

**A Proposal to Create an Alaska State Lottery Corporation
A White Paper in Q&A Form**

March 17, 2020

A Proposal to Create an Alaska State Lottery Corporation: A White Paper in Q&A Form

1. What is the history of state lotteries and the scope of this white paper?

Forty-five states plus the District of Columbia currently have some form of state lottery. State lotteries have evolved significantly since the earliest states began to create state-owned organizations to operate and regulate the sale of traditional lottery tickets. Scratch-off instant tickets were soon added and became a major source of state lottery revenues. Next, multi-state draw games like Powerball and Mega Millions appeared for sale under the purview of the state lottery organizations. More recently, games traditionally associated with private casinos began to be legally offered through a variety of venues under the banner of the state-owned lotteries. Some examples include keno and similar monitor games and video lottery terminals located in controlled establishments where players can play video versions of popular casino games. Most recently, sports betting has been established as an option for state lotteries. Some state lottery organizations have even gone so far as to establish state-owned casinos. Technologically, it is now possible and common for states to provide iLottery opportunities through which players located in the state can buy lottery tickets and access various games through a state lottery website or app. While state lotteries must be owned and regulated by the states, much of the work can be outsourced to private contractors, a public-private partnership (“P3”) approach, as described below in questions 6, 7 and 12.

Alaska might be a late entrant to the state lottery business. However, this late entrance has provided the State with the opportunity to observe other states’ successes and failures. This white paper examines the pros and cons of various organizational structures and game offerings. The administration has concluded that the best recommendation for Alaska is to form an Alaska State Lottery corporation with broad authority to establish, operate, and regulate a state-owned lottery with the ability to offer a wide range of games.

Currently, Alaska allows charitable gaming under Title 5, Chapter 15 of the Alaska Statutes and collects tax on cruise ship gaming under Title 43, Chapter 35 of the Alaska Statutes. Charitable gaming activities are regulated by the Department of Revenue. The pull-tab tax and cruise ship gaming tax are collected by the Department of Revenue. This state lottery corporation proposal is not meant to change or further regulate the gaming activities contemplated in those statutes

2. Does Alaska State law allow the State to create an Alaska State lottery?

The Alaska Constitution does not expressly forbid gaming or a state lottery. However, there are statutes barring these kinds of games (AS11.66.200 – AS11.66.280). The Department

of Law believes the State would need to change its statutes in order to establish an Alaska State Lottery. To that end, the Governor has submitted a Bill to establish an Alaska State Lottery (HB 246 and SB 188).

3. How would the State Lottery organization be structured?

The administration held discussions with several state lottery directors, representatives of several gaming companies, officials of the North American Association of State and Provincial Lotteries (“NASPL”), and the Multi State Lottery Association (“MUSL”). This question of organization structure was usually the first discussed. Several structures are possible, but the general consensus was that a state lottery is best set up within an independent state-owned corporation. The administration decided to propose that such a corporation be created by statute; with the authority to hire its own staff, promulgate its own regulations, create, operate, and oversee an Alaska State lottery, raise funding and pay its profits to the State general fund. The Bill contemplates provisions for an Alaskan State Lottery Corporation to be comprised of a seven-member board with the ability to hire a director and staff and enter into contracts. The members of the Board would be comprised of two Department Commissioners and five public members appointed by the Governor for staggered five-year terms. The administration believes that a State corporation, limited to operating an Alaska State Lottery, would be the most efficient way to operate a State lottery.

4. Besides a State corporation what other structures were considered?

A few states operate their lotteries within one of their departments. The logical departments in Alaska might be Commerce or Revenue. The main issue is that a state lottery is a business. Presumably, state departments do not have the experience or culture to operate a profit seeking endeavor. An independent corporation, with minimal statutory restrictions, seems the better choice.

