Oklahoma Lottery Commission

Minutes of Special Meeting
May 1, 2006 – 9:00 a.m.

Members Present:

Mr. Orbison, Chairman
Dr. Dzialo, Secretary
Mr. Riley, Treasurer
Mr. Paul

Members Absent:

Mr. Norick, Vice Chairman
Mr. Charlton
Ms. Ball

Others Present:

Maryanne Maletz, State Regents
Lynn Roger, AG's Office
Jim Scroggins, OLC
Beverly Hughes, OLC
Tony Thornton, Daily Oklahoman
Greg Sawyer, State Regents
Claudia San Pedro, Office of State Finance
Rollo Redburn, OLC
Penny Nicholson, OLC

ITEM 1

Call to Order. Roll Call and Announcement of Quorum

Roll Call: Mr. Orbison, Mr. Riley, Dr. Dzialo, and Mr. Paul were present. Mr. Norick, Ms. Ball, and Mr. Charlton were absent. Mr. Orbison declared a quorum.

ITEM 2

Announcement of Filing of Regular Meeting Notice and Posting of the Agenda in Accordance With the Open Meeting Act

Posting of Special Meeting Notice and Agenda were confirmed, in accordance with the Open Meetings Act.

ITEM 3

Approval of Minutes of the April 18, 2006 Regular Meeting

Mr. Paul made a motion to approve the minutes. Dr. Dzialo seconded the motion.

In discussion, Mr. Riley indicated that there was a typographical error that needed to be fixed, and that he would send Ms. Nicholson an e-mail pointing it out.

Mr. Paul amended his motion to approve the minutes with the suggested correction. Roll Call: Mr. Orbison, Mr. Riley, Dr. Dzialo, and Mr. Paul voted to approve. The motion was carried.

ITEM 4

Discussion and Possible Action to Accelerate the Transfer of Net Proceeds to the State Treasury

The Board was provided copies of three letters from the State Regents for Higher Education and financial information from Claudia San Pedro, Director of the Office of State Finance and Stan Van Ostran, Comptroller for the Oklahoma Lottery Commission. Mr. Scroggins reported that it had been determined that the letter sent by the Regents on April 5th had probably not been received by OLC because it contained an incorrect zip code in the address. He pointed out that the latest letter received from the Regents (dated April 28, 2006) asked for monthly fund disbursements to cover debt service on the bonds beginning in June 2006 and also contained a request for monthly funds to match private gifts to the endowed chairs program. The letter also contained clarification of administrative fees on the debt service obligation. Mr. Scroggins also pointed out a document provided by Ms. San Pedro showing the debt service payments over the full thirty years of the bonds.

Mr. Orbison stated that it was important to clarify that the Board could agree to make monthly payments of a given amount to the Lottery Trust Fund, but could not specifically ear-mark those funds for a particular purpose or beneficiary. Mr. Scroggins agreed, but reminded the Board that Ms. San Pedro had stated at the previous Board meeting that the Office of State Finance could ear-mark funds for a specific need, such as debt service. She had also stated that although Lottery revenue was identified as the primary source for debt payment, if the Lottery did not have sufficient funds to make a transfer to cover debt service, the State would look to other funding sources to meet the obligation.

Mr. Riley asked Ms. San Pedro to clarify some of the figures on the spreadsheet and Ms. San Pedro did so. Mr. Scroggins stated that he had asked Ms. San Pedro to provide the spreadsheets so that the Trustees could see the payments over the full thirty-year life of the bond issue and would not be surprised by some fluctuations.

Mr. Riley asked Mr. Redburn if sufficient funds had been disbursed to cover the Regents' bond obligation for the remainder of FY06. Mr. Redburn replied that sufficient funds had been transferred, but weren't necessarily spent for the payment of debt service on the bonds.

Mr. Paul stated that he had made some rough calculations and that based on current sales levels he estimated that approximately $110 million would be raised for distribution to education, or roughly $8 to $9 million per month. Higher Education's full 45% share of that would be approximately $4 million per month. He pointed out that the $7 million per month being requested by the regent exceeded the amount of their projected share of revenue.

Mr. Paul stated that although he would prefer to continue with quarterly distributions of funds, it now seemed clear that the terms of the bond debt required monthly payments. He stated that he now feels convinced that in order to assist the State with meeting its monthly obligations, the Lottery Commission must make some monthly distributions in an amount sufficient to cover debt service. However, he stated that he did not favor making monthly distributions in excess of the amount needed for bond payments.

