

State Government

The most noteworthy act of the 2005 legislative session was the State Lottery. The General Assembly also enacted major reform of its lobbying regulations as well as legislation affecting the Administrative Procedures Act, the Escheat Fund, and several executive branch agencies.

The Lottery

When the Senate and House of Representatives reached agreement on the state budget in mid-August and worked into the wee hours of the morning—events generally indicative of impending adjournment—without adopting H 1023, the lottery bill passed by the House in April 2005, many declared the lottery defeated. A few lottery opponents even left the city in the recess that followed the budget's passage with no plans to return for the waning days of the session, much like sports fans heading early to the parking lot, confident that the game is in the bag. But in a dramatic end that few predicted, the Senate voted 25-24 on August 30, 2005, in favor of the State Lottery Act, thus ending a losing streak for lottery proponents that had spanned more than two decades. Lieutenant Governor Beverly Perdue cast the deciding vote, and Governor Easley signed S.L. 2005-344 (H 1023) into law the next day.

A discussion follows of the players, rules, and revenue subject to new Chapter 18C, the North Carolina State Lottery Act, enacted by S.L. 2005-344 (H 1023), as amended by the Current Operations and Capital Improvements Appropriations Act of 2005, S.L. 2005-276 (S 622).

The Players

State Lottery Commission. Article 2 of new G.S. Chapter 18C establishes the North Carolina State Lottery Commission, an independent, self-supporting, and revenue-raising agency charged with overseeing operation of the state lottery. The commission consists of nine members, five of whom are appointed by the Governor. One of the Governor's appointees must have served five years in law enforcement. Two members of the commission are appointed by the General Assembly upon recommendation of the President Pro Tempore of the Senate. One of these persons must be a certified public accountant. The final two commission members are appointed by the General Assembly upon recommendation of the Speaker of the House of Representatives. One of these appointees must have

served as the owner or manager of a retail sales business. In making appointments to the commission, the appointing authorities must consider the composition of the state with respect to geographic representation and gender, ethnicity, race, and age.

The Governor selects the chair of the commission from among its members. Members initially are appointed to staggered terms of one to three years. All succeeding appointments are for five-year terms. Members may not serve for more than two successive terms. The commission meets at least quarterly. Members receive per diem, subsistence, and travel reimbursement for their service, but no other compensation.

The commission is empowered and required to

- select a director to operate and administer the lottery and to serve as the Secretary of the Commission;
- set the amount of compensation for the director;
- specify the types of lottery games and gaming technology;
- set rules for lottery games and methods for determining winners;
- prescribe the nature of lottery advertising within statutory parameters;
- set the number and value of prizes for winning tickets or shares in lottery games;
- establish the retail sales price for tickets or shares for lottery games;
- establish a system to claim prizes and verify validity of tickets or shares;
- specify the manner of distribution and sale of lottery tickets or shares to lottery game retailers or directly to the public;
- determine incentives for lottery employees, vendors, contractors, or electronic computer terminal operators; and
- send quarterly and annual reports on its operations to the Governor, State Treasurer, and General Assembly.

State Lottery Director. Article 3 of G.S. Chapter 18C sets forth the powers and duties of the State Lottery Director, who serves as the chief administrator of the lottery. The director is authorized and required to

- report payment of prizes to state and federal tax authorities and withhold state and federal income taxes as required by law;
- conduct background checks of applicants for employment with the commission, lottery retailers, and lottery contractors;
- set salaries of commission employees;
- enter into contracts with lottery retailers and contractors upon approval by the commission;
- coordinate and collaborate with law enforcement in investigations of violations of the laws relating to operation of the lottery;
- study the operation and administration of other lotteries and make recommendations to improve the operation and administration of the lottery;
- provide monthly financial reports to the commission of lottery revenues, prize disbursements, expenses, net revenues, and all other financial transactions involving lottery funds; and
- enter into agreements with other states to operate and promote multistate lotteries.

Lottery retailers. The commission contracts with lottery retailers to sell tickets or shares in lottery games. Lottery retailers retain 7 percent of the retail price of tickets or shares. The director recommends lottery retailers to the commission. In making these recommendations, the director must, to the extent practicable, meet minority participation goals under the laws governing public contracts. The director may not recommend contracting with a person under twenty-one, a person who would be engaged exclusively in the business of selling lottery tickets or operating computer terminals solely for entertainment, a person who owes delinquent state taxes or has failed to file state tax returns, a person who resides in the same household as a member of the commission, the director, or any employee of the commission.

