

## **STATEMENT OF REASONS FOR THE DECISION OF THE NATIONAL LOTTERY COMMISSION ON THE GRANT OF A LICENCE TO RUN THE NATIONAL LOTTERY**

1. The National Lottery Commission has decided to award Camelot Group plc the next seven-year licence to run the National Lottery. 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”).

2. The Commission has made a detailed evaluation of the bids from Camelot and The People’s Lottery in the form in which the bidders have revised them to meet the Commission’s concerns as set out in its statement of 23 August 2000.<sup>1</sup> The People’s Lottery was given a month to submit its revised proposals and did so on 23 September. Camelot submitted its revised proposals on 24 October after the High Court’s decision that it should have a similar opportunity to allay the Commission’s concerns.

3. The Commission has considered the bids in the light of the factors that it listed in The Invitation to Apply.<sup>2</sup> It has looked at the bids afresh and without regard to any earlier provisional conclusions that it might have reached, whether on returns to the National Lottery Distribution Fund (NLDF) or on any other issues.<sup>3</sup> The bidders were told that the Commission would take account of changes intended to rectify the original bids as they stood on 23 August in the areas of concern that the Commission had identified. Apart from that, the Commission would only take account of such changes as were necessarily incidental or consequential to the main changes. The only changes that the Commission has identified as falling into this category are certain potential increases in costs for The People’s Lottery resulting from its proposed trust fund arrangements and those for an additional financial facility. The Commission has concluded that these costs are not material to its evaluation.

4. Since the National Lottery began in November 1994, it has become a national institution. It has also become one of the largest lotteries in the world in terms of sales, with a high proportion of households playing each week. Sales during the present licence period have averaged £5.0 billion at an annual rate, with total contributions so far to the NLDF of over £9 billion.<sup>4</sup>

### **The qualifying statutory criteria**

5. When the Commission announced on 10 November 2000 that it would evaluate both bids, it said that each now had the potential to meet the criteria in section 4(1) of

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<sup>1</sup> Statement of Reasons for the Decision of the National Lottery Commission not to Grant a Licence to Operate the National Lottery, 23 August 2000.

<sup>2</sup> Invitation to Apply, November 1999, especially chapter 4.

<sup>3</sup> New Lottery Bids Go to the Next Stage, 10 November 2000.

<sup>4</sup> The cumulative total of sales to date is £30.4 billion. The total given for contributions excludes interest earned by the NLDF.

the Act. These concern the running of the National Lottery with all due propriety and the protection of the interests of every participant. The Commission has concluded that as a result of the changes made since 23 August 2000 both bids now meet these criteria.

- For Camelot, the Commission reached this conclusion after considering Camelot's proposals to buy out the UK operations of GTech Corporation and noting progress made so far by Camelot and GTech on implementing commitments made to the Commission in the light of a software incident during the course of the first licence.
- For The People's Lottery, the Commission has reached this conclusion after considering The People's Lottery's trust fund proposals. The Commission is satisfied that these proposals would ensure that all outstanding prizes would be paid and that all ticket holders would be reimbursed in the event of the failure of the licensee.

### **Maximising proceeds for the NLDF**

6. Provided that the qualifying statutory criteria are satisfied, section 4(2) of the Act requires the Commission in exercising its functions to do its best to secure that the net proceeds of the National Lottery are as great as possible. In making its assessment the Commission has taken account both of forecasts of returns to the NLDF and of the risks associated with the bids.

7. The Commission has concluded that the uncertainty relating to achievable sales is greater with The People's Lottery than with Camelot. There are also greater risks in The People's Lottery's bid as regards costs and financial soundness. These risks combine with those that would inevitably arise from a change of operator.

8. Although The People's Lottery offers higher contributions to the NLDF than Camelot at the same sales levels, this factor is outweighed by two considerations. The first is that the Commission has concluded that Camelot is on balance likely to deliver more sales over the licence period than The People's Lottery. The second is that the accumulation of risks that is inherent in The People's Lottery's bid, particularly in the early stages, is uncomfortably high by comparison with those posed by Camelot's bid.

