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*VIA E-MAIL ONLY*

Re: Proposed Amendment to Rules Governing Compensation of State Lottery Retailers,  
Minnesota Rules, 7856.4030; Revisor's ID Number R-04551

Dear Librarian:

The Minnesota State Lottery intends to adopt rules regarding compensation of lottery retailers. We plan to publish a Notice Intent to Adopt Rules without a Public Hearing in the August 26, 2019 State Register.

The Lottery has prepared a Statement of Need and Reasonableness. As required by Minnesota Statutes, sections 14.131 and 14.23, the Department is sending the Library an electronic copy of the Statement of Need and Reasonableness prior to mailing our Notice of Intent to Adopt Rules.

If you have questions, please contact me at (651) 635-8213.

Respectfully,

A handwritten signature in black ink, appearing to read "Ben Freedland". The signature is fluid and cursive.

Ben Freedland  
*General Counsel*

## **Minnesota State Lottery**

### **STATEMENT OF NEED AND REASONABLENESS**

#### **Proposed Amendment to Rules Governing Compensation of State Lottery Retailers, Minnesota Rules 7856.4030; Revisor's ID Number R-04551**

### **INTRODUCTION**

The Minnesota State Lottery (the "Lottery") sells lottery tickets through a network of over 3,000 contract retailers. The Lottery sells two types of lottery tickets: (1) preprinted instant-win tickets, commonly called "scratch tickets"; and (2) computer generated numbers games tickets, commonly called "lotto tickets." Lottery retailers receive preprinted instant-win lottery tickets and computer terminals for printing lotto tickets from the Lottery and sell tickets on the Lottery's behalf. Lottery retailers also redeem (or "cash") winning lottery tickets of under \$600, provided the cash is on hand. Winning tickets of \$600 or over must be cashed at a Lottery office.

Lottery retailers accept tickets on consignment and are compensated primarily by a commission on tickets sold and winning tickets cashed. This commission compensates retailers for their time, efforts, and point-of-sale real estate in their stores and incentivizes retailers to promote the Lottery in order to sell additional lottery tickets. Lottery retailers are also compensated by incentive programs as described in Minnesota Rules 7856.4030, subp. 2.

From the inception of the Lottery in 1989 until 1998, the commission on selling lottery tickets was five percent, and no commission was paid on cashing winning lottery tickets. In 1998, the Lottery was instructed by Minnesota Statutes section 349A.16 to (1) increase commissions by one-half of one percent, (2) institute a cashing commission of one percent for each winning ticket cashed, and (3) periodically review commissions to maintain appropriate return to the state. This directive was codified in Minnesota Rules 7856.4030. These rates remain unchanged since 1998.

With this amendment to Minnesota Rules 7856.4030, the Lottery is adjusting commissions by increasing the commissions paid to lottery retailers on sales of preprinted instant-win lottery tickets and on cashing of all lottery tickets by an additional one-half of one percent. The Lottery believes these commission increases will maintain the appropriate return to the state by appropriately compensating and incentivizing retailers.

### **ALTERNATIVE FORMAT**

Upon request, this information can be made available in an alternative format, such as large print, braille, or audio. To make a request, contact Ben Freedland, General Counsel, Minnesota State Lottery, 2645 Long Lake Road, Roseville, MN 55113, (651) 635-8213, [ben.freedland@mnlottery.com](mailto:ben.freedland@mnlottery.com).

## STATUTORY AUTHORITY

The Lottery's statutory authority to adopt the rules is stated in Minnesota Statutes section 349A.16, which provides, "The director of the State Lottery shall periodically review lottery ticket sales and make such adjustments to lottery retailer commission rates as are deemed necessary to maintain appropriate return to the state," and Minnesota Statutes section 349A.05, which provides, "The director may adopt rules under chapter 14 governing ... (5) compensation of lottery retailers." Minnesota Statutes section 349A.05 was adopted and effective before January 1, 1996 and has not been revised by the Legislature since then, so Minnesota Statutes section 14.125, regarding the time limit on authority to adopt, amend, or repeal rules, does not apply. Additionally, Minnesota Statutes section 14.125 should not apply to section 349A.16 because 349A.16 places an ongoing responsibility on the Lottery to periodically review sales and adjust retailer commissions.

