

TouchPlay Timeline (2001 – January 2006)

2001: The Appropriations Subcommittees asked the Lottery to find new revenue streams to assist in balancing the budget.

2002: Lottery previewed a number of possible ideas with leadership. Monitor vending machines were included. No law changes would be necessary to implement any of the new games. Ed Stanek requested the legislature pass language anyway, because of the time and money needed for monitor vending machine development.

May 28, 2002: Language signed into law.

November 2002: Lottery invited Oversight chairs to the Lottery to see machines.

December 2002: Lottery appeared before the Oversight Committees and the Administrative Rules Review Committee to demonstrate the difference between lottery machines and slot machines. The Lottery reported to the Oversight Committee on its plans to test monitor vending machines and what restrictions it would place to restrict access to the machines by minors. The Lottery was cautioned by the Oversight Committee not to simply give a contract to one company cooperating in the test, but to take bids for different devices from various manufacturers.

May 2003: Thirty machines from three different manufacturers were deployed between Des Moines and Waterloo for a six-month test. All were placed in bars.

September 2003: The Lottery appeared before the Government Oversight Committees.

2004 Session: The Legislature put limits on the number of amusement devices (which involve slot machines technology) to about 7,000 and decided to leave them in C-stores, where they were competing with lottery products and cutting into lottery sales. The Oversight Committees asked the Lottery to work things out with the amusement operators and C-store industry. The operators wanted to put in machines that would be competitive with their devices. The Lottery wanted to add criminal backgrounds and accountability to the system of gaming machine entertainment operating in the state. As directed by the Oversight Committees, the Lottery worked with private industry to address cost issues in the TouchPlay project and make TouchPlay machines competitive.

November 2004: The Lottery appeared before the Oversight Committees and reported that 20 monitor vending machines were being tested in C-stores, where the Lottery was monitoring sales and problem gambling. The Lottery made a presentation on the differences between TouchPlay, amusement devices, and

slot machines and also reported that about 400 TouchPlay machines had been installed statewide.

January 2005: The Lottery made a PowerPoint presentation to a joint meeting of the Oversight Committees and the Administration Regulation Subcommittees showing the history of TouchPlay and how the machines had evolved with different companies, as instructed. The Lottery again went over similarities and differences between TouchPlay, slot machines, and amusement devices, and showed photographs detailing that TouchPlay machines looked very much like slot machines but were based on a different technology.

March 2005: Casinos objected to TouchPlay machines and circulated information to many legislators. The Iowa Gaming Association circulated photographs of a Lottery TouchPlay retailer in Davenport that was illegally advertising TouchPlay as slot machines. The retailer's license was suspended for one week.

Three objections to the TouchPlay operation were formulated by House Study Bill 288. The bill was designed: (a) to codify penalties for false advertising; (b) to codify the limits of two machines and four machines per location, depending on location; and (c) to prohibit TouchPlay machines from using themes based on poker, blackjack, and keno. The Lottery agreed with the House Majority Leader to put (a) and (b) from above into administrative rules to avoid a gambling debate. The Lottery had not deployed machines using blackjack or keno themes (although they had been used for over a decade on other products) and it was agreed to allow poker which is now less than 1% of all TouchPlay machine income and will soon be totally phased out.

May 2005: Lottery took (a) above to Rules Review Committee.
Lottery imposes moratorium on manufacturers and retailer operator numbers.

August 2005: Lottery submitted its report to Oversight Committees on TouchPlay finances and accountability, as requested,

September 2005: Lottery appeared before the Oversight Committees to discuss TouchPlay and electronic and mechanical amusement devices and social gambling.

November 2006: Lottery imposes a moratorium on trade types.

December 2005: Lottery semiannual report submitted to Oversight Committee, providing update on TouchPlay program.

January 2006: The Lottery took (b) noted in March 2005 entry above to Rules Review Committee.

Resources

	BOARD APPROVED 2006 AMENDED BUDGET	REVISED PROJECTED 2006 WITH REVISED TOUCH PLAY ACTIVITY	BOARD APPROVED 2007 AMENDED BUDGET	REVISED PROJECTED 2007 WITH REVISED TOUCH PLAY ACTIVITY
Lottery Sales	225,000,000	350,000,000	241,500,000	417,970,600
Bond Proceeds	-	-	-	-
Reimbursements - Other Agencies	-	-	-	-
Interest	500,000	500,000	500,000	500,000
Rents	-	-	-	-
Application Fees	25,000	25,000	25,000	25,000
Other -	5,000	5,000	5,000	5,000
Total Resources	225,530,000	350,530,000	242,030,000	418,500,600

Expenditures

Prizes	114,699,191	114,699,191	114,699,191	114,699,191
Retailer Compensation	22,219,024	117,219,024	34,322,324	165,792,921
Marketing, Education and Information	9,000,000	9,000,000	9,660,000	9,660,000
Retailer Lottery System	6,790,443	6,790,443	6,790,443	6,790,443
Instant/PT Ticket Expense	3,136,963	3,136,963	3,149,768	3,149,768
Instant/PT Vending machine rentals	-	-	-	-
Terminal Communications	540,000	540,000	540,000	540,000
Terminal equipment/Ticket dispensers	100,000	100,000	100,000	100,000
PTVM/TTVM Servicing	503,076	503,076	503,076	503,076
Depreciation Expense (TTVM/PTVM/BUILDING)	1,401,245	1,401,245	1,401,245	1,401,245
Interest Expense (TTVM/PTVM/BUILDING)	246,262	246,262	180,592	180,592
Increase in fixed assets due to principal payment in excess of book value	598,755	598,755	598,755	598,755
Refunds/Other	2,100	2,100	2,100	2,100
PTVM/TTVM's	-	-	-	-
Building/Improvements	294,935	294,935	-	-
Lottery Operations	10,873,005	10,873,005	10,875,005	10,875,005
Total Expenditures	170,405,000	265,405,000	182,822,500	314,293,097
Transfers				
Proceeds Transfer	54,000,000	83,375,000	58,000,000	102,117,650
Gamblers Assistance Transfer	1,125,000	1,750,000	1,207,500	2,089,853
Total Expenditures and Transfers	225,530,000	350,530,000	242,030,000	418,500,600

Iowa Lottery TouchPlay Project



Presentation to:

**Legislative Oversight Committees and
Administration & Regulation Appropriations Subcommittee**

Jan. 26, 2005

Iowa Lottery Authority CEO Ed Stanek

Where We Were:

History of TouchPlay



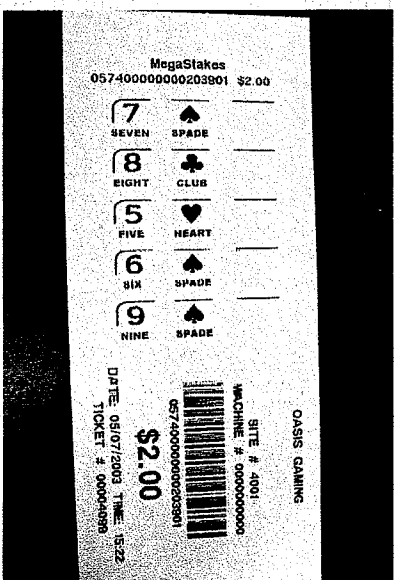
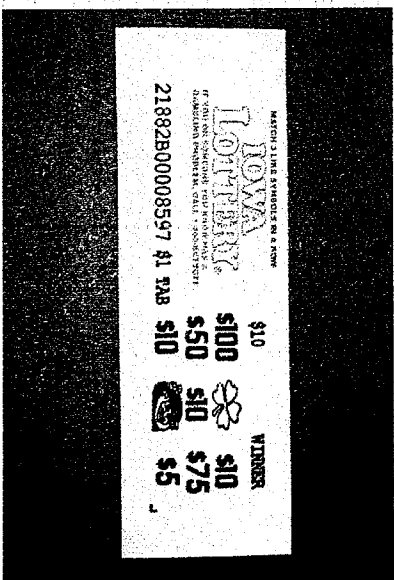
- Initial investigation of concept began in 2001 when Iowa Lottery received prototype equipment of monitor vending machines.
- Project was reviewed in late 2001 with legislative leadership and governor's office.

Where We Were:

History of TouchPlay

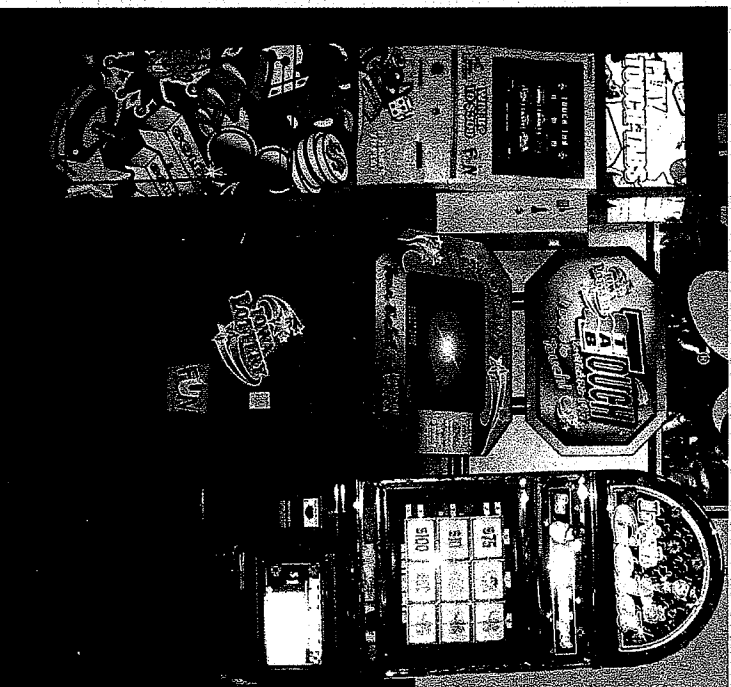
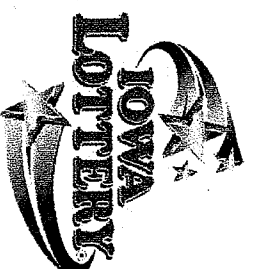


- Monitor vending machines use video and sound to reveal the results of the tickets they dispense.
- The machines do not dispense cash. They dispense tickets that are redeemable for lottery prizes.