Lottery retailers must, if requested, furnish bond or a letter of credit. The director may purchase blanket bonds for all lottery retailers if authorized by the commission. Lottery retailers and persons applying to become lottery retailers are prohibited from giving gifts, loans, or favors to the director, commission members, or employees, or to immediate family members residing in the same household

as these individuals. Lottery retailers may provide food and drink not exceeding \$100 per calendar year to these individuals.

Lottery vendors and lottery contractors. Lottery vendors are persons other than lottery retailers who submit bids, proposals, or offers to procure contracts for goods or services for the commission. Lottery contractors are persons other than lottery retailers with whom the commission contracts for goods or services. Article 6 of G.S. Chapter 18C governs the commission's relationship with vendors and contractors.

Public bidding laws, including provisions relating to minority participation goals, apply to contracts entered into by the commission. Moreover, contracts of \$90,000 or more for the purchase of services, apparatus, supplies, materials, or equipment may be awarded by the commission only after it has done the following:

- Advertised an invitation for the submission of proposals, requiring proposals to be accompanied by a bond or letter of credit equal to 5 percent of the proposal plus the fee to cover the costs of a criminal record check
- Complied with minority participation goals
- Investigated and compared business practices, ethical reputation, criminal records, civil litigation, competence, integrity, backgrounds, and regulatory compliance records of lottery vendors

No lottery vendor who has been convicted of a felony or any gambling offense in the last ten years, or who employs officers and directors with such convictions, may be awarded a contract by the commission.

Before a contract is awarded to a lottery vendor, the director must conduct background investigations of the vendor, any parent or subsidiary corporation of the vendor, any shareholders with a 5 percent or more interest in the vendor or its parent or subsidiary, and the officers and directors of the vendor and its parents and subsidiaries.

The prohibition barring gifts from lottery retailers to the director, members of the commission, commission employees, and their respective family members also applies to lottery vendors.

Auditors. Chapter 18C of the General Statutes sets forth specific roles for the State Auditor and independent audit firms selected by the commission. The State Auditor must conduct annual audits of all accounts and transactions of the commission. An independent auditing firm must conduct an audit of security procedures for the lottery at the beginning of each calendar year. In addition, an independent auditing firm must biennially at the end of the fiscal year evaluate the operation of the lottery.

Department of Health and Human Services. The commission must consult with the Department of Health and Human Services (DHHS) to develop and provide to the public information about gambling addiction and treatment. The department must study the effects of the state lottery on gambling addiction in the state and report the results of the study to the General Assembly by January 1, 2007. Annual transfers of \$1 million to DHHS for gambling addiction education and treatment programs are considered an expense of the lottery pursuant to G.S. 18C-163.

Alcohol Law Enforcement. The State Lottery Act amends G.S. 18B-500(b) to vest Alcohol Law Enforcement agents with primary responsibility for enforcing lottery laws. Commission contracts with lottery retailers for the sale of tickets or shares are considered "permits" for purposes of G.S. Chapter 18B.

Rules of the Game

Types of games. The commission determines the types of games that comprise the state lottery. Those games may include instant lotteries, online games, games played on computer terminals, and games that have been conducted by other state government-operated lotteries. Slot machine games using computer terminals or electronic devices that directly dispense money to players are prohibited. In addition, lottery games may not involve wagering on the outcomes of sporting events.

At the time the lottery game is offered for sale to the public, the commission must provide a detailed tabulation of the estimated number of prizes of each particular denomination that it expects to be awarded in each lottery game or the estimated odds of winning these prizes.

Lottery advertising. Advertising must be “tastefully designed” and presented in a manner to minimize the appeal of lottery games to minors. The use of cartoon characters or of false, misleading, or deceptive information in lottery advertising is prohibited. All advertising promoting the sale of lottery tickets or shares for a particular game must include the actual or estimated overall odds of winning the game.

Ticket sales. Tickets or shares may not be resold for more than the retail sales price set by the commission. Each ticket or share in a lottery game must have a retail price of at least 50 cents. This minimum price does not apply to discounts or promotions authorized by the commission for a particular lottery game.

The sale of a lottery ticket or share to a person under eighteen is a Class 1 misdemeanor, pursuant to G.S. 18C-131. It is a defense for the person who sold a ticket or share to a minor if the person produces evidence of facts that reasonably indicated at the time of sale that the purchaser was at least eighteen years old. No prize may be paid to a person under eighteen.

In addition to minors, the following persons may not purchase a lottery ticket or share or be awarded a prize: commission members and employees, the director, or a spouse, parent, or child living in the same household as one of these individuals.

