

MINUTES
ARKANSAS LOTTERY COMMISSION
Monday, March 27, 2012
1:30 p.m.
ALC Conference Room
Third Floor
124 West Capitol Avenue
Little Rock, Arkansas

Chairman Lamberth called the meeting to order. In attendance also were Commissioners Malone, Pickard, Campbell, Engstrom, Faris, Frazier, and Campbell and by telephone Hammons. The ASL was represented by Director Woosley, Internal Auditor Hyde, Julie Baldrige, Patti Vick, Jerry Fetzer, Robert Stebbins, Lisa Tater, Lance Huey, Valerie Basham, Jeremy Smith, Remmele Mazyck, and Justin Rogers.

Chairman Lamberth requested approval of the minutes of the March 19 meeting, and after motion of Commissioner Frazier, seconded by Commissioner Campbell, the minutes were approved without dissent.

Chairman Lamberth tabled discussion of the Outside Legal Counsel Guidelines (Item III) because there was insufficient time for discussion and because the revisions are not complete. She called attention to the February bill from the Mitchell firm and asked that Commissioner Pickard sign it to authorize payment. She noted that the bill was \$1500, the monthly minimum, the retainer amount.

She called on the Internal Auditor Michael Hyde to make a presentation on vendor offers. Commissioner Faris moved that for both presentations, the Commissioners agree to hold all questions until the end so that the flow of the presentation is not interrupted. With a second by Commissioner Campbell, the motion was approved without dissent. Mr. Hyde made his presentation (included in file). He said that his audit was in the preliminary stages and was an audit in progress. Questions and discussion followed. Commissioner Engstrom asked Mr. Hyde if it was true that when Director Passailaigue decided to resign, the Commissioner had asked Mr. Hyde to slow down on his work on this matter during the Director Search when there was an interim director, and Mr. Hyde said he continued to work on it some but it was dropped. Commissioner Engstrom asked Mr. Hyde whether, when Julie Baldrige was Interim Director, he had asked Mr. Hyde to hold off on the matter so as not to drop the matter into her lap while she was working on so many other issues, and Mr. Hyde affirmed that he had. They also agreed that Commissioner Engstrom had planned to bring the matter forward once there was a new permanent Director. He also said that during Executive Sessions in that time period he had mentioned that the issue was coming forward and that it would have to be addressed. He asked whether this audit was required, and Mr. Hyde said it was not required but that it was listed on the Audit Plan for this year. Commissioner Engstrom referred to Schedule 5 and said it appeared that through February 29, 2012, Scientific Games had received about \$7,500,000 more than they should have, a portion from scholarships and a portion from prize funds. Mr. Hyde agreed. Mr. Hyde asked Robert Stebbins to describe Tel-Sell, and Mr. Stebbins said it was a telemarketing operation to provide retailers a place to order ticket packs and to learn about other tickets that were newly available. Commissioner Engstrom asked him how many people worked in the operation and Mr. Stebbins said he was not certain. Commissioner Faris expressed concern about venturing into questioning staff present in the audience, and Chairman Lamberth agreed. Commissioner Campbell asked Mr. Hyde who he works for, and

he answered that he works for the Commissioners. The Commissioner then said he had not heard about any of these matters from him and asked if he had reported it to the Audit Committee or any other Commissioners. Mr. Hyde said he had had conversations with Mr. Pickard, the Audit Committee Chair, Commissioner Lamberth and he believed Commissioner Faris. Commissioners Lamberth and Faris said they had not been briefed in any detail. Commissioner Engstrom said he had offered the documents to all of the Commissioners in a sack one day during Executive Session, and she said she remembered him bringing the subject up but had no information in detail. Commissioner Faris said he would have thought the matter would have been vetted thoroughly in the Audit Committee. Commissioner Engstrom said he and Mr. Hyde had wanted to do that, but that was not possible because the new proposed vendor offers might have foreclosed the discussion and prevented any retribution or relief. Commissioner Faris asked Commissioner Pickard, chair of the Audit and Legal Committee, if he had been party to a discussion of bringing the matter to that Committee, and he said it was not discussed. Mr. Hyde said that he was proceeding mid-audit, and would have taken it to the Audit Committee once it was final. He said all he had presented was preliminary because the wheels went into motion the previous Monday ALC meeting. Commissioner Faris said that while he was interested in what Mr. Hyde had to say, he would have preferred to stay within the Committee system. He asked Commissioner Engstrom what he meant when he said the Commission was about to sign away some needed right. Commissioner Engstrom said that the agreement brought forth in the Monday, March 19 Commission meeting suggested alterations to the contract, and he thought if the contract would be discussed, the Commission should discuss everything about it; and he said that no action on any agreement with Scientific Games should be taken until the audit on the contract is completed. Commissioner Campbell asked Mr. Hyde if he had hand-written documents pertaining to this that he had destroyed. Mr. Hyde answered in the negative, and Commissioner Campbell said that would be against the law.