Under these statutes, the Lottery has the necessary statutory authority to adopt the proposed rules.

## REGULATORY ANALYSIS

**(1) a description of the classes of persons who probably will be affected by the proposed rule, including classes that will bear the costs of the proposed rule and classes that will benefit from the proposed rule**

The Lottery anticipates the proposed rule amendment will affect current and prospective Lottery retailers, and beneficiaries of Lottery proceeds.

### *Lottery Retailers*

The Lottery anticipates that increasing Lottery retailer commissions will more fairly compensate retailers for their time and efforts and increase the incentive for retailers to further support the Lottery's mission by selling additional lottery tickets. Retailers will receive more compensation for each preprinted instant-win lottery ticket sold, and for every winning lottery ticket cashed. This additional financial incentive will encourage retailers to be more proactive in selling lottery tickets by, for example, asking customers to buy tickets and allowing the Lottery additional space to place point-of-sale advertisements in high retail traffic areas of their stores. Additionally, the increased commission may convince retailers who are considering stopping lottery sales to remain active. Finally, increased commissions will also allow the Lottery to more effectively recruit new retailers. The Lottery depends on easy and readily available player access to lottery tickets via an extensive retail network throughout Minnesota. Recruiting new retailers is essential to maintaining and increasing lottery sales because of natural turnover of businesses and population growth in underserved areas.

## *Lottery Beneficiaries*

The Lottery anticipates that the beneficiaries of Lottery proceeds will be impacted by the proposed rule amendments. The nature of the impact, however, is uncertain. The Lottery's primary beneficiaries are the Environmental and Natural Resources Trust Fund and the General Fund. See Minnesota Statutes section 349A.10, subdivision 5. Other beneficiaries include the Game and Fish Fund and the Natural Resources Fund. See Minnesota Statutes sections 297A.65 and 297A.94(h). The Lottery is optimistic that the impact on the Lottery's beneficiaries will be positive and that the proposed rules will increase beneficiary revenue through increased sales. Increasing retailer commissions, as explained above, may increase lottery sales enough to offset the increased commissions.

The Lottery's optimism that the rule amendment will increase payments to its beneficiaries is supported by the Lottery's sales experience beginning July 1, 2018. On July 1, 2018, the Lottery initiated a retailer incentive program under Minnesota Rules Part 7856.4030, subp. 2 that increases the commissions on preprinted instant-win tickets by one-half of one percent, and on redemptions of winning tickets by one-half of one percent. This retailer incentive, discussed in section (4) below, achieves most of the goals of this rule amendment. From July 1, 2018, to December 31, 2018, scratch sales were approximately \$14.6 million over the equivalent period in 2017. The commission increase generated approximately \$2.7 million incrementally for Lottery beneficiaries. During this time, the Lottery paid only \$1.8 million in additional sales and cashing commissions. While this analysis is preliminary and it is influenced by factors beyond the ongoing retailer incentive program such as historical high lotto jackpots it supports the Lottery's optimism that the rule amendment will increase payments to its beneficiaries.

It is possible, however, that there will be no impact on the Lottery's beneficiaries or the impact will be negative because the proposed rules will not increase revenue, or they will not increase revenue enough to cover the cost of the increased commissions. This possibility, however, is provided for by the statutory authority for these rule amendments. See Minnesota Statutes section 349A.16. The Lottery was directed to maintain "appropriate return to the state" and to "periodically review" commission rates. *Id.* If the rule amendments cause an inappropriate return to the state, the Lottery is under the same obligation to further adjust retailer commissions. *Id.*

### **(2) the probable costs to the agency and to any other agency of the implementation and enforcement of the proposed rule and any anticipated effect on state revenues**

Beyond the costs associated with the Lottery's promulgation of these rules, the Lottery anticipates the implementation and enforcement costs of the amended rules will be negligible. Commission rates can be modified with minimal effort by the Lottery's back office accounting systems. The impact on state revenues is discussed in section (1) above and in the Rule Analysis, below.