Games with tickets. Each ticket must be imprinted with a unique number, abbreviated game play rules, and resources for information on responsible gaming. Tickets may have cartoon characters designed to appeal to adults, not minors. In games using tickets with preprinted winners, the overall estimated odds of winning prizes must be printed on each ticket. No names or photographs of current or former elected officials may appear on game tickets.

Drawings. G.S. 18C-132 sets forth procedures for drawing and claiming prizes, payment of prizes, and protecting information identifying certain prize winners.

Games that employ daily or less frequent drawings of winning numbers, drawings among entries, or drawings among finalists must comply with the following conditions:

- The drawing must be open to the public.
- An independent certified public accountant (CPA) must witness the drawing.
- An independent CPA and a commission employee must inspect the equipment used before and after the drawings.
- Audio and visual records of the drawings and the required inspections must be made.

Prizewinners. Winners of less than \$600 may claim prizes from any lottery retailer or the commission. Winners of more than \$600 must claim prizes directly from the commission.

Identity protection. If a prize winner presents a protective order issued under G.S. 50B-3, a court order restricting access to or contact with the person, or an Address Confidentiality Program authorization card, the winner’s identifying information must be treated as confidential.

Withholding. New G.S. 105-163.2B requires the commission to withhold state income taxes from payment of lottery winnings at a rate of 7 percent.

Debt set-off. The commission may establish a debt set-off program allowing prize payments to be used to satisfy a debt of at least \$50 owed by the winner to a state or local government agency. The commission must match the information submitted by agencies with persons entitled to prize payments of \$600 or more. A collection assistance fee of \$5 for state agency debt and \$15 for local agency debt applies.

Reporting. After the period for claiming prizes for each game expires, the commission must make available a detailed tabulation of prizes claimed and paid directly by the commission.

Prohibition of local regulation. Pursuant to G.S. 18C-170, counties and municipalities are prohibited from enacting ordinances or regulations relating to the lottery. Chapter 18C of the General Statutes preempts all existing ordinances that impose additional restrictions or requirements upon the operation of the lottery.

The Revenue

New G.S. 18C-160 creates the North Carolina State Lottery Fund, an enterprise fund, within the State Treasury. The State Lottery Fund is appropriated to the State Lottery Commission, which is authorized to expend the funds to operate the commission and the lottery games.

The following revenues must be deposited in the lottery fund:

- Proceeds from the sale of lottery tickets or shares
- Funds for initial start-up costs provided by the state
- All other funds credited or appropriated to the commission from any source
- Interest earned by the fund

Section 15 of the State Lottery Act requires the State Treasurer to lend to the lottery commission funds not exceeding \$10 million to cover its initial operating expenses and requires the commission to repay the funds, with interest, in twenty-four months. Pursuant to Section 15.1, all net revenues from the lottery in 2005–06 must be transferred to the Education Lottery Reserve Fund.

Beginning in 2006–07, G.S. 18C-162 requires that State Lottery Fund revenues be allocated as follows:

- At least 50 percent of revenues must be expended as prizes.
 - At least 35 percent of revenues must be transferred to the Education Lottery Fund, established by G.S. 18C-164.
 - No more than 8 percent of revenues may be allocated for lottery expenses.
 - No more than 7 percent of revenues may be allocated for compensation to lottery retailers.

Permissible commission expenses are

- costs incurred in operating and administering the commission;
- costs resulting from commission contracts for the purchase or lease of goods or services;
- the appropriation of \$1 million annually to DHHS for gambling addiction education and treatment programs;
- costs of supplies, materials, tickets, independent studies and audits, data transmission, advertising (not to exceed 1 percent of annual revenue), promotion, incentives, public relations, communications, bonding for lottery retailers, and printing and distribution of tickets and shares; and
- reimbursement to other governmental entities for services provided to the commission.

If commission expenses total less than 8 percent of revenue, the commission may use surplus funds to increase prize payments or for any public purpose described in G.S. Chapter 18C.

Unclaimed prizes are not considered abandoned property but instead are allocated in equal portions to enhance prize payments and to the Education Lottery Fund. The General Assembly must transfer unclaimed prize money from the State Lottery Fund to the Escheat Fund in an amount equal to the principal transferred from the Escheat Fund for scholarships in fiscal years 2003–04, 2004–05, 2005–06, and 2006–07 until the Escheat Fund is repaid for any amounts of principal transferred in those fiscal years.

Net revenues of the State Lottery Fund, which must be at least 35 percent of total revenue, must be transferred to the Education Lottery Fund. Five percent of the net revenue of the prior year must be transferred to the Education Lottery Reserve Fund, a special revenue fund established in the State Treasury. The reserve fund is capped at \$50 million.