Where We Were:

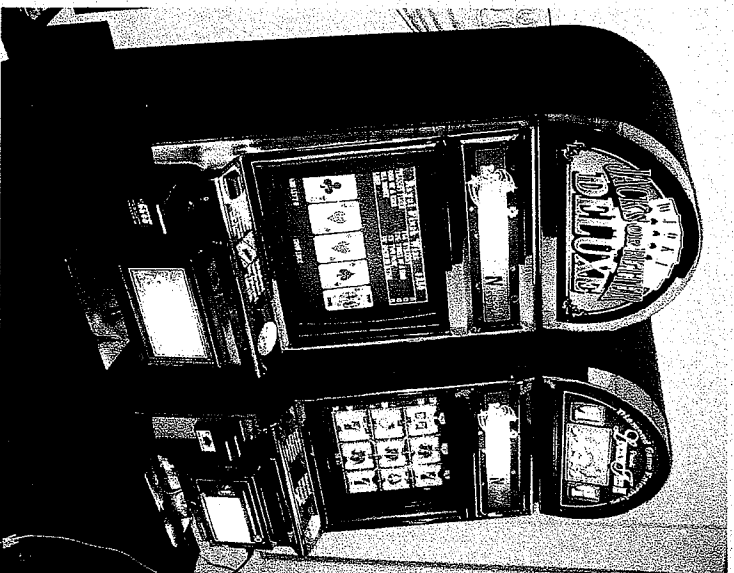
History of TouchPlay



- May 2002 legislation authorized the lottery to develop a business plan for the machines' deployment.
- The Lottery began a market test that included machines from three companies.

Where We Are:

Machines' Statewide Deployment



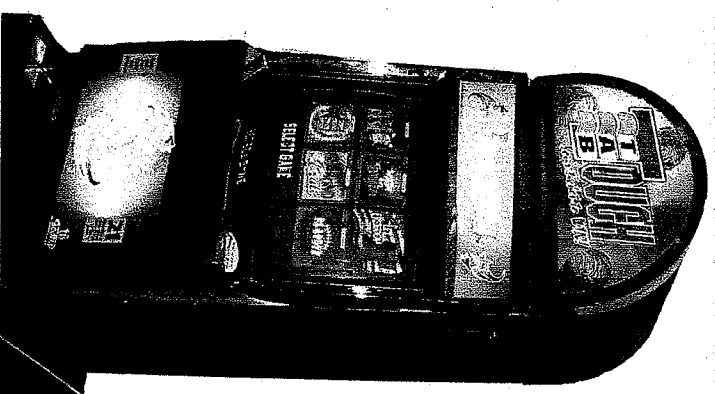
- In April 2004, statewide deployment of TouchPlay machines began.
- Machine manufacturers are certified by the lottery, distributors and retail locations are licensed.

Where We Are:

Machines' Statewide Deployment



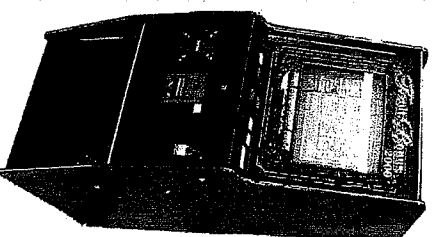
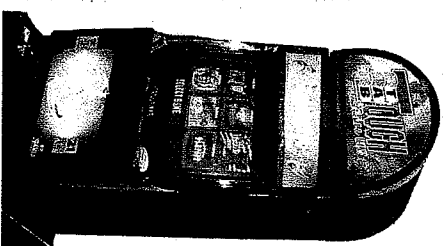
- As of Jan. 22, 422 TouchPlay machines had been deployed statewide.
- The TouchPlay project to date has produced \$2.3 million in net sales.



Compare and Contrast



- Lottery TouchPlay machines and amusement devices are governed by separate chapters of Iowa Code.
- While TouchPlay machines are regulated by the lottery, amusement devices are registered with the Department of Inspections and Appeals.



The legislation initially was passed in the first Omnibus Appropriations bill of the 2002 session. Governor Vilsack vetoed most of that bill and the Legislature came back in special session to address budget matters. In the special session, the Legislature again approved language directing the lottery to develop a business plan for TouchPlay. The language was included in the second Omnibus Appropriations bill that passed on May 28, 2002, and was signed into law. That bill (HF 2627) included the following section:

“It is the intent of the General Assembly that the lottery should investigate whether the deployment of vending machines with video screens would enhance the lottery’s ability to perform its statutory duties and if, in the business judgment of the lottery commissioner and the lottery board, it would do so, that the lottery is authorized to establish a plan to implement the deployment of pull-tab vending machines with video monitors consistent with the requirements of this subsection. At a minimum, the deployment plan shall include provisions for restricting access to these machines by minors, including but not limited to requirements relating to the location of these machines. Prior to implementing the deployment plan as described in this subsection, the lottery shall notify the Legislative Oversight Committee and shall submit a report to the committee describing the deployment plan, including measures the lottery will implement to restrict access to the machines by minors.”

**Distinctions Between Lottery TouchPlay Machines,
Electrical and Mechanical Amusement Devices, and Slot Machines**

TouchPlay

1. Machine does not have an internal randomizer to produce plays, which differentiates it from an amusement device, slot machine or video lottery. All plays from a TouchPlay machine come from a predetermined pool of plays, just like instant-scratch games and pull-tab games.
2. Machines are connected to a central reporting system that tracks the number of plays made and prizes won to accurately account for revenue.
3. Machines do not pay cash. Players receive tickets that can be redeemed for cash prizes, as with all other lottery games.
4. Machine manufacturers go through background checks by the Iowa DCI and are certified and regulated by the Lottery.
5. Machine distributors and retail operators go through background checks and are licensed by the lottery.
6. The lottery thoroughly tests all games to ensure veracity.
7. The state receives a share of the net revenue from the machines. The state's percentage starts at 24 percent in calendar year 2005 and increases to 34 percent over five years' time.
8. Program is governed by Iowa Code Chapter 99G and regulated by the Lottery.

Electrical and Mechanical Amusement Devices

1. Machines have internal randomizers that produce plays, meaning you are playing against the house each time you play – exactly like a slot machine.
2. Machines are run on a cash basis and currently have no equipment to track sales or prizes. Counters scheduled to be installed by 2006 will track "volume of business" through machines.
3. Machines legally can produce only \$5 in coupons at a time, which legally can be redeemed only for merchandise at the business where the coupons were purchased.
4. Machines are registered with the Department of Inspections and Appeals, but no background checks are run on any of the businesses involved. There are 6,928 amusement devices registered in Iowa.
5. No checks or tests are done by the state to approve games or attest to their veracity.
6. Sales are subject to 5 percent state sales tax but are not required to be reported as separate income stream.
7. Amusement devices are governed by Iowa Code Chapter 99B and registered with DIA.

Slot Machines

1. Machines have internal randomizers that produce plays, meaning you are playing against the house each time you play.
2. Machines are connected to a central reporting system that tracks the number of plays made and prizes paid to accurately account for revenue.
3. Machines can dispense cash.
4. Industry is regulated by DCI and Iowa Racing and Gaming Commission.
5. State receives fees and taxes from gaming facilities.
6. Iowa gaming facilities are governed by Iowa Code Chapters 99D and 99F and regulated by the Iowa Racing and Gaming Commission.

Monitor Pull-tab Test Business Plan

Objectives

Pursuant to the provisions of HF 2627, the Iowa Lottery is interested in evaluating the feasibility of monitor pull-tab vending machines in a live test. The lottery is inviting interested vendors to submit proposals for testing of their equipment and games in this jurisdiction based upon the result of the request for information process conducted in July.

In the test, the lottery is seeking to measure revenue potential and serviceability of this technology from a variety of perspectives, including but not limited to:

- Sales potential in both single and cluster form
- Machine/product-to-machine/product comparison
- Rural versus urban setting sales comparison
- Casino property proximity

Test Locations

The test will be conducted in existing lottery accounts (bars, clubs and other adult social venues) in and/or near the following communities:

- Des Moines
- Waterloo/Cedar Falls
- Center Point
- Vinton
- Marion (suburb of Cedar Rapids)

These locations offer a mix of rural and urban settings, experienced existing lottery accounts and proximity to casino properties. Additionally, within a two and a half hour drive between southwest Des Moines and the northeast Waterloo/Cedar Falls region, a limited amount of service is feasible.

Machines/Test Period

The lottery is planning for a test of approximately 40 machines total with an equal number of machines made available through each interested vendor. The lottery anticipates testing machines in head-to-head cluster formats as well as dual to singular venues.

Ideally, a start date of January 2, 2003 is anticipated. The test would last a period of six months.

Costs

The lottery is requesting that vendors supply test machines at no cost. The lottery recognizes that there are other costs associated with the test such as ticket printing, service of machines, etc. As part of this proposal, vendors must provide a detailed listing of all costs associated with the test including: quantity of tickets, price per ticket and service.

The lottery will review cost proposals and decide whether it is feasible to proceed with testing each vendors' machines.

Service

With the small number of machines involved in the test, the lottery is sensitive to the logistical complexities involved in servicing these machines. However, the length of the test dictates that a limited amount of service will be required.

Based upon the proximity involved, the lottery expects limited (i.e. service within 48 hours of call) service will be made available as a part of each proposal. Additionally, the lottery expects that interested vendors would propose training for lottery employees who could assist in service efforts during this limited test period.

Game Design/Prize Structure

Based on marketing experience, vendors are encouraged to propose game designs they feel will sell best in this jurisdiction. However, vendors are reminded that the Iowa Lottery reserves the right to reject themes or concepts that it feels would exceed the limits of taste and political sensitivity.

For sake of comparison, vendors must use a 80 percent payout rate. Vendors may propose games and accompanying prize structures accordingly.

Background Investigation

Due to the security associated with a live test of these games, all interested vendors printing tickets for these games will be subject to a background investigation pursuant to the Iowa Code.

Legislative/Public Relations

Iowa Lottery staff has conducted favorable briefings with legislative leaders and representatives of the media. Legislative language authorizing a test of this technology was signed into law during the 2002 session as part of the Administration/Regulation Appropriations bill.

To address concerns raised by members of the Rules Review Committee, staff will make a presentation to the committee again in December to clarify administrative rules revisions the committee felt were appropriate to deployment of these machines in a test scenario.

Iowa Lottery staff will also brief members of the Legislative Oversight Committee in December as to plans for a test.

As planned throughout the course of evaluation of this product, the machines will only be placed in adult social venues such as bars and fraternal clubs.