Mr. Riley asked Ms. San Pedro if the State was authorized to utilize the earnings from the sinking fund. Ms. San Pedro replied that funds were generally allowed to accumulate for a while, but they could be used. Mr. Riley stated that the two troublesome issues were 1) going around the Act by specifying beneficiaries and 2) the need to maximize earnings through interest. He pointed out that transferred funds would continue to accumulate interest in the sinking fund. He stated that it appears that it would be in the best interest of education to transfer funds sufficient for debt service monthly rather than quarterly. He noted that the Lottery had not yet experienced a full twelve-month sales period, and that Mr. Scroggins had already warned the Board to expect a slump in sales during the summer months. Realistically, based on current sales figures, Mr. Riley stated he was comfortable with a sales figure of $2.5 million per week, or approximately $10 million per month. Based upon that, he stated that he would be supportive of a motion to transfer $3 million per month to the Trust Fund. He stated that he wanted to be sure that this was accomplished through a policy of the Lottery Commission rather than becoming a part of the permanent Rules.

Mr. Paul agreed with Mr. Riley's remarks and reiterated Mr. Orbison's point that the Trustees could not earmark the funds that were transferred. The burden of disbursements would be with the Office of State Finance. He stated that if the Board decided to take action to institute monthly transfers, it would be important to state that they could rescind that decision at a later time. He stated that it should be made clear that this is a temporary action and should not be seen as a permanent obligation on the part of the Lottery Board of Trustees.

Mr. Paul expressed his continuing concern with the loss of interest income due to early distributions. He pointed out that the Lottery Commission was operating under very tight parameters, and that it would probably be more prudent to stay with quarterly distributions rather than agree to disburse some funds monthly. He stated that he would like to see some arrangement made whereby the Lottery would be compensated for loss of interest. He added that he continued to be concerned that loss of interest could result in unequal treatment of the beneficiaries. However, he stated that as long as it was clear that the Lottery Commission was not earmarking funds, he felt comfortable making the monthly transfers.

Dr. Dzialo asked Ms. Maletz to make an oral presentation to the Board explaining the funding requests in her letter dated April 28, 2006.

Ms. Maletz explained that due to the pressing monthly financial obligations of the Regents, they would find it most helpful to receive monthly distributions of 1/12 of their lottery appropriation. She explained the various needs pertaining to debt service, endowed chairs, and scholarships. She stated that the funds for endowed chairs would be matched by other sources and would accrue interest income which would be used for faculty salaries. She stated that the Regents would be willing to reimburse the lottery for the amount of lost interest resulting from the transfer of money for endowed chairs.

Mr. Paul asked if the $4 million request was a per month figure, and Ms. Maletz replied that it was not, but was just the balance for this fiscal year. She expressed concern that the remainder of FY06 appropriations would not be received until after July 15th. She stated that at a meeting last week, the Regents had approved a request for a supplemental appropriation to cover any shortfall in revenues for FY06 and to cover bond payment cash flow in the first quarter of FY07.

Dr. Dzialo asked if the Regents needed monthly disbursements of the total amount of their lottery appropriation, and Ms. Maletz replied that they would like that if it was possible, but the primary concern was debt service. She stated that the Regents were working intensively with the Legislature to make sure they understood their cash requirements for scholarships and other financial needs. She stated that if the Regents could not receive the lottery funds on a timely basis, they would need to ask the Legislature to designate another source of funds for the payments. Mr. Paul asked if the $3.1 million dollar request was the amount needed monthly, and Ms. Maletz replied that it was just the amount needed for June of 2006. $3.2 million per month would be needed monthly for FY07. She stated that amount was to cover three capital bond issues, plus matching funds and bond debt for the endowed chairs program. She stated that in FY07 the Regents would need $2.6 million per month for debt service and $.6 million per month for matching funds for endowed chairs.

Dr. Dzialo asked why the Regents were offering to reimburse the lottery for lost interest only on the endowed chairs portion of the funds, and Ms. Maletz replied that the funds for endowed chairs were invested and would earn interest, whereas funds for debt service would not.

Mr. Paul asked what harm would be encountered on the $600,000 endowed chairs portion of the funding request if the funds were received quarterly rather than monthly. Ms. Maletz replied that receiving the funds monthly rather than quarterly would simplify their bookkeeping. She stated that she did not know the Legislature's intention for appropriations of Lottery funds for FY07, and was not sure if money would be appropriated for endowed chairs. She expected that, at a minimum, the Legislature would appropriate funds for the capital debt service, although it was quite likely they would also fund the endowed chairs program.

Mr. Riley commented for the record that there was no concern at this time that the lottery would fail to meet projected revenue goals. He wanted to make it clear that that there was no information to indicate there would be any shortfall. Ms. Maletz asked the Board if the final portion of appropriations for FY06 would not be received until the middle of the first month of FY07. Mr. Orbison replied that absent a change in policy, the final disbursement of FY06 funds would occur on July 15, 2006.

