.

Mr. Geller noted that some of the studies that concluded that casinos impact lottery sales were done during the recession of 2008. He said he would argue that lotteries would have suffered a decline due to the recession alone.

Mr. Geller said that his opinion is that casinos do impact lottery sales but it's probably a relatively small effect. He indicated that most of the studies whose findings report an impact usually report a two to three percent impact on lotteries. He stated that people have a limited amount of discretionary income and people who are going to spend it on gambling will likely spend it in one area not another.

Paul Sternburg of PRS Strategies said that he has examined several studies with conflicting findings. He reported that one study in Maryland reported a decline in lottery sales of two and a half percent, however, it was the first decline in lottery sales in 16 years. He noted that while only one casino is currently open in Maryland, there is another one that will be opening on the Inner Harbor. He reported that while they expect an impact on lottery sales from the casino, it would have more of an impact on the surrounding retailers.

Mr. Sternburg said that Pennsylvania suffered a decline in lottery sales during 2008 and 2009, which was also the first time that lottery saw a reduction as a whole. He reported that Pennsylvania has recovered and current sales are moving ahead because of an aggressive policy of more marketing, higher price points, and higher payouts in order to mitigate competition from the casinos. He stated that in Massachusetts, the first casino will be opening, as a racino followed by casinos, and that officials are expecting a decline in lottery sales. He reported that the Massachusetts legislature has mandated that casinos sell the lottery product and not their own. He said that MGM, which just broke ground in Springfield, announced that it will sell Powerball megamillion tickets at the slot machines. He stated that there is a partnership between the casinos and lotteries in Massachusetts.

Mr. Sternburg reported that Michigan, which has 27 casinos, recently started to sell lottery products on the internet and is expecting its first year of internet sales to be \$150 million. He said that is more than all the lotteries combined. He said he thinks there is an opportunity for an Atlantic City partnership with the state lottery because people trust the lottery more than they do casinos.

LOTTERIES' USE OF DIGITAL SPACE

Carole Hedinger of the New Jersey Lottery reported that in 2014 overall lottery sales were approximately \$70 billion, which was up from the previous year of \$68.7 billion. She said the total prizes paid in 2014 were \$40 billion as opposed to \$39 billion in 2013. She said that the total net revenue to jurisdictions in 2014 was \$21 billion up from \$20 billion the year before. She stated that the total commissions paid to retailers in 2014 were \$3.8 billion compared with \$3.5 billion in 2013.

Ms. Hedinger said that within the last year there has been small incremental growth in lottery sales with approximately half of state lotteries experiencing less revenue than the year before and the other half experiencing more revenue than the prior year. She stated that there has been much activity regarding lotteries including jackpot figures and increased competition from other forms of gaming. She noted that lotteries are examining different products that will attract and keep people engaged.

Ms. Hedinger stated that every lottery has a website and commented that it is a vital source of information that contributes to player engagement. She noted that some states allow for subscription programs where players can buy tickets in advance, while some states do not allow

any type of internet use for lottery transactions. She said that some states have started selling tickets online, including Michigan where she indicated that success has been connected to their willingness to use the latest technology to advance the lottery. She noted that some states exclude the sale of any lottery items in the internet.

Ms. Hedinger indicated that the future use of digital space will be completely on the internet. She stated that other retailers have realized the importance of offering their products online in addition to in-person locations. She said this is something that lotteries should take into consideration in order to keep competitive.

ADVERTISING AND ADMINISTRATION

Ms. Hedinger of the New Jersey Lottery said that the first customers lotteries sell to are retailers because they have to believe in the product in order to promote it. She noted that retail counter space is expensive and that the lottery must promote the benefits of these products, including the fact that research demonstrates that customers who make lottery purchases generally spend more on other products. She said advertising and marketing the product to the customer at the point of sale is very effective.

Michael Jones, Former Executive Director of the Illinois Lottery, said that he joined the Illinois lottery in the early 1980s when sales were stagnant and profits were down. He said the lottery was perceived as a benign form of gambling because the odds were terrible. He reported that when lotteries first returned to the United States in the 1960s, the prize percentage payout was a mandated 50 percent, which made lotteries highly profitable.

Mr. Jones reported that after three years of working for the Illinois Lottery, sales achieved \$1 billion a year without an increased prize payout. He stated that in more recent years when the Illinois Lottery had achieved sales of \$1 billion a year, it was done by prize percentage payout. He said once you get prize percentage payout v. profit things happen. He stated that he currently sees misaligned incentives in the lottery business because states set up the lottery to maximize revenue for the common good.