The Lottery has made it clear to all concerned that evaluation of this product is consistent with our mission to increase revenues while preserving the dignity of the state. A limited test of this technology allows for a true analysis of the revenue potential for deployment of these machines and any operational difficulties that may need to be overcome in the future.

Thomas J. Vilsack
Governor
Sally J. Pederson
Lt. Governor



Edward J. Stanek, Ph.D
President and CEO

Semiannual Report On Lottery Operations

To: Members of the House Government Oversight Committee and Senate Government Oversight Committee

From: Ed Stanek

Date: Nov. 10, 2004

The Iowa Lottery Authority ended its first year of operations with an increase of millions of dollars in its profits to the state – a 16.4 percent improvement over the previous year's results. And while the Lottery continues to explore new product concepts and make other strategic marketing and budgeting decisions to increase sales and profits, early results from FY 2005 show that high fuel prices and concerns about upcoming home heating bills are having an effect on lottery returns.

Lottery profits to state programs totaled nearly \$55.8 million in fiscal year 2004, which ended June 30. Total sales for the year were \$208.5 million. Comparative figures for FY 2003 were \$187.8 in sales and \$47.9 million in proceeds.

The lottery achieved FY 2004 sales increases in nearly all of its products, most notably in instant-scratch games (12.1 percent sales increase to \$95.3 million) and Powerball (14.6 percent sales increase to \$66 million). The creation of the Iowa Lottery Authority, with its accompanying freedom to operate as a business with business-type incentives, continues to set the stage for future lottery success.

However, fuel and energy prices this year in Iowa are taking a toll on lottery sales and lottery proceeds to the state in early FY 2005. Gas stations and convenience stores make up about 75 percent of the Iowa Lottery's approximately 2,500 retailers. When gasoline prices in Iowa hit an average of \$1.96 a gallon in mid-May (the highest average on record since the Dept. of Natural Resources began surveying fuel prices in 1980), the price spike drove down sales of the Iowa Lottery's instant-scratch tickets, which like snacks, pop and magazines, are discretionary purchases often made at c-stores. Instant-scratch ticket sales in Iowa fell from \$8.3 million in April to \$8 million in May.

Summer months, when many people are on vacation and away from their day-to-day routines, traditionally are a slower time for lottery sales. However, lottery sales generally pick back up in the fall and increase further during winter months. The Iowa Lottery

should have seen a sales increase beginning in September of this year, but the effect of high fuel prices continued to show through.

Instant-scratch sales in September were \$7.3 million, down from \$7.4 million in August. And, while lottery sales did rebound in October, total Iowa Lottery sales are down in the first four months of fiscal year 2005 compared to FY 2004 (\$65.5 million in 2005 compared to \$70 million in 2004 with some of that difference due to variations in the Powerball jackpot).

Gas prices in October averaged \$1.94 a gallon, according to the DNR's monthly fuel survey. Energy analysts at the DNR also began warning in October about higher home heating costs this winter. Natural gas prices are expected to be as much as 29 percent higher this winter, according to the DNR, and approximately 69 percent of Iowans heat their homes with natural gas.

Fuel prices also had a noticeable effect on Iowa Lottery sales in spring 2001, when high gasoline prices drove down sales in many areas of discretionary spending. The Iowa Lottery responded at that time by working with the Iowa Corn Growers Association to design a promotion to give away free fuel. The "It's a Gas" promotion that began in January 2002 awarded seven grand prizes of \$1,040 in ethanol certificates – enough to buy \$20 in fuel each week for a year.

The Iowa Lottery is looking into that and other innovative ideas to respond to the current high energy prices, but realizes that in the end, consumers do have to make common-sense choices in their purchases.

Lottery Legislation Planned For 2005 Session

During the 2005 legislative session, the Iowa Lottery will introduce legislation to close a bit of a loophole in Iowa law that has allowed the spread of a "grey area" product that competes with lottery pull-tab tickets.

The product is known in Iowa as "Ad-Tab" tickets, but similar products by different names have been the subject of court action in other states, including Minnesota, Michigan and Maryland. The tickets, which look much like Iowa Lottery pull-tab tickets, are sold by private operators in the state and presented as promotional/advertising materials. There is no regulation of the product and it is having a detrimental effect on the sale of Lottery pull-tab tickets and their income to the state.

Pull-tab tickets are the only lottery product that saw a sales drop in fiscal year 2004, with sales in the category down 10 percent, or about \$2.8 million.

The Iowa Lottery believes that a change in Iowa's Vice Law, Iowa Code Chapter 725, will address the Ad-Tab situation in Iowa without involvement of the courts, as has been the case in other states. The Lottery plans to introduce language to make the Code change in the 2005 session. The proposed language is included at the end of this report as Attachment A.

Court decisions in other states highlight the need for legislative action in Iowa:

- In Minnesota, the state Court of Appeals ruled in October that a promotional game sponsored by a company called Minnesota Souvenir Milkcaps is illegal in that state. The appeals court upheld a lower court ruling that the game is really a lottery because customers pay for the chance to win a cash prize – not for any tangible good.
- In Michigan, an Ingham County Circuit Court judge ruled in June that Ad-Tabs coupons being sold in that state were an illegal lottery.
- In Maryland, the Circuit Court for Worcester County in July 1993 granted summary judgment to a county attorney who had removed a vending machine containing Ad-Tabs coupons from a pizza restaurant. The court noted in its ruling that “the undisputed facts support the supposition that the Ad-Tab campaign is a pretext, designed to evade Maryland’s gambling statutes.”

Monitor Vending Machines

(marketed under the brand name TouchPlay)



Statewide rollout of the lottery’s monitor vending machines began in late April and the project has produced more than \$1.3 million in net sales since that time. The machines, being marketed under the brand name “TouchPlay,” are being installed in businesses across the state by amusement operators, small-business owners who have been licensed to sell lottery products.

Players insert money into the monitor vending machines as they do with any other vending machine. When the play is made, the TouchPlay machine’s video monitor displays the results of the play while electronic tones indicate whether the play has won a prize. The machines do not pay out money. Players receive tickets that can be redeemed for cash prizes at the businesses where they play or at Lottery regional offices. The machines do not utilize a randomizer or random internal selection of plays. All plays come from a predetermined pool. The machines are located in age-controlled environments (premises where the age of patrons is monitored by the employees of the establishment).

The lottery has been discussing the vending machines with legislators since late 2001. A test period for the machines started in May 2003, with 30 machines installed at businesses from Des Moines to the Waterloo-Cedar Falls area. In the test, the lottery measured the machines’ revenue potential, reliability and serviceability and tracked whether there were any calls to the state Gamblers’ Treatment program related to the machines. After a six-month test period in which the 30 machines produced average weekly sales of \$900 and there were no reports related to the machines made to the

gambling treatment hotline, the lottery decided to move forward with statewide sales from the devices.

The Lottery Board has approved a limit of two TouchPlay machines per location with the exception of fraternal and charitable social clubs, which can have up to four MVMs each. The TouchPlay machines are connected to a central system and the lottery and machine operators have access to the reports produced to track sales and prize information.

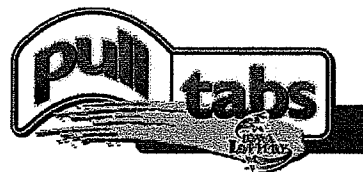
Operators are gradually buying and deploying TouchPlay machines at age-restricted locations in Iowa. As of Nov. 6, 69 operators had been licensed by the lottery and had installed nearly 400 machines in retail locations across the state.

During the 2004 session, legislation was approved that established a minimum playing age for amusement devices in Iowa but left the machines in all of the locations that currently had them, including bars, taverns, restaurants and convenience stores. The Lottery warned legislators during discussions about the devices (there are about 7,000 in operation in Iowa) that they were proving to be a significant form of competition to lottery products and were having a detrimental effect on the sale of lottery products, especially pull-tab and instant-scratch games. Members of the Oversight Committees suggested that the Lottery, amusement operators and convenience stores work together to try to develop a cooperative program. The lottery has responded in an effort to preserve its revenue to the state.

In August, the Lottery began a market test of TouchPlay machines at 20 convenience stores in Iowa, many of which also offer amusement devices to their customers. As with its initial test of TouchPlay technology, the lottery is measuring results of the c-store test on a number of fronts, including the machines' overall revenue potential, their effect on the sale of other lottery products and any effect on calls to the state Gamblers' Treatment program.

The TouchPlay machines have performed well in the c-store market test, with the businesses that offer them and those businesses' customers both appreciating a new entertainment option. The machines also are providing a valuable new revenue stream to the c-stores. The addition of TouchPlay machines in the c-stores has had an effect on the sale of some other lottery products there, but overall sales at stores involved in the test have increased – and increased at a higher rate than sales at the lottery's other retail locations. Officials at the state Gambling Treatment Program report no calls to the gambling hot line related to the TouchPlay machines and no reports of underage use have been received.

Purchase of Vending Machines and Lottery Headquarters Building



Earlier this year, the Lottery notified members of the Oversight Committees about its plans to issue revenue bonds to pay for a headquarters location in Des Moines and vending machines for its instant-scratch and pull-tab tickets. Both purchases should mean long-term savings to the state and plans on both fronts are moving forward.

The revenue bonds to pay for the projects were issued in early October.

On Nov. 15, the Lottery will begin replacing its existing leased vending machines for instant-scratch and pull-tab tickets with new machines that the lottery has purchased. The transition to the new equipment will continue through April, with a total of about 1,020 new pull-tab vending machines and 300 new instant-ticket vending machines installed in retail locations.

The Lottery expects to close by the end of the calendar year on its purchase of a headquarters location at 2323 Grand Ave. in Des Moines. Moving the Lottery's operations to the new building is planned for summer 2005. The building currently is home to Farmers Mutual Hail Insurance Co., which is constructing a new headquarters location in West Des Moines.

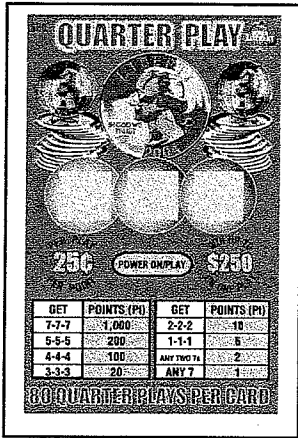
The 2003 legislation that created the Iowa Lottery Authority included language authorizing the Authority to "enter into contracts to incur debt in its own name and enter into financing agreements with the state, agencies or instrumentalities of the state, or with any commercial bank or credit provider." Written notice to the Legislative Oversight Committee and approval from the Executive Council is required for the lottery to borrow more than \$1 million.

