

Illinois takes first step towards outsourcing the management of the state lottery

By Elizabeth Corey, Partner with Law Firm of Foley & Lardner, LLP

Cash strapped states with and without state lotteries have their eyes on Illinois as it moves toward the nation's first third party state lottery management. Steps like last month's hiring of a financial advisor will be evaluated and likely imitated if other states decide to explore ways to innovate lottery management by a third party.

While "privatization" has been used to describe a variety of proposals in the industry, the Illinois version calls for naming an experienced manager who can increase lottery revenues to fund important Illinois construction and educational projects. The concept of "privatization" as it is being applied in Illinois is to outsource the management of the lottery. The State of Illinois retains ownership, and certainly continues to exercise regulatory control, but will appoint a lottery manager with the expectation that private management, with expertise and competencies acquired from experience in the competitive commercial environment as opposed to the state government environment, will result in increased revenue to fund important Illinois construction and education objectives.

Under Illinois' process (as adopted in July 2009 and amended last December), an early step requires the Illinois Department of Revenue to name a financial advisor to manage the bid process for the selection of the lottery manager. The result was the Department's appointment in April, 2010 of the Oliver Wyman Group, a unit of New York's Marsh & McLennan Companies, to the position. The Oliver Wyman contract runs from April 5, 2010 to October 14, 2011.

Consistent with Illinois' cautious approach to the process for engaging a third party manager, candidates for the financial advisor were restricted to those who had no material business or financial relationships with any potential management offeror within the last three years. Any entity which provides equipment to support the lottery was also prohibited from acting as financial advisor.

By barring these and other conflicts of interest, the legislation sought an advisor who could maintain clear objectivity in evaluating management candidates. In fact, the legislation limited the advisor's ability to enter into any business relationship with a potential offeror for one year following the engagement by the Illinois Department of Revenue.

These strict requirements meant that most or all financial service advisors normally identified with the lottery and gaming industry were excluded from consideration. The Illinois legislative requirements specifically addressed the need for a short list of consultants outside the industry. This should bring clear vision – with new insight – on how the lottery should be managed, distribution issues, technology issues, flexibility for new games and expansion opportunities within existing



demographic categories and global lottery relationships.

The role of Oliver Wyman is expected to focus on analyzing the existing lottery, recommending areas for expansion and growth, and, most importantly, shaping the request for qualifications prepared by the Illinois Department of Revenue (pursuant to the amended July legislation and the requirement of the Department of Justice) for a lottery manager that will survive, political and social objection. Oliver Wyman will also have the opportunity to structure the fee payable to the potential lottery manager in order to attract experienced global lottery managers and persuade them an investment in Illinois would be worthwhile. Oliver Wyman will also help determine which responsibilities will remain with the State and

which should be delegated to the lottery manager, balancing the need to attract qualified offers, the Department of Justice limitations, and the need for increased growth and revenue.

Oliver Wyman is an experienced and respected financial services advisor. Even though – by design – the state has chosen an advisor that has limited contact with the lottery and gaming industry, Oliver Wyman's knowledge in evaluating other retail services is expected to bring an objective review of the lottery program. Its global presence should significantly enhance the qualifications presented for the management bid.

Under the current schedule, the Illinois Department of Revenue is to select at least two offerors to potentially serve as the private manager by August 9, 2010. The Governor (or designee) is to choose the lottery manager by September 15, 2010, based on the Department of Revenue's recommendation. The legislation specifically places the selection process outside the state's normal procurement code.

The choice of lottery manager was to have taken place earlier, but Illinois politics and other factors have delayed the process. Provisions that increased the number of video lottery terminals and authorizing a pilot internet gaming program have created additional controversy and delays.

Further delays might be possible. The timing for producing the report of the financial advisor and its recommendation for a bid package (coupled with its engagement until October, 2011) may anticipate a further delay in circulating the bid package and, eventually, appointment of the lottery manager. Such a cautious approach probably is inevitable for any state selecting a lottery service provider and wanting to avoid any appearance of "pay to play" and insider favoritism.

Illinois' approach will be watched carefully by other states that may have an interest in privatizing lotteries. If the use of an independent financial consultant is successful in Illinois, it most likely will become part of standard practices elsewhere, along with any other features of the Illinois system that appear to enhance profitable and responsible management. ♦