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## Foreword by the Secretary of State

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The National Lottery has been a great success. It caught the imagination of the public, and quickly became a national institution. Some of the reasons are straightforward: high-profile jackpot wins, and the many projects, great and small, which Lottery funding made possible. But this success was not inevitable or pre-determined. The Lottery has, from the outset, been well run. We are fortunate to have had an effective private sector operator working within a well-regulated system which, while seeking to raise as much as possible for good causes, maintains protection for children and the vulnerable and a high standard of propriety. Of course there have been problems of various kinds along the way, and no shortage of critics to point them out. But they should not obscure the fact that overall our Lottery is widely recognised as one of the most successful in the world. We want to build on that success, with a Lottery that continues to be operated for the public good in the most efficient way at arms' length from the government of the day.

Camelot's second licence as the operator of the Lottery has about six and a half years to run. I hope and expect that it will do a good job in raising income for good causes. But the time is now right to look again at the system of licensing and regulation within which the Lottery is run, to see what changes might be necessary when that licence ends.

We want to consider whether there might be scope for more competition to run the Lottery, or for more companies to participate in it. We also want to see whether there is scope for streamlining the day-to-day regulation, without of course sacrificing useful safeguards. We now have ample experience of how the Lottery works, and some of the concerns raised at the outset may now be seen to have been overdone.

It is also important that the arrangements for regulating the Lottery should be consistent – though not necessarily identical – with our plans for the regulation of other kinds of gambling, as set out in **A safe bet for success**, which we published on 26 March 2002.

Consideration of options for change does not imply criticism of Camelot or the National Lottery Commission. We all have to work within the current statutory provisions. It is that framework which is now due for a fresh look. This study will run hand in hand with the initiatives that I have already taken to ensure that the arrangements for spending Lottery income for good causes are as effective as they can be.

This consultation document sets out what we see as the main options for changes to the licensing and regulation of the Lottery. We have an open mind on the outcome. I do not rule out the conclusion that the present arrangements are essentially sound and the benefits of change would be at best uncertain. We would welcome your views.



TESSA JOWELL

## Section 1: Introduction

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1.1 The National Lottery was launched in 1994 to raise money for a variety of good causes, including sport, the arts, charities, the national heritage and Millennium projects. Following a competition, Camelot, a consortium of major companies, was awarded the first licence to run the Lottery for seven years. By the end of this period the public had spent almost £32 billion on the Lottery, receiving back around £16 billion in prizes. Good causes received some £10 billion including unclaimed prizes and interest payments. The Government took nearly £4 billion in Lottery duty (introduced with the Lottery to ensure that it did not result in a loss of Government revenues from taxes on other consumer expenditure). The balance went on running the Lottery and providing a return for the operator.

1.2 The table below sets out ticket sales and revenue distribution over the first licence period. All figures in £m

	94/95	95/96	96/97	97/98	98/99	99/00	00/01
<b>Ticket Sales</b>	1,191	5,217	4,723	5,514	5,228	5,094	4,983
<b>Income to NLDF</b>	312	1,457	1,444	1,753	1,671	1,581	1,551
<b>Lottery Duty</b>	143	626	567	662	627	611	598
<b>Retailer Commission</b>	61	265	242	282	265	258	253
<b>Operating Costs</b>	131	401	264	259	252	267	246

Source: NLC

1.3 The first licence was awarded, and Camelot regulated, by the Director General for the National Lottery. The National Lottery Act 1998 replaced his office by the National Lottery Commission (NLC). The NLC's first key task was to organise a competition for a second licence. This resulted in its award to Camelot, with a number of changes in licence conditions.

1.4 The National Audit Office has just reviewed this process. Its report, **Awarding the new licence to run the National Lottery** (*HC 803 Session 2001-2002: 10 May 2002*), concluded that, notwithstanding well-publicised difficulties, the NLC conducted a thorough review of the bids and the process it used provided a sound basis for its decision to award the licence to Camelot. But the report included a number of recommendations aimed at a future licensing process.

1.5 This consultation document, which takes account of the NAO's report, sets out options for change to the arrangements for licensing and regulating the Lottery, aimed at:

- ensuring that it raises as much income as possible for good causes without weakening necessary protections
- ensuring effective competition for its operation
- maintaining public confidence in the Lottery and the arrangements for running it.

- 1.6 The Government does not envisage changes to the basic concept of the National Lottery, as the only large-scale lottery allowed in the United Kingdom and whose purpose is to provide income for good causes.
- 1.7 But the Government does not at this stage rule out any options for delivering a Lottery of this kind. Whether the Lottery is operated on a standard commercial or a not-for-profit basis does not itself matter: what matters is the outcome.
- 1.8 The best available current forecast is that Lottery sales will run at about £5 billion a year over the second licence period; although the Government hopes that Camelot, which has recently carried out a major re-launch, will do better than that. The Government does not accept that what has been termed “lottery fatigue” – a gradual but remorseless decline in public interest and sales – is inevitable or irreversible. Certainly such a decline has been common in the case of lotteries around the world. It is indisputable that the chances of winning a major prize are very low, so that the people who play may find it increasingly hard, as time goes on, to sustain their hopes. This suggests that the arrangements for providing the Lottery after the end of the second licence period will need to place considerable weight on the ability of the operator and regulator – whoever they are – to engage players’ interest and enthusiasm, using the full range of media available for running games and selling chances. Innovation and flair will be needed to maintain mass appeal.
- 1.9 The Lottery does not of course operate in a gambling vacuum. The overall context is set out in **A safe bet for success**, which gives the Government’s response to the recommendations of the Gambling Review Body and proposals for reform of the law governing gambling in Great Britain. The Gambling Review Body were asked not to consider changes to the National Lottery, but to consider the impact of their recommendations on it. **A safe bet for success** explains that the Government has decided to accept most of the Review Body’s recommendations, which will ensure that the gambling industry can improve its ability to meet customer demand and that the public can be confident that gambling will be conducted fairly and honestly, and with proper safeguards for children and the vulnerable. While the National Lottery clearly involves gambling, the unique support that it provides for good causes has led the Government to conclude that it should not be exposed to direct competition that could undermine its role. Lotteries for commercial gain will continue to be prohibited by law; and the Government remains committed to ensuring that the law should broadly maintain the National Lottery’s current competitive position in relation both to commercial gambling and other lotteries.
- 1.10 Nevertheless, implementation of the legislative proposals in **A safe bet for success** will enable the overall gambling sector to grow. This is another reason for thinking ahead about how the National Lottery of the future, after the second licence period, should be enabled to thrive in what will by then be a more dynamic market. The safeguards in the law against direct competition from commercial gambling and other lotteries may be a necessary condition for the National Lottery to succeed, but they are not sufficient. This again underlines the need to ensure that the statutory framework for the Lottery does not hold back its ability to innovate, in respect both of technology and content.