In investigating options available to the lottery, lottery executives found that the Authority could obtain federally tax-exempt financing as an instrumentality of the state. With the assistance of the State Treasurer's office, lottery executives prepared the necessary paperwork and received approval from the state Executive Council to borrow up to \$10 million to buy the headquarters building and vending machines.

To recap both projects for you:

- The Lottery is purchasing the vending machines from Pollard Banknote, based in Winnipeg, Canada. The machines are being manufactured in Council Bluffs by Pollard's subsidiary, American Games Inc., which also will provide maintenance for them. American Games already employs 220 people in Council Bluffs and the company expects to add between 50 and 75 additional jobs to fulfill the Iowa Lottery contract. Financial projections show that by purchasing the machines instead of using traditional six-year leasing arrangements, the lottery should save about \$1.7 million in that time. The lottery could extend the machines' use even beyond that, resulting in further savings to the state.
- Purchasing the building at 2323 Grand Ave. also is projected to produce annual savings for the Lottery. Rent on the Lottery's current headquarters at 2015 Grand

Ave. totals \$348,000 per year, with no accumulation of equity. The lottery's annual payment on the bonds issued to buy 2323 Grand Ave. will total \$200,345 and the lottery will build up equity during the 15-year amortization period for the bonds.



Electronic Game Card Update

In October, the Iowa Lottery became the first in the world to sell an electronic version of the traditional instant-scratch game with a market test of a product called "Quarter Play."

Initial sales of the battery-powered cards were strong, with an enthusiastic response from both retailers and players. More than 60 percent of the electronic game cards ordered for the market test had been sold in the product's first five weeks on the market.

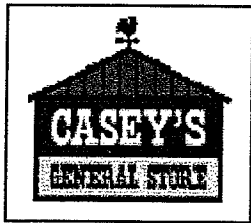
Based on the market test's strong results, the lottery plans to begin statewide sales of electronic game cards in May 2005. The initial game sold statewide also will be called Quarter Play, with future games planned for fall 2005.

Each Quarter Play card, about the size of a driver's license, is battery powered and loaded with dozens of random plays. Players activate the cards by pulling off a plastic tab on the back. Pushing a "play" button on the front of each card activates one of the plays on the card – essentially the same as an individual scratch ticket. But in the case of the game card, an electronic play replaces the traditional scratch play of a paper ticket. Three small LCD screens on the front of the card display the numbers in a particular play and show whether it has won a prize.

Each card features 80 plays and sells for \$20 (25 cents per play). Players accumulate points, each having a value of 25 cents, by matching three like numbers as they advance through the 80 plays.

At the conclusion of all the plays, the game card displays the total points accumulated. Each card in the market test offers a guaranteed \$5 prize and the chance to win a top prize of \$300. Players redeem the cards as they do any other lottery product – by having their ticket validated at an Iowa Lottery retailer or one of the lottery's regional offices.

The market test of the cards was conducted at about 10 percent of Lottery retailers in the Cedar Rapids, Waterloo-Cedar Falls and Dubuque areas. The Lottery chose eastern Iowa for the test because of its heavy population base and variety of retailers and sales markets.

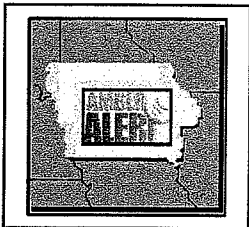


Casey's General Stores

In mid-September, Casey's General Stores began selling Iowa Lottery products again. A decade earlier, the Ankeny-based convenience store chain had made a corporate-wide decision to stop selling lottery products in all states where it did business. The decision was based on a variety of reasons, including accounting issues. Casey's is gradually installing equipment and training its staffers to sell Iowa Lottery products with final installations at its 335 stores in this state scheduled for early January. The Lottery will invest \$1.8 million in fiscal year 2005 for satellite communications equipment, ticket-vending equipment and point-of-sale materials at Casey's stores. However, the addition of 335 stores to the Lottery's retail base will mean significant long-term benefits to Lottery sales and proceeds.

Promoting Iowa

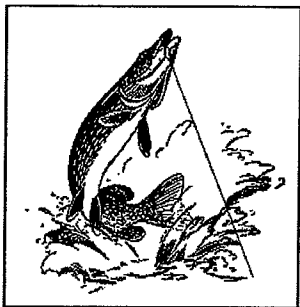
Fiscal year 2005 finds the Lottery continuing the important work of highlighting the state's success stories. Examples of projects include:



The Lottery's participation in the Amber Alert emergency notification system, which has been used multiple times to successfully locate missing children and return them to safety. The lottery has provided information to the public about abducted and endangered children by printing messages on its lotto tickets, displaying information on its customer display units at retail locations and through detailed messages sent to each of the 2,200 retailers that sell lotto and instant-scratch tickets in Iowa.



The "Cash on a Stick" instant-scratch game and "Iowa State Fair 150th Anniversary Sweepstakes" promotion both celebrated the fair, Iowa's largest tourism event and one of the nation's oldest and largest agricultural expositions. The sweepstakes promotion concluded with a prize drawing during the fair in August. The Lottery and State Fair had worked together to design a contest featuring Iowa-made and Iowa-marketed products. Contestants in the prize drawing won one of 12 cash prizes of \$1,500; a Dave Lennox Signature Collection® furnace installed in the winner's home; a 2004 Dodge Ram pickup; or a 2005 Winnebago 22-foot Minnie® motor home.



In April, the Lottery will release a fishing-themed instant-scratch game as part of a joint project with the Department of Natural Resources designed to encourage people to buy fishing licenses in Iowa. Sales of resident fishing licenses have fallen nearly 9 percent since 2000, resulting in a budget cut to the DNR's fisheries, wildlife and conservation law enforcement bureaus in FY 2004. The Lottery and DNR are working together to develop the fishing-themed scratch game and each ticket will feature a message encouraging players to visit the DNR's web site (www.iowadnr.com) to buy their fishing licenses.

Turning 20

In 2005, the Iowa Lottery will mark its 20th birthday. Lottery sales in Iowa began on Aug. 22, 1985. Total lottery revenues to the state will top the \$900 million mark in its anniversary year, while prizes to players will continue to climb towards \$1.8 billion. The lottery is planning several games and promotions throughout the year to celebrate the milestone and highlight the revenues it has provided to the state through the years.

On-Going Issues

Gambling Decisions: With the Racing and Gaming Commission's decision in June to begin the process of rescinding its rule putting a moratorium on gambling licenses, the stage is set for a gambling expansion in Iowa. New casinos and the addition of table games at racetracks in Iowa will create more competition for consumers' discretionary income, meaning more competition for the Iowa Lottery and other businesses in the entertainment industry. The lottery will continue to monitor the expansion of gambling in Iowa and what impact that could have on lottery income to the state.

Distinctions Between Lottery TouchPlay Machines, Electrical and Mechanical Amusement Devices, and Slot Machines

TouchPlay

1. Machine does not have an internal randomizer to produce plays, which differentiates it from an amusement device, slot machine or video lottery. All plays from a TouchPlay machine come from a predetermined pool of plays, just like instant-scratch games and pull-tab games.
2. Machines are connected to a central reporting system that tracks the number of plays made and prizes won to accurately account for revenue.
3. Machines do not pay cash. Players receive tickets that can be redeemed for cash prizes, as with all other lottery games.
4. Machine manufacturers go through background checks by the Iowa DCI and are certified and regulated by the Lottery.
5. Machine distributors and retail operators go through background checks and are licensed by the lottery.
6. The lottery thoroughly tests all games to ensure veracity.
7. The state receives a share of the net revenue from the machines. The state's percentage starts at 24 percent in calendar year 2005 and increases to 34 percent over five years' time.
8. Program is governed by Iowa Code Chapter 99G and regulated by the Lottery.

Electrical and Mechanical Amusement Devices

1. Machines have internal randomizers that produce plays, meaning you are playing against the house each time you play – exactly like a slot machine.
2. Machines are run on a cash basis and currently have no equipment to track sales or prizes. Counters scheduled to be installed by 2006 will track "volume of business" through machines.
3. Machines legally can produce only \$5 in coupons at a time, which legally can be redeemed only for merchandise at the business where the coupons were purchased.
4. Machines are registered with the Department of Inspections and Appeals, but no background checks are run on any of the businesses involved. There are 6,928 amusement devices registered in Iowa.
5. No checks or tests are done by the state to approve games or attest to their veracity.
6. Sales are subject to 5 percent state sales tax but are not required to be reported as separate income stream.
7. Amusement devices are governed by Iowa Code Chapter 99B and registered with DIA.

Slot Machines

1. Machines have internal randomizers that produce plays, meaning you are playing against the house each time you play.
2. Machines are connected to a central reporting system that tracks the number of plays made and prizes paid to accurately account for revenue.
3. Machines can dispense cash.
4. Industry is regulated by DCI and Iowa Racing and Gaming Commission.
5. State receives fees and taxes from gaming facilities.
6. Iowa gaming facilities are governed by Iowa Code Chapters 99D and 99F and regulated by the Iowa Racing and Gaming Commission.

Stanek, E

From: Raecker, Jeffrey [LEGIS]
Sent: Monday, March 28, 2005 3:55 PM
To: Stanek, E
Cc: Gipp, Charles [LEGIS]; Neubauer, Mary; Hrdlicka, Joe
Subject: RE: HSB 288

I know that Mary and Joe had the opportunity to visit with Rep. Gipp today and I have also visited with him.

I have cancelled the sub-committee meeting scheduled this week for HSB 288. It is not an option to withdraw the bill after it has been filed.

At this time the direction is that the bill will not run, allowing the Lottery Authority to continue through the rulemaking process on the advertising issue as you indicated, as well as the opportunity for your board to take action regarding promulgating rules related to the number of machines as indicated in your message. In addition, I welcome the opportunity to have you demonstrate the game applicability of the MVM as related to existing lottery ticket options.

Have a good day.

Thomas J. Vilsack
Governor
Sally J. Pederson
Lt. Governor



Edward J. Stanek, Ph.D
President and CEO

Iowa Lottery Report On Operations, Summer 2005

To: Members of the House Government Oversight Committee and Senate Government Oversight Committee

From: Dr. Ed Stanek, President and CEO

Date: August 2005

The Iowa Lottery Authority achieved record sales in its latest fiscal year and raised nearly \$51 million for state programs.

