

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE MINNESOTA STATE LOTTERY

In the Matter of
Proposed Permanent
Rules Relating to
Lottery Retailers.

REPORT OF THE
ADMINISTRATIVE LAW JUDGE

The above-entitled matter came on for hearing before Administrative Law Judge George A. Beck on February 9, 1990, at 9:00 a.m. in Room 300 North, State Office Building, St. Paul, Minnesota.

This report is part of a rulemaking proceeding held pursuant to Minn. Stat. §§ 14.131 to 14.20, to hear public comment, to determine whether the Minnesota State Lottery (Lottery) has fulfilled all relevant substantive and procedural requirements of law or rule, to determine whether the proposed rules are needed and reasonable, and whether or not the rules, if modified, are substantially different from those originally proposed.

Kevin Staunton, Special Assistant Attorney General, 200 Capitol Office Building, St. Paul, Minnesota 55103 appeared on behalf of the Lottery at the hearing. The agency panel appearing in support of the proposed rules consisted of George R. Andersen, Director of the Minnesota State Lottery; Dale McDonnell, Legal Counsel; Nancy Goodspeed; and Aaron Roth.

Twenty-one persons attended the hearing. Nineteen persons signed the hearing register. The Administrative Law Judge received nineteen exhibits as evidence during the hearing. The Lottery offered all those exhibits. The hearing continued until all interested persons, groups or associations had an opportunity to be heard concerning the adoption of these rules.

The record remained open for the submission of written comments for five business days following the date of the hearing or February 16, 1990. Pursuant to Minn. Stat. § 14.15, subd. 1 (1988), three business days were allowed for the filing of responsive comments. On February 22, 1990, the rulemaking record closed for all purposes.

Beyond the oral comments at the hearing, the Administrative Law Judge received no post-hearing written comment from interested persons. The Lottery submitted a written comment responding to matters discussed at the hearing.

This Report must be available for review to all affected individuals upon request for at least five working days before the agency takes any further action on the rule(s). The agency may then adopt a final rule or modify or withdraw its proposed rule. If the Lottery makes changes in the rule other

than those recommended in this report, it must submit the rule with the complete hearing record to the Chief Administrative Law Judge for a review of the changes prior to final adoption. Upon adoption of a final rule, the agency must submit it to the Revisor of Statutes for a review of the form of the rule. The agency must also give notice to all persons who requested to be informed when the rule is adopted and filed with the Secretary of State.

Based upon all the testimony, exhibits, and written comments, the Administrative Law Judge makes the following:

FINDINGS OF FACT

Procedural Requirements.

1. On December 19, 1989, the Minnesota State Lottery (Lottery) filed the Notice of Hearing proposed to be issued with the Chief Administrative Law Judge.

2. On January 2, 1989, the Lottery filed the following documents with the Chief Administrative Law Judge:

- (a) A copy of the proposed rules certified by the Revisor of Statutes.
- (b) The Order for Hearing.
- (c) The Statement of Need and Reasonableness.
- (d) A Statement of Additional Notice.
- (e) The Notice of Hearing as mailed and a mailing list.

3. On January 2, 1990, a Notice of Hearing and a copy of the proposed rules were published at 14 State Register 1650.

4. On December 22, 1989, the Lottery mailed the Notice of Hearing to all persons and associations who had registered their names with the Lottery for the purpose of receiving such notice.

5. On January 5, 1990, the Lottery filed a copy of the State Register containing the proposed rules with the Administrative Law Judge.

6. On January 19, the Lottery filed the following documents with the Administrative Law Judge:

- (a) The Notice of Hearing as mailed and a mailing list.
- (b) The Agency's certification that its mailing list was accurate and complete.
- (c) The Affidavit of Mailing the Notice to all persons on the Agency's list.
- (d) The names of Commission personnel who will represent the Agency at the hearing together with the names of any other witnesses solicited by the Agency to appear on its behalf.