## Section 2: Background

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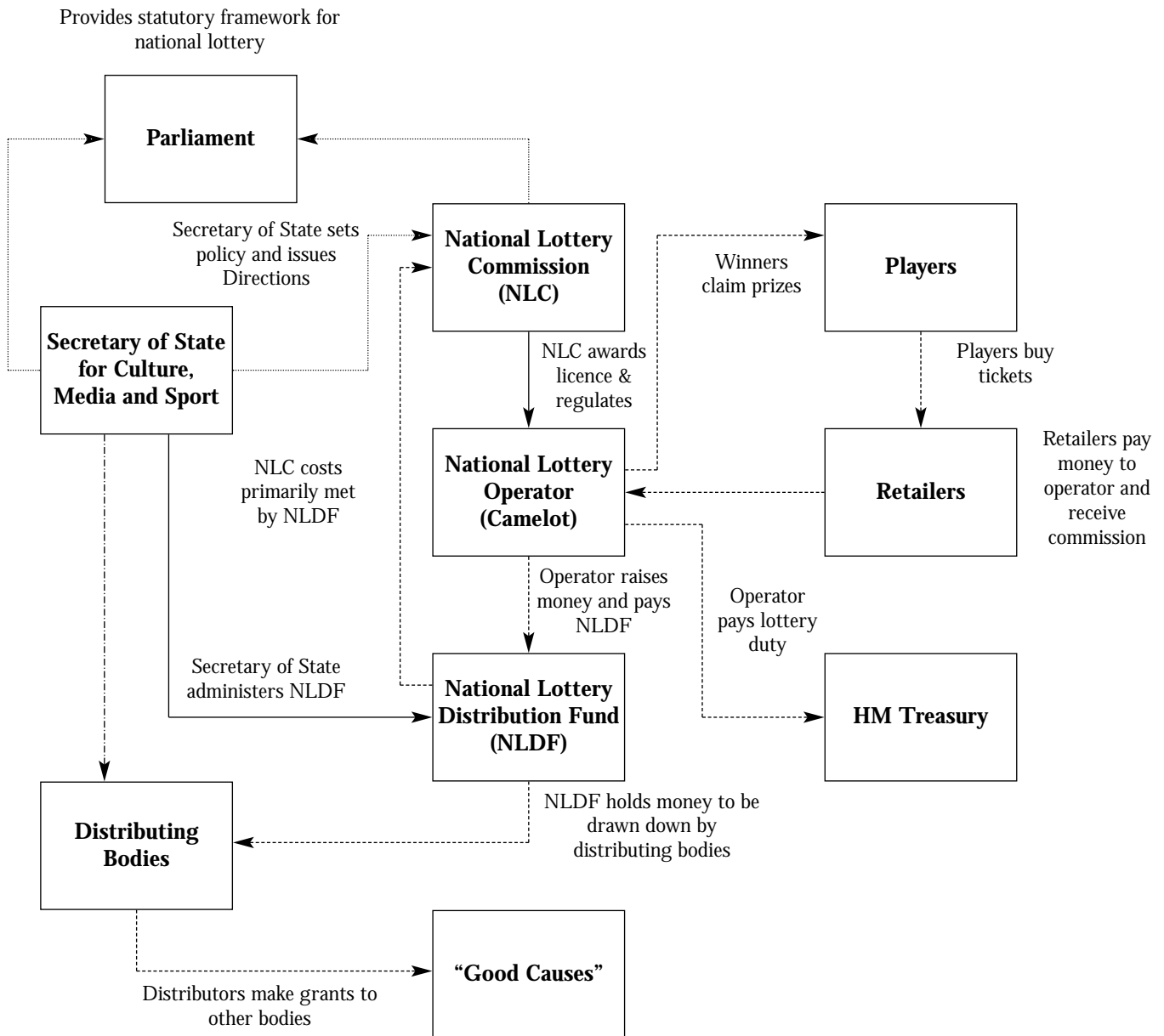
### Legislation

- 2.1 The Lottery is governed by the National Lottery Acts 1993 and 1998. They provide for a Lottery comprising a series of games, to be played by anyone aged 16 or more. The proportion of sales income to good causes goes into the National Lottery Distribution Fund (NLDF) to be shared amongst the distributing bodies. The NLC has no responsibility for income once it goes into the NLDF. The Government is not considering any change in this respect.
- 2.2 The 1993 and 1998 acts do not prescribe the design of the Lottery: it is for companies wanting to run the Lottery or promote games within it to develop their own proposals. So, for example, game design, prize structure and distribution mechanisms are all left unmentioned in the legislation. What the Acts do is lay down the control framework within which the Lottery is to be managed.
- 2.3 This framework recognizes four key parties:
- the Secretary of State, whose overriding duty is to ensure that the Lottery is run properly and that players' interests are protected and, subject to that, to maximise the income for good causes. The Secretary of State has the power to give directions about how the Lottery is to be licensed, and to make regulations about how it is run.
  - the NLC, whose duties mirror those of the Secretary of State. The key function of the NLC is to issue and enforce licences for the operation of the Lottery. There are two kinds of licence: a licence under section 5 of the 1993 Act, which is granted to a body corporate to run the National Lottery; and one or more licences under section 6 of that Act, granted to a body or bodies corporate to promote lotteries as part of the National Lottery.
  - the section 5 licensee: currently Camelot. It is the responsibility of this licensee to provide the technical, retailing and marketing infrastructure within which section 6 licensees can operate, and for ensuring that payments to prizewinners, the NLDF and the Exchequer are made.
  - the section 6 licensee(s), responsible for the games. At present Camelot holds all section 6 licences itself.
- 2.4 The Acts therefore envisage that the operation of the National Lottery will be in the hands of private sector companies. They provide considerable flexibility, at least in principle: there is no presumption that the section 5 and 6 licensees will be the same or different, or how many section 6 licensees there will be. However, the 1993 Act provides that any prospective section 6 licensee can promote a game within the National Lottery only under an agreement with the section 5 licensee. The NLC may not require that licensee to let in other companies.

