



COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF REVENUE

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December 28, 2012

Honorable Robert M. McCord
State Treasurer
Commonwealth of Pennsylvania
129 Finance Building
Harrisburg, PA 17120

Dear Treasurer McCord:

Thank you for your December 12, 2012 letter regarding the Lottery Private Management Agreement (PMA). I appreciate your support of our efforts to seek new and innovative ways to increase Lottery revenue for the benefit of Pennsylvania seniors. Additionally, I share your view that the state should pursue new ways to serve taxpayers and maximize the return that our public assets earn.

The Department of Revenue respects the Treasury's role in approving payments with respect to the proposed PMA (as we do with all public contracts). Therefore we are pleased to fully address several concerns raised in your letter.

1. **Explanation of Lottery Expansion:** In accordance with Section 511(d) of the Procurement Code, 62 Pa.C.S. §511(d), a tabulation of the Camelot Global Services PA, LLC's ("Camelot") binding bid was made public on November 20, 2012. The Annual Profit Commitments ("APCs") offered by Camelot are based upon a comprehensive Business Plan (per Schedule 5.3.1(a) of the PMA Schedules and Exhibits available at www.revenue.state.pa.us/LotteryPMA), which will be subject to pre-approval annually by the Commonwealth.

Camelot's plan is broad based and includes enhancing existing games, introducing new games, and retiring low performers. Also impacting profit assumptions are branding, marketing and social responsibility strategies (e.g., increase participation of play to a broader audience resulting in a less regressive player base), among other growth drivers. Importantly, the PMA and Business Plan do not contemplate video poker or video poker like games.

If the Administration elects to move forward with the PMA, significant additional detail will be made public with respect to Camelot's Business Plan for our Lottery. In the interim, the Administration must adhere to the commonwealth's procurement laws, which specifically provide for the framework and structure the commonwealth is following in

this endeavor. The Administration will continue to offer as much transparency as possible, having publicly testified in legislative hearings; participating in more than 100 meetings with individual legislators and staff; providing updates publicly through press releases and online resources; and providing updates to Lottery employees, stakeholders, and groups within the aging community.

2. **Scope of Monitor-based Games:** The PMA contemplates a carefully considered and regulated roll-out of keno in accordance with the publicly posted Operating Standards. The relevant excerpt is provided below:

"Manager shall assist with the establishment, implementation, and administration of certain monitor-based Games, subject to all Commonwealth Policies and Rules, that may allow an individual of eighteen (18) years of age or older, to play certain monitor-based Games in no event any earlier than July 1, 2013 except as otherwise expressly approved by the Lottery Bureau. In no event shall Manager permit such monitor-based Games to be installed in more than approximately five hundred (500) eligible retail locations during the initial launch; one thousand (1,000) eligible retail locations by the end of first year; fifteen hundred (1,500) eligible retail locations by the end of second year; two thousand (2,000) eligible retail locations by the end of the third year; two thousand five hundred (2,500) eligible retail locations by the end of the fourth year; and three thousand (3,000) eligible retail locations by the end of the fifth year. Manager shall, not later than sixty (60) days prior to any commercial launch of a monitor-based Game, establish Internal Controls to ensure compliance with the provisions of this Section 5.3.3 and Commonwealth Policies and Rules."

In the absence of a PMA, existing Lottery management would be expected to adhere to the same monitor-based games rollout schedule and scope. In any case, the impact on monitor-based games is not projected to cannibalize existing casino slots revenue as a result of the transactions contemplated pursuant to the PMA.

3. **Purview of Monitor-based Games:** In examining existing Lottery regulations as well as the Race Horse Development and Gaming Act and corresponding regulations, it is readily apparent that any monitor-based games that would be implemented by the Lottery fall clearly within the scope of the Lottery's existing terminal-based game regulation, rather than the more restrictive definition of "slot machine," contained within the Gaming Act.

