

**STATE LOTTERY DEPARTMENT**  
**Lottery Board Meeting**  
**September 11, 2002**

The State Lottery Board met on Wednesday, September 11, 2002, at 9:30 a.m., at the State Lottery Department, 900 East Main Street, Richmond, Virginia.

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MEMBERS PRESENT:      Stephen C. Fogleman (Chairman)  
                                 Virginia D. Hall (Vice Chairman)  
                                 Gilliam M. Cobbs  
                                 Paul J. Lanteigne  
                                 Stuart C. Siegel

STAFF PRESENT:        Penelope W. Kyle, Executive Director  
                                 Mary L. Stafford, Chief of Staff  
                                 Mark D. Cannon, Director – Internal Audit  
                                 Shelton M. Coleman, Director - Information Technology  
                                 Mickey K. Collins, Director – Human Resources  
                                 Mark R. Merritt, Director – Sales  
                                 Edward A. Scarborough, Director - Public Affairs  
                                 Dennis P. Shaw, Director - Security  
                                 Donna M. VanCleave, Director – Finance  
                                 Richard G. Wilkinson, Director – Lottery Operations  
                                 Timothy C. Brown, Product Development Manager –  
                                 Marketing  
                                 Charmayne Vincent, Lottery Promotions Supervisor –  
                                 Marketing  
                                 Barbara L. Robertson, Board, Legislative & Regulatory  
                                 Coordinator - Director’s Office

OTHERS PRESENT:      Enoch W. Love, Jr. – Former Lottery Board Member  
                                 (during the reconvened meeting only)

Mr. Stephen C. Fogleman, chairman, presided and Barbara L. Robertson was the recording secretary.

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**CALL TO ORDER**

The chairman called the meeting to order and stated that a quorum was present. He dedicated the meeting to the remembrance of those people who lost their lives last September 11<sup>th</sup> in the terrorist attacks and to those who protect us both here and abroad.

CALL TO ORDER (Continued)

The chairman congratulated Ms. Kyle on her reappointment by Governor Warner. Ms. Kyle has served as Lottery Director since 1994.

MINUTES OF LAST MEETING

On motion duly made and seconded, the minutes from the regular and closed meetings held on June 19, 2002 were approved as distributed.

PUBLIC COMMENT

Mr. Fogleman then opened the floor for public comment. There was none.

FINANCIAL REPORT

Ms. VanCleave reported the Lottery's FY 2002 year-end and July 2002 financial performance.

Total sales in FY 2002 were a record \$1.108 billion, which was \$66.0 million (6%) more than budget and \$105.3 million (10.5%) more than last year. Sales of every Lottery product increased and exceeded budget in the fiscal year. Sales for the scratch games, Pick 4 and the Big Game/Mega Millions broke all prior sales records.

She reported that total daily game sales (Pick 3, Pick 4, and Cash 5) increased 5.7% over the prior year, which was particularly significant because sales of these products had been relatively flat over the past several years. The increase was partially the result of the prize payout rate that was significantly higher than statistically expected during the first quarter of the fiscal year. This higher payout rate helped maintain players' interest in all daily games products.

Lotto South sales (8% of total sales) increased by 8.8% over the prior year. The increase was due to the revisions made in the Lotto product (introduction of "Lotto South") that increased the game's player population and caused the jackpots to grow more quickly. Also, in 2001, there were no advertised Lotto jackpots higher than \$20 million; in FY 2002, there were ten drawings for jackpots higher than \$20 million.

She pointed out that the Big Game/Mega Millions sales (11% of total sales) were 57.7% higher than last year due in large part to a \$331 million jackpot in April 2002. In FY 2001, the largest Big Game jackpot had been \$107 million.

FINANCIAL REPORT (Continued)

Scratch game sales (44% of total sales) were 7% higher than the previous year. All of the growth in this product occurred in the higher price-point games. The migration of play to the higher price-point games has caused the average price per scratch ticket sold to rise from \$1.41 at the beginning of FY 2001 to \$1.96 by the close of FY 2002.

An additional reason for the sales increase in FY 2002 was the addition of 500 retail locations selling online products. Also, the Lottery replaced online terminals that had been in use since the introduction of the first online game, Pick 3, in 1989. The Lottery selected the new terminals for their speed and reliability, factors that are especially important during peak sales periods. These more efficient machines at a greater number of locations likely had a positive impact on sales in all online products, which increased 13.4% over last year.