The Chair introduced Director Woosley for his report (in file). He began his presentation with a review of why the group was gathered. He said that on his first day as Director, Commissioner Engstrom had told him he was going to bring this matter back up. He said that he responded that bringing it back up was fine because this matter has been going on for 17 months, and that it is time for a resolution. He said the Lottery had now had three Directors under this issue, and this issue affects the Lottery's ability to plan games; and concerns Directors as they sign invoices. He added that the issue had caused a great deal of uncertainty for the staff and made it very difficult to operate. He said in an attempt to resolve the matter, after speaking with most or all Commissioners individually, he had spoken with Mr. Hyde and Mike Smith, and eventually decided it would be best to bring Scientific Games in. He said the Lottery staff initially involved [in negotiating the contract] were no longer here and that, since he couldn't ask them questions, he thought SGI could answer many questions. He said that, in order to be transparent, he had asked Commissioner Pickard to observe and that he had done so without participating in the meeting. He noted he had confirmed the SGI meeting at the March 19 ALC meeting, and wanted to state again that he is not advocating for a particular decision but only for a resolution by the Commission of a matter that has become disruptive to the agency and the staff. He said he had been working almost exclusively on this issue for his first four weeks as Director and that he takes it very seriously and wants to see it resolved properly. He stressed that he had not been privy to many of the factors surrounding the issue, to most conversations between Mr. Hyde and the former management team, or to some of the related documents. He noted that the issue is not new but that it has existed for 17 months and has been the subject of 13 or 14 public meetings of the Lottery Commission, the Legislative Oversight Committee, and the Legislative Joint Audit Committee. To capture this long history, he said, he had put together a timeline. He said in the back of his mind, looking at news articles and listening to various sources, the subject of litigation is out there. With this possibility, he said, the Commission

needs to have a thorough and comprehensive understanding of what would be considered in that setting: public documents such as minutes from meetings and other records of fact. He then began his presentation, going back to the documents produced in June 19, 2009, when the online and the instant ticket RFPs were drafted, and moving to present time. He reminded the Commissioners that at that time no one knew how many retailers there would be, how much the lottery would make, whether the state would be invited to join Powerball or allowed to sell Mega Millions, etc. He pointed out that from a vendor's standpoint and also the Commission's standpoint, this was a lot of guesswork. He said that looking back, some things we got wrong and some things we got right, but in the end the ALC has sold a lot of tickets and made a lot of money for scholarships. He then articulated the timeline and presented the documents to verify each point made in the timeline (included in file). At the end of Director Woosley's presentation, he said that the process was leading toward the Commission being asked to invalidate the SGI contract and pursue a multimillion dollar lawsuit based on a contract price of 1.15 and 2.3078 that was never approved, never reviewed, never in force, and never operated under by either party, and not one prize has been given or ticket sold under this price. He said that was the Commission's decision.

Commissioner Engstrom asked about the points system utilized by the panel which evaluated the RFP responses. He asked which company was ahead in points before the cost of the contract was evaluated, and Mr. Woosley said it was GTech. Commissioner Engstrom pointed to the 1.15% with Properties Plus and asked whether, had that option been chosen, that would include every SGI benefit the Lottery now had. Mr. Woosley disagreed and said Play It Again, Tel-Sell, website marketing, merchandise prize fulfillment, Second Chance Drawing administration, and Points for Prizes would not have been included. Mr. Woosley said whether we have a good deal is not the same as whether we have a valid contract. He said he believes we have a valid contract and that whether or not we have a good deal is a separate issue, not relevant to whether there is a valid contract. Commissioner Engstrom and Mr. Woosley discussed the amounts paid through Properties Plus and Mr. Woosley said the amounts were all paid out in prizes, and that he and Mr. Hyde disagreed on that point. Mr. Woosley said the overall prize structure was not reduced but that the distribution (percentages that went to players directly vs. the percentages that went to players through the Players Club) was different. Commissioner Engstrom said he wasn't talking about the contract, but about whether it was a good deal. Mr. Woosley said that was up to the Commission to decide. Commissioner Shipp said that was water under the bridge. Commissioner Lamberth said it's over. Mr. Woosley said if the percentages used had been 1.15% (instant tickets) and 2.3078% (prizes), sales may have been quite different, and so it would be speculation. He said you can't plug in past sales to prove actual damages.

