

THINK NEW MEXICO

A Results-Oriented Think Tank Serving New Mexicans

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EXCERPT FROM THINK NEW MEXICO'S POLICY REPORT

"AVERTING THE CRISIS: MAKING LOTTERY SUCCESS SCHOLARSHIPS SUSTAINABLE"

In early 2002, the New Mexico Lottery distributed a press release announcing that it had negotiated a new contract with its online gaming vendor¹, GTech, which reduced the percentage it paid GTech from about 10.35% to 8.52% starting in 2003. It seemed like a good deal for New Mexico.

However, the new contract was far less of an improvement than it might appear. In the chart on page 19 of "Averting the Crisis," we rank all of the lotteries with 2005 online sales between \$25 million and \$100 million by the percentage they paid to their online vendor, using data collected from the lotteries themselves by La Fleur's World Lottery Almanac, the respected independent source on lotteries.

The chart reveals that New Mexico pays a higher percentage of its online sales to its vendor than any of the seven states with sales between \$25 million and \$100 million: 8.52%. By contrast, New Hampshire pays only 2.16%, or less than a third of what New Mexico pays.

Even tiny Montana, whose sales of slightly more than \$23 million (less than half of New Mexico's sales of approximately \$48 million) were not high enough to qualify for our chart, pays only 5.8% of sales to its online vendor. Because of its greater lottery ticket sales, greater population size, and greater economies of scale, one would expect New Mexico to enjoy a lower contract rate than Montana.

Nebraska, which with approximately \$44 million in online sales is closest to New Mexico, also pays significantly less: 2.39%. Nebraska makes for a good comparison to New Mexico because in addition to its comparable gross online sales, it is also a sparsely populated state and has about the same number of people living within its boundaries.

New Mexico's current contract with GTech contains an "Online Pricing Matrix" which lowers the percentage of online sales payable to GTech to slightly more than 7.5% if online lottery sales climb from their current level to a range between \$60 million and \$100 million.

In contrast to that 7.5% figure, Delaware, West Virginia and New Hampshire have online lottery sales between \$60 million and \$100 million and smaller population sizes than New Mexico, yet

¹ Online games are drawing-based, like Powerball and Roadrunner Cash, as opposed to instant scratch-off games. Online vendors make and maintain the ticket vending machines and computer systems necessary to operate online games. In return, the online vendor typically receives a percentage of the sales.

they pay only 4.18%, 3% and 2.16% of online sales, respectively, to Scientific Games, a GTech competitor.

Idaho, the only other state in this category with a GTech contract, pays a rate of 2.99%, nearly of third of New Mexico's contract rate.

New Mexico's payments to GTech extend even beyond the 8.52% of sales specified in the contract. The Lottery also pays GTech fees of \$24 a week for each of the state's more than 1,100 terminals, for a total of \$1,372,800 in 2005. Last year, GTech also charged the Lottery approximately \$380,000 in additional assorted fees that are not broken out in the contract. All told, last year New Mexico paid GTech a grand total of 12.14% of the revenues from its online sales, which comes to \$5.9 million.

So what might explain why New Mexico's Lottery pays such a high percentage of its sales to GTech? One explanation might be that GTech won the current New Mexico lottery vendor contract without having to compete because GTech was the sole bidder.

GTech is a publicly traded Rhode Island company that operates lotteries in over 50 countries and has a market capitalization in excess of \$4 billion. This fall, GTech was bought out by gambling giant Lottomatica SpA, a multinational corporation based in Italy, in a sale that created the world's biggest lottery operator.

GTech has provided the New Mexico Lottery's online machines and online gaming services since it entered into its original contract with the Lottery in 1996 and the first online games were introduced in New Mexico. A November 11, 1996 article in *Fortune* magazine reported that "[I]n New Mexico, where GTech was the only bidder, the company was able to submit a bid millions higher than if it had faced real competition."

That same article concluded that "rare is the company that has faced as many allegations of baldly sleazy conduct as GTech" and its executives have "perfected the backroom art of lottery politics: rewarding political friends, annihilating enemies and crushing the competition."

GTech received some attention during last year's fight over the Harriet Miers Supreme Court nomination because she chaired the Texas Lottery Commission when GTech had a contract with the Texas lottery. According to an October 7, 2005 *New York Times* article, Lawrence Littwin, the former director of the Texas Lottery, has "said that he was dismissed after a little over four months on the job when he tried to look into the GTech contract and the company's campaign contributions...[Another] issue was whether to extend GTech's contract or open it to other bidders, as Mr. Littwin preferred."

In 2002 the New Mexico Lottery, under the leadership of former CEO Tom Shaheen, extended GTech's contract for five years rather than opening the state's contract for online sales to other bidders. (No members of the 2006 Lottery Authority were serving on the Board in 2002.) Although legal, this is curious because there were other online vendors available, such as Scientific Games.

Unfortunately, this unconscionable contract with GTech does not expire until November 20, 2008 (although the parties are, of course, always free to re-negotiate the rate if both parties consent).

Setting aside the question of whether it is a good idea to award a sole-bid contract to a company with GTech's history and then extend that contract without opening it to other bids, there can be no question that it is fundamentally inconsistent with the Lottery's statutory mandate to maximize revenues for scholarships.

By comparing New Mexico to Nebraska, the lottery most comparable to ours, we estimate that the New Mexico Lottery is overpaying GTech by at least \$2.9 million annually or about \$17.5 million over the life of the extended contract². That represents more than 800 scholarships per year and nearly 5,000 annual scholarships over the extended contract. Every dollar that the New Mexico Lottery overspends on its contract with this multinational gambling giant is a dollar less to invest in deserving high school graduates here in New Mexico.

² Savings calculated by applying Nebraska's 2.39% online vendor payment rate to New Mexico's 2005 online sales, assuming online terminal fees remain constant.