5. How about a gaming commission?

Gaming commissions are not usually set up to operate state lotteries. They are regulatory agencies of the states, set-up to regulate privately owned gaming ventures like casinos. In the future, if the legislature decides to allow privately owned casinos, a gaming commission could be created as the regulator. Wyoming is considering such an arrangement. The Director of the Wyoming Lottery suggested that its state lottery would be exempt from regulation by any future gaming commission since a state lottery is not privately owned.

6. How would the State corporation operate a lottery – do we have any experience?

The lottery directors we spoke to told us that state lotteries are sophisticated businesses that require experience in lottery marketing, accounting, technology, licensing, law enforcement, and management. There are at least two ways to acquire the needed expertise. The corporation could seek to operate the lottery with minimal outsourcing. It would need to attract and hire several executives with lottery experience and would probably need 25 to 35 employees. The ability to pay higher salaries might be necessary.

Or, the corporation could contract with a gaming company to do as much as possible on an outsourced P3 basis. At least three gaming companies provide a wide range of lottery services: International Game Technology (“IGT”), Scientific Games and Intralot. By outsourcing as much as possible, the corporation might be able to hire as few as 10 employees; though it would still be helpful if some had lottery experience. This option would limit the number of additional state employees added but might require higher fees be paid to a gaming contractor.

In general, the administration recommends that the management structure and decisions on how much of the lottery operation to outsource be left up to the lottery board and corporation to determine.

7. How much do gaming companies charge to provide outsourced services?

The corporation would need to acquire at least some services from a gaming company. At a minimum, it would need a company to install and service the lottery ticket dispensing terminals, print instant scratch off tickets, and train retailers. Additional services could include marketing, advertising, game selection to improve revenue, iLottery software, video lottery games, revenue collection and accounting. The typical spread of costs is estimated by IGT to be in the range of 5% to 15% of gross sales. The exact percentage depends on the amount outsourced and level of sales. Whatever level of service the corporation selects, identifying a gaming company vendor through the request for proposal (RFP) process would be one of its first tasks.

8. How would the State corporation develop an RFP for lottery services?

There are independent consultants who could help the corporation create an RFP. NASPL has indicated that they could provide names of suitable candidates.

9. What is the timeframe to get up and running?

We believe the State can set up the lottery corporation near the beginning of FY21 if legislation is passed in the current session. The state lottery directors that we spoke with told us that conservatively, the State ought to be able to sell its first tickets by the beginning of FY22. Most state lotteries phased-in new games a few at a time. By the beginning of FY23, the Alaska State Lottery could be at regular operation.

10. What will it cost during the phase-in and how will the start-up costs be financed?

Some of the state lottery directors we spoke with advised us to expect first-year start-up costs totaling at least \$3 million. The main costs will be consulting fees, personnel services, background checks and licensing of the retailers. Some states used bank financing to raise initial funding. Bank financing could be possible in Alaska. Or, the State could consider an appropriation out of the general fund. The fiscal note attached to the Governor's Bill seeks an FY21 capital appropriation of \$3 million with additional authority to borrow needed funds. Some lottery directors suggested that the corporation might earn enough in the first year of operations (FY22) to pay off any loan. It seems feasible that the corporation could earn enough to start making deposits into the State general fund beginning in the second year of operations; FY23 in this example.

11. Would it be possible to streamline costs through shared service contracts with other State corporations?

There are instances where Alaska State corporations share services. For example, AIDEA and the Alaska Energy Authority ("AEA") share accounting, human resource, and other services. However, broadly speaking, lottery experts in other states have cautioned against using a "shared services" approach for a lottery. Lottery corporation employees have unique job descriptions, pay requirements, accounting protocols, procurement, and information technology IT needs. One example we were provided was that prime lottery purchase times, such as the hours immediately after the workday ends, tended for some states to be the same hours that IT outages were planned for needed updates at various state agencies. Lottery sales might suffer if the technology needed for sales was often shut down during higher sales times. Again, in general, the administration favors leaving management decisions such as whether to share services up to the lottery corporation.

