



## **Economic Impact Analysis Virginia Department of Planning and Budget**

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### **11 VAC 5-31 – State Lottery Department Licensing Regulations October 8, 2002**

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The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.G of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.G requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. The analysis presented below represents DPB's best estimate of these economic impacts.

### **Summary of the Proposed Regulation**

The proposed amendments include numerous editorial and other changes, which will update the regulations to reflect the operational and procedural changes occurred in practice since 1996 when these regulations were last amended.

### **Estimated Economic Impact**

These regulations will apply to licensing of both instant and online lottery games offered by the State Lottery Department (the department). Both games give players the chance to win a prize or entry into a prize drawing. For instant games, whether the player has won is revealed immediately after scratching off the latex covering over a portion of the ticket. Instant games are also known as "scratchers." Currently, the department offers about 60 different types of instant games with top prizes varying from \$50 to \$1 million. Online games, on the other hand, are played through sales terminals linked to central computers via communications networks. The department also offers five types of online games, which include Pick 3, Pick 4, Cash 5, Lotto South, and Mega Millions. The prizes offered by online games may be high ranging from \$2 to

multi-millions for Lotto South and Mega Millions. For example, on May 9, 2000, the jackpot for an online game then known as the Big Game reached a record \$363 million. The jackpot for Mega Millions, a recently adopted multi state game in place of the Big Game, is believed to have the potential to reach up to \$500 million. Last year, revenues from instant and online games were slightly over \$1 billion. Of this amount, approximately \$557 million was distributed to winners, \$56 million was distributed to retailers, \$73 million was kept by the department as operating expenses, and \$329 million was revenues to the Lottery Proceeds Fund for public education.

The proposed changes are, in large part, designed to help reorganize two of the department's current regulations into two new regulations. Currently, the department has instant game regulations (11 VAC 5-30) and online game regulations (11 VAC 5-40) in place. The instant game regulations contain requirements for both licensing of lottery retailers and for gaming. Licensing regulations establish eligibility criteria for retailers, application procedures, general licensing standards, license fees, requirements for termination of licenses, requirements for inspection of retailers, etc. And, gaming regulations contain provisions on prize structures, ticket prices, chances of winning, retailer compensation, retailer transactions, payment of prizes, etc. Similarly, online regulations contain requirements both for licensing of lottery retailers and for gaming. Since the two current regulations contain similar provisions for different games, there is significant overlapping regulatory language on licensing and gaming. In order to reduce and simplify the regulatory language, the State Lottery Board (the board) proposes to reorganize the lottery regulations that contain provisions for instant and online games under two new categories: licensing (11 VAC 5-31) and gaming (11 VAC 5-41) regulations. In short, the board proposes to reorganize instant and online game regulations under licensing and gaming regulations.

In addition to the reorganization, the board proposes to update the regulations to reflect the changes in practice that occurred since 1996 when these regulations were last amended. Although this proposed action will introduce a completely new regulation, most of the proposed requirements are in current regulations, which are being repealed under a separate regulatory action. The requirements, which are simply a replica of current requirements, are not discussed in this report. This report discusses only new or modified provisions.

Several proposed changes are editorial. One is the proposed promulgation of copies of licensing forms that must be submitted to the department as regulations instead of listing their names in the regulations. Also, several requirements for retailers that appear throughout the regulations such as bonding requirements, electronic fund transfer requirements, annual license fee requirements, license cancellation requirements, promotional point of sale material display requirements, and service charge requirements for outstanding debt are included in retailer contract which will be promulgated as part of these regulations. Moreover, the details of general licensing standards will be moved from instant and online game regulations and will be promulgated as forms in these licensing regulations. These details include how the retail applicant's financial responsibility and security, accessibility of a retailer to public, sufficiency of other retailers in the area, volume of expected lottery sales, and the ability of good customer service are determined. All of these details except the details on the sufficiency of other retailers in the area are included in the retailer licensing application, retailer location form, or the retailer contract, all of which are promulgated as forms with these proposed regulations. Since these changes are editorial in nature, no significant economic effect is expected.