Preliminary figures show that lottery sales totaled \$210.7 million in fiscal year 2005, which ended June 30. That was up about 1 percent from FY 2004 sales of \$208.5 million and marked the highest sales total for the lottery in its 20-year history.

The unaudited figures show the lottery raised \$50.9 million in revenues for state programs during FY 2005, a decrease of about 8 percent from the previous year. Two main factors affected the lottery's 2005 profits: the cost of equipping Casey's General Stores locations in Iowa to sell lottery products; and a decrease in Powerball® sales.

The lottery was pleased to welcome Casey's 350 Iowa convenience stores to its retailer base in fiscal year 2005, but the addition meant an expenditure of about \$2 million by the lottery for satellite communications equipment, ticket-dispensing equipment and point-of-sale material for those locations. All of that cost fell into one fiscal year, but the long-term benefits to the state will more than offset that.

The lottery began installing equipment in Casey's stores in mid-September 2004 and completed installations in late January 2005.

Iowa Powerball sales in FY 2005 were down more than 17 percent compared to the previous year. And, although sales of other lottery products more than made up the difference, those other products had a lower profit margin. Changes announced in Powerball that will take effect in August are projected to positively impact the game.

FY 2005 also saw the Iowa Lottery become the first in the world to begin selling an electronic version of the instant-scratch game. The new product, known as the electronic game card, is battery powered and loaded with dozens of plays on each card. The first

game card, called "Quarter Play," sold strongly in a market test that began in October 2004, and the lottery went forward with statewide sales in May 2005.

Sales of instant-scratch tickets, the lottery's traditional sales leader, again led the way in FY 2005, with sales in the category increasing by more than 8 percent to \$103.3 million. Sales in Hot Lotto made the biggest increase among the lottery's traditional products, jumping nearly 23 percent to more than \$2 million. Hot Lotto is a multi-state game that is played like Powerball, but with easier odds and jackpots starting at \$1 million.

Throughout FY '05, the lottery also continued its partnership with small businesses around the state in the deployment of monitor vending machines, which add video and sound to the process of dispensing a ticket. Net sales from the machines, which are marketed under the brand name TouchPlay, totaled about \$6.4 million for the year.

Turning 20

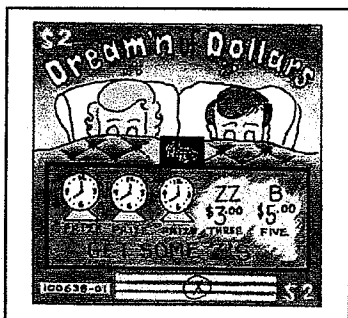


The Iowa Lottery is marking its 20th birthday with games and promotions designed to thank players for two decades of support. Legislation creating the Iowa Lottery was signed into law on April 18, 1985, and lottery sales in Iowa began on Aug. 22, 1985.

Some "landmark" figures for Iowa's lottery through the end of FY 2005:

- Lottery sales in the state have totaled nearly \$3.5 billion.
- The lottery has raised nearly \$935 million for state programs.
- Iowa Lottery players have won nearly \$1.9 billion in prizes.
- Lottery tickets are sold at more than 3,800 retail locations in Iowa.

The lottery's 20th birthday initiatives include:



- A "design-a-game" contest. Some of the most inventive ideas for lottery games have come from players themselves and the lottery's latest contest reinforced that concept. Alice Hayes of Webster City won the contest's top prize of \$3,000 with a ticket design she entitled "Dream'n of Dollars." The ticket art she drew showed a couple tucked in bed with just the tops of their heads peeking out from under the covers. Above them are scenes from their happy dreams of big winnings. Hayes' entry was among more than 1,900 that the Iowa Lottery received in its "Design A Game From Scratch" contest from



May 2-27. Iowans were invited to submit their original ideas for instant-scratch games for the chance to win cash prizes. The lottery has held a few design-a-game contests during its 20-year history and several contestants' ideas have gone on to become popular games.

□ The "Thanks A Million" instant-scratch game and promotion. Sales of the \$10 instant-scratch game began July 18 and drawings in the promotion continue through late January. Players who don't win a cash prize on their ticket can mail it in for drawings that are held every two weeks. The first drawing on Aug. 4 was for \$500 and prize amounts in the drawings go up to \$1 million, which will be given away Jan. 26.

Powerball Changes – And What About Those Fortune Cookies?

Earlier in this report, we referenced changes upcoming in the Powerball game. The changes are designed to meet player expectations for larger, faster growing jackpots and accommodate population changes in the Powerball group. Powerball sales began in April 1992, with 15 states, including Iowa, participating in the game. Today, Powerball is sold by 29 lotteries, including three that joined the game in 2004 and pushed its combined population to about 92 million.

Beginning Aug. 28, the guaranteed starting jackpot in Powerball will increase from \$10 million to \$15 million. Another change will double the prize for those players who match the first five numbers but miss the Powerball. They'll win \$200,000 instead of the current \$100,000. Two white balls will be added to the first pool of numbers in Powerball drawings, meaning players will choose five numbers from 55. Players will continue to select the Powerball from a pool of 42.

Powerball's annuity option will be changed so that players receive an annual payment that increases each year (the jackpot currently is paid out in 30 equal installments over 29 years). Players also can continue to choose to receive the jackpot as a lump-sum cash payment, but the option to receive ever-growing payments is in response to players who have voiced concerns about the effects of inflation on their annuity.

Powerball plays will still cost \$1 and drawings will continue to be held at 9:59 p.m. on Wednesdays and Saturdays. The overall chance of winning a prize in Powerball will change only slightly, from about 1 in 36 to 1 in 36.6. The odds of winning the jackpot will change from about 1:120.5 million to 1:146.1 million.

Fortune Cookies

Two recent Powerball drawings highlighted the unusual events that can occur in the world of random statistics. In the March 30 drawing, a Powerball player in Tennessee won the \$25.5 million jackpot, but the unusual part of the story came at the game's second-prize level: Lottery officials had expected just four or five players to match the first five numbers to win either \$100,000 or \$500,000. The results that night, however, revealed that 110 players around the country won the "Match 5" prize. All of those players, including three

who bought their tickets in Iowa, chose their Powerball numbers from the “lucky numbers” they had gotten in fortune cookies.

The fortune cookies were produced by Wonton Food Inc. of Long Island City, N.Y., which makes about 4 million cookies each day. The company started printing lottery numbers for entertainment on fortunes 10 years ago, with employees choosing numbers from those mixed in a big bowl. The lucky numbers on the Powerball players’ fortunes came close to winning it all, with the numbers 22-28-32-33-39 being drawn as the first five numbers that night. Only the sixth number on the fortunes was wrong: The Powerball on March 30 was 42; the fortunes picked it as 40.

Eighty-nine Powerball tickets won a \$100,000 prize in that drawing by matching the first five numbers. Three of the \$100,000 winners were Iowa Lottery players. Another 21 tickets won a \$500,000 prize each by matching the first five numbers and the Power Play® number. Players purchase the Power Play option for another \$1 per play for a chance to increase prizes (except the jackpot) up to five times.

Security standards of the West Des Moines-based Multi-State Lottery Association, which administers the Powerball game, require an emergency reserve fund to handle such drawing anomalies that can – and do – happen despite extensive modeling to predict prize payouts based on sales in the game. Without the emergency fund, Powerball member lotteries would have faced an assessment to cover the \$19.4 million unanticipated payout on March 30.

On June 18, the fortune cookie phenomenon in Powerball happened again. Statistical modeling predicted five Match 5 winners in the drawing, but there were 86 (72 of \$100,000 and 14 of \$500,000). Many of the winners again stated that they had chosen their Powerball numbers from those they received in fortune cookies.

New Lottery Headquarters – And A Fire There



Iowa Lottery headquarters building at 2323 Grand Ave. in Des Moines.

On Aug. 4, the Iowa Lottery moved to its permanent headquarters building on Grand Avenue in Des Moines, culminating a purchase project that had started more than a year earlier.

In September 2004, the lottery notified members of the Oversight Committees about its plans to issue revenue bonds to pay for a headquarters location in Des Moines and vending machines for its instant-scratch and pull-tab tickets. Both purchases are designed to achieve long-term savings to the state.

The revenue bonds to pay for the projects were issued in October 2004. From November 2004 through April 2005, the lottery installed 1,020 new pull-tab vending machines and

300 new instant-scratch ticket vending machines in retail locations around the state.

On Dec. 30, 2004, the lottery closed on the purchase of its headquarters building at 2323 Grand Ave. in Des Moines. The building, across the street from Iowa's governor's mansion, had been home to Farmers Mutual Hail Insurance Co., which built a new headquarters location in West Des Moines.

The 2003 legislation that created the Iowa Lottery Authority included language authorizing the Authority to "enter into contracts to incur debt in its own name and enter into financing agreements with the state, agencies or instrumentalities of the state, or with any commercial bank or credit provider." Written notice to the Legislative Oversight Committee and approval from the Executive Council is required for the lottery to borrow more than \$1 million.

In investigating options available to the lottery, lottery executives found that the Authority could obtain federally tax-exempt financing as an instrumentality of the state. With the assistance of the State Treasurer's office, lottery executives prepared the necessary paperwork and received approval from the state Executive Council to borrow up to \$10 million to buy the headquarters building and vending machines.

The Lottery purchased the vending machines from Pollard Banknote, based in Winnipeg, Canada. The machines were manufactured in Council Bluffs by Pollard's subsidiary, American Games Inc., which also provides maintenance for them. Financial projections show that by purchasing the machines instead of using traditional six-year leasing arrangements, the lottery should save about \$1.7 million in that time. The lottery could extend the machines' use even beyond that, resulting in further savings to the state.

Purchasing the building at 2323 Grand Ave. also is projected to produce savings for the Lottery. Rent on the Lottery's past headquarters at 2015 Grand Ave. totaled \$348,000 per year, with no accumulation of equity. The lottery's annual payment on the bonds issued to buy 2323 Grand Ave. will total \$200,345 and the lottery will build up equity during the 15-year amortization period for the bonds.

Fire At Headquarters

An electrical fire Aug. 23 shut down the lottery's new headquarters for about 24 hours. No one was injured in the incident, but employees had to evacuate the building for the day. Lottery sales and drawings were not affected by the fire.

Lottery workers in the basement of the building reported hearing several loud pops about 8:50 a.m. Aug. 23 and saw white flashes of light from an equipment room. Smoke then began filling the building. Investigators indicated that the fire was started by electrical equipment.