2.5 During the first licence period Camelot had only one agreement with another company, when Vernons Pools were granted a section 6 licence to operate one game. It was not thought to be a success. Since then, Camelot has held all section 6 licences. There have been many such licences. Each new scratchcard game, for example, has had to have its own section 6 licence. Under the terms of the second section 5 licence, Camelot has to develop and implement a strategy, subject to the NLC’s approval, for encouraging potential applicants for section 6 licences. It remains to be seen how this will turn out.

2.6 Figure 1 below sets out the current structure of the Lottery, as helpfully set out in the NAO’s recent report.

### Operation of the National Lottery



**Key**  
 - - - - -> Accountability  
 - - - - -> Flow of money  
 - - - - -> Policy Direction  
 - - - - -> Regulation

Source: NAO Report, *Awarding the new licence to run the National Lottery*

## Previous competitions

- 2.7 Eight applications for the first seven-year section 5 licence were submitted. The Director General of the National Lottery decided how the competition should be run and on what basis. It was, for example, his decision that bidders should be asked to commit a percentage of sales revenue to good causes rather than bid an upfront cash sum, which they would aim to cover from revenue over the licence period.
- 2.8 The NLC decided to run a competition for the second licence along the same lines as the first which resulted in only two compliant bids, although several companies had expressed an initial interest in bidding. The competition was delayed by the NLC's initial decision to negotiate exclusively with The People's Lottery Ltd, which was the subject of a judicial review. Following this review and a further evaluation of both bids, the NLC awarded a second seven-year licence to Camelot.
- 2.9 The NAO report on this process considered how successful the NLC had been in achieving genuine competition for the second licence. It concluded that, while there had self-evidently been a significant reduction in the number of bidders from 1994, the level of competition achieved was comparable with that of other countries that run a national lottery on a similar basis. But the report drew attention to the risk that further competition of the same kind might fail to attract a serious challenge to the incumbent operator.

## The nature of competition in the Lottery context

- 2.10 The National Lottery main game is itself a natural monopoly. One of the reasons for the Government's decision, as set out in **A safe bet for success**, to retain limits on the size of charitable and other society lotteries was a concern that competition between lotteries offering unlimited prizes would set off a vicious circle in which none would sell enough tickets to support prize pools capable of paying prizes large enough to sustain mass support through ticket sales.
- 2.11 Competition to run the National Lottery is another matter. The familiar benefits of competition are that it forces companies to constrain costs, improve productivity and innovate. Competition does not require a large number of market participants, provided that the market is contestable – that is, that barriers to entry are low.
- 2.12 The contestability of a section 5 licence is arguable. Some have suggested that it is constrained by the limited number of suppliers able to show a track record of providing and supporting the very large IT and communications network through which tickets are sold and income brought to account. Others have argued that contestability is impaired by other factors, including the costs of bidding; the reputational risks of having to operate so much in the public eye; and the limits on the commercial returns which the regulator would allow. As to bidding costs, lottery operation is not a core business function for most companies, so that teams or consortia have to be created specifically to put together a bid. The National Lottery also operates on a scale involving requirements that may not be obvious: for example, to ensure that all players can be reimbursed if a draw is voided. Overall, it has been widely argued that the incumbent operator has a large advantage: other possible bidders would have to spend more on obtaining information about the Lottery and putting together a consortium willing to accept all the relevant risks.

- 2.13 On the other hand developments in technology may increase future contestability. It is conceivable that the present stand-alone network could be replaced by arrangements in which supermarket or bank networks provided a realistic alternative. Furthermore, the second section 5 licence includes a number of new conditions which could facilitate future competition:
- the licensee is required to cooperate with a new licensee up to two years prior to the end of the licence
  - the NLC has acquired rights over retailer information. This could have the effect of helping to ensure that future bidders are able to work from common assumptions about the retail estate
  - the NLC can now ensure the transfer of intellectual property rights to a new licensee
- 2.14 As noted above, competition at the section 6 licence level has so far been scant. In some other contexts – for example, the making of television and radio programmes – broadcasters have been required to take a percentage of their output from independent producers.
- 2.15 The split licensing structure might suggest that, so long as there is an adequate degree of contestability for a future section 5 licence to provide assurance that there will be a sound technical infrastructure for the Lottery, the real focus for competition can be at the section 6 level, and that it is at that level that other companies can best contribute. An alternative view would suggest that competition at that level might help to stimulate new game design, but that it cannot make a significant impact on the overall costs of running the Lottery, the overall marketing strategy or indeed on what a new section 5 bid would promise in the way of income for good causes.

## International comparisons

- 2.16 For most major lotteries around the world such issues of competition do not arise, because they are run directly by a national or state government, or at any rate by a public sector operator under government control. This is the traditional pattern, followed by the oldest lotteries in Europe (in Portugal and the Netherlands) which have several hundred years experience of supporting good causes. In the USA most lotteries are operated as state government agencies. A few (including Georgia, Connecticut and New Mexico) are state corporations acting as commercial entities. This kind of structure also applies to a minority of European lotteries. For example, the operator of the Irish lottery – An Post – is 80% owned by the Irish Post Office and 20% by the Minister of Finance.
- 2.17 A few major lotteries are run by non-government bodies under licence. Some are commercial companies, as in the UK. Others are charities that benefit from the proceeds.
- 2.18 Some countries have more than one kind of operator. In Italy CONI runs a lottery as a public sector body for the benefit of Olympic sports, while Lottomatica and Sisal Sport Italia are run by the private sector. In Spain, the Loterías y Apuestas del Estado, which runs the famous El Gordo lottery, is a state organisation, while ONCE is a charity for the blind that runs a state-sanctioned lottery to help support its members.

2.19 Tables 1 and 2 below show the top 25 lotteries in the world by total sales and sales per capita respectively (*NB – all figures shown are in US\$m*). The UK is third on the first measure, but outside the top 25 on the latter. This could be seen as a measure of the Lottery's success in providing moderate and well-controlled gambling, or as a reflection of unaggressive marketing. But in considering the scope for increasing sales it is important to bear in mind the differences between the kinds of gambling allowed here and in other jurisdictions.