**(3) a determination of whether there are less costly methods or less intrusive methods for achieving the purpose of the proposed rule**

The Lottery has determined that there are no less costly methods of clearly and predictably increasing the incentive for Lottery retailers to promote the Lottery and sell lottery tickets.

**(4) a description of any alternative methods for achieving the purpose of the proposed rule that were seriously considered by the agency and the reasons why they were rejected in favor of the proposed rule**

The Lottery can offer Lottery retailer incentive programs under Minnesota Rules, Part 7856.4030, subp. 2. The Lottery considered an open-ended incentive that would increase commissions to the rates found in the amended rules. The Lottery is currently offering such an incentive during the pendency of this rulemaking. This alternative was rejected in favor of the rule amendment increasing commission rates for two reasons: (1) retailers should be able to plan and budget for commissions, knowing that commission structure cannot be changed abruptly by the Lottery; and (2) retailers deserve the opportunity to comment on commission rates through the formal rulemaking process.

**(5) the probable costs of complying with the proposed rule, including the portion of the total costs that will be borne by identifiable categories of affected parties, such as separate classes of governmental units, businesses, or individuals**

The Lottery anticipates the implementation and enforcement costs of the amended rules will be negligible or zero. The impact on state revenues is discussed in section (1) above and in the Rule Analysis, below.

**(6) the probable costs or consequences of not adopting the proposed rule, including those costs or consequences borne by identifiable categories of affected parties, such as separate classes of government units, businesses, or individuals**

The Lottery anticipates the implementation and enforcement costs of not adopting the amended rules will be immaterial. Not increasing commissions, however, may have the inverse effect described in section (1) above and in the Rule Analysis, below. In short, the Lottery and Lottery retailers are concerned that leaving rates unchanged since 1989 will decrease the incentive for Lottery retailers to promote the Lottery and sell lottery tickets.

**(7) an assessment of any differences between the proposed rule and existing federal regulations and a specific analysis of the need for and reasonableness of each difference”**

Not applicable.

**(8) an assessment of the cumulative effect of the rule with other federal and state regulations related to the specific purpose of the rule . . . . ‘[C]umulative effect’**



**means the impact that results from incremental impact of the proposed rule in addition to other rules, regardless of what state or federal agency has adopted the other rules. Cumulative effects can result from individually minor but collectively significant rules adopted over a period of time.**

Not applicable.

## **PERFORMANCE-BASED RULES**

The Lottery is committed to a commission-based compensation structure for its retail partners that incentivizes retailer performance. Retail compensation is uncapped and directly tied to a simple formula: the more tickets sold, the more the retailer earns. Furthermore, as described below, the proposed rule provides a greater commission for preprinted instant-win lottery tickets because the Lottery believes its retailers have a greater ability to increase sales on this product.

## **ADDITIONAL NOTICE**

The Lottery Notice Plan also includes giving notice required by statute.

The Lottery will mail the rules and Notice of Intent to Adopt to everyone who has registered to be on the Department's rulemaking mailing list under Minnesota Statutes, section 14.14, subdivision 1a. Additionally, the Lottery will e-mail the rules and Notice of Intent to Adopt to the 289 people and entities the Lottery has identified as potentially interested parties. On June 20, 2018, the Lottery e-mailed these 289 people and entities to alert them to the State Register advertisement for a Request for Comments for Possible Amendment to Rules Governing Compensation of State Lottery Retailers, Minnesota Rules 7856.4030 (Revisor's ID Number R-04551).

The Lottery will also give notice to the Legislature per Minnesota Statutes, section 14.116.