On January 25, 1990, the Lottery filed its statement of expected attendance and time to present its testimony. It also filed its notice of fixing a fee to the appropriate legislative committee chairs.

The documents were available for inspection and copying at the Office of Administrative Hearings from the date of filing to February 22, 1990, the date

the record closed. Not all of the above documents were timely filed. However, no one asked to inspect them and therefore no prejudice occurred and the late filing does not constitute a defect in this proceeding.

Nature of the Proposed Rules.

7. The proposed rules establish the procedure by which the Lottery will accept and process applications for individuals, businesses and organizations to become retailers of tickets for the games which will be conducted by the Lottery. In addition, the proposed rules will govern the ongoing relationship between the Lottery and those granted retailer contracts. Specifics such as the maximum to be charged for a ticket, the percentage of ticket price to be retained by the retailer, responsibility for lost or damaged tickets and grounds for suspending the contract are included in the proposed rules.

Statutory Authority.

8. In its Statement of Need and Reasonableness (SONAR), the Lottery cites Minn. Stat. § 349A.05 (Supp. 1989) as authorizing the Lottery to adopt the proposed rules. Minn. Stat. § 349A.05 grants the Director the authority to adopt rules pursuant to Minn. Stat. Ch. 14 in the areas of retailer location, number, qualifications, and compensation. The Director is also granted rulemaking authority in the areas of investigation of retailer applicants and appeal procedures of adverse action against retailer contracts. The Lottery has general authority to adopt these rules.

Small Business Considerations in Rulemaking.

9. Minn. Stat. § 14.115, subd. 2 (1988) requires state agencies proposing rules affecting small businesses to consider methods for reducing adverse impact on those businesses. In the SONAR, the Lottery acknowledged that the proposed rules will affect small business, but that the impact on those businesses will be negligible. The Director has considered the impact of the rules and the need to maintain the integrity and security of the games organized by the Lottery. The Director has concluded that the rules cannot be made less rigorous when applied to small businesses. The Administrative Law Judge notes that many of those who will be retailers of lottery tickets are small businesses. Associations representing small businesses gave oral comments at the hearing. No one objected to the rules as having too adverse an impact on small businesses. The Lottery has met the requirements of Minn. Stat. § 14.115, subd. 2 with respect to the impact of the proposed rules on small businesses.

Fiscal Note.

10. Minn. Stat. § 14.11, subd. 1 requires proposers of rules requiring the expenditure of public funds in excess of \$100,000 per year by local public bodies to publish an estimate of the total cost to local public bodies for a two-year period. The proposed rules will not require any expenditure of funds by a local agency or school district.

Impact on Agricultural Land.

11. Minn. Stat. § 14.11, subd. 2 requires proposers of rules that have a "direct and substantial adverse impact on agricultural land in this state" to

comply with additional statutory requirements. These rules have no impact on agricultural land and, therefore, the additional statutory provisions do not apply.

Substantive Provisions.

12. The portions of the proposed rules which received comment or otherwise need to be examined will be discussed below. Any rule not mentioned is found to be needed and reasonable. Also, any rule not mentioned is found to be specifically authorized by statute.

Proposed Rule 7856.1000 -- Definitions.

13. Proposed Rule 7856.1000 contains 13 subparts defining the terms to be used in the proposed rules. None of those who commented objected to any of the definitions proposed by the Lottery. These definitions are needed and reasonable to promote comprehension of the rules. Subpart 1 has been altered by the Lottery to cross reference the proposed rules in Chapter 7857 of Minnesota Rules. (Ex. R). The change is intended to clarify the scope of the definitions in this rule part and does not constitute a substantial change.

Proposed Rule 7856.1020 -- Director; Powers and Duties.