12. Where would the State's share of the lottery revenues go, and practically, how would the State collect its share?

Some states' lottery directors suggested that a state's share of the revenues could be deposited into the state's general fund. Deposit into the state's general fund gives current and

future legislatures and governors maximum flexibility to appropriate the profits from the lottery. Deposit into a sub-fund of the general fund is contemplated in the Governor’s Bill. Some of the consulted directors advised that some states found it advantageous to designate revenues to education or other social services in order to win public support. In addition to education, the Governor’s Bill designates revenues to a variety of important social services. Wherever the proceeds are ultimately directed by the legislature, the Bill specifies that all profits in excess of required reserves for corporation expenses and prize distributions are to be remitted to the State.

Practically, lottery ticket sellers, called the retailers or agents, deposit all net lottery ticket proceeds into approved bank accounts. The lottery corporation periodically sweeps the accounts. From the proceeds of the sweeps, the corporation pays larger prizes, pays the gaming company contractor, pays retail commissions (about 6% of its ticket sales), pays membership fees, covers its administrative and other expenses, sets asides a reserve for corporation expenses and prizes and pays the State the balance of the revenues. Corporation accountants and auditors who perform these functions comprise many of the corporate employees. It is also possible to outsource the collection of ticket sales revenues to the gaming contractor.

13. What can the State expect for gross ticket sales and for its profit allocation?

Once the lottery is established, gross sales will depend on the type of games offered. Traditional single or multi-state draw game lottery sales can be negligible when the prizes are “small.” When the prizes grow to large amounts, sales can be significant. Scratch-off instant tickets, in states that allow them, usually generate more sales than draw games. Nationally, 57.8% of state lottery sales are generated by instant ticket sales. Video lottery terminals, where allowed, are relatively new and generate large revenues. For example, South Dakota generates \$221 million of its \$278.8 million of gross lottery sales from video lottery terminals. In order to maximize revenues, the Governor’s Bill proposes that the corporation be granted maximum flexibility to offer a wide range of lottery games. Following is a list of the 2018 revenues and distributions in states with similar population and geographic profiles to Alaska.¹

<u>State</u>	<u>Population</u> Thousands	<u>Gross Sales</u> \$ Millions	<u>Instants</u> \$ Millions	<u>Distribution to State</u> \$ Millions (and as a % of gross sales)	<u>Comments</u>
WY	557	\$28.70	NA	\$5.0 (17.4%)	No Instants
ND	760	\$31.30	NA	\$8.0 (25.6%)	No Instants
SD	882	\$278.80	\$30.80	\$124.7 (44.7%)	\$221 Video
MT	1,057	\$56.60	\$17.80	\$10.7 (18.9%)	

¹ Thank you to the NASPL for supplying this data.

ME	1,338	\$294.10	\$223.50	\$63.0 (21.4%)
ID	1,754	\$265.10	\$146.90	\$53.5 (20.2%)
NE	1,929	\$183.40	\$100.80	\$45.2 (24.6%)
NM	2,095	\$134.00	\$72.30	\$40.2 (30.0%)
AVG	1,295	\$159.00	\$87.80	\$43.8 (27.5%)

Every state lottery is profitable and provides a distribution of revenue to its state. There is no reason to believe an Alaska lottery will be any different. The amount of the revenue stream will depend on policy decisions, including the types of games offered, any restrictions or regulations on the lottery, and the administrative cost structure adopted. A general revenue estimate can be generated by scaling revenue in other lottery states to Alaska based on population. Various policy decisions will help determine whether Alaska comes in on the high or low end of the range.

There are two states lotteries offering draw games only: Wyoming and North Dakota. Based on experience in these states, \$5-8 million of annual transfers to the state would be a reasonable forecast.

For a lottery with both draw and instant games, potential revenues could range from \$7.5 million (based on Montana) to \$107 million (based on Massachusetts) with a midpoint of about \$35 million (Maine, for example).

