



National Lottery
Commission

Background

Licence to run the National Lottery

7 August 2007

Introduction

The UK National Lottery is one of the most successful lotteries in the world. Since 1994, it has raised over £20 billion for good causes and had a major impact across the UK with 270,000 grants.

The National Lottery Commission, commensurate with its statutory duties, and after a period of extensive consultation, analysis and feedback, structured a process designed to achieve:

- High standards of propriety and player protection;
- A vigorous competition for the licence, on the basis that this is the best means to generate the greatest returns to good causes;
- As far as possible a level playing field for all Bidders; and
- Well-aligned incentives for the licensee to increase returns to good causes.

The Commission sought a licensee to provide a complete solution for the Lottery, including: setting up and running the Lottery; designing, building, financing and operating the requisite infrastructure and systems; designing, distributing and marketing Lottery games¹; and ensuring a smooth transition of the Lottery from the current operations.

This note sets out the background to the National Lottery Commission, the third licence competition process, including information on the Bids received, and identifies that the Commission will prepare a report on the competition.

¹ This may also be done by organisations other than the licensee, referred to as independent section 6 licensees.

National Lottery Commission

The Lottery was created under UK legislation as a National Lottery, with a dedicated regulator responsible for oversight of the way it operates². In exercising their functions, the Secretary of State and the Commission have three overriding duties:

- To secure that the National Lottery is run, and every lottery that forms part of it is promoted, with all due propriety; and
- To secure that the interests of every participant are protected;
- Subject to these, to do its best in exercising its functions to secure that the net proceeds of the National Lottery for good causes are as great as possible.

The Commission is established as an executive Non-Departmental Public Body. Schedule 2A of the National Lottery Act sets out detailed provisions in relation to the Commission's organisation, status, capacity and powers of delegation.

² National Lottery etc. Act 1993 (as amended)

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An important feature of the regime is that it is open to competition. Whilst there can only be a single licence to operate the Lottery, there are periodic competitions for that licence. These are open to all. The competition is not restricted to UK organisations.

The Commission recognised the wide range of experience and skills that managing such a significant competition requires, and the demands that it places on a small group of part-time Commissioners and the relatively small organisation of forty people that supports them. The Commission therefore put in place particular arrangements to manage the competition, including a dedicated Project Board, chaired by a Commissioner (Robert Foster). Input from Commission staff was heavily supplemented by external consultants³ to support the additional workload. The competition was subject to the Gateway Review Process⁴ and was augmented by further independent review provided by Cornwell Management Consultants plc⁵, to provide the Commission with assurance that the process was properly conducted when it came to make its final decision.

The main stages in the competition process were:

Stage	Date	Output
Identification of barriers to entry	July 2004 - January 2005	Independent research commissioned. Discussion document
Further work on the options available	January 2005 - October 2005	Summary of responses and areas for further analysis
Evaluation of the options and broad structure for the competition itself	November 2005	Statement of Main Principles
Drafting of detailed terms of the competition	November 2005 – April 2006	Draft Invitation to Apply and draft Licence
Finalisation of the detailed terms of the competition	April 2006 – June 2006	Final Invitation to Apply and final draft Licence
Bidders compile and submit bids	June 2006 – 9 February 2007	Bids
Evaluation of Bids	9 February 2007 – 7 August 2007	Announcement of Preferred Bidder
Licence finalisation	End August 2007	Terms of Licence to be issued
Transition period	September 2007 – 31 January 2009	Commencement of new Licence

³ Advisers appointed to support the process were: NM Rothschild (lead adviser, financial and commercial); HEDRA plc (technology and IT); NERA UK Limited (economics); Freshfields Bruckhaus Deringer (legal); Mazars LLP (tax and accounting); and April Strategy (marketing).

⁴ Developed and administered by the Office of Government Commerce

⁵ Now SERCO Consulting

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Identification of barriers to entry

In January 2005, the Commission issued a discussion paper *A Lottery for the future: shaping the structure of the competition*. This identified that the current Lottery licence expires in 2009 and that the Commission anticipated that the competition for the next licence would need to take place in 2007. Before publishing the document four strands of independent research had been commissioned to help identify what factors might prevent a vigorous competition.

The results of this work further informed the Commission's thinking about three key areas set out in the document: the timetable for the third licence competition; where potential barrier to entry may lie; and potential strategies to address the barriers. The Commission posed a number of questions within the paper to help focus comments.