Sales varied significantly from forecast because several of the factors that so positively influenced sales could not have been statistically predicted, and the impact of operational decisions could not have been estimated at the time the budget was developed.

All expense categories - prizes, retailer compensation, and operating costs - were equal to or lower than budget. The amounts paid for retailer compensation and prizes paid to players were the highest ever for the Virginia Lottery.

In FY 2002 prizes totaled \$613.7 million or 55.4% of sales. Although the overall percentage of sales paid to players for prizes was very close to the FY 2001 rate, with the increased sales, players won over \$56.5 million more than in FY 2001.

For the year, retailers earned \$6.4 million (11.4%) more than last year. The increase was due primarily to the commission earned on the additional \$105 million in lottery sales. Retailers also earned almost \$1 million more (an 82% increase) from incentive programs offered throughout the year.

Operating expenses (general, administrative, instant ticket printing costs) were \$74.7 million, which was \$1.7 million more than last year. Most of the increase occurred in scratch ticket printing costs that increased \$1.3 million, or nearly 24%. Nearly \$1 million of the increase was due to higher printing costs. Contract rates increased by one-third beginning in FY 2002.

Because of strong sales, net income generated in FY 2002 was a record \$367.7 million, which was \$38.6 million or 11.7% more than net income for last fiscal year and the FY 2002 forecast. Profits surpassed the 1997 record of \$342.5 million earned by \$25.2 million or 7.4%.

FINANCIAL REPORT (Continued)

Ms. VanCleave stated that FY 2003 has begun with strong financial results. Sales for the first month were \$90.7 million, which was \$13.7 million (18%) higher than last July. Most of the additional revenue resulted from strong scratch sales and the increasing Mega Millions jackpot that reached \$165 million before it was won on July 16.

Prizes were substantially lower than last year when the prize payout rate (prize expense as a percent of sales) for Pick 3 was almost 70%. This year prizes were lower than expected at only 53.8% of sales. In July, retailers earned \$5.0 million, which was almost \$700,000 more in compensation this year because of higher lottery sales. Operating costs, including scratch ticket printing, through July were \$5.6 million, which was almost \$500,000 less than operating costs for the same period last year.

With strong sales and low expenses, net income generated for the first month of FY 2003 was \$31.4 million. This was \$10.4 million or 49% more than net income for this month last fiscal year.

BOARD ISSUES

Audit Committee Report

Ms. Virginia Hall, Chairman of the Audit Committee, reported that the committee met today at 8:30 a.m. Mr. Cobbs, Mr. Fogleman, Mr. Cannon and she attended the meeting.

Mr. Cannon had reviewed significant findings noted in the audit reports issued since January 11, 2002 and had provided a report on the audit division's progress in completing the audit plan for FY 2002. There were no new cases resulting from the State Employee Waste, Fraud and Abuse Hotline during this calendar year.

The members of the committee had reviewed the audit plan for FY 2003. The plan included completion of audits now in progress as well as additional audits. In addition to the anticipated audits, the plan included time for special projects that may be requested by management and for systems development.

The committee will hold its next scheduled meeting in January 2003.

Compensation and Personnel Committee Report

Mr. Stuart Siegel, Chairman of the Compensation and Personnel Committee, reported that the committee met today at 9:00 a.m. Mr. Lanteigne, Mr. Fogleman, Ms. Kyle, Ms. Stafford, Mr. Merritt, Ms. McKenzie and he attended.

BOARD ISSUES (Continued)

Compensation and Personnel Committee Report (Continued)

Mr. Merritt had proposed “Jingle Bills,” the lottery retailer incentive program to be conducted October 28 – December 20, 2002. The program contains two components:

- (1) Lottery retailers can earn 0.5% bonus commission, with no compensation cap, on all scratcher product sales once they reach their individual program goals. The commission, when earned, would be based from dollar one.
- (2) Three weekly drawings will be held to reward retailer employees for cashing tickets from the three new holiday scratcher games. The retail location winner will receive up to \$1,000 and each store employee (maximum of 10) will receive \$100.