14. This proposed rule part sets forth the specific powers and duties held by the Lottery Director. By statute, the Director is granted the authority to adopt rules and game procedures; issue retailer contracts and rule on appeals relating to retailer contracts; enter into employment contracts; hire employees; contract with other States for conducting a joint lottery; advertise games; and "take all necessary steps to ensure the integrity of, and public confidence in, the state lottery." Minn. Stat. § 349A.02, subd. 3. The powers enumerated in this proposed rule part all fall within the statute's broad grant of authority. The proposed rule specifies the Director's duties (which are generally authorized by statute), and is needed and reasonable.

Proposed Rule 7856.2010 -- Retailer Application.

15. Subpart 1 requires any person interested in obtaining a contract to sell tickets to any games run by the Lottery to submit an application. The subpart also requires a separate application be filed for each location where game tickets will be sold. Objections to this subpart were raised by Joel Hoiland of the Minnesota Grocers Association, Dan Coborn, a St. Cloud food retailer, and Judy Cook of the Minnesota Retail Merchants Assn. Mr. Hoiland asserted that requiring a fee for each location was unfair. Further, he suggested that a lower fee be charged for renewals. Mr. Hoiland proposed that a twenty dollar fee be charged when the contract is renewed. The Lottery, in its post-hearing comment (Ex. T), responded to Mr. Hoiland's objections by stating that each location is a separate account for the purpose of security and game control, that there is no material reduction in the costs of the review process where multiple locations are involved and no justification exists for establishing a different fee structure for businesses with more than one location.

The Lottery is required, by Minn. Stat. § 349A.06, Subd. 9, to charge a "nonrefundable application fee . . . in an amount sufficient to cover the costs of making the investigation required under subdivision 4." The Lottery has

rationaly concluded that one hundred dollars per location is a uniform amount which will meet the statutory requirement. Other states with new lotteries charge the same fee. Many commentators objected to the application fee being made nonrefundable. The Lottery cannot adopt a rule which expressly conflicts with a substantive provision in the statute. Therefore, the Lottery cannot make the application fee refundable.

The Lottery did propose, however, that renewal fees be changed from one hundred dollars to twenty dollars, in accordance with Mr. Holland's recommendation. Further, the Lottery added a provision that the one hundred dollar fee would cover any reapplication by an unsuccessful applicant for a contract, so long as no material change existed from the original application. The Lottery has shown that charging the application fee by location is needed and reasonable to cover the costs of investigation as required by Minn. Stat. § 349A.06, Subd. 9. Not charging an additional fee upon reapplication (where there is no material change) is within the Lottery's rulemaking authority and does not conflict with the requirements of Minn. Stat. § 349A.06, Subd. 9. The fee is not refunded, but reused. With no material change in the application, the costs of investigation have already been paid. These changes conform to the requirements of Minn. Stat. § 349.06, Subd. 9. The changes were fully discussed at the hearing and do not constitute a substantial change.

Proposed Rule 7856.2020 -- Selection of Retailers.

16. Proposed Rule 7856.2020, Subpart 1 lists the specific requirements which must be met by applicants to obtain a contract for selling game tickets. Subpart 3 makes residency of the State of Minnesota an additional requirement for obtaining a contract. No one objected to any of these requirements. Subparts 1 and 3 are needed and reasonable for providing standards which applicants must meet to obtain a contract.

Subpart 2 requires the Director to consider: 1) the applicant's financial responsibility; 2) the applicant's honesty and integrity; 3) the location's accessibility; 4) whether sufficient ticket sales are already being made; 5) anticipated sales by the applicant; 6) the veracity of the application; 7) the retailer's experience in business; and, 8) the nature and type of the applicant's business. Judy Cook of the Minnesota Retail Merchants Association asserted that permitting the Director to consider these factors would lead to inequity in granting contracts. Ms. Cook suggested that fair and equal access would result if applicants who meet the other restrictions (those in Subparts 1 and 3) automatically received a contract. The market would then determine which retailers would continue selling game tickets. Dan Coborn, a retailer with stores in Minnesota and Iowa, commented on his experience with the Iowa Lottery. In that State, Mr. Coborn found carrying Iowa Lottery games to be a necessity if he wished to remain competitive with other retailers. Mr. Coborn further stated that the Iowa Lottery was not generating income for his business.