Repair crews restored electrical service to the lottery building the next morning, allowing employees to return to the workplace. Clean-up crews that specialize in fire-damage cleaning also were called in.

During the period that the lottery's headquarters was closed, players could purchase tickets and claim prizes at retail outlets, however, they could not validate tickets or claim prizes at any Iowa Lottery office. Those functions resumed Aug. 24.

Under Iowa law, funds of the state cannot be spent to pay lottery expenses so the Iowa Lottery, unlike state agencies, has insurance. The Lottery is working with its insurance company to determine total damage and losses from the fire.

Monitor Vending Machines
(marketed under the brand name TouchPlay)



As we noted earlier in this report, the lottery has continued its partnership with small businesses around the state in the deployment of monitor vending machines, which add video and sound to the process of dispensing a ticket. Net sales from the machines, which are marketed under the brand name TouchPlay, totaled about \$6.4 million for FY 2005. Eighty-three small businesses have passed financial and criminal history background checks to be licensed by the lottery as retailer-operators that can place TouchPlay machines in the state, and four companies have been certified by the lottery to manufacture TouchPlay machines. Those private companies have invested at least \$45 million to date in manufacturing, purchasing and installing TouchPlay machines.

In late May, the Iowa Lottery imposed a moratorium on new applications for manufacturer certifications and retailer-operator licenses. Lottery executives monitoring the development of the TouchPlay project determined that numbers on both the manufacturer and retailer-operator front were sufficient to serve the public convenience. While the lottery will continue to monitor the situation, both moratoriums will continue indefinitely.

Lottery personnel are inspecting each business where TouchPlay machines are being installed and operated to ensure compliance with state rules and regulations regarding the sale of lottery tickets. All TouchPlay premises locations are inspected before equipment is installed and lottery personnel will continue the inspections on a recurring basis.

The lottery also is requiring that the retailer-operators installing TouchPlay machines around the state undergo training regarding the rules and regulations involved in the machines' operation. In mid-July, the lottery led five training sessions around the state that were attended by TouchPlay retailer-operators and dozens of their employees. Retailer-operators will not be able to install machines until they have completed the lottery's TouchPlay training session and the lottery will continue to conduct the training on an annual basis.

Statewide deployment of TouchPlay machines began in April 2004. All parties involved in the TouchPlay project receive a share of the net revenue from machines (net = sales –

prizes). The Lottery's share of the net is the same from retailer to retailer and is established on a calendar-year basis. For the current calendar year, the Lottery receives 24 percent of the net revenue from TouchPlay and that figure will increase to 34 percent by calendar year 2009. The rest of the net revenue from each machine is split by the machine manufacturer, the retailer who purchases the machine and the business location where the machine is installed. The Lottery does not establish payment levels for those three parties, and instead, leaves that determination open to negotiation among them.

The price of TouchPlay tickets varies from game to game, just as prices vary for the Lottery's other products (instant-scratch games, pull-tab games and lotto games). For example, tickets in some pull-tab games cost \$1 each while tickets in other games may cost 25 cents or 50 cents each. The price of the game is the same from retailer to retailer, but different games have different price points. The same is true for the Lottery's instant-scratch, lotto and TouchPlay games. All TouchPlay retailers charge the same price per ticket in a particular game, but different games have different price points.

Here is a day-to-day working picture of how the Lottery accounts for revenues in the TouchPlay program: All Lottery TouchPlay machines report via telephone line to a central system so that money going into the machines and prizes being paid from TouchPlay tickets can clearly be tracked. Information about sales and prizes is collected at each machine manufacturer's central system and then compiled in the Lottery's accounting system, where an invoice is prepared for each retailer. That invoice details TouchPlay sales by location and breaks out the Lottery's share of net revenue from each machine as well as the manufacturer's share of the net. Through electronic funds transfer, the Lottery collects money each week from retailers' bank accounts. The Lottery collects both its share of the net and the manufacturer's share of the net, then forwards the manufacturer's share to that particular company. TouchPlay revenues become part of the total Lottery transfer made each quarter to the state.

The TouchPlay project has addressed several key areas of concern with state leaders:

1. The machines do not pay out cash. Players receive tickets that can be redeemed for Lottery prizes at the businesses where they play or at Lottery regional offices.
2. The machines do not utilize an internal randomizer when producing a play. All plays come from a predetermined pool of plays, just like the Lottery's instant-scratch games and pull-tab games.
3. Like all other Lottery products, the machines must be located in age-controlled environments (premises where the age of patrons is monitored by the employees of the establishment). And, players must be 21 to use TouchPlay machines.

Businesses that offer an age-controlled environment may have two TouchPlay machines, with four machines allowed in fraternal organizations or those businesses that provide an age-restricted environment, meaning an area where those under 21 years of age cannot enter. The Lottery has included the per-location machine limits in its business plan for the TouchPlay project, but is currently drafting changes to its administrative rules to include the per-location restrictions. That proposed rules change will soon be filed with the Administrative Rules Review Committee.



Electronic Game Card Update

In May, the Iowa Lottery began statewide sales of the world's first electronic version of the instant-scratch game. The lottery was the first to bring the new product, known as the electronic game card, to market. The first game card is "Quarter Play," which aptly describes it – with 80 plays on a card sold for \$20, each play costs 25 cents.

Players and retailers greeted the new product enthusiastically and sales have remained strong. The lottery has scheduled two more game cards for release in late 2005 and early 2006.

Each game card, about the size of a driver's license, is battery powered and loaded with dozens of random plays. Players activate the cards by pulling off a plastic tab on the back. Pushing a "play" button on the front of each card activates one of the plays on the card – essentially the same as an individual scratch ticket. But in the case of the game card, an electronic play replaces the traditional scratch play of a paper ticket. Three small screens on the front of the card display the numbers in a particular play and show whether it has won a prize. Players accumulate points, each having a value of 25 cents, by matching three like numbers as they advance through the 80 plays.

At the conclusion of all the plays, the game card displays the total points accumulated. Players redeem the cards as they do any other lottery product – by having their ticket validated at an Iowa Lottery retailer or one of the lottery's regional offices.

Lotto Game Patent

In May, the U.S. Patent Office issued a new patent to Ed Stanek in conjunction with the Iowa Lottery and the Multi-State Lottery Association for a new lotto game design. Stanek is noted as the inventor of the game, but any royalties or other financial benefits derived from it would become the property of the Iowa Lottery and MUSL.

The new game design involves the concept of a "super pool" of money that could be split among more than one prize level. The game could be played by lottery players in different countries who use different currencies and could be playing for a top prize that varies from country to country.

The game would work this way: When ticket sales closed for a particular drawing, all lotteries would report their sales to a central entity and the different currencies involved would be converted into one reference currency. After the drawing, each lottery in the game would be notified if there had been a jackpot winner (called the Super Pool winner). If there was no jackpot winner, the amount of money in the Super Pool would increase, but each lottery in the game would be able to set a jackpot "ceiling," or maximum amount, for its players.

There could be more than one jackpot winner in the game, as there can be in Powerball today. The jurisdictions without a jackpot winner would pay prizes at each prize level as normal. However, a different approach would be used by the lotteries with a jackpot winner. In those areas, each jackpot winner would be paid in local currency up to the amount of the jackpot “ceiling” established in that jurisdiction. Any money above that amount would “spill down” to lower prize levels in the game, creating the possibility of many large-prize winners.

The game design would create a new lottery dynamic. In today’s lotto games, players buy tickets in hope of winning the jackpot and if they aren’t the jackpot winner, they don’t really care who is. But in the newly patented game, players who don’t win the jackpot still would be rooting for a jackpot winner from their jurisdiction so they could share in the larger prizes created by the “spill down” effect.

Currency fluctuations between countries would be addressed in the game in a number of ways, including a requirement that each lottery deposit in the Super Pool a uniform amount in a single currency for each chance sold.

Promoting Iowa

Fiscal Year 2005 found the Lottery continuing the important work of highlighting the state’s success stories. Examples of projects include:



Reelin' In The Cash. On April 18, the Iowa Lottery released a \$1 fishing-themed instant-scratch game called “Reelin’ in the Cash.” Players who didn’t win a cash prize could use their non-winning tickets to buy a fishing license at a discounted price through the Iowa Department of Natural Resources (DNR) Web site.

During the “Reelin’ in the Cash” promotion period from April 20-May 31, the number of annual fishing licenses sold through the DNR Web site increased more than five fold. And, after just seven weeks of sales, the scratch game was nearly sold out at lottery retail locations, translating into success for both state partners.

The focus on fishing began in August 2004, when statistics revealed a drop in Iowa fishing license sales and a resulting budget shortfall at the DNR. Sales of resident fishing licenses had fallen nearly 9 percent since 2000, resulting in a budget cut to the DNR’s fisheries, wildlife and conservation law enforcement bureaus in fiscal year 2004. Staffers at the Iowa Lottery, which has supported other state agencies through past games and promotions,

began brainstorming with the DNR about ways the two could work together to remind people about fishing opportunities in the state.

Reelin' in the Cash tickets went on sale April 18, featuring playful artwork of a fisherman who had caught a brightly colored fish with a mouthful of cash. Lottery players tried to find three like amounts or a fish symbol to win prizes of up to \$900. A printed message near the play area on each ticket reminded lottery players: "Buy your fishing license online now at www.iowadnr.com!"

That message was backed up with a value-added promotion through the DNR's Web site. Players with nonwinning tickets could visit the site and use the serial number on the back of their ticket to buy a 2005 annual Iowa fishing license at a special discounted price.

The promotion ran from April 20-May 31, providing a \$3.49 discount on each license purchased. The discount was sponsored by the Iowa Lottery and through the waiving of an online convenience fee of \$2.49 by Central Bank, which processes the license fees for the DNR. During the promotion period, the DNR sold 1,626 annual resident and nonresident fishing licenses through its Web site. That compares to just 284 during the same period of 2004.

On-Going Issues

WTO Decision: Iowa Lottery executives continue to closely monitor a decision by the World Trade Organization (WTO) that could affect all gambling in the United States. A WTO arbiter on Aug. 19 gave the United States until April 3, 2006, to comply with a decision that a U.S. ban on Internet gambling from the small Caribbean nation of Antigua & Barbuda violates WTO rules.