## **CONSULTATION WITH MMB ON LOCAL GOVERNMENT IMPACT**

As required by Minnesota Statutes section 14.131, the Lottery will consult with Minnesota Management and Budget (MMB). Specifically, the Lottery will send MMB copies of the documents sent to the Governor's Office for review and approval on the same day the Lottery sends them to the Governor's office. The Lottery will send the documents before the the Lottery's publication of the Notice of Intent to Adopt. The documents will include the Governor's Office Proposed Rule and SONAR Form; the proposed rules; and the SONAR. The Lottery will submit a copy of the cover correspondence and any response received from MMB to the Office of Administrative Hearings at the hearing or with the documents it submits for Administrative Law Judge review.

## **DETERMINATION ABOUT RULES REQUIRING LOCAL IMPLEMENTATION**

As required by Minnesota Statutes section 14.128, subdivision 1, the Lottery has considered whether these proposed rules will require a local government to adopt or amend any ordinance or other regulation in order to comply with these rules. The Lottery has determined that these rules will not require changes on the part of local government because retailer compensation is not governed by local ordinance or regulation.

## **COST OF COMPLYING FOR SMALL BUSINESS OR CITY**

### **Agency Determination of Cost**

As required by Minnesota Statutes section 14.127, the Lottery has considered whether the cost of complying with the proposed rules in the first year after the rules take effect will exceed \$25,000 for any small business or small city. The Lottery has determined that the cost of complying with the proposed rules in the first year after the rules take effect will not exceed \$25,000 for any small business or small city.

The Lottery has made this determination based on the lack of costs of complying with the proposed rule, as described in the Regulatory Analysis section of this SONAR.

## **RULE-BY-RULE ANALYSIS**

The Proposed Rule Amendment is below. Additions are underlined, deletions are in ~~strikethrough~~:

### **7856.4030 COMPENSATION.**

Subpart 1. **Commission.** Retailers shall receive a commission of ~~five and one-half~~ six percent of the price of each preprinted instant-win lottery ticket, and five and one-half percent of the price of any other lottery ticket sold by that retailer. Retailers shall also receive a commission of one and one-half percent on the amount of each winning ticket cashed by that retailer.

The Amendment makes two changes. First, it changes the commission rate on preprinted instant-win lottery tickets from five and one-half percent to six percent. Second, it changes the commission on each winning ticket cashed from one percent to one and one-half percent. The justification for each change is discussed below and in the Regulatory Analysis section of this SONAR. Additionally, the justification for not changing the commission on lottery tickets that are not preprinted instant-win tickets is included.

*Increasing the commission on instant-win lottery tickets from five and one-half percent to six percent*

There are several reasons why the Lottery needs to change the commission on sales of instant-win lottery tickets from five and one-half percent to six percent. The increase from five and one-half percent to six percent is reasonable because it places the Lottery's

compensation structure in line with its retailers' cost of doing business, and it is in line with other state lotteries.

As described above, the Lottery attracts and retains retailers by paying a commission on ticket sales. According to retailer comments and the Lottery's independent research, the retailers' cost of doing business is increasing. This includes "an over 80% increase in the state's minimum wage since 1998." See Minnesota Grocers Association, Minnesota Retailers Association Letter dated August 18, 2018. The increase in commissions more accurately compensates retailers for their time and expense selling Lottery tickets. Further, by increasing the incentive to sell Lottery tickets, the Lottery believes it can increase sales of instant-win lottery tickets. See *id.* As described below, incentivizing the sale of instant-win lottery tickets is an important strategic and economic goal for the Lottery.

Additionally, the Lottery's commission structure falls behind those of other state lotteries. This is an important justification for increasing commissions for two reasons. First, it shows that the Lottery is not properly balancing the incentive to sell tickets against the current commission rate. The Lottery recognizes that balancing sales incentives is uncertain, but the most relevant information comes from lotteries similar to Minnesota. Second, the Lottery needs to stay competitive with neighboring state lotteries with chain retailers that also sell lottery tickets in Minnesota. Wisconsin and Iowa are the Lottery's most important geographic comparators because Speedway, Holiday, Kwik Trip, Kum & Go, Casey's, Hy-Vee, and other retail chains span these states. As shown in Figure 1, the Lottery's current commission rates are below the neighboring comparator states of Wisconsin and Iowa.