**Table 1 Worldwide Lotteries Ranked by Top 25 Calendar 2001 Total Sales**

Rank	Lottery	Country	Year	Population	Total sales*	PC sales*
1	Dai-Ichi Kangyo Bank Ltd	Japan	2001	126.8	8,091.7	64
2	Lottomatica S.p.A	Italy	2001	57.7	7,021.8	122
3	UK National Lottery	UK	2001	59.6	6,992.7	117
4	Loterias y Apuestas del Estado	Spain	2001	40.0	6,751.5	169
5	La Francaise des Jeux	France	2001	59.6	6,272.5	105
6	New York Lottery	USA	2001	19.0	4,580.3	241
7	Massachusetts Lottery	USA	2001	6.4	3,974.9	621
8	California Lottery	USA	2001	34.5	2,893.0	84
9	Texas Lottery	USA	2001	21.3	2,777.8	130
10	Georgia Lottery Corporation	USA	2001	8.4	2,339.2	278
11	Florida Lottery	USA	2001	16.4	2,329.9	142
12	SISAL Sport Italia S.p.A	Italy	2001	57.7	2,241.7	39
13	ONCE	Spain	2001	40.0	2,198.9	55
14	Ohio Lottery	USA	2001	11.4	1,943.7	170
15	Pennsylvania Lottery	USA	2001	12.3	1,926.3	157
16	New Jersey Lottery	USA	2001	8.5	1,866.8	220
17	Westdeutsche Lotterie GmbH	Germany	2001	18.0	1,841.3	102
18	Loto-Quebec	Canada	2001	7.4	1,836.5	248
19	China Sports Lottery	China	2001	1273.1	1,799.8	1
20	Singapore Pools	Singapore	2000	3.5	1,702.2	486
21	Michigan Lottery	USA	2001	10.0	1,612.9	161
22	OPAP	Greece	2001	10.6	1,610.1	152
23	China Welfare Lottery	China	2001	1273.1	1,594.5	1
24	AB Svenska Spel	Sweden	2001	8.9	1,508.5	169
25	Lotteria Sociedad del Estado	Argentina	2000	37.4	1,503.6	40

Source: La Fleur's World Sales Report April 2002

(\*sales figures in US\$millions)

Table 2 **Worldwide Lotteries Ranked by Top 25 Calendar 2001 Per Capita Sales**

Rank	Lottery	Country	Year	Population	Total sales*	PC sales*
1	Rhode Island	USA	2001	1.1	1,079.1	1,020
2	Delaware	USA	2001	0.8	643.6	809
3	South Dakota	USA	2001	0.8	609.4	806
4	Masachusetts Lottery	USA	2001	6.4	3,974.9	623
5	Singapore Pools	Singapore	2001	3.5	1,702.2	482
6	West Virginia Lottery	USA	2001	1.8	713.1	396
7	D.C Lottery	USA	2001	0.6	222.0	388
8	Georgia Lottery Corporation	USA	2001	8.4	2,339.2	279
9	Conneticut Lottery Corp.	USA	2001	3.4	887.0	259
10	Atlantic Lottery Corporation	Canada	2001	2.4	602.4	254
11	Loto-Quebec	Canada	2001	7.4	1,836.5	248
12	New York Lottery	USA	2001	19.0	4,580.3	241
13	Oregon Lottery	USA	2001	3.5	811.1	234
14	Maryland Lottery	USA	2001	5.4	1,251.3	233
15	New Jersey Lottery	USA	2001	8.5	1,866.8	220
16	Lottery Gibraltar	Gibraltar	2001	0.0	5.9	215
17	Norsk Tipping	Norway	2001	4.5	965.0	214
18	Oy Veikaus Ab	Finland	2001	5.2	953.7	184
19	Ohio Lottery	USA	2001	11.4	1,943.7	170
20	AB Svenska Spel	Sweden	2001	8.9	1,508.5	170
21	Loterias y Apuestas del Estado	Spain	2001	40.0	6,751.5	169
22	New Hampshire Lottery	USA	2001	1.3	211.5	168
23	Michigan Lottery	USA	2001	10.0	1,612.9	161
24	Virgin Islands Lottery	USA	FY99	0.1	19.3	160
25	Pennsylvania Lottery	USA	2001	12.3	1,926.3	157

Source: La Fleur's World Sales Report April 2002

(\*sales figures in US\$millions)

- 2.20 **Table 3** below offers comparative operator costs of the UK against average operator costs for all state and territory lotteries in the US, Canada and Australia.
- 2.21 All this suggests that the best prospects for improving competition in our Lottery do not lie in taking its operation into the public sector as a matter of policy choice.

**Table 3 UK, US, Canadian and Australian Comparative Operator Costs**

	<b>Costs as percentage of revenue</b>
UK National Lottery+	5.00
USA*	5.80
Canadian*	6.40
Australian*	6.40

\*Source: La Fleurs World Lottery Almanac

+Source: NLC

## Section 3: Options for change within the current framework

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- 3.1 There are a number of possible further measures, beyond those which the NLC has already taken, which might help to strengthen competition in a future section 5 licensing round, without radically changing the 1993 and 1998 Acts. Some of these options have already been noted by the NLC and the NAO as requiring further consideration nearer such a time.
- 3.2 The options are:
- a contribution to bidding costs so that applicants would make a short initial bid and those seriously in the running would then be asked to prepare a fuller bid which the NLC would subsidize. The NAO's concern that safeguards would be needed to prevent payments which corrected bid deficiencies, rather than supported the unavoidable costs of making a compliant bid, would have to be addressed; but the provision of a fixed amount for all bidders going through to the second stage would be a starting point. There are certainly precedents for this approach, which the NLC itself considered in setting up the last competition.
  - less detailed information during the early stages. The NAO noted that this could itself reduce bidding costs. It might, for example, be possible for the NLC to consider key suppliers only after selecting a preferred bidder on the basis of track record and expertise in managing lotteries and developing games. Such an approach would not be without its own risks; but potentially it could enable the NLC to consider bids from more companies than those who have already entered into firm consortia with the limited number of leading suppliers.
  - a more prescriptive bidding framework might ease the burden on bidders and so have some tendency to widen participation in the bidding process. On the other hand this option would also run the risk of discouraging innovation, which, as noted previously, will be particularly important in the future.
  - extension of the licence period. The NLC, like the Director General before it, took the view that seven years was the optimum term for a section 5 licence, judging that this allowed enough time for the operator to make reasonable returns for an appropriate level of investment. It is possible that a longer term might encourage more bidders; but the Government has no evidence to suggest that in the case of the Lottery it would. The capital infrastructure costs are not of an order of magnitude that would obviously justify a longer term.
  - key supplier phased competitions. The NLC could require a future operator, as a licence condition, to hold regular phased competitions for key suppliers during the licence period. In principle one or more of such supply contracts could run beyond the end of the licence period, so that the following (that is, fourth) licence could be offered with suppliers already in place, so that new bidders would not have to include new arrangements in their bids unless they wished to do. In effect the costs of bidding would be reduced at the outset, and spread over the licence period. One problem might be the operator's own ability to secure effective competition amongst suppliers, with what would be less security for them.