Commissioner Engstrom said that was informative and then asked whether Mr. Woosley was familiar with Arkansas Code 23-115-503 and went on to say it was part of the Lottery legislation called Cancellation, Suspension, Revocation, or Termination of a Major Procurement Contract. He said among the reasons specified in that section for which a contract may be cancelled: "commission of any fraud, deceit, misrepresentation, conduct prejudicial to the public confidence in the lottery." Commissioner Engstrom said that any material change can be made upon approval from the Lottery Commission, and that this section counters Commissioner Shipp's statement that the Commission can't do anything about it, and that the Commission can if it chooses to do so. Commissioner Campbell said that he appreciated the clarity of the presentation and Mr. Woosley said that, if the Commission goes to court, they will be answering for the documents he presented. Commissioner Faris said the last point the Director made was very important. He pointed out that some who were here at the beginning are gone and some who are here now were not here then and said it was important to vet this out in the process.

and determine what the issues and liability might be. Addressing Mr. Hyde, he said it would have been better to have the items he presented in a more organized format, and had he had them in advance, it would have helped to better understand. He said it appeared we have a Director who is trying to mop up a mess he didn't make and a Commission that is trying to do its best to do what is right and provide scholarships in an above-board and transparent way. He said there had not been time to check and discuss the figures for validity. Commissioner Malone mentioned that Mr. Hyde had talked about the exclusivity clause during his presentation and said he recalled that the first Director had talked about the Commission's ability to obtain instant tickets elsewhere; and he said he didn't recall any further discussion about it when it changed. He asked Mr. Woosley whether he could shed light on how that happened. Mr. Woosley said it was included in the Recital of Selected Options, and in visiting with SGI recently, the discussion was that the revised pricings were based on previous management's agreement to exclusivity. Mr. Woosley said that he had asked for this provision to be changed, and although he said what was offered did not get to where he wanted to be, language has been offered that modifies those terms. Commissioner Malone noted that Mr. Hyde started working on his audit while previous management was still here and asked if he had talked to them about the percentages. Mr. Hyde said the only answers he had received was Tel-Sell. He said that prior to this recent investigation, the contract terms had not been part of any of his audits. He said that once that began, he factored in the impact on the players. He said he wanted to restate that at the end of the day whether 1.75 was what they agreed, the proposal also had the 1.15% and Properties Plus. He stated that Arkansas is a Properties Plus state and asked Mr. Woosley to agree. Mr. Woosley did not agree and said his argument was the same that raised in the FY 2010 legislative audit, which asserted that any changes were subject to Commission and LOC review. Mr. Hyde said he didn't know whether Legislative Audit is empowered to make those kinds of determinations. Mr. Hyde questioned why the Commission would choose the higher percentage and then add Properties Plus, and Mr. Woosley said that raised the question of whether it was a good deal. Commissioner Engstrom said Mr. Woosley's position was that whether "we got screwed or not, we're stuck with it?" Mr. Woosley said he believes it was a valid contract and that the Commission has the right to decide what is a valid contract. He pointed out that following Legislative Audit's FY2010 findings, the matter was discussed in several meetings, once for 46 minutes, and that he believes the Commission acquiesced at that time. Commissioner Faris moved that the Director should continue to work toward a positive resolution with Scientific Games that benefits the Lottery. Commissioner Hammons asked why this was necessary since this is one of the duties of the Director. Commissioner Faris said that he wanted to give the Director credit for the work and ask him to move forward and bring a resolution back to the appropriate Committee or the full Commission. Commissioner Hammons said that if the Lottery is losing money on a daily basis, why is it premature to bring this issue forward. He said if there is a correction to be made, then the Lottery is losing money.

At that time, Mr. Phillip Bauer, Counsel for SGI, came forward, asked to make a statement, and was recognized by the Chair. His prepared statement is included in the file.

Mr. Hyde said he wanted to emphasize that Legislative Audit's finding for FY2010 was that all contracts go to the Legislative Oversight Committee for approval. He said that is where the followup work was done and there were questions, for example, whether new licensing agreements were submitted and it was found that they were. Commissioner Engstrom asked whether \$5.5 Million came out of the pockets of the players. Mr. Hyde said he would have to get clarification on that. There was a second to Commissioner Faris' motion. The motion carried without dissent.

Commissioner Lamberth said that the Commission has been asked by SGI to affirm that it has a legal and binding contract with them. She said it had been shown by Director Woosley that ALC does have a legal and binding contract with SGI and said it has been affirmed several times. She called for discussion. Commissioner Hammons said the Commission didn't have enough information to make that decision today. Commissioner Faris said that the Director should have continuing dialogue with Mr. Bauer from SGI. He said the Commission could come back after further conversations between the Director and SGI, and he said he was not prepared to make a decision today. Commissioner Frazier opined that the Lottery is operating under the contract, so it is ratified.