The Director of the Lottery is specifically authorized to promulgate rules "which the director considers necessary for the efficient operation and administration of the lottery." Minn. Stat. § 349A.05 (10). The Lottery's games will not be operating efficiently if they create a net loss for retailers, yet retailers believe they must continue to offer the game to remain competitive. Limiting the number of retailers is one method of preventing market saturation, and preventing the subsequent change from net profit to net

loss for retailers. The Lottery asserts that balance in awarding contracts is needed, both to offset the competitive advantage held by chain stores over "mom-and-pop" style businesses and to prevent saturation of the retail market. Using the eight factors in Subpart 2, the Director can ensure a mix of retail providers of game tickets in an area. The Lottery argues that, without limits to the number of retailers in any one area, the market for game tickets will become saturated. Once the market is saturated, the return from sales of game tickets will decline, operating costs will increase and retailers will either abandon selling game tickets or not promote them. At that stage, retailers would experience a loss from ticket sales.

The Lottery has shown that limiting the number of retailers who may sell game tickets is appropriate to protect both the efficiency of the games and the interests of retailers who sell game tickets. Proposed rule 7856.2020 is needed and reasonable to accomplish those goals.

Proposed Rule 7856.301 (sic) -- Denial of Application; Reconsideration.

17. The Lottery added this provision to the proposed rules at the hearing in response to comments received prior to the hearing which objected to the lack of an appeal process (Ex. R). The amendment requires written notification of denial of an application for a contract which must include the reasons for that denial and notice of the applicant's appeal rights. The amendment sets forth a 30 day appeal period for the applicant to request reconsideration of the application. The Lottery may request additional information and must decide the appeal within 45 days of receiving all the information. The Director makes the ultimate decision on the application. This amendment, setting up an appeal process, is authorized by Minn. Stat. § 349A:05 (4). An appeal process is essential to permit clarification of applications and corrections of errors made in the application process. The Director is the person named to rule on contract appeals. Minn. Stat. § 349A.02, Subd. 3(2). Proposed rule 7856.301 is needed and reasonable to establish an appeal process for applicants. The amendment was proposed at the hearing in response to widespread comments by the regulated public. The addition of this part is not a substantial change. The Administrative Law Judge suggests, however, that the number of this rule part be changed or the typographical error corrected to prevent confusion with proposed rule 7856.3010.

Proposed Rule 7856.4020 -- Bonding of Retailers.

18. Mr. Hoiland of the Minnesota Retail Grocers Association objected to this proposed rule part requiring a bond from each retailer selling game tickets. He objected on the ground that the bond increased the insurance burden on retailers, while the State did not need the protection provided by bonding. Minn. Stat. § 349A.06, Subd. 3 requires that retailers post a bond, in an amount to be set by the Director. The Lottery altered the proposed rule to further specify that the bond must be in the "form provided by the Lottery." (Ex. R). This rule part is needed and reasonable to carry out the intent of the statute. The change is not a substantial change.

Proposed Rule 7856.4030 -- Compensation.

19. Subpart 1 of proposed rule 7856.4030 sets the commission received by a retailer selling game tickets at five percent of the price of each ticket sold by that retailer. R.J. McCue, Controller for SuperAmerica stores in

Minnesota, commented that the commission level should be increased or other financial incentives provided. He also asserted that, with a higher commission level, retailers would be encouraged to "push" game tickets as a desirable product. George Anderson, Director of the Lottery, responded that the experience of lotteries in many states indicates the single most important factor in a successful game is a large prize pool. Mr. Anderson asserted that a higher percentage of winners would lead to increased ticket sales. In such a situation, a marginally smaller commission could result in higher revenues to the retailer. Assuming that the Lottery is correct in its assertion that smaller commissions generates a larger prize pool and thereby increase ticket sales, the proposed commission rule will operate to the benefit of retailers. Should the larger prize pool generate increased sales, two \$1.00 purchases will result in \$.10 of commission under the proposed rule, while in a State with a six percent commission, the retailer's return from the sale of one ticket would be \$.06, owing to reduced sales. The Lottery is entitled to use its expertise in setting a percentage for retailer commissions. (Ex. S; Ex. T). Many other States use the five percent level for their lottery commissions. The proposed rule is needed and reasonable.