- 3.3 These options are all worthy of consideration, and comments on them would be welcome. But they do not need to be decided now. If the current legislative framework stays broadly in its present form then it will be for the NLC to reach a view on them in several years' time, when preparing for the next licensing round, and for the Secretary of State to decide what if any directions to give the NLC. Both would need to have regard to the state of the market and other circumstances at the time. It would not be sensible to make firm commitments about the detailed conduct of a competition at this distance from it.
- 3.4 What does need to be decided now is whether measures of this kind could on their own be enough to address the risk that next time round there will be no real competitive pressure on the incumbent – even though its performance, including its ability to retain and motivate key staff, may suffer towards the end of the licence period simply on account of the prospect of competition.
- 3.5 This question cannot be left dangling, because if the answer is that legislation to change the framework set out in the 1993 and 1998 Acts is needed, it has to be enacted in good time to influence the next competition.
- 3.6 Given the success that the Lottery has achieved, the arguments for radical change would need to be strong. **The Government would welcome views on whether the measures set out above, or other measures of a kind which could be accommodated without radical change to the 1993 and 1998 Acts, are likely to go far enough to meet the objectives set out at the beginning of this document.**

## Section 4: More radical options

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4.1 More radical options would require legislation, which would have to be enacted to come into effect no later than 2006. The following options appear possible.

### Option 1 – Separation of infrastructure and Lottery products

4.2 Under this option, which was mooted by the House of Commons Select Committee for Culture, Media and Sport last year (*Culture Media and Sport Committee, First Report – The Operation of The National Lottery Volume 1 – HC Session 2000-01, 7 March 2001*) the NLC would offer separate licences for the provision of Lottery infrastructure, supplied and maintained to specified standards, and for the management of the Lottery using the systems supplied. The second licensee would therefore be responsible for game and prize design, marketing, the collection of sales income and all other functions. There would be no reason to exclude one company from applying for or holding both licences, if it made the best bids; but the essence of the option is that there should be separate competitions for distinct licences. If different companies held the two licences, they would have to work together to develop and operate the portfolio of games comprising the Lottery. It would in principle be possible to have several games licensees.

### Benefits

4.3 Possible benefits would include:

- separate competitions would make it easier, on the face of it, for more companies to compete. The number of technology suppliers would no longer constrain the number of bidding consortia
- the NLC would be less likely to find itself in a situation in which it had to balance one bid which was strong on technology but weaker on game innovation against another which was its mirror image

### Risks

4.4 On the other hand there would be some important drawbacks:

- the separation of the licences would be analogous to the split of responsibilities for the railways. The Lottery infrastructure would correspond to the track, stations and signalling equipment, the game portfolio to the rolling stock using them. This parallel must raise concerns that, as in the case of the railways, there could be scope for disputes about where responsibility for problems or poor performance lay and who should pay what for the action needed to address them. Indeed, the distinction between games and infrastructure is arguably less sharp than between track and trains, especially if the Lottery involves increasing use of the Internet, interactive television and new mobile communication networks, not just as distribution mechanisms for selling tickets but as parts of new games

themselves. The separation of infrastructure has been less problematic in the case of other industries; but the relationship between different Lottery licensees would be complex, and would have to be actively managed: the NLC could not just cheer from the sidelines. It would have to acquire a new capacity and expertise.

- this option could also restrict the ability of the Lottery to innovate and be flexible. The requirements sought of the infrastructure licensee at the time of the competition might be apt for circumstances applying and foreseeable then, but less apt for circumstances several years into the licence period. It is not clear what incentives or levers could be used to encourage improved responsiveness and willingness to innovate. This is partly because it is not clear under this option how and on what basis the infrastructure licensee would be paid. It would have no direct source of income: it would have to be paid either by the NLC or by the other licensee. It could be argued that in either case the relationship should be seen more naturally as one of contract rather than licence
- the requirement to have two competitions would lengthen the licensing process and potentially introduce more uncertainties into it.

## **Option 2 – NLC runs Lottery through private sector**

4.5 Under this option the NLC would become more than the body responsible for licensing the operator or operators. It would follow the route taken by most overseas lotteries and become responsible itself for the operation of the Lottery. This option would be intended to address the points that could be argued against option 1, so that the NLC would not have to hold the ring between independent licensees.

4.6 The most direct way of realising this option would be for the NLC to let a contract for the infrastructure of terminals and communications, and then license one or more companies to supply games products. In principle this could provide substantial flexibility. The NLC might, for example, issue one licence for the main on-line game, a second for scratchcard games and a third for new Internet games. Alternatively, and again in principle, it would be possible, for example, to issue separate licences for Wednesday and Saturday draws. They could have different formats and prize structures. Any rollovers would run for a week rather than to the next draw. There are a number of possible variations on this licensing theme. But the key points are that private sector operators would be responsible for developing and managing these games using the NLC's systems, and each would have the same relationship with the NLC. There would not be a single section 5 licensee in charge of the whole operation. The NLC would be in charge, and would therefore have to decide whether the games that it licensed should be marketed and sold by their licensees, within an overall strategy which it laid down, or whether it should itself be responsible for sales and marketing through a further private sector contractor (as happens, for example, in Texas).