Commissioner Lamberth said that the Lottery has been operating and paying under the contract all along, and she would like to get this behind us as soon as possible. She said she understands the frustration of the employees and having this continually brought up. She asked how soon the Commission wants to resolve it. Commissioner Malone said he agreed. Commissioner Pickard said that he felt that the Audit Legal Committee had already fully discussed this matter. Several Commissioners agreed and asked that it come directly back to the full Commission. Commissioner Malone asked Mr. Hyde how quickly he could be ready. The Commissioner said his understanding was that the Auditor prepares a report, which goes to the Director for a response, and that the matter is then brought to the Commission to hear and to resolve areas of disagreement.

Commissioner Campbell asked the Director if there were ramifications should the contract not be reaffirmed. Mr. Woosley said they could remove the offer and, if it continues to a point that SGI is unsure whether the Commission is willing to continue to honor the contract, there could be action. Commissioner Faris asked why SGI would think the ALC is not honoring the contract. Mr. Woosley said it might be because there had not been a public and proactive ratification action by the Commission and at the same time there was talk about whether the contract is valid. Commissioner Faris suggested this public act take place at the time the offer is considered. Commissioner Engstrom praised Commissioner Malone's statement on process. Commissioner Faris said he would like to be able to ask Mr. Bauer questions.

Commissioner Lamberth commented that the Internal Auditor had received a couple of extensions on this part of the audit. She asked him how quickly could get it done, and he responded fairly quickly. She said that would mean the next 10 days. Commissioner Faris agreed with the timetable. Commissioner Pickard and Commissioner Lamberth discussed that the 10 days would include the presentation of the Auditor's report and findings to the Director, the Director's response, and the matter brought before the Commission.

Commissioner Faris called on Mr. Bauer and said that while he agreed that the Commission and SGI have a valid contract, the Commission would like to bring the matters before the Commission and to come back in 10 to 14 days and do everything needed. He said that he would like to consider what Mr. Bauer is asking at that same time. Commissioner Faris said that several of the Commissioners are new and asked Mr. Bauer to continue to work with ALC staff a few more days in good faith, and that the matter would be resolved on the timetable mentioned above. Mr. Bauer said they were happy to cooperate with the Lottery and said SGI was proud to be a part of the unprecedented success in Arkansas. He also said that SGI's reputation was being harmed by some of the public discussions and remarks, and that they could not stand for statements regarding fraud to be put into the record. Commissioner Faris said that 10 to 14 days should not be too much to ask. Mr. Bauer said that SGI was committed to the Lottery and would do everything possible to assist, but they need to have a resolution. Commissioner Faris said the Commission was acting in good faith. Mr. Bauer said he could not guarantee that the

offer would be on the table for 14 days, and Commissioner Faris said that SGI's good faith may go down the drain. Mr. Bauer said that he was concerned about what might be done or said in the interim. They agreed to cooperate for a good resolution. Commissioner Faris asked that the remaining items on the agenda be suspended and finished at the next meeting. Commissioner Hammons asked if they were rushing the Auditor. The Chair responded that he had had a long time to get this done and that he could carve out time to finish it in 10 days to two weeks. She said it looks as if he almost has it completed and that the full process would be completed in that time. Commissioner Malone said that would be a draft report, a response from the Director, and a resolution from the Commission. Director Woosley asked if his timeline and addenda could be his response, and no one objected.

The Chair asked whether it would be a good day to evaluate the two employees. She said the requirement was to do the evaluation as close to the first of the year as possible. She said she had evaluation forms prepared for the Commissioners. The forms were handed out. Commissioner Engstrom suggested doing the evaluations later. The Commissioners agreed that they would complete the forms in the interim between today's meeting and the next meeting. Commissioner Shipp asked that each Commissioner complete both forms without seeking advice from or discussing them with anyone else. Commissioner Malone said he would prefer to do the evaluation separate from the audit discussions. Commissioner Lamberth said she would like to discuss the evaluations at the next meeting. Commissioner Faris agreed with the Chair, as did Commissioner Malone. Commissioner Lamberth said that the forms should be filled out by the next meeting, the evaluation would be on the agenda, and it may or may not be discussed based on time remaining. Commissioner Lamberth asked Ms. Baldrige to send out dates and work on an agreement for a date.

There being no further business, Commissioner Lamberth adjourned the meeting.