At issue is a complaint filed by Antigua & Barbuda over U.S. restrictions on Internet gambling. The small island nation has invested heavily in the electronic gambling industry to improve its economy and job opportunities, but the U.S. ban has kept American banks and major Internet search engines from doing business with gambling interests there.

Antigua & Barbuda had based its arguments on the General Agreement on Trade in Services (GATS) that was signed in 1994. A WTO dispute panel and appeals body both have found for the island nation. Under GATS, the United States agreed that it would not enact any laws or take any action that would be counter to open trade among nations signing the agreement. The United States agreed that entertainment and recreational services would be covered in GATS, but later argued that it did not mean for gambling to be included in that category.

Antigua & Barbuda argued that because the United States allows casinos, lotteries and other forms of betting, it has no basis to claim that gambling shouldn't be included in GATS.

The U.S. Trade Representatives Office has said it will do its best to meet the WTO's deadline for complying with the rulings in favor of Antigua & Barbuda. However, the trade representatives office also does not plan to ask Congress to weaken U.S. restrictions on Internet gambling.

Does the WTO decision mean that foreign interests should have the right to set up intrastate lotteries in the United States and offer casinos services on Indian reservations? Will more Internet gambling be allowed in this country? Time will tell.

Fuel Prices: Iowa Lottery executives continue to closely monitor fuel prices to determine their effects on sales and profits.

Gasoline prices in Iowa have spiked into record territory. According to the latest fuel price survey from the Department of Natural Resources, on Aug. 15, the average price for a gallon of self-serve, regular gasoline blended with ethanol in Iowa was \$2.45 per gallon – 28 cents higher than a month earlier and nearly 40 percent higher than at the same time a year earlier. Home heating costs also are predicted to be 15 to 20 percent higher this coming winter than last year.

With fuel prices cutting into consumers' discretionary income, sales of lottery products and other convenience items likely will be impacted. And the lottery, like other businesses, will face higher delivery costs and see other budget impacts from the higher fuel costs. But while some businesses can adjust the price of their products to pass along higher costs to consumers, that is not a possibility for lotteries, which sell products for firmly established prices such as 25 cents or \$1. An increase in the price of a lottery ticket from \$1 to \$1.05 would be shunned by consumers and have an extremely detrimental effect on sales.

Gambling Decisions: With the Racing and Gaming Commission's decision in May to allow four new casinos in Iowa, more competition will be created for consumers' discretionary income, meaning more competition for the Iowa Lottery and other businesses in the entertainment industry. The lottery will continue to monitor the expansion of gambling in Iowa and what impact that expansion could have on lottery income to the state.

Viruses and Spam: The popularity of lottery games also makes lotteries highly visible to those who try to infect e-mail systems with viruses, overload them with spam, or gain unauthorized access. Protecting the Iowa Lottery's e-mail system against such attacks requires ongoing resources and attention.

In one 30-day period this spring, the Iowa Lottery intercepted 936 e-mail messages that were infected with viruses and another 250 messages from spam-related sources. The lottery's firewall systems also showed 7 attempts – all unsuccessful – to access the lottery's network from outside the firewall.

The West Des Moines-based Multi-State Lottery Association, which oversees the Powerball game, also routinely sees incoming virus and spam attempts. Powerball players can e-mail MUSL staffers through a link on www.powerball.com. In one recent month, the MUSL system recorded 572,826 spam attempts and 14,023 virus attempts.

Thomas J. Vilsack
Governor
Sally J. Pederson
Lt. Governor



Edward J. Stanek, Ph.D
President and CEO

Iowa Lottery Report On Operations

To: Members of the House Government Oversight Committee and Senate Government Oversight Committee

From: Dr. Ed Stanek, President and CEO

Date: December 2005

After achieving record sales in its latest fiscal year, the Iowa Lottery is quickly closing in on another big number: \$1 billion in revenues raised for the state programs that benefit all Iowans.

Through the end of November, the lottery had raised \$965.3 million in revenues since its start in 1985. With several more months to go in fiscal year 2006, the lottery could end its 20th anniversary celebration by topping the \$1 billion mark in profits to the state.

Legislation creating the Iowa Lottery was signed into law on April 18, 1985, and lottery sales in Iowa began on Aug. 22, 1985.

Lottery revenues in Iowa have been dedicated to different causes through the years. When the lottery started in 1985, lottery proceeds were dedicated to economic development through a fund called the IOWA Plan. In 1991, lottery profits to the state were dedicated to natural resources programs. After one year, the Legislature was having difficulty balancing the state budget and directed lottery revenues into the state general fund. Most lottery revenues have continued to go into the general fund since that time, although 0.5 percent of gross lottery sales are dedicated to the Iowa Gambling Treatment Program.

Some other "landmark" figures for Iowa's lottery through the end of November 2005:

- Lottery sales in the state have totaled nearly \$3.6 billion.
- Iowa Lottery players have won more than \$1.9 billion in prizes.
- Lottery tickets are sold at more than 3,800 retail locations in Iowa.

Celebrating No. 20 A Million Times Over!

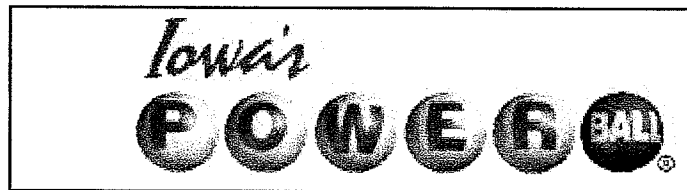
One of the games the Iowa Lottery introduced to thank its players for two decades of support will bring a big prize drawing in January!



Sales of the \$10 "Thanks A Million" instant-scratch game began July 18 and drawings in the promotion being run in conjunction with the game will culminate with a \$1 million drawing in late January.

Players who didn't win a cash prize on their Thanks A Million ticket could mail it in for drawings that began Aug. 4. Just one drawing is left, and it's for the \$1 million prize on Jan. 26! Winners in the drawings so far were:

- Margaret Venteicher of Corning won \$500 in the drawing on Aug. 4.
- Ken Keene of Stanhope won \$500 in the drawing on Aug. 18.
- Margaret Stripling of Lu Verne won \$1,000 in the drawing on Sept. 1.
- Edwin Hobbs of Bedford won \$1,000 in the drawing on Sept. 15.
- Virginia Miller of Shenandoah won \$2,500 in the drawing on Sept. 29.
- Helga McMicken of Carroll won \$2,500 in the drawing on Oct. 13.
- Robert Winn of Rock Island, Ill., won \$5,000 in the drawing on Oct. 27.
- Jay O'Brien of Atlantic won \$5,000 in the drawing on Nov. 10.
- Raymond Rose of Ottumwa won \$10,000 in the drawing on Dec. 1.
- Rick Johnson of Estherville won \$20,000 in the drawing on Dec. 22.



Powerball Changes – And Iowa's Biggest Lottery Prize

In August, changes took effect in the Powerball game that were designed to meet player expectations for larger, faster growing jackpots and accommodate population changes in the Powerball group. Those changes helped create the largest jackpot in the history of the game – a \$340 million prize that was won by an Oregon family in the drawing on Oct. 19. And, the Iowa Lottery saw its biggest prize winner to date when a Powerball player who bought a ticket in Des Moines won a \$113.2 million prize in the drawing on Dec. 14.

Powerball sales began in April 1992, with 15 states, including Iowa, participating in the game. Today, Powerball is sold by 29 lotteries, including three that joined the game in 2004 and pushed its combined population to about 92 million. And, two additional states – Oklahoma and North Carolina – have both joined the game but have not yet begun to sell tickets. Oklahoma will begin selling Powerball tickets in January and North Carolina should follow suit later in the year.

On Aug. 28, the guaranteed starting jackpot in Powerball increased from \$10 million to \$15 million. Another change doubled the prize for those players who match the first five numbers but miss the Powerball. They win \$200,000 instead of the previous \$100,000 prize.

Two white balls were added to the first pool of numbers in Powerball drawings, meaning players choose five numbers from 55. Players continue to select the Powerball from a pool of 42.

Powerball's annuity option also was changed so that players receive an annual payment that increases each year (the jackpot used to be paid out in 30 equal installments over 29 years). Players also can continue to choose to receive the jackpot as a lump-sum cash payment, but the option to receive payments that increase over time is in response to players who have voiced concerns about the effects of inflation on their annuity.

Powerball plays still cost \$1 and drawings are held at 9:59 p.m. on Wednesdays and Saturdays. The overall chance of winning a prize in Powerball has changed only slightly, from about 1 in 36 to 1 in 36.6. The odds of winning the jackpot changed from about 1:120.5 million to 1:146.1 million.

Still Waiting To Meet Iowa's Biggest Lottery Prize Winner

As the end of calendar year 2005 neared, the lottery – and the rest of the state – was still waiting to learn who had won Iowa's biggest lottery prize to date.

An Iowa Lottery player who bought a ticket at a Des Moines supermarket won the \$113.2 million jackpot in the Powerball drawing on Dec. 14. The jackpot-winning ticket was sold at Dahl's, 1819 Beaver Ave. in Des Moines.

The winning numbers in the drawing were: 8-15-16-45-51 and Powerball 11. The jackpot-winning ticket matched all six numbers drawn. Winning tickets in the Powerball game expire one year after the date of the drawing. Dahl's received a \$10,000 bonus from the Iowa Lottery for selling the jackpot-winning ticket in Powerball.

The jackpot-winning ticket was the 87th purchased in Iowa to win a prize of \$1 million or more.

Powerball jackpot prizes won in Iowa must be claimed at the lottery's headquarters at 2323 Grand Ave. in Des Moines. Iowa Lottery players now have won five Powerball jackpots. The four previous winners are:

- Ed Brown of Washington, who split a \$10.4 million jackpot with a Missouri woman in December 1992.
- Tim Schultz of Des Moines, who won a \$28 million jackpot in February 1999.
- The Larry Hasken family of Sabula, who claimed a \$31.8 million jackpot in January 2000.
- Jacquelyn Moore of Omaha, Neb., who won a \$14.4 million jackpot in October 2004 (she bought her ticket at a convenience store in Carter Lake in western Iowa).

Self-Exclusion Policy

In early December, the Iowa Lottery Board voted to establish a player "self-ban" policy designed to address issues related to problem gambling.

At its meeting Dec. 6, the board voted to create a policy that will allow players to sign contracts stating that they are problem gamblers and wish to enter into voluntary self-exclusion agreements with the lottery. The agreements would ban those players from the lottery's five regional offices in the state and allow the lottery to deny payment of any prize at a lottery office to those players.