Proposed Rule 7856.7010 -- Deposit of Funds.

20. This proposed rule part, requiring deposit of Lottery game proceeds in a separate account in a designated bank, did not receive critical comment in the rulemaking process. The Lottery has proposed to amend the rule to require use of a bank with electronic funds transfer (EFT) capability, where possible. This amendment was proposed at the hearing and was not objected to. The proposed rule, as amended, is needed and reasonable to efficiently operate the Lottery's games. The change is not a substantial change.

Other Comments.

21. Mr. McCue suggested that a Retail Advisory Board be created to assist in the Lottery's decision-making regarding methods and terms of sale used for game tickets. Although the Lottery's authorizing statute does not mention such a Board, the Director may establish such a body if it is deemed necessary to ensure the security and integrity of the games. Not establishing such a body does not impair the need for and reasonability of the proposed rules.

Alan Mathiason of the Minnesota Department of Human Services suggested that retailers be required to post signs containing the toll-free HELPLINE number. These signs would be required at each ticket purchase location and aid those individuals who are compulsive gamblers and who desire help to end that condition. Mr. Anderson responded that the HELPLINE number would be made available through brochures and perhaps, in the form of a decal to be displayed at ticket purchase locations. The content of any signs relating to the Lottery's games required to be posted by retailers has been left to the Director's discretion. Minn. Stat. § 349A.02, Subd. 3. Including information on counseling in the Lottery's promotional materials is an issue to be resolved by the Director. Omitting such information does not impair the need for and reasonableness of the proposed rules.

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

CONCLUSIONS

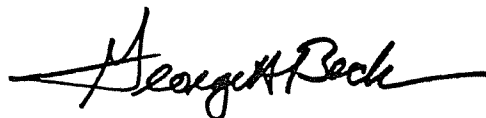
1. That the State Lottery gave proper notice of the hearing in this matter.
2. That the Lottery has fulfilled the procedural requirements of Minn. Stat. §§ 14.14, and all other procedural requirements of law or rule.
3. That the Lottery has documented its statutory authority to adopt the proposed rules, and has fulfilled all other substantive requirements of law or rule within the meaning of Minn. Stat. §§ 14.05, subd. 1, 14.15, subd. 3 and 14.50 (i) and (ii).
4. That the Lottery has demonstrated the need for and reasonableness of the proposed rules by an affirmative presentation of facts in the record within the meaning of Minn. Stat. §§ 14.14, subd. 2 and 14.50 (iii).
5. That the additions and amendments to the proposed rules which were suggested by the Lottery after publication of the proposed rules in the State Register do not result in rules which are substantially different from the proposed rules as published in the State Register within the meaning of Minn. Stat. § 14.15, subd. 3, Minn. Rule 1400.1000, Subp. 1 and 1400.1100.
6. That any Findings which might properly be termed Conclusions and any Conclusions which might properly be termed Findings are hereby adopted as such.
7. That a finding or conclusion of need and reasonableness in regard to any particular rule subsection does not preclude and should not discourage the Lottery from further modification of the rules based upon an examination of the public comments, provided that no substantial change is made from the proposed rules as originally published, and provided that the rule finally adopted is based upon facts appearing in this rule hearing record.

Based upon the foregoing Conclusions, the Administrative Law Judge makes the following:

RECOMMENDATION

It is hereby recommended that the proposed rules be adopted consistent with the Findings and Conclusions made above.

Dated: this 2 day of March, 1990.



GEORGE A. BECK
Administrative Law Judge