## **Benefits**

4.7 Possible benefits are:

- this option, like the first, would involve breaking the Lottery down into constituent parts, and so potentially bring about greater competition for smaller and more manageable elements of the operation
- it would also be possible to see competition beyond the point of the licensing decision: if, for example, midweek and Saturday draws were run by different companies then their effectiveness in selling tickets could be compared
- the infrastructure would be provided on behalf of the NLC, so the NLC could drive changes to it – at a cost

## **Risks**

4.8 This option would not avoid all the problems arising under option 1:

- the overall Lottery operation would become more complex than it is now. The coordination of separate licences and contracts would be a substantial management challenge, not least because the NLC would want competition between the licensees to result in overall growth rather than simply transferring sales from one product to another.
- the available evidence suggests that national lotteries managed by public bodies are less efficient, and the NLC has no track record of management of the kind required. Part-time Commissioners could not possibly run it as now.
- it has been argued – by Camelot amongst others – that any large lottery works best when run as a single integrated business with a clear unity of purpose. There are successful lotteries that are exceptions to the rule. But in the UK context this option would involve a large step into the unknown.
- it might be difficult for the NLC both to be responsible for the operation of the Lottery and its regulation in the public interest. There are of course precedents for public bodies to regulate their own business activities: in the gambling context the Tote provides one. It has an exclusive licence to provide pool betting on horseracing and is its own regulator. But there are fixed odds alternatives for dissatisfied punters. For people who want to play a lottery there are smaller society lotteries to choose between. But there is nothing to rival the National Lottery for prizes.
- having different companies running main draws could be confusing for some players, especially if they used different formats and were differently branded

### Option 3 – Maximum flexibility

4.9 This option is one, which by definition cannot be firmly characterised now. It is based on the view that gambling is changing fast, and that by the time we get nearer the end of the second licence period the needs of the Lottery may call for solutions that are not now obvious. It is not impossible that a much wider range of infrastructure suppliers will be available, as doubts about the scalability of smaller systems are resolved. The growth of interactive platforms for gambling products could itself change the nature of the Lottery operation and the expectations of the public. Such thoughts prompt the idea that it might not be sensible to embed in relatively early legislation any specific structure for the organisation and management of the Lottery. On this approach, amending legislation would remove the section 5 and section 6 licence requirements, and instead give the NLC discretion to decide at the time what the best approach would be: whether to maintain the current split licensing structure or bring forward one of the more radical options discussed in this document.

#### *Benefits*

4.10 This option would obviously have the benefit of flexibility. But it is hard to know what more could be said in its favour.

#### *Risks*

4.11 This option:

- would place on the NLC a responsibility which would not only be onerous but arguably one which should be for Parliament. Apart from anything else, the NLC would not be a disinterested body. One model would give it far more responsibility and require substantially greater resources than another. It might be possible to construct a provision that made the NLC's choice subject to Parliamentary approval, although the NLC's position might be untenable if this were not forthcoming
- would lose much of its apparent value if it turned out that the decision at the time was no easier than it is now. It would also inevitably elongate the process. The NLC would have to decide not just the form of the competition before launching it, but a whole set of prior basic questions to do with licences and contracts.

### Option 4 – A National Lottery operating company

4.12 This option would essentially involve separation of the question of which company should operate the National Lottery from the question of ownership of that company. There would be a permanent private sector operating company, holding a section 5-type licence; but it would not necessarily keep the same shareholders and top management. The NLC would run periodic competitions in which companies would bid to run the operating company. It would require Camelot's current shareholders to sell their interests in the company, at an agreed price, to a new set of shareholders, unless of course the incumbent owners and top management team put forward the best bid.

- 4.13 Such an option would have strong parallels to the transfer of television broadcasting franchises. A prospective new franchisee does not have to develop a wholesale alternative to the incumbent's personnel and plant: the only things that have to change are the shareholders and top management, reflecting a different view of what the company should provide and how it should be directed. In the case of the Lottery the new shareholders would take over all contracts, including those of the staff working on sales, games, accounts, infrastructure and all other continuing operations. It would then be for the new owners to run the company as efficiently and effectively as possible, making such changes in staff or plant, as they judged necessary over time.

### **Benefits**

- 4.14 This option would provide a high degree of continuity for the Lottery operation:
- Camelot's workforce would be retained, and there would be no risk of a wholesale loss of experienced staff fearing that the company would lose its licence as a new licensing round approached
  - at the same time competitions would be more inviting for prospective bidders: they would bid to take over a going concern, rather than starting from scratch
  - the NLC could keep its present form: indeed its task would be eased. Instead of having to make one very large decision once every seven years, it would be able to evaluate a series of changes over time as the company's new owners brought proposals forward, so that the NLC's workload would have a less lumpy profile, as it would be responsible for checking key suppliers' competence and propriety at staged points during the licence period.

### **Risks**

- 4.15 Against these benefits, a number of drawbacks have also to be considered:
- every competition involves a mixture of objective and subjective considerations. Whatever might be said now, it is probable that a competition run under this model would place increasing weight on the latter
  - the establishment of a permanent operating company could then make it more difficult for the NLC to act if the hopes reflected in its decision were disappointed: radical change would be closed off
  - this option places a lot of weight on the premise that, while the Camelot operation might be capable of marginal improvement and innovation, the day to day operations are basically as good as they can be. It is not clear why another set of shareholders would have stronger incentives to put the company's assets to more productive use; and the assurance of permanence could itself lead over time to a loss of edge and drive
  - it might be hard to assess what price Camelot (or future owners of the company) should receive. Camelot does not itself own substantial material assets, and what it does own should be fully written down by the end of the licence period. But the price to be paid could still prove controversial; and the basis for it would have to be agreed with Camelot during the current licence period.