Board members said they believe the policy will act as a deterrent and take away the incentive to gamble from those who sign self-ban agreements with the lottery. The lottery has been considering such a ban for some months, and the lottery's record sales of more than \$210 million in fiscal year 2005 became the impetus for moving ahead with the plan.

The lottery has not been a big contributor to problem gambling in Iowa - just 4 percent of those admitted to treatment through the state Gambling Treatment Program cite lottery games as their primary form of wagering. However, Lottery Board members stated that adopting the self-ban policy was a proactive, responsible step they wanted to take. The Iowa Lottery is believed to be the first in the country to have such a policy.

Under the policy, a lottery player who wished to enter into a lifetime self-ban agreement with the lottery will sign a contract provided by the lottery and have it notarized, then turn it in to the lottery. In the contract, players will acknowledge that they are problem gamblers, and that their ability to claim lottery prizes is an unwelcome incentive for them to play. The players will acknowledge that they want to reduce the incentive to play lottery games by entering into a voluntary self-exclusion agreement restricting them from claiming prizes at lottery offices.

The lottery will honor the players' requests by developing a computer database containing the names and Social Security numbers of those who have signed the contracts. The lottery will check information against the database whenever someone tries to claim a prize at an Iowa Lottery office. Those players on the list will be denied prize payment.

The lottery also will remove from any mailing or promotional lists the names of those players who entered into self-ban contracts.

Because lottery products are sold at about 3,800 business locations in Iowa, enforcement of such a ban at the retail level is not feasible. However, the policy will act as a deterrent by denying large lottery prizes to players signing the contracts, because all prizes of more than \$600 must be claimed at a lottery office.

The lottery has regional offices in Council Bluffs, Storm Lake, Mason City, Des Moines and Cedar Rapids.

The voting members of the Iowa Lottery Board are: Chairperson Elaine Baxter, a former secretary of state from Burlington; Vice Chairman Tim Clausen, a Sioux City attorney; Mary Junge, an accountant and lawyer from Cedar Rapids; Mike McCoy, an insurance executive from West Des Moines; and Bill Brosnahan of Dubuque, a retired DCI agent. State Treasurer Michael Fitzgerald is an ex-officio member of the Board.

The lottery is finalizing the procedures it will need to implement the policy and anticipates making the program functional in early 2006. A copy of the lottery's self-ban contract is included as an appendix to this report.

Monitor Vending Machines
(marketed under the brand name TouchPlay)



Throughout 2005, the lottery continued to develop its partnership with small businesses around the state in the deployment of monitor vending machines. Profits to the state from ticket sales from the machines, which are marketed under the brand name TouchPlay, are estimated at \$30 million for fiscal year 2006 and \$45 million for FY 2007.

Eighty-three small businesses have passed financial and criminal history background checks to be licensed by the lottery as retailer-operators that can place TouchPlay machines in the state, and four companies have been certified by the lottery to manufacture TouchPlay machines. Those private companies have invested more than \$60 million to date in manufacturing, purchasing and installing TouchPlay machines. About 4,500 TouchPlay machines had been installed in about 2,500 business locations in Iowa as of late December, making a difference in the bottom lines of local restaurants, bars, convenience stores and other retail locations that sell Iowa Lottery products.

The lottery has continued to monitor the development of the TouchPlay project and has enacted a number of restrictions on the placement and operation of machines.

In late May, the Iowa Lottery imposed a moratorium on new applications for manufacturer certifications and retailer-operator licenses. Lottery executives determined that numbers on both the manufacturer and retailer-operator front were sufficient to serve the public convenience. While the lottery will continue to monitor the situation, both moratoriums will continue indefinitely.

In November, the lottery imposed a moratorium on the trade types of businesses eligible to become TouchPlay retailers. The moratorium is designed to limit TouchPlay placements only to those types of businesses that have regularly sold lottery tickets and other age-sensitive products. Those business types are: convenience stores, gas stations, truck stops, grocery stores, drug stores, liquor stores, bars, restaurants serving alcohol, bowling alleys and fraternal organizations. The Lottery will continue to monitor the situation, but the moratorium on trade types eligible to become TouchPlay retailers will continue indefinitely.

The Lottery also has proposed administrative rules to address the limitation on TouchPlay machine numbers that it has had in place as part of the TouchPlay business plan since the program's inception.

The proposal would put in place administrative rules limiting the number of TouchPlay machines in businesses that provide an age-controlled environment to two, with the exception of fraternal or charitable social clubs, which may place up to four machines. Businesses that provide an age-restricted environment – meaning an area where those younger than 21 are not allowed – also may have four machines. No location can have more than four machines.

Lottery personnel are inspecting each business where TouchPlay machines are being installed and operated to ensure compliance with state rules and regulations regarding the sale of lottery tickets. All TouchPlay premises locations are inspected before equipment is installed and lottery personnel will continue the inspections on a recurring basis.

The lottery also is requiring that the retailer-operators installing TouchPlay machines around the state undergo training regarding the rules and regulations involved in the machines' operation. In July, the lottery led five training sessions around the state that were attended by TouchPlay retailer-operators and dozens of their employees. Retailer-operators will not be able to install machines until they have completed the lottery's TouchPlay training session and the lottery will continue to conduct the training on an annual basis.

The lottery videotaped one of the TouchPlay training classes and used that footage to produce a training video that it has supplied to all retailer-operators in the program for their ongoing staff use. A copy of the 25-minute video is enclosed in DVD format with this report.

Deployment of TouchPlay machines began in May 2003. All parties involved in the TouchPlay project receive a share of the net revenue from machines (net = sales – prizes). The Lottery's share of the net is the same from retailer to retailer and is established on a calendar-year basis. For the current calendar year, the Lottery receives 24 percent of the net revenue from TouchPlay and that figure will increase to 34 percent by calendar year 2009. The rest of the net revenue from each machine is split by the machine manufacturer, the retailer who purchases the machine and the business location where the machine is installed. The Lottery does not establish payment levels for those three parties, and instead, leaves that determination open to negotiation among them.

The price of TouchPlay tickets varies from game to game, just as prices vary for the Lottery's other products (instant-scratch games, pull-tab games and lotto games). For example, tickets in some pull-tab games cost \$1 each while tickets in other games may cost 25 cents or 50 cents each. The price of the game is the same from retailer to retailer, but different games have different price points. The same is true for the Lottery's instant-scratch, lotto and TouchPlay games. All TouchPlay retailers charge the same price per ticket in a particular game, but different games have different price points.

Here is a day-to-day working picture of how the Lottery accounts for revenues in the TouchPlay program: All Lottery TouchPlay machines report via telephone line to a central system so that money going into the machines and prizes won on TouchPlay tickets can clearly be tracked. Information about sales and prizes is collected at each machine manufacturer's central system and then compiled in the Lottery's accounting system, where an invoice is prepared for each retailer. That invoice details TouchPlay sales by location

and breaks out the Lottery's share of net revenue from each machine as well as the manufacturer's share of the net. Through electronic funds transfer, the Lottery collects money each week from retailers' bank accounts. The Lottery collects both its share of the net and the manufacturer's share of the net, then forwards the manufacturer's share to that particular company. TouchPlay revenues become part of the total Lottery transfer made each quarter to the state.

The TouchPlay project has addressed several key areas of concern with state leaders:

1. The machines do not pay out cash. Players receive tickets that can be redeemed for Lottery prizes at the businesses where they play or at Lottery regional offices.
2. The machines do not utilize an internal randomizer when producing a play. All plays come from a predetermined pool of plays, just like the Lottery's instant-scratch games and pull-tab games.
3. Like all other Lottery products, the machines must be located in age-controlled environments (premises where the age of patrons is monitored by the employees of the establishment). And, players must be 21 to use TouchPlay machines.

Lotto Game Patent

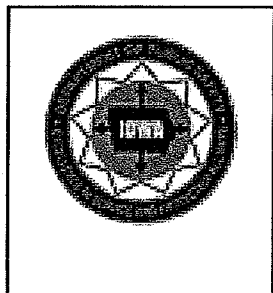
A European patent has been issued to Ed Stanek for a new lottery game.

The game, which is similar to Powerball, consists of two pools of numbers. The lottery operator picks a predetermined number of selections out of the first pool and each player of the lottery game also picks out the same predetermined number of selections out of the first pool.

The lottery operator picks two or more selections out of the second pool while each player is allowed to pick only one selection out of the second pool. The jackpot prize is won by matching all selections from the first pool and any of the lottery operator selections out of the second pool. By adjusting the number of selections in each pool, the prize structure of the game increases the amount of money awarded to the jackpot and lower-range prizes and decreases the amount paid to intermediate-range prizes.

Promoting Iowa Programs

Fiscal Year 2006 finds the Lottery continuing its important work of highlighting the state's success stories. Examples of projects include:



- Seat belt safety. During the months of December, May and August, the lottery will run messages on its tickets and customer display units to encourage people to buckle up. The messages will run during times of peak holiday travel, vacation season and just before the start of school. One of the first messages that the lottery printed on its lotto tickets to promote seat belt use was:
Winners wear seat belts.
Be a winner. Buckle up!



- Eliminating litter. During the months of March, April and July, the lottery will run messages on its tickets and customer display units to encourage Iowans to eliminate littering. The messages will run during the period leading up to Earth Day (April 22) and during peak vacation travel season. One of the messages that the lottery will print on its lotto tickets to support the program is:

Keep Iowa Beautiful
Prevent Littering.

On-Going Issues

Fuel Prices: Iowa Lottery executives continue to closely monitor fuel prices to determine their effects on sales and profits.

Gasoline prices in Iowa have spiked into record territory and home heating costs this winter also are predicted to be extremely high.

With fuel prices cutting into consumers' discretionary income, sales of lottery products and other convenience items likely will be impacted. And the lottery, like other businesses, will face higher delivery costs and see other budget impacts from the higher fuel costs. But while some businesses can adjust the price of their products to pass along higher costs to consumers, that is not a possibility for lotteries, which sell products for firmly established prices such as 25 cents or \$1. An increase in the price of a lottery ticket from \$1 to \$1.05 would be shunned by consumers and have an extremely detrimental effect on sales.

Gambling Decisions: With new casinos under construction in the state, more competition will be created for consumers' discretionary income, meaning more competition for the Iowa Lottery and other businesses in the entertainment industry. The lottery will continue to monitor the expansion of gambling in Iowa and what impact that expansion could have on lottery income to the state.