The Lottery estimated that during the program retailers are expected to sell \$85.5 million in scratcher products. The program’s goal was set 1.5% higher. If 70-75% of the retailers reach their goals, the total estimated cost of the program would be \$364,307.

Also, Mr. Merritt had reviewed the results of the “3-4-5 Ca\$h Plus” retailer promotion that was conducted February 18 – April 14, 2002. The program focused on Pick 3, Pick 4 and Cash 5 daily game sales. Although fewer retailers than anticipated achieved their goals, many retailers far exceeded their goals because of high Big Game jackpot levels that occurred during the program period. Based on incremental net sales of \$5.35 million over the department forecast and \$2.25 million over the program target, the resulting net income was approximately \$1.35 million over department forecast and \$1.07 million over the program target.

At the recommendation of the committee, and upon motion duly made and seconded, the board members present unanimously approved the “Jingle Bills” incentive program, as presented.

Following discussion of the level of retailer participation in incentive programs, Ms. Kyle suggested that, in licensing action hearings that are brought before the board, the department will provide the members with information regarding whether or not that retailer availed himself of lottery incentive programs.

Proposed Regulations

Ms. Stafford briefly explained the regulatory process as prescribed by the Administrative Process Act. She then reviewed several proposed revisions to the department regulations.

BOARD ISSUES (Continued)

Proposed Regulations (Continued)

On motion duly made and seconded, the board unanimously approved the proposed regulations. A copy of the amendments is attached to and made a part of these minutes.

Legislative Proposals for 2003 General Assembly Session

Ms. Kyle asked the board's approval of two legislative amendments that the department proposed for consideration at the 2003 Session of the General Assembly.

The first proposal, a housekeeping measure, resulted from notification by the Department of State Police of requirements for the submission of fingerprints to the Federal Bureau of Investigation. The amendment to §§ 58.1-4008 and 4009 of the *Code of Virginia* would codify the requirement that fingerprints of certain vendors to the Lottery may be submitted to the Federal Bureau of Investigation for criminal history record checks.

The second amendment would permit the Lottery Board to go into closed meetings to deliberate and reach decisions regarding lottery licensing appeal actions. Ms. Stafford noted that two other state agencies had obtained this exemption in last year's Session.

Mr. Fogleman commented that even if deliberations take place in closed meetings, the board's final decisions are issued in open sessions.

Upon motion duly made and seconded, the board unanimously approved both legislative proposals. The amendments are attached to and made a part of these minutes.

State Fair Promotion

Ms. Charmayne Vincent presented "Spin for Cash," the second chance promotion to be conducted at the 2002 State Fair of Virginia. She explained that the promotion was designed to increase sales for all Virginia Lottery products and to provide the Lottery with an avenue through which to expand its player base. The estimated cost of the second chance promotion is \$14,732.

On motion duly made and seconded, the board unanimously approved the 2002 State Fair second chance promotion, as presented.

Overview of the Literary Fund and the Annuity Purchase Process

At the request of Mr. Cobbs at a previous meeting of the board, Ms. VanCleave reviewed the establishment and uses of the Literary Fund. She explained that the Literary Fund

BOARD ISSUES (Continued)

Overview of the Literary Fund and the Annuity Purchase Process (Continued)

was established in the Constitution of Virginia as a permanent and perpetual school fund that provides low-interest loans to school divisions for capital expenditures. Depending upon the current economy, funds can be diverted for other than building purposes. For example, in 2002-2004, the Fund will be used for teacher retirement costs and debt service on bonds issued for technology grants. It is administered by the Virginia Department of Education.

The Lottery's unclaimed prizes total approximately 8% of the overall yearly revenue deposited to the Fund. Since the Lottery's startup, the department has transferred over \$106.9 million to the Literary Fund.

Ms. VanCleave then discussed the department's annuity purchase process that is followed for the investment of Lotto South and Mega Millions jackpots. She reviewed parameters established by the Department of Treasury, types of settlements and investment restrictions. She outlined the process that occurs when a jackpot is won and the procedures involved if the winner chooses cash or bonds.

Discussion of Retailer Hearing Process

The board then briefly discussed the retailer licensing appeal process and the outcome of several of the past final decisions.