Mr. Riley expressed concern about getting away from the original provisions of the Act and stated that he still was not sure why there was a cash flow problem. He stated that he would prefer not to look at individual beneficiaries when making transfers, but simply fulfill the primary mission of the lottery, which is to make as much money as possible for education. He pointed out that funds put into scholarships would be returned to the universities in the form of tuition. Mr. Orbison added that the Trustees also had to consider how much the lottery could afford to put in on a monthly basis. Mr. Riley stated that based on current sales projections, he felt $3 million per month would be a reasonable cap for monthly disbursements at this time. Mr. Orbison agreed with Mr. Riley, and expressed concern about paying out a monthly amount larger than $3 million.

Mr. Paul asked Ms. Maletz if an advance distribution of $3.25 million in June and monthly distributions of $3 million in FY07 would be sufficient to cover at least the debt service portion of their request. Mr. Riley suggested that instead of looking at specific funding issues, the Board should simply agree to begin $3 million monthly transfers commencing in June. Some general discussion was held about the precise figure to transfer, as it appeared that only $2.7 million was necessary for debt service and it was uncertain if those funds had already been transferred for FY06. Mr. Riley asked Mr. Redburn what day of the month the Lottery Commission was most likely to have sufficient cash on hand to make transfers, given the issue of receivable and payables. Mr. Redburn replied that he felt a transfer could be done by around the 8th or 9th of the month. Mr. Riley agreed that this timing would be workable for the Lottery Commission. Mr. Riley pointed out that the regular quarterly distribution, which occurs on the 15th day of the month following the end of the quarter, would occur too late to allow the Regents to make their monthly bond payment. Therefore, he recommended that the Commission should plan on making regular, monthly disbursements, with the balance of the Regents' share of revenue being transferred to them in the regular quarterly distributions. Mr. Paul asked Ms. Maletz if a disbursement of $3 million made on or before June 10th, and then regular monthly disbursements within the first ten days of each month in FY07 of $2.7 million, would cover the Regents' immediate cash flow needs for debt service, without regard for the endowed chairs or scholarship programs. Ms. Maletz asked how July disbursements would be handled. Mr. Paul replied that under this plan, $2.7 million would be disbursed on or before July 10th, and then the regular "true up" transfer of the balance from the final quarter of FY06 would be made on or before July 15th.

Mr. Redburn pointed out that the original revenue projections for the Lottery Commission were extremely aggressive. He asked Ms. San Pedro if the final disbursement for FY06 would have to be made by June 30th rather than July 15th in order to meet the revenue projections for FY06. He expressed concern that an early transfer on June 30th might make it impossible for the Lottery Commission to make an early disbursement to the Regents by the 8th or 9th of the month. Ms. San Pedro explained that lottery funds were set up as certified funds, which meant that revenue accrued by June 30th would be applied to FY06, even if the funds are not actually transferred to the Lottery Trust Fund until July 15th. Ms. San Pedro explained that certified fund accounts normally maintain a cash flow reserve to deal with the issue of revenues collected in June but unavailable until July. That is why the Legislature normally appropriates only 95% of revenue, in order to retain a 5% cash reserve. Because this is the Lottery Commission's first year, there is no 5% reserve to draw on. However, since the State has had a very good year for overall revenue collections, OSF has sufficient funds to assist with cash flow until the final transfer for FY06 is made.

Mr. Paul offered some possible language for a motion on monthly transfers for the Board's consideration. Mr. Scroggins suggested that if the Trustees were coming to a consensus, he recommended that the Board meeting be briefly recessed in order to go upstairs and draft a written motion.

More discussion was held regarding the loss of interest and the possible disparate treatment of the other beneficiaries of the Lottery Trust Fund. Ms. San Pedro stated that she would make whatever effort she could under statutory guidelines to assure fair treatment of all beneficiaries and would assist with recommending legislative action as needed to assure fair and equal treatment.

Mr. Riley suggested that the Board make their action as clear and short as possible. He asked Mr. Paul why he felt that the motion should contain language stating that the Commission could rescind the decision to make monthly transfers in the future. Mr. Paul replied that he just wished to make it clear that the decision to make monthly transfers should not be considered a permanent, irrevocable action. Mr. Riley asked other Board members if they felt the motion should include language regarding the reasonable basis for arriving at a specific transfer amount based upon a conservative estimate of revenue. In discussion, it was decided that such language would merely clutter up the motion and was probably unnecessary. Mr. Riley asked the Board members why they were willing to consider a transfer of $3 million per month when a conservative estimate of revenue indicated that a comfortable amount of transfer for the Lottery Commission budget was $2.7 million. Mr. Paul replied that it was his understanding that the Regents needed to have a larger amount for June 2006. Mr. Riley stated that it was still unclear whether or not the necessary funds for FY06 had already been transferred. In further discussion Mr. Riley and other Board members stated they were willing to commence transfers in June 2006.