Further work on the options available

In July 2005, the Commission issued a document *A Lottery for the future: summary of responses and areas for further analysis*. The purpose of the paper was to give a summary of the views expressed so far, some of the Commission's initial reaction to these, and to highlight the areas where the Commission intended to carry out further work.

The areas for further analysis were: encouraging competition; handover; balancing retention rates and funds for good causes; recovery of investment mechanisms; and bidder performance and licence extension.

Evaluation of the options and broad structure for the competition itself

In November 2005, the Commission issued the *Statement of Main Principles*. This marked the formal start of the competition to award the Licence. It set out the principles that would underpin the competition and ensure a fair and transparent process.

The Commission also recognised that Bidders would wish to understand the basis on which their Bids would be evaluated. The Commission set out that it intended to deliver a simplified and transparent evaluation process. The Commission said that it would adopt Required Standards in certain areas. The assessment of each Required Standard would not impact on the Commission's evaluation of the overall returns to good causes or be used as a comparator between Bids. On transition, the Commission set out that it intended to require Bidders to meet a defined Required Standard. It must be satisfied that a Bidder has a comprehensive transition plan that convinces the Commission that the Bidder has the ability to effect transition successfully, identifying the associated risks and mitigating them successfully. This decision was

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based on research and on the experience of overseas lotteries that have managed similar transitions.

The Commission would also make an assessment of a Bidder's ability to maximise returns to good causes. Bidders would be required to propose retention rates, which would in turn determine the amounts available for good causes. The Commission would analyse the present value of the expected contributions to good causes over the life of the licence under a number of scenarios. These scenarios would include a common sales scenario, which the Commission would provide to Bidders, and Bidders' own sales scenarios.

Following publication of the *Statement of Main Principles*, the Commission, supported by its lead advisers Rothschild, continued to take steps to highlight the Lottery opportunity, including in a series of international meetings with interested parties and information available on its website.

Drafting of detailed terms of the competition

In April 2006, the Commission published the draft Invitation to Apply (ITA), setting out the detailed terms of the competition. It set out near-final details of the ten-year third Lottery Licence bidding opportunity, as well as clear guidance on the competition process, its requirements and evaluation criteria. A draft Licence was published at the same time.

The draft ITA was released in order to provide Bidders with further detail on the near final requirements to be contained in the Final ITA and to allow Bidders to provide comments on the structure, requirements and process contained in the draft ITA and similarly to allow Bidders to provide feedback on the draft Licence.

Finalisation of the detailed terms of the competition

In June 2006, the Commission issued the formal invitation to bid for the third Licence to operate the National Lottery. The ITA contained only minor changes to the draft ITA, reflecting the generally positive response from interested parties on the structure of the competition for the third Licence. The final draft Licence was published at the same time.

The ITA confirmed that the evaluation of Bids would be based on the Commission's statutory duties. The Commission would evaluate a number of specific elements, which can be grouped in two parts:

- Required Standards, which each Bid will be required to meet; and
- Returns to good causes, which will then be the basis of comparison between Bids.

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The Required Standards were in respect of the following areas: propriety; player protection; management of transition risks; overall ability of management and capacity of organisational structure; financial soundness; security, capacity, resilience and integrity of the technology design, its implementation and operation, and its suitability as a basis for a modern lottery; and operational risk management. For each area where information was to be supplied as part of the Bid, the ITA sets out the requirement, the evaluation criteria and the evidence required from Bidders.

On returns to good causes, Bidders were expected to submit a detailed business plan in support of their Bid, together with a sales and marketing plan and vision for the Lottery. Bidders were expected to include, as part of their sales and marketing plans for the third licence period, details of dedicated Olympic Lottery games to fulfil the National Lottery's commitment to support staging of the Olympic Games in London in 2012.

Bidders compile and submit Bids

Both ahead of and during the Bid preparation period, the Commission made a range of information available to Bidders through twelve Bid Notes. These covered a range of issues including TUPE⁶, transition monitoring and research. In order to enable each party to evaluate fully the Lottery opportunity and to provide a level playing field, the Commission made available further information on the Lottery. This was provided in a secure Virtual Data Room (VDR) accessed via the Internet.

Bidders could request further clarification and further information from the Commission about issues arising from the ITA. The Commission published 34 ITA clarifications on its website. In addition, it published four ITA amendments on the website.