DIRECTOR'S REPORT

Ms. Kyle reported that pursuant to the Setoff Debt Collection Act, the Lottery made a payment to the Department of Taxation totaling \$28,674 in July, and in accordance with provisions in the Lottery Law, the Lottery transferred unclaimed prizes of \$1,020,393 in July to the Literary Fund.

Ms. Kyle then announced the names and hometowns of several winners of top instant game prizes, \$100,000 Cash 5 winners, Lotto South jackpot winners from Virginia and Georgia, and Mega Millions jackpot and \$175,000 winners. The current Lotto South jackpot is \$6.0 million. The current Mega Millions jackpot is \$10.0 million.

She announced that this is the fourth year that the Virginia Lottery has honored outstanding public school educators from across the Commonwealth. This year's first Virginia Lottery Excellence in Education Award was presented to Ms. Charla Faulkner Crews of Halifax County. Five additional educators will receive the award this year.

DIRECTOR'S REPORT (Continued)

In procurement action, Ms. Kyle announced that the contract for the replacement of the AS400 was awarded to CAS, Inc., the contract for new instant ticket vending machines was awarded to Interlott Technologies, the contract for the performance of lottery field service was awarded to GTECH, and the contract for on-line network services was awarded to Verizon.

She reported that in August the annual sales conference was held in Roanoke. She announced that Mr. Mark Merritt has accepted the position of Director of Sales, effective September 1<sup>st</sup>. Mr. Merritt had been serving as interim director for some time.

Ms. Kyle then updated the members on the status of possible lottery referenda in North Carolina and Tennessee.

The board members discussed several public relations issues. Ms. Kyle asked that Mr. Ed Scarborough work with Mr. Lanteigne to improve the informational newspaper messages in the Tidewater area.

Finally, she explained that a board meeting needed to be scheduled for October to give the members the opportunity to review the department's budget and projections before they are submitted to the Governor in November. Following discussion, it was the consensus to hold the next meeting on Wednesday, October 30<sup>th</sup> and to cancel the previously scheduled November 13<sup>th</sup> meeting.

OTHER BUSINESS

Mr. Fogleman then confirmed that the next meeting of the board is scheduled for Wednesday, October 30, 2002.

CLOSED MEETING

Mr. Lanteigne made the following motion:

MOVED: that, in accordance with the provisions of § 2.2-3711 of the *Code of Virginia*, the board go into a closed meeting for the purpose of discussing or considering State Lottery Department matters related to proprietary lottery game information exempted from disclosure under subdivision 37 of § 2.2-3705A, specifically, game information for proposed instant games; legal matters, including briefings by staff members, pertaining to potential litigation; and personnel matters.

CLOSED MEETING (Continued)

The motion was seconded and approved by all members present. Mr. Fogleman then announced the conclusion of the open session, and the board went into a closed meeting.

RECONVENED MEETING

Following its closed meeting, the board reconvened in open session. Mr. Lanteigne then read the following certification for the closed meeting:

WHEREAS, the State Lottery Board has convened two closed meetings on this date pursuant to an affirmative recorded vote and in accordance with the provisions of The Virginia Freedom of Information Act; and

WHEREAS, § 2.2-3712 of the *Code of Virginia* requires a certification by this Board that such closed meetings were conducted in conformity with Virginia law and the motions by which the closed meetings were convened;

NOW, THEREFORE, BE IT RESOLVED that the State Lottery Board certifies that, to the best of each member's knowledge, (i) only public business matters lawfully exempted from open meeting requirements by Virginia law were discussed in the closed meetings to which this certification resolution applies, and (ii) only such public business matters as were identified in the motions convening the closed meetings were heard, discussed or considered by the Board.

By roll call, all members present voted in the affirmative that the certification was accurate as read.

On motion duly made and seconded, the board members present approved, as presented in the closed meeting, prize structures for Instant Games 242 through 244 and 542 through 550, including the  $\pm$  0.5% prize structure policy adopted by the board on September 13, 2000.

BOARD PRESENTATION

The members of the board then welcomed Mr. Enoch W. Love, Jr., former member of the board, who joined the meeting at this point.

On behalf of the board members, Mr. Fogleman presented Mr. Love with a board resolution and token of appreciation for his service as a member of the board.

ADJOURNMENT

There being no further business to come before the board, the chairman declared the meeting adjourned.

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Penelope W. Kyle  
Secretary

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Stephen C. Fogleman  
Chairman