

The Education Lottery

By Shea Riggsbee Denning

In mid-August of 2005 the Senate and House of Representatives, working into the wee hours of the morning, reached agreement on the state budget—an event generally indicative of impending adjournment. When they did not adopt H 1023, the lottery bill passed by the House in April of 2005, many declared the lottery defeated once again. After the budget's passage, a few lottery opponents even left Raleigh with no plans to return for the waning days of the session—like sports fans heading to the parking lot early, confident that the game is in the bag. But on August 30, 2005, in a dramatic ending few had predicted, the Senate voted 25 to 24, with Lieutenant Governor Beverly Perdue casting the deciding vote, in favor of the State Lottery Act, thus ending a losing streak for lottery proponents that had spanned more than two decades. Governor Michael Easley signed S.L. 2005-344 (H 1023) into law the next day.

Net proceeds of the North Carolina Education Lottery will fund public education expenses, including those related to reduced class size in the early grades, academic prekindergarten programs for at-risk four-year-olds, school construction, and scholarships for needy college and university students. This article discusses the players, rules, and revenues subject to new Chapter 18C of the North Carolina General Statutes (hereinafter G.S.), the North Carolina State Lottery Act (Lottery Act), enacted by S.L. 2005-344 (H 1023), as amended by the Current Operations and Capital Improvements Appropriations Act of 2005 (State Budget Act), S.L. 2005-276 (S 622).

Although the Lottery Act spells out the way net lottery proceeds are to be allocated among specified educational priorities and programs, it does not address the question of whether revenues from other sources traditionally used to fund such priorities and programs may be reduced or

diverted in light of lottery funding. The lottery bill ratified by the General Assembly and signed by the governor, H 1023, pledged that net lottery revenues would not *supplant* existing or projected state revenues for the public purposes identified in the Lottery Act, but would *supplement* existing funds. Had this provision become law, lottery proceeds would have resulted in a significant increase in state funding for the educational purposes designated in the act. However, the State Budget Act, ratified two weeks before the Lottery Act, provided that if the Lottery Act became law, language prohibiting net lottery revenues from supplanting existing revenues was to be deleted from new G.S. 18C-102. Thus, the Lottery Act, as amended, does not address the issue of whether state spending for the purposes set forth in the act—or for that matter, education in general—will increase as a result of the lottery.

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 the recommendation of the president pro tempore of the Senate. One of these persons must be a certified public accountant (CPA). The final two commissioners are appointed by the General Assembly upon the recommendation of the speaker of the House of Representatives. One of these appointees must have experience owning or managing 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, gender, ethnicity, race, and age.

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The governor selects the chair of the commission from among its members. The initial nine members appointed serve staggered terms of one to three years. All succeeding appointments are for five-year terms. Commissioners may not serve for more than two successive terms. They receive per diem, subsistence, and travel reimbursement for their service, but no other compensation.

The commission meets at least quarterly. It is empowered and required to

- select a director to operate and administer the lottery and 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;¹
- 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. 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 director recommends to the commission the retailers who will sell tickets or shares in lottery games, and the commission contracts with the retailers. In making these recommendations, the director must, to the extent practicable, meet the minority-participation goals mandated in 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; or a person who resides in the same household as a member of the commission, the director, or any employee of the commission.

Lottery retailers retain 7 percent of the retail price of the tickets or shares they sell. Lottery retailers must, if requested, furnish a bond or letter of credit. The director may purchase blanket bonds for all lottery retailers if authorized by the commission to do so. Lottery retailers and persons applying to become lottery retailers are prohibited from giving gifts, loans, or favors to the director, commission members, lottery employees, or 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 and 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, the commission may award contracts of \$90,000 or more for the purchase of services, apparatus, supplies, materials, or equipment only after it has

- advertised an invitation for the submission of proposals that requires proposals to be

1. According to Ch. 18C-103(9), “[s]hare” means any method of participation in a lottery game, other than by a ticket purchased on an equivalent basis with a ticket.”

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; and
- investigated and compared the business practices, ethical reputations, criminal records, civil litigations, 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 an interest of 5 percent or higher in the vendor or its parent corporation or subsidiary, and the officers and directors of the vendor and its parent corporation 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 evaluate the operation of the lottery every other year at the end of the fiscal year.

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. They may include instant lotteries, online games, games played on computer terminals, and games that have been conducted by the lotteries of other state governments. 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 it expects to award in each lottery game or the estimated odds of winning these prizes.

Lottery advertising

Advertising must be “tastefully designed” and presented in a manner that minimizes 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 fifty cents. This minimum price does not apply to discounts or promotions authorized by the commission for a particular lottery game.

Under G.S. 18C-131 the sale of a lottery ticket or share to a person under eighteen is a Class 1 misdemeanor. It is a defense for the person who sold a ticket or share to a minor if he or she 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, paying prize money, and protecting the identity of certain prize winners.

When the lottery holds daily or less-frequent drawings of winning numbers, drawings among entries, or drawings among finalists, it must comply with the following conditions:

- The drawing must be open to the public.
- An independent certified public accountant 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 commission must treat the winner's identifying information 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 such 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.

Exemption from the State Administrative Procedure Act

The state lottery is exempted from the State Administrative Procedure Act.

Prohibition of local regulation

Pursuant to G.S. 18C-170, counties and municipalities are prohibited from enacting ordinances or regulations relating to the lottery. G.S. Ch. 18C preempts all existing ordinances that impose additional restrictions or requirements on 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, and
- interest earned by the fund.

Section 15 of S.L. 2005-344 of the Lottery Act requires the state treasurer to lend to the lottery commission funds not exceeding \$10 million to cover its initial operating expenses; the funds must be repaid, with interest, in twenty-four months. Pursuant to Section 15.1, all net revenues from the lottery in 2005–2006 must be transferred to the Education Lottery Reserve Fund.

Beginning in 2006–2007, 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. Ch. 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 2003–2004, 2004–2005, 2005–2006, and 2006–2007 until the Escheat Fund is repaid for all 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 annually 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 achieve class-size ratios not to exceed 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 on revenue estimates. If actual revenues are less than appropriations, the governor may transfer from the reserve fund the amount necessary to make up the shortfall. If the reserve funds are insufficient to cover the shortage, the governor must transfer whatever funds are available for the following purposes, listed in order of priority:

- Academic prekindergarten programs for at-risk four-year-olds
- Reductions in class size
- Financial aid for needy students to attend college
- 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. Counties are not required to match funds appropriated pursuant to the effective tax rate category. Counties may use these funds to pay for school construction projects in local school administrative units and to retire indebtedness for school construction projects incurred on or after January 1, 2003; they may not use the funds to pay for school technology needs.

College Scholarships

New Article 35A of G.S. 115C sets forth criteria for awarding college 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 expenses 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.

They 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. By

June 1, 2008, and annually thereafter, the authority must report 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. The authority may use 1.5 percent of appropriated scholarship funds for administrative purposes.

And the winner is . . .

The General Assembly estimates that net proceeds from the lottery will total \$425 million in the 2006–2007 fiscal year. All of those funds will be allocated to the educational

funding priorities set forth in the Lottery Act. When the chair of the State Board of Education, Howard Lee, bought the ceremonial first state lottery ticket on March 30, 2006, he pronounced the children of North Carolina the greatest winners of the new games. Whether children are the primary beneficiaries of the Lottery Act remains to be seen. Although the act itself does not bar the substitution of lottery revenues for existing state education funding sources, policy considerations and political constraints may indeed prevent, or at least minimize, the supplanting of traditional school revenue sources. Time will tell whether the lottery lives up to its billing as the Education Lottery. ■