- 4.16 **The Government would welcome views on these options outlined above.** It is also worth noting the need for adequate contingency arrangements, should no or minimal changes be made to the present legislation and a competition for a third section 5 licence fail for one reason or another, and again, **views are invited as to what such contingency measures might be.**

## Section 5: Machinery of regulation

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- 5.1 This section considers questions about the future role and organisation of the National Lottery Commission (NLC). Clearly some of the options outlined above would radically change the NLC's functions and size. But it is in any event worth considering whether there is a case for separating the NLC's current functions of licensing the Lottery and regulating it; and whether there is a case for bringing the regulation functions within the new Gambling Commission (GC) which the Government proposes to establish.
- 5.2 One reason for looking at the first question is that, at any rate under the present arrangements, the NLC faces one very large task every seven years, in organising the award of its section 5 licence, and a less onerous set of tasks in the intervening period. It has to license new games, monitor the operator's compliance with licence conditions (which include requirements relating to the sale of tickets to children), vet key operator personnel and in other ways give effect to its statutory duties to protect players' interests and ensure that the Lottery is operated fairly. These are of course essential and important responsibilities. But they do not require the same resources and effort as the big licensing decision, and the two tasks arguably do not require the same set of competences: the issue is not simply one of achieving a more even workflow.
- 5.3 But there are wider issues too. The establishment of a single regulator for all gambling in the form of the GC would deliver economies of scale: one body instead of two. And it should be easier for that body to achieve consistency of regulation, in relation for example to the measures which should be taken to protect problem gamblers against excessive play and to control the sale of lottery tickets and playing of lottery games in premises selling alcohol. From the player's point of view it is now hard to see the difference between the new *Lotto Hotpicks* National Lottery game and some fixed odds numbers betting products offered by bookmakers, although these are provided on a different legal basis, one constituting a lottery and the other betting. However, the point remains that different regulators could apply different standards to, for example, conditions of sale or play.
- 5.4 However, the current role of the NLC goes beyond straightforward licensing and regulation: it has, as noted above, a statutory responsibility to maximise income for good causes. In this respect the contrast between the NLC and the current regulator of most commercial gambling, the Gaming Board is instructive. Both are NDPBs, are of similar sizes and have similar regulatory objectives relating to propriety and fairness. The Board regulates casinos, bingo clubs, gaming machines and society lotteries. It has a chairman and four members, all appointed by the Secretary of State. It is funded by grant-in-aid, although fees paid by those it regulates cover its costs. Its annual budget is about £3.9m. The NLC also has 5 members, all appointed by the Secretary of State (although, unusually, the 1998 Act provides for the members to elect their chairman, who may serve in that office for no more than a year and is not eligible to chair the NLC again for the same period). It too is funded by grant-in-aid, at a similar level.

- 5.5 But the Gaming Board has no responsibility for the commercial outcome of the gambling activities that it regulates, and does not license operators on the basis of a competition for a restricted number of licences. The Board's responsibility is rather to consider whether applicants meet the prescribed standards (including competence and probity) and then enforces them. How licensed operators then fare is a matter for the market. This is as true of society lotteries as for commercial gambling. The GC, which the Government proposes will subsume the current functions of the Gaming Board, will in this respect have an equivalent relationship with the gambling industry.
- 5.6 The report of the Gambling Review Body did not include a recommendation about whether the GC should take over the regulation of the National Lottery, since this question was outside their terms of reference. But it envisaged the possibility that such a change might be justified, *"if it were ever proposed that the regulatory role of the National Lottery Commission should be separated from its sponsoring and commercial roles"* (para. 35.5 of the *Gambling Review Report* published by DCMS in July 2001).

### **Separation of the NLC licensing and regulation functions**

- 5.7 What might the arguments for such a separation be? If the NLC's role in relation to the management of the Lottery was increased, for example under options 2 or 3 above, it would make no sense at all for it to strip it of "sponsoring and commercial" functions: these functions are the essence of these options. Even under other less radical options the arguments are unclear, because the Government wants the Lottery to prosper and there will be no direct market competition to it. Without a duty to maximise revenue good causes it would be open to the GC to select an operator which was wholly safe and of unquestionable integrity but also wholly ineffective. It might be argued that the operator itself has a strong incentive to maximise sales, so that no further duties on its regulator are needed. But that incentive is there only because the NLC structured the licence and the competition for it in such a way as to provide that incentive. However, a regulator might approach the task quite differently depending on what its statutory duties are in respect of maximising income. Furthermore, the issue does not arise only at the initial competition stage, but throughout the licence period, whenever the NLC has to consider proposed changes to games, prizes, sale arrangements etc, in each case having to balance its current statutory duties.
- 5.8 It might be argued the Government should find other ways of meeting this point. Such an argument would concede that the NLC has from the outset had a duty to maximise revenue for good causes, subject to fulfilling the essential regulatory duties; and that this combination of duties had not in practice caused serious problems. It would also concede that state-run lotteries around the world had to find ways of reconciling sales success with player protection. But it would note that the potential conflict between them was likely to become sharper in future years: especially if there was pressure to promote new games through the internet or interactive video terminals which carry more risks of addiction or misuse than traditional lottery products. This document has, after all, stressed the importance of innovation.
- 5.9 So long as the NLC retains a responsibility for the proceeds of the Lottery there are obvious arguments against contemplating its incorporation into the GC. Clearly, the GC would be

expected to treat all the gambling activities that it regulated even-handedly. The case for bringing the regulation of the Lottery under the GC turns in part precisely on the idea of consistency of regulation. But it would always be at risk of complaints from commercial operators that it was holding them back in order to advantage the Lottery. The GC would be judge in its own cause. On this view the interests of consistency of regulation would be better served by greater liaison and discussion on matters of common interest between the NLC and the GC as independent regulators.