<b>Lottery</b>	<b>Scratch Commission</b>	<b>Lotto Commission</b>	<b>Cashing Commission</b>
<b>Minnesota (Current)</b>	5.5%	5.5%	1%
<b>Wisconsin</b>	6.25%	5.5%	0%
<b>Iowa*</b>	5.5–7%	5.5–7.75%	0%

Figure 1

\*Iowa's base commission rates increase to 7% with adherence to the "Gold Star Program" and an incentive during high jackpots. Most retailers qualify for the Gold Star Program. Additionally, Iowa retailers receive a 0.75% sales bonus when certain jackpots reach \$400 million.

Without the rule amendment, the Lottery's commission rates are significantly below the rates paid by the Wisconsin and Iowa lotteries.

Similarly, the Lottery's current commission rates, compared with the national comparator states of Colorado, Arizona, and Oregon are shown in Figure 2. These three states are useful comparators for the Minnesota Lottery because each is a geographically large



state with about 5.5 million residents and a single central metropolitan area. The Lottery's commission rates are also below these comparators.

<b>Lottery</b>	<b>Scratch Commission</b>	<b>Lotto Commission</b>	<b>Cashing Commission</b>
<b>Minnesota (Current)</b>	5.5%	5.5%	1%
<b>Arizona*</b>	6.5–7%	6.5–7%	0%
<b>Colorado**</b>	7%	6–7%	1%
<b>Oregon***</b>	5–10%	5–10%	1%

Figure 2

\*Arizona retailers earn 6.5% commission on all lottery sales, with an opportunity to earn an additional 0.5% via a performance incentive.

\*\*Colorado retailers can earn up to an additional 1% commission on certain lotto game sales if compliant with a bonus plan.

\*\*\*Oregon's commission is based on weekly sales, from 5% for sales up to \$1,000 to 10% for sales \$7,000 and above. The average rate overall is 8.2%.

Without the rule amendment, the Lottery's commission rates are significantly below the rates paid by the Arizona, Colorado, and Oregon lotteries. This is strong evidence that the Lottery's commission rates are not balanced correctly to incentivize the Lottery's retailers.

*Increasing the cashing commission from one percent to one and one-half percent*

Increasing the cashing commission serves two related purposes: (1) it is a greater incentive to retailers to sell lottery tickets, as selling lottery tickets invariably leads to cashing winning tickets, as many lottery tickets are played immediately upon purchase; and (2) the cashing commission also incentivizes retailers to have cash on hand to pay winners, an important consideration in whether players will purchase lottery tickets.

*Not increasing the commission on "lotto" tickets*


As explained above, the Lottery sells (1) preprinted instant-win tickets, and (2) computer generated "lotto" tickets. The Lottery has determined that the current five and one-half percent commission on lotto tickets properly incentivizes retailers and maintains the appropriate return to Lottery beneficiaries. The primary reason is the largest incentive to buy lotto tickets is jackpot sizes. Unlike scratch tickets that have fixed, pre-determined odds and prizes, lotto tickets have variable and often increasing jackpots.

When a lottery product has fixed odds, it is up to the retailer to sell by asking for the sale, providing more point-of-sale advertisements, giving additional time and customer service to lottery customers, or employing other sales techniques. These sales techniques require effort by retail employees or valuable point-of-sale real estate. As explained above, the Lottery does not feel the use of these retailer resources is being correctly compensated. Conversely, the largest incentive to buy lotto tickets is jackpot sizes. For

lotto games like Powerball®, Mega Millions®, Gopher 5®, and Print-N-Play®, an increasing jackpot drives sales. When jackpots are low, sales are low. When jackpots increase, sales increase. The Lottery does not believe that retailer effort, point-of-sale real estate, or other sales techniques have nearly the impact of jackpot sizes on overall sales. Therefore, increasing the commission on lotto tickets is not necessary to meet the goals of this rule amendment, as described above.

**CONCLUSION**

Based on the foregoing, the proposed rules are both needed and reasonable.



Robert A. Doty  
Executive Director, Minnesota Lottery

3/22/14  
Date