Evaluation of Bids

On 9 February 2007, the Commission received Bids from Camelot Group plc ("Camelot") and Sugal & Damani UK Limited ("SDUK") to operate the third National Lottery licence.

Shareholders connected with the Camelot Bid were: Cadbury Schweppes plc, De La Rue Holdings plc, Fujitsu Services Limited, Thales Electronics plc and Royal Mail Enterprises Limited. Principal contractors connected with the Camelot Bid were:

- GTECH Corporation
- Elsym Consulting Inc
- GTECH Global Services Corporation Limited

⁶ Transfer of Undertakings (Protection of Employment) Regulations

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- Scientific Games International Limited
- ICM Business Continuity Limited
- Hughes Network Systems Ltd

Shareholders connected with the SDUK Bid were: Sugal & Damani Lottery Agency Pvt Ltd, Deutsche Bank, Financial Technologies Limited and Gopsons Papers Limited. Principal contractors connected with the SDUK Bid were:

- Ogilvy & Mather Group (Holdings) Ltd
- Transaction Network Services (UK) Ltd
- System Consultant Services Limited
- Betware H/F
- HCL Infosystem Limited

The evaluation was carried out in accordance with the process set out in the ITA.

In addition to its own evaluation analysis process, the Commission invited Bidders to make presentations to it during the week commencing 5 March 2007. This provided Bidders with the opportunity to describe whatever aspects of their Bids they wished. The Commission also invited Bidders to make further detailed presentations in the week commencing 16 April 2007. This enabled Bidders to describe at greater length certain aspects of their Bid proposals. The Commission also visited operations where services are being provided by Bidders or their Consortium members, in order to assist its evaluation. In line with the provisions of the ITA, the Commission sought further information from Bidders and allowed them to address deficiencies identified⁷.

On 7 August 2007, the Commission announced that it had selected Camelot as Preferred Bidder for the next ten year Licence to run the National Lottery⁸. The Commission will now seek to finalise with Camelot the details necessary to enable it to award the Licence. The ITA provided that a Reserve Bidder may also be appointed and the Commission selected SDUK as Reserve Bidder⁹. The full text of the Statement of Reasons may be found at www.natlotcomm.gov.uk

⁷ The ITA made clear that no amendment, either upwards or downwards, may be made to a Bidder's Principal Forecast, retention rates and hence forecast contributions to good causes at any time after the Bid had been submitted.

⁸ This statement discharges the duty of the Commission to give reasons for its decision under paragraph 9 of Schedule 2A of the National Lottery etc. Act 1993 as amended ("the Act"). The licence includes the possibility of extensions. The ability of the Commission to grant extensions was conferred by the National Lottery Act 2006.

⁹ A Reserve Bidder is the Bidder with whom the Commission would intend to finalise the Draft Licence in the event that finalisation of the Draft Licence were not achieved with the Preferred Bidder.

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Licence finalisation

The Commission will seek to finalise the Draft Licence and Enabling Agreement with the Preferred Bidder by the end of August 2007. The Enabling Agreement is the agreement to be entered into by the Commission and the Preferred Bidder governing the Transition Period. During finalisation of the Draft Licence, the Preferred Bidder will be required to secure any consents, approvals or other conditions that may be required. Once the Commission is satisfied that these consents have been obtained, it will award the Licence.

Transition period

The Commission has an interest in the continued sustainability of the Lottery in order to deliver its statutory duties. The Commission has therefore decided that, although the successful Bidder is responsible for delivering the Lottery operation in accordance with the Bid commitments and the Licence, it wishes to undertake regular monitoring of the successful Bidder's progress with transition to provide it with assurance that the successful Bidder is delivering in accordance with its Bid commitments¹⁰.

The Commission will achieve this by having full access to the progress monitoring reports available to the successful Bidder's senior management. In addition, the Commission will undertake regular reviews of the successful Bidder's progress. The Commission intends that the reviews will use a risk-based approach as part of a Commission risk mitigation strategy.

¹⁰ Further details are available in Bid Note 09 (20 October 2006), available from www.natlotcomm.gov.uk.

Review of the competition process

The award of the Licence through competition is one of the key responsibilities of the Commission and one that it undertakes on only a periodic basis. The Commission therefore intends to produce a report on the competition process. The Commission proposes to publish that report, with appropriate supporting documents, by the end of the year.

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