- 5.10 For these reasons the case for retaining a separate Lottery Commission to regulate the National Lottery, but with a continuing duty to maximise revenue for good causes, appears to have merit; **but before reaching conclusions the Government would welcome views.**
- 5.11 It does not, of course, follow that improvements to the way in which the NLC is organised are ruled out. **There are a number of options for change on which views would also be welcomed:**
- **chairman** The requirement in the 1998 Act that the role of chairing the NLC should rotate at least annually has caused difficulties for all concerned and has few friends. Apart from anything else, it artificially constrains the selection of members to serve on the NLC. The normal arrangement would be for the Secretary of State to appoint a chairman for a fixed term
  - **executives** The 1998 Act does not expressly preclude the appointment of a Commissioner who is also the chief executive, but leaves it unclear whether such an appointment could be made. There is an argument that such an appointment should be possible, and indeed that a body which has responsibility for business outcomes should follow the normal commercial pattern, where the chief executive (and other members of the top executive team) are members of the board. So it is in the case of the Tote. But such a change should go hand in hand with the ending of the rotating chair, so that different people would always fill the chief executive and chairman roles
  - **flexibility of size** In normal circumstances the NLC with five, all part-time, members is large enough to carry out the responsibilities set out in the 1993 and 1998 Acts. But, as noted above, the process of selecting and licensing a new operator is a substantial responsibility of a different kind, requiring a wider range of expertise. The case for setting up a special body, separate from the NLC, just to run a section 5 competition when one is needed is hard to argue. The NLC can, of course, as it did before, appoint expert advisers from all relevant professional disciplines. But there may be a case for empowering them to co-opt, or the Secretary of State to appoint, additional temporary members to share responsibility for the big decision and to make sure that the full range of relevant interests is properly represented in the NLC's deliberations. The contrary view would be that to enlarge the NLC would probably make the decision even harder than it is now, as there would be more scope for disagreement. The "core" Commissioners would in any event themselves have all the relevant experience of regulating the Lottery
  - **pre-licensing** As explained earlier in this document, the NLC has to issue a new licence for each game before it is played. In the case of straightforward scratchcard games this process takes a few weeks. In other cases it can take much longer. It would be an option to

dispense with this prior approval system, and instead allow the operator a larger measure of discretion. If confident that a new game would satisfy the NLC's requirements on fairness and player protection, the operator could market it without delay, subject of course to the risk that the NLC took a different view, caused the game to be withdrawn or modified and imposed a financial penalty. If less confident, the operator would consult the NLC or formally seek approval. This option could potentially reduce regulatory costs, and help the Lottery to keep pace with a fast-changing market. On the other hand, it might be argued that the regulator itself should retain the ability to operate on a pre- or post- approval basis, exercising its judgment according to the operator's track record and willingness to test the legal limits on Lottery games

- 5.12 Subject to conclusions on the more radical options for change discussed earlier in this document, **would these changes help to make the regulation of the Lottery more effective and efficient; and are there others which should be pursued?**

## Section 6: Conclusion

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This document has set out a number of specific questions on which views are invited. They turn on whether the 1993 and 1998 Acts provide a sound basis for the management and regulation of the National Lottery of the future, subject to relatively minor though useful amendment, or whether some more radical change of structure or direction is now needed to ensure that income for good causes will be maximised into the future. The options for change outlined above are not intended to be exhaustive. Comments on them, or any other points relating to the licensing and regulation of the Lottery, should be sent to:

Anna Paxton  
Gambling and National Lottery Licensing Division  
Department for Culture, Media and Sport  
2-4 Cockspur Street  
London SW1Y 5DH

by 27 September 2002

You may also e-mail with the subject heading as “Review of Lottery Licensing and Regulation” to [Anna.Paxton@culture.gsi.gov.uk](mailto:Anna.Paxton@culture.gsi.gov.uk)

Any submissions made to the Department in response to this consultation will be assumed to be open and may be published or made available to third parties. However, should you wish any part (or all) of your comments to be treated in confidence, you should make this clear, together with your reasons for requesting confidentiality, and we will consider treating them in confidence.

# Initial Regulatory Impact Assessment

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## 1. (i) Title

Review of National Lottery Licensing and Regulation

## 2. (i) The issue and objective

Issue: The 1993 and 1998 Lottery Acts set down the framework within which the UK National Lottery is operated and established the NLC to license and regulate the operator. Following the publication of the Gambling Review Body's report and the Government's response – **A safe bet for success** – and the publication of the NAO report into the award of the last licence, Government is reviewing the structure of licensing and regulation.

We do not envisage changes to the basic concept of the National Lottery, as the only large-scale lottery allowed in the United Kingdom and whose purpose is to maximise income for good causes that they would not otherwise receive from public funds. Equally, we are not ruling out any options for delivering a Lottery of this kind. For example, whether the Lottery is operated on a standard commercial or a not-for-profit basis does not itself matter: what matters is the outcome.

### Objective:

- ensuring that the Lottery raises as much income as possible for good causes without weakening necessary protections
- ensuring effective competition for its operation
- maintaining public confidence in the Lottery and the arrangements for running it.

## (ii) Risk Assessment

The main risks relate to a declining income for good causes should we be in a position of not having a strong, or indeed any, competition to run the national lottery within whatever framework emerges from this consultation.

## 3. (i) Identifying the Options

Section 3 of the consultation document explores options for changes within the current framework, whilst Section 4 suggests some more radical options for changes to the structure and framework for operating the National Lottery.

## (ii) Issues of Equity or fairness

None at this stage.

## 4. (i) Identifying the benefits

Within sections 3 and 4, the possible benefits and risks in policy terms are explored for the various options proposed and *we would welcome views upon these in responses.*

**(ii) Quantifying and Valuing the Benefits**

We are unable to place any likely cash values upon the impact of ticket sales and thus income to good causes at this stage. *Again, we would welcome any information on this issue in responses.*

**5. (i) Compliance costs for Business, Charities and Voluntary Organisations**

None.

**(ii) Compliance costs for a typical business**

'Typical' lottery operators do not exist, groups of companies have come together in the past to form consortia to bid for the Section 5 licence. Therefore not appropriate in context of this consultation document.

**(iii) Total compliance costs**

None at this stage.

**6. Consultation with small business: The litmus test**

Not appropriate within the context of this consultation document. *(See 5ii above)*

**7. Identifying any other costs**

Section 5 explores the machinery of regulation in the context of the National Lottery and suggests that certain economies of scale might be achieved by transferring some of all of the functions of the National Lottery Commission to the proposed Gambling Commission. We will be looking at responses to ascertain what if any functions might transfer and develop more detailed costs on these options as they emerge, *although early views on this would be welcomed.*

**8. Results of consultation**

In developing the consultation document, we have taken note of recommendations and suggestions put forward by the Culture, Media and Sport Select Committee and the National Audit Office.

**9. Summary and Recommendations**

At this stage we are not proposing any specific changes in the licensing and regulation of the UK National Lottery. It is our intention to consider the responses to this consultation and issue a decision document by the Spring 2003, which will be accompanied by a full RIA.

**10. Enforcement, Sanctions, Monitoring and Review**

There are no enforcement issues at this stage. Ultimately, income to good causes will be the determining factor in assessing the effectiveness of any changes that might be made to the future regime of licensing and regulation.