Mr. Orbison stated he had no problem with making the $3 million dollar monthly transfer, but was still concerned about the loss of interest. Mr. Riley pointed out that money transferred to the bond fund would continue to earn interest, albeit only for higher education. Furthermore, the Regents indicated they were willing to reimburse the interest on the portion of the money invested for endowed chairs. Mr. Orbison reiterated that he was still bothered by the fact that early transfers would result in a loss of revenue which should accrue to all of the beneficiaries. Dr. Dzialo agreed with him. Mr. Paul asked if the equal treatment of the beneficiaries was a matter to be handled by the Office of State Finance. Mr. Orbison stated that he thought that language should be included to require the Regents to reimburse the loss of interest. Mr. Paul did a rough calculation indicating the Commission would lose approximately $100,000 per year in interest revenue. He asked Mr. Redburn if he agreed with that calculation. Mr. Redburn replied that when he had gone through the calculations earlier he estimated a loss of around $126,000 assuming and interest rate of 3.76%. Mr. Riley suggested that the minutes reflect that Ms. San Pedro indicated that adjustments for the loss of interest would be made by OSF. The Board discussed the issue of lost interest in some detail.

Mr. Scroggins suggested that the motion contain language stating that the monthly transfers would be made contingent upon the funds being available. Other Board members agreed. Dr. Dzialo asked if the motion should contain language regarding the reimbursement of lost interest on endowed chairs. Ms. Maletz stated that she wished to clarify that there would only be funds available for reimbursement if they received funds for the endowed chairs program. Board members generally agreed that an amount of $3 million per month would not cover the endowed chairs, and therefore the interest question was not relevant. It was decided that the motion should call for a monthly transfer of $3 million to the Lottery Trust Fund, to be distributed as seen fit by the Office of State Finance. The motion should also state the transfer would be subject to the availability of funds and could be rescinded by the Board at any time.

Mr. Orbison called for a recess in order that the Motion could be drafted.

When the Board reconvened, Mr. Paul noted that the minutes of the meeting should reflect the Board's concerns about treating all beneficiaries of the Oklahoma Education Lottery Act fairly, and that the Board had received assurances from the Director of the Office of State Finance that every effort would be made to assure that the various beneficiaries were treated equally. He stated that the minutes should also make clear that the Board was not ear-marking the distribution of funds, but was merely performing its statutory duty to deposit money to the Trust fund.

Mr. Paul then moved that:

> "Unless sooner rescinded by the Commission, and subject to the availability of funds, monthly transfers be made to the Oklahoma Education Lottery Trust Fund as follows: The sum $3 million per month on or before the 10^{th} day of the month commencing in June 2006 and ending in June 2007, such transfers to be credited against the quarterly deposits to the Trust fund which are required by the Oklahoma Education Lottery Act."

Mr. Riley seconded the motion.

Roll Call: Mr. Orbison, Mr. Riley, Dr. Dzialo, and Mr. Paul voted to approve. The motion was carried.

Additional discussion was held regarding the lost interest that would result from the Board's action. Mr. Orbison and Mr. Paul noted that ultimately the money would all end up in the same place, enhancing education. Mr. Paul expressed concern that loss of interest could impact the financial performance of the lottery. Mr. Orbison asked Mr. Redburn if earned interest income was a category in the lottery budget and whether the budget would need to be amended to reflect the loss of interest. Mr. Redburn replied that is was categorized in the budget, but that he did not think it would have a significant impact for FY06. Loss of interest income would need to be taken into consideration in the FY07 budget.

Mr. Scroggins stated that he would send a copy of the approved motion to the members of the Board who were unable to attend today's meeting, and that he would forward a copy of the minutes as soon as they were transcribed.

ITEM 5

Adjournment

Dr. Dzialo made a motion to adjourn the Board Meeting. Mr. Riley seconded the motion.

Mr. Scroggins reminded the Board that the next meeting would be held on May 16th, at which time four current lottery vendors would be making short presentations regarding the extension of their contracts with the Lottery Commission. He stated that decisions regarding extensions could be made in July, as the contracts did not expire until August 19th. Mr. Orbison stated that it was possible the Board would be ready to vote on extensions following the oral presentations on May 16th.

Mr. Scroggins reminded Board members that the June Board meeting was being cancelled due to scheduling difficulties.

Mr. Paul announced that the Audit and Finance Committee would cancel their June meeting, but would plan to meet at 11:00 a.m. on May 18th (prior to regular Board meeting) and would discuss future meetings at that time.

Mr. Redburn stated that he would probably need to have a temporary budget ready for the Board's approval in June, and then the final budget could be submitted for approval at the July meeting.

Roll Call: Mr. Orbison, Mr. Riley, Dr. Dzialo, and Mr. Paul voted to adjourn the meeting. Motion was carried and meeting adjourned.

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Linda Dzialo, Secretary

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James Orbison, Chairman