The Lottery's terminal-based lottery game regulation establishes procedures for the creation of a terminal-based lottery game, sales of tickets, validation of winners and the payment of prizes concerning said games. 61 Pa. Code § 875.1. A "terminal-based lottery game" is defined by the regulation as "[a]ny Lottery game . . . for which a

terminal-based lottery game ticket is generated through a computer connected to a Lottery central computer system.” 61 Pa. Code § 875.3.

The key distinction between a proposed terminal-based or monitor-based game and a game played through a slot machine is that a terminal-based game must be played through a Lottery central computer system with only bets being registered through a retail location. *Id.* In essence, a monitor-based game as has been discussed (e.g., keno) allows for a player to compete against multiple players from various locations within the Commonwealth for each drawing.

Contrast that method of gameplay with a traditional slot machine where a player essentially competes against the machine the player is located at. This view is supported by the unique nature of the Gaming Control Board’s regulations that govern slot machine specifications which clearly show that the regulations have no applicability to the monitor-based games under discussion. 58 Pa. Code § 461a et seq. These regulations set rules on issues such as payment vouchers, coupons, venue seating requirements, and slot machine progressive capabilities – all issues that have no bearing on the monitor-based games under discussion. In short, the Department does not believe that the Gaming Control Board’s regulations have any applicability to the discussion at hand. However, the Department reiterates its commitment to ensuring that any future gaming opportunities comply with all existing state and federal law and that said games will only be implemented to the extent authorized by law.

4. **Legislative Authorization:** Pennsylvania law and regulations grant the Department of Revenue broad authority over operating, controlling and administering the Lottery. The Administration believes that exploring and executing a PMA for the Lottery – in the best interest of seniors who benefit from Lottery-funded programs – are well within that authority.

Specifically, the State Lottery Law vests the Secretary of Revenue with the authority and “duty to operate and administer the lottery, and to promulgate rules and regulations governing the establishment and operation” of the Lottery. 72 P.S. § 3761-303(a). The Commonwealth’s statute provides a non-exhaustive list of areas within the operation and control of the Lottery, including: the type of lottery conducted, the price of lottery tickets, the numbers and sizes of prizes for the winning tickets, the method of selecting winning tickets, the manner of payment of prizes, the types of locations where tickets may be sold, the method of ticket sales, the amount and type of compensation to be paid to licensed sales agents where appropriate, the apportionment of revenues realized from sales of lottery tickets, and the production and merchandising of promotional items for the Lottery. *Id.* at § 3761-303(a)(1)-(11.1). The final item of the aforementioned list illustrates the scope of the Secretary’s authority regarding the conduct and control of the Lottery; § 3761-303(a)(12) extends the Secretary’s authority over “[s]uch other matters

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necessary or desirable for the efficient and economical operation and administration of the lottery..." (emphasis added). The relevant section of the Pennsylvania Code sets forth the Secretary's "power and duty to operate the lottery" in a substantially identical manner. See 61 PA.CODE § 803.11.

Further, the United States Department of Justice, interpreting 18 U.S.C. § 1301 et seq. (the "Anti-Lottery Law"), believes the exemption to the federal statute governing the operation of lotteries "conducted by a State" permits private management provided, however, (a) a State manages and directs the course of lottery operations by exercising "actual control" over all significant business decisions, and (b) said State retains all but a de minimus share of the equity interest in the profits and losses of the business, as well as the rights to certain intellectual property and assets essential to the State's lottery.

Over the past 20 years, the longest stretch of consecutive positive Lottery profit growth the commonwealth has achieved is 5 years. Additionally, the Lottery experienced negative profit growth in eight of the last 20 years. As evidenced by these facts and others, a PMA may provide more reliable and predictable revenue ensuring the continued strength and viability of programs supporting a dramatically growing population of older Pennsylvanians.

After reviewing this letter, I would be pleased to meet with you and your staff to ensure that Treasury's information requirements are fully satisfied.

Sincerely,

A handwritten signature in black ink, appearing to read "Dan P. Meuser". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Dan P. Meuser
Secretary of Revenue