The commission must distribute the remaining revenue in the Education Lottery Fund as follows:

- Fifty percent to support reduction of class size in early grades to class size allotments not exceeding 1:18 and to support academic prekindergarten programs for at-risk four-year-olds
- Forty percent to the Public School Building Capital Fund
- Ten percent to the State Educational Assistance Authority to fund college and university scholarships

The General Assembly must appropriate funds in each category annually based upon revenue estimates. If actual revenues are less than appropriations, the Governor may transfer from the reserve fund moneys to equal the appropriation. If the reserve funds are insufficient to cover the shortage, the Governor must transfer money for the following purposes, listed in order of priority:

1. To fund academic prekindergarten programs for at-risk four-year-olds
2. To reduce class size
3. To provide financial aid for needy students to attend college
4. To fund the Public School Building Capital Fund

If, on the other hand, actual revenues exceed appropriations, excess revenues must be transferred in equal portions to the Public School Building Capital Fund and the State Educational Assistance Authority for expenditure in the same manner as appropriations from the Education Lottery Fund.

New G.S. 115C-546.2 requires that lottery revenues transferred to the Public School Building Capital Fund must be allocated as follows: 65 percent on a per average daily membership basis as determined by the State Board of Education and 35 percent to local schools in counties in which the effective county tax rate as a percentage of the effective state average tax rate is greater than 100 percent. The effective county tax rate is defined as the actual county tax rate multiplied by a three-year weighted average of the most recent annual sales assessment ratio studies. Counties are not required to match funds appropriated pursuant to the effective tax rate category. Counties may use appropriations based upon effective tax rates to pay for school construction projects in local school administrative units and to retire indebtedness incurred for school construction projects on or after January 1, 2003, but may not use the funds to pay for school technology needs.

New Article 35A in G.S. Chapter 115C, "College Scholarships," sets forth criteria for awarding scholarships from appropriated lottery revenues. Students who are legal residents of North Carolina, who meet Pell Grant eligibility requirements (other than family contribution requirements), and whose expected family contribution to college under federal guidelines does not exceed \$5,000 are eligible for scholarships. Students must be admitted, enrolled, and classified as undergraduates at a North Carolina community college or an accredited college or university in North Carolina.

Students must maintain satisfactory academic progress and may not receive a scholarship for more than four years. A scholarship must be at least \$100 and not more than \$4,000 per academic year. The State Education Assistance Authority must administer scholarships under rules it adopts. The authority must report by June 1, 2008, and annually thereafter to the Joint Legislative Education Oversight Committee the amount of scholarship money disbursed, the number of eligible students, and the eligible institutions that received the funds. It may use 1.5 percent of appropriated scholarship funds for administrative purposes.

Lobbying

S.L. 2005-456 (S 612) reforms and strengthens the North Carolina laws on lobbying. The act makes the following changes, effective January 1, 2007:

- Closes the goodwill lobbying loophole, which required reporting of only those expenses incurred while discussing specific legislation. Under the new law, lobbyists must report all lobbying expenditures above \$10 a day, whether to influence specific legislation or to create goodwill.
- Requires expense reports to be filed monthly while the legislature is in session and quarterly between sessions. Currently, lobbyists report their expenses twice a year.
- Enacts new Article 4C of G.S. Chapter 147, imposing the same registration and reporting requirements on lobbyists who solicit members of the executive branch.
- Institutes a six-month cooling off period, preventing former legislators and executive branch officials from becoming lobbyists for six months after leaving office.
- Creates a "no gifts" registry that allows legislators and executive branch officials to voluntarily signal that they do not want to receive gifts or anything of value from lobbyists or lobbyist principals.
- Authorizes the Secretary of State to impose a civil fine of up to \$5,000 per violation for false or incomplete reporting. This civil penalty would be in addition to the other consequences of being convicted of violating the lobbying laws: a two-year ban on lobbying and, in the case of intentional violations, criminal punishment as a Class 1 misdemeanor.

Administrative Procedure Act

Analysis of Impacts on Transportation Projects

A special provision, Section 28.8 of S.L. 2005-276, the 2005 appropriations act, amends the State Administrative Procedure Act (G.S. Chapter 150B) to require any agency adopting a rule that affects environmental permitting by the Department of Transportation to submit the draft rule to the Board of Transportation before publication in the North Carolina Register and to consider any recommendations from the board prior to adopting the rule. Further, the special provision gives the board the unique ability to delay the effective date of the rule by objecting to it within a day after the rule is approved by the Rules Review Commission, whether or not any other parties have concerns about the rule.