For a lottery with draw games, instant games and video lottery terminals, potential revenues could range from \$69 million (based on Ohio) to \$255 million (based on Rhode Island) with a midpoint of about \$135 million (Oregon, Maryland, or New York, for example).

In terms of revenue timing, based on conversations with other states, we should not expect significant transfers to the state in the first two years after enacting a lottery bill (one year of preparation and the first year of sales). It might be reasonable to assume that a lottery with instant and draw games could be fully operational by the third year after passage (second year of sales), with full transfer to the state coming in that year. For video lottery terminal games, it may be reasonable to allow for a longer ramp-up period because of greater startup costs.

14. How are state lottery proceeds usually distributed?

The largest share of state lottery proceeds are paid in prize money. Prize payments often range from 50% to 65% of the total proceeds. High payouts can lead to increased ticket sales. Low payouts can lead to low ticket sales. Retailers are typically granted commissions equaling about 6% of their gross sales. The gaming contractor’s share ranges from 5% to 15% depending on the services provided and the gross sales amounts. Administrative expenses of the corporation should range from about \$2 million to \$5 million for a state with the population size of Alaska. The

variance is a function of how many tasks are outsourced. At \$100 million of sales, the expected percentage range for the corporation’s administrative expenses is 2% to 5%. The residual is partly retained by the corporation as a reserve for prize money and expenses, and partly deposited in the state general fund. Following is a possible table for Alaska:

<u>Distribution Category</u>	<u>Percentage</u>
Prize Money	60%
Retailer Commissions	6%
Gaming Contractor	10%
Corporation Administrative Expenses	4%
Distribution to the State General Fund	20%
Total	100%

Other states have advised that these percentages not be dictated in statute because there is no way to gauge the future success of the lottery. Rather, the exact percentages should be determined and adjusted as necessary by the lottery corporation board. For example, the prize payout percentage may need to be adjusted over time to respond to the market, keep players interested, and maximize revenue.

Appendix – Game Descriptions and Some Terminology²

Draw Game: The current name some lotteries use for computerized numbers games (daily numbers, lotto, etc.).

Instant or Scratch-off Ticket: A lottery ticket on which a player scratches latex coating from one or more play areas to determine if he or she has instantly won, as indicated by the symbols and words that are revealed.

Keno: A lottery game in which a player chooses “X” numbers with the object to match as many of “Z” numbers chosen by the lottery from a field of “Y” numbers. One of the classic keno games is 10 of 20 of 80. With most keno games, players can choose how many numbers they want to pick to match, thereby affecting price and their odds of winning. Typically, keno draws occur every four or five minutes. Daily keno is an alternate form of the game offered only once per day.

Monitor Games: These are games like keno with draws every few minutes. Ongoing, often animated, results are posted on large monitors. Monitor games are frequently offered in establishments like restaurants or bars.

² Primarily based on information published by NASPL at <https://www.naspl.org/glossaryoflotteryterms> .

Multi-Jurisdiction Lottery or Multi-State Draw Games: Lottery games that are offered in more than one jurisdiction, allowing lotteries to generate larger jackpots than they could individually. Jackpots may be paid in lump sums or annuities. The prize pool is shared by all participating lotteries. Examples include Powerball, Mega Millions, Hot Lotto, Tri-State Megabucks, Cash4Life and Lucky for Life in the United States, and Lotto 6/49 and Lotto Max in Canada.

Sports Lottery or Sports Betting: Offered by many lotteries around the U.S. and the world, and all lotteries in Canada. A sports lottery involves wagering on sporting events. May also be known as “Toto” or “Sports Pools” in some jurisdictions.

Video Lottery Terminal (VLT): A free-standing electronic terminal offered by some lotteries and connected to a central gaming system, on which the player may play a variety of casino-style games similar to slot machines.