Similarly, other proposed new or modified regulations discussed below are not expected to introduce any major additional costs or benefits associated with enforcement because they are already enforced in practice. One proposed change will add that if the retailer fails to properly care for, prevent abuse of, position, or display the vacuum fluorescent display unit, the director of the department may cancel a retailer license as is the case with other lottery equipment. Vacuum florescent display is new equipment and the proposed regulations will mention it along with other types of lottery equipment that are already included in the regulations. Also, the proposed changes will add requirements for inspection and examination of lottery equipment during inspection of premises and records. Currently, retailers are required to provide access to lottery materials and tickets for inspection purposes, but in practice the department also inspects the lottery equipment. Moreover, in addition to the current requirement that the retailer maintain a separate bank account, the proposed changes will add the requirement that the bank account must be styled in the name of the retailer followed by "Virginia Lottery Trust." According to the section 58.1-4021 of the Code of Virginia, all proceeds from the sale of lottery tickets received by a retailer constitute a trust fund until deposited into the State Lottery Fund. Another change clarifies that in the event that retailer fails to make a deposit of lottery receipts, interest and

service charges may be waived if the retailer is not faulty. Similar to the other provisions, this has been the current practice. Overall, none of these changes are expected to create any significant economic effects at this time because they are already being enforced in practice.

Similar to other changes already discussed, provisions regarding several operational requirements that have been enforced in practice will be included in the regulations. The changes under this category appear to be policy related and imposed at the discretion of the department to change the department's operations or procedures. One proposed change under this category will remove the requirement that the retailer's eligibility is reviewed on an annual basis. The department indicates that contrary to this annual review requirement in the regulations, periodic reviews are conducted in practice because the department found out that annual review of about 5,000 retailers was prohibitively costly. The department also indicates that the most important aspects of the annual review are collecting license fees and making sure that the liability of retailers covered under the bond. Currently, annual fees are collected and bonding is verified annually, but a full license renewal review is conducted only at such time that a retailer problem is reported or identified, at the department's discretion. It is indicated that periodic reviews are initiated only in circumstances such as when the retailer fails to make the deposits, there is a change in the retailer's organization, or when a criminal, credit, or financial review is required.

Another policy related change is updating the regulations to incorporate the changes in retailer bonus compensation that occurred in practice. Previously, retailers who sold the low-tier (\$25 or less) winning tickets used to receive the prizes as bonus compensation if the ticket is not claimed within 180 days of announced end of the game. Currently, with the approval of the board, the department pays 1% of the cash value of all prizes the retailer paid as bonus instead of the cash value of the unclaimed low-tier tickets. The proposed changes will replace the previous method of determining retailer bonus compensation with the current bonus method enforced in practice. With the 1% cashing bonus, retailers have been receiving more compensation than with the former method. For example, since the cashing bonus was implemented in 1998, the department has paid retailers a total additional bonus of \$18,065,227 versus \$17,419,887 that they would have received in low-tier unclaimed prizes. The department believes that this change has resulted in greater convenience to the players because of the ease of cashing winning tickets.

Finally, the proposed changes will increase the maximum amount of the surety bond a retailer may be required to submit from \$5,000 to \$50,000 for instant game retailers and from \$10,000 to \$100,000 for online game retailers. In practice, the instant game retailers are generally required to submit \$10,000 in bonds already and most online retailers are required to submit \$20,000 in bonds. In some cases, the amount of bonding required from online retailers already reaches up to \$100,000. According to the department, approximately 69 retailers out of about 3,000 online game retailers have bonds over \$20,000. When the department started requiring bonds in excess of the amounts allowed under the current regulations, bonding costs to retailers must have increased. In short, the department already requires retailers to submit bonds in excess of what is required under the regulations. Similar to others, these proposed amendments will not change the way the regulations are currently implemented and consequently are not expected to create any significant economic effects upon promulgation.

The department's current approach to implement operational or procedural changes on issues such as retailer compensation, bonding requirements, and other similar issues without going through the regulatory process and then updating the regulations to reflect what is implemented in practice is problematic as the agency is operating contrary to its regulation in this case. The lack of authority to enforce these provisions combined with discrepancies between regulations and procedures followed in practice creates the potential for costly litigation expenses. However, this does not mean that the department would not forgo potential benefits if operational or procedural changes are implemented in practice only after going through the usual regulatory process as timely response to developments in the market place the department operates in may be valuable. One way to reduce potential costs associated with delay would be to seek an expedited process for promulgating regulations. This might take the form of an exemption, or the use of an expedited process such as the "fast track" process proposed in the 2002 General Assembly Session (SB 536).

## **Businesses and Entities Affected**

Lottery retailers selling instant and online games are subject to these regulations. According to the department, 4,971 retailers are licensed to sell both instant and online games.

## **Localities Particularly Affected**

The proposed regulations apply to all localities in Virginia.

## **Projected Impact on Employment**

No significant impact on employment is expected upon promulgation of the proposed amendments.

## **Effects on the Use and Value of Private Property**

The proposed changes are not expected to affect the use and value of private property upon promulgation.