State Lottery Exemption

A special provision in S.L. 2005-276, Section 31.1(ff), completely exempts the State Lottery from the State Administrative Procedure Act.

Wildlife Resources Contested Case Exemption

The Coastal Recreational Fishing License bill, S.L. 2005-455 (S 1126), exempts the Wildlife Resources Commission from the contested case provisions of the Administrative Procedure Act in regard to the granting or terminating of the right to sell licenses. The act is summarized in detail in Chapter 26, "Wildlife and Boating."

Escheat Fund

During the 2005 regular session, the General Assembly enacted several changes affecting escheated property. Escheated property is property the state assumes ownership of under G.S. Chapter 116B, either because the property is determined to be abandoned or because the property was owned by a person who died and had no heirs. Article IX, section 10, of the North Carolina Constitution requires property in the Escheat Fund to be used to "aid worthy and needy students who are residents of this State and are enrolled in public institutions of higher education in this State." The State Treasurer administers the Escheat Fund.

In S.L. 2005-252 (S 341), the General Assembly authorized up to 20 percent of the Escheat Fund to be invested in (1) insurance contracts, trusts, limited partnerships, and limited liability companies whose primary purpose is investing in or owning real estate or related debt financing; (2) certain corporate stock; and (3) limited partnerships and limited liability companies whose primary purpose is to invest in public or private debt, public or private equity, or corporate buyout transactions. In Section 28.17 of S.L. 2005-276, the General Assembly extended until October 1, 2007, the maximum maturity date of an Escheat Fund investment in obligations of the North Carolina Global TransPark Authority and provided that if any of the authority's property is divested, the proceeds must be applied to repay these obligations.

Section 9.6 of S.L. 2005-276 appropriates from the Escheat Fund just under \$68 million to the UNC Board of Governors and just over \$15 million to the State Board of Community Colleges to be allocated by the State Education Assistance Authority for need-based student financial aid. Section 96 states that the funds will be drawn from Escheat Fund principal if there is insufficient income to pay the appropriations, except that the Escheat Fund may not be drawn down below \$400 million. The 2003 General Assembly began addressing budget problems by reducing General Fund support for need-based scholarships and appropriating funds for this purpose from the principal as well as the interest of the Escheat Fund. At the conclusion of the 2004 regular session, the State Treasurer warned that continued withdrawals at the same rate would drain the Escheat Fund in five to seven years. The

State Lottery Act, S.L. 2005-344, as amended by Part 31 of S.L. 2005-276, provides in Section 15.3 that the General Assembly must transfer unclaimed prize money from the North Carolina State Lottery Fund to reimburse the Escheat Fund for any principal taken from the Escheat Fund for scholarships in fiscal years 2003-04 through 2006-07.

Finally, S.L. 2005-132 (H 672) reduces from five to three years the holding period before certain property escheats. The act applies to

- stock or another equity interest in a business association if (1) the cash dividend is unclaimed, (2) two or more consecutive communications from the holder to the apparent owner have been returned unclaimed or undeliverable, or (3) the holder has discontinued communications to the apparent owner;
- debts of business associations if the interest or principal payment is unclaimed by the apparent owner; and
- dividends, profits, distributions, and other security-related payments that are unclaimed.

Miscellaneous

State Controller

S.L. 2005-65 (H 231) authorizes the State Controller to review a state agency's compliance with prescribed uniform state accounting system standards. The act also enacts new G.S. 143B-426.39B, which excludes the work papers and other supportive material created as a result of such a review from the definition of public record under G.S. Chapter 132.

Borrowing for Highway Projects

S.L. 2005-403 (H 254), which was recommended by the Joint Legislative Transportation Oversight Committee, authorizes the State Treasurer to issue grant anticipation revenue vehicle (GARVEE) bonds on behalf of the Department of Transportation to fund highway projects. The act specifies that North Carolina will not be obligated to pay the principal or the interest on the bonds except from federal transportation funds and that neither the state's full faith and credit nor its taxing authority is pledged for payment of principal or interest. The bond authorization becomes effective February 1, 2006. The act directs the Secretary of Transportation and the State Treasurer to submit to the General Assembly by December 1, 2005, an implementation plan for issuance of GARVEE bonds.

State Bar

S.L. 2005-237 (H 896) provides the North Carolina State Bar with an appeal of right to the Court of Appeals from final orders of the bar's disciplinary hearing commission. The act also increases from \$200 to \$300 the maximum annual membership fees that may be assessed by the State Bar Council.

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