Mr. Jones said that misalignment comes when lotteries pay their retailers and vendors their percentage of sales, but when you start increasing prize percentage payout from 50 percent to 60, 70, 80, and 90 percent you have misalignment. He indicated that this misalignment happens when vendors start requesting increased prize percentage payouts in order to increase their own compensation. He stated when you see a reported 13 percent sales increase and a two percent prize increase you need to examine the actual benefit.

Mr. Jones said that a lottery should be marketing from the perspective of maximizing revenue in an ethical and socially responsible manner. He stated that a lottery is an occasion when good public policy and effective business practices are aligned. He commented that there is not a distribution problem but a consumer problem. He reported several attempts to keep people playing the lottery had reduced the number of individuals who play. He said what needs to be done is to offer games that people want to play with prizes they want to win and with the knowledge that the money is going to a useful cause.

TECHNOLOGY PRODUCTS

Ms. Hedinger of the New Jersey Lottery stated that the lottery industry as a whole has always been great at adopting technology in order to track and maintain sales. She said the question is what now needs to be done in order to use the technology in a more efficient manor. She reported that the traditional model was always a retailer that had a terminal and you physically got your ticket from that machine or got a scratch-off ticket that was pulled off one of the rolls.

Ms. Hedinger noted several new technology products for the delivery of lottery items to consumers. She said they include self-service machines, which allow players to select from a number of games, including instant tickets and tickets that can be dispensed directly from a gas pump.

Ms. Hedinger said that one future innovation she does see on the horizon is an attempt to harmonize business practices across state lines. She said, for example, that New Jersey has settlement terms for its retailers regarding how tickets will be settled and how they will pay for that, but so does Pennsylvania, New York, Virginia, and California. She noted that each state has its own business models and systems and does not interact with other states for these reasons. She also said she believes that there will be innovation of the games themselves in order to attract more players. Ms. Hedinger stated that the big jackpot games really suffered last year and that the casual player only buys tickets when the jackpot reaches a particular level. She said she has seen this change over the years from \$40 million to \$100 million to \$200 million. She observed that it currently seems that \$300 million is that magic number that attracts the casual player to purchase.

LOTTERY PRIVATIZATION

Mr. Sternberg of PRS Strategies said he has been in the lottery business for 18 years and that the privatization of lottery is a partnership. He said in order to have a successful partnership there has to be goodwill between the state and the private company. He reported that thus far privatization has missed its numbers. There have been some record-breaking sales and record-breaking returns, he said, but what they promised in returns to the states has missed their targets. He noted that in Indiana, officials are expecting a \$65 million shortfall, despite expecting a record return of \$270 million.

Mr. Sternberg said the monopoly game has not done well. He stated that the vendor predicted very high sales and a high return that didn't happen, which he commented is part of the problem with privatization. He said the good things about privatization include that costs and staff are paid by the vendor.

Mr. Sternberg noted that Massachusetts is the only state in the country that runs its lottery completely. He said it does its own repairs and runs its own system, with no vendor involved. He said the positive of this model is that more money goes back to the state. He said the negative of this model is that the state is replacing machines for the first time in 18 years. He reported that a state that enters into a partnership with a vendor can expect a new system every five to 10 years.

In response to a question from Mr. Geller, Mr. Sternberg said cutting retailers' commissions is one of the worst things a lottery can do. He said that vendors have less pressure than states to account for where the money is going and for responsible gaming initiatives.

Michael Jones of the Illinois Lottery stated that the basis for privatization began in Illinois when then-Governor Rob Blagojevich decided he wanted to sell the Illinois Lottery. Mr. Jones said the Governor had been advised by financial professionals that he could earn billions of dollars for the state by selling the lottery to a franchise that would benefit by gaining the profits over the next 60 to 70 years. He noted that Indiana was the next state to follow the Illinois model.

Mr. Jones said that the legislative leaders of the House and Senate, budget directors, and governors were all surprised when 10 to 15 separate financial firms expressed interest in the lottery and began making offers of \$10 billion or more. He said this opened the eyes of governors. He said that business people examined the lottery marketplace and realized that if they took nine percent of the core audience and increased it to 12 or 13 percent, that change would generate billions of dollars. The increases from privatization, he said, are not dependent on an increased prize percentage payout but on increasing consumer demand.

AJOURNMENT

There being no further business, the Committee meeting adjourned at 12:00 p.m.