9. The remainder of this statement sets out more fully the Commission's assessment of the main factors that it has weighed in reaching its conclusion that the prospect of maximising the likely proceeds for the NLDF is greater with Camelot's bid than it is with The People's Lottery's.

### ***Ability to operate the National Lottery***

10. The Commission has concluded that Camelot will be able to operate the National Lottery satisfactorily after it has absorbed GTech's UK operations. In reaching this conclusion, the Commission has taken account of the additional responsibilities and risks for management that will result from the change.

11. Camelot's IT systems overall have demonstrated a high level of operational reliability. The Commission notes that the proposed gaming software is not as up-to-date as the version currently being introduced in many other lottery jurisdictions and that this may involve some risk in the longer term as regards maintenance, development and adaptability.

12. The Commission considers that a largely outsourced operation, such as that proposed by The People's Lottery, is capable of providing a suitable structure for running the National Lottery. However, the Commission is concerned that The People's Lottery might not have sufficiently recognised the resources required for the management tasks involved in start-up and subsequent operation.

13. The IT systems proposed by The People's Lottery are more modern than those proposed by Camelot. The Commission considers that they would have had considerable potential to benefit the National Lottery if The People's Lottery had been chosen as the preferred bidder.

14. The Commission does not regard the risks associated with a change of operator and systems as in themselves preventing it from awarding the licence to a new operator. It considers that a change of both operator and systems must be accepted as a possible consequence of the legislation. It believes that such a change can in principle be managed successfully, even though clear precedents on the scale of the National Lottery are lacking. However, the Commission has concluded that the risks presented in this area by The People's Lottery are considerable when combined with other risks involved in the bid. By comparison, the risks in terms of systems in Camelot's bid are likely to be more important in the later stages of the licence and the Commission considers them to be less critical.

### ***Game plans***

15. Camelot intends to continue with the 6/49 matrix for the main online game and to conduct a phased introduction of new games. The Commission notes that the portfolio of online games has proved popular in its present form. In contrast, Camelot's record on Instants has, after an initial successful period, been disappointing and the Commission has reservations about Camelot's plans for them. The Commission is also uncertain whether the Euro Bloc game proposed by Camelot would be capable of introduction within the proposed licence period, given the practical difficulties involved.

16. The People's Lottery proposes to increase the size of the matrix for the main online game from 6/49 to 6/53. The Commission accepts that there is an argument for doing this, given the large number of National Lottery players and the small number of rollovers that the present matrix generates. The proposed change should result in a larger number of rollovers, which in itself might well increase player appeal. However, the longer odds

might equally cause some players to defer purchases until rollovers occur. The experience of other lotteries with regard to a matrix change is mixed and, because of the difficulty of isolating the impact of a matrix change from other variables, inconclusive. On the evidence available, including that provided by The People's Lottery, the Commission is not convinced that a change would have a positive net effect on sales, having regard to the risks involved.

17. The Commission also has some concerns about the ability of The People's Lottery to manage delivery of the considerable number of new games that it proposes to introduce at the start of the licence, particularly given all the other elements of start-up that need to be delivered. The Commission considers that The People's Lottery may have assumed too much in terms of players' willingness to adapt to changes in the current games and to take part in new ones. The Commission is also unconvinced that the Regional game as proposed by the People's Lottery would be workable.

18. The Commission has concluded that The People's Lottery offers some advantages over Camelot in its game plan proposals, notably with regard to Instants. However, there are considerable risks in combining a matrix change with the early introduction of many new games. The Commission also notes that The People's Lottery's plans for new media are comparatively undeveloped. The Commission is not persuaded that The People's Lottery's game plan is superior to that of Camelot and considers that it involves greater risks.

### *Expected sales*

19. The bidders' principal forecasts show average annual sales over the licence period of £7.3 billion in the case of Camelot and £7.4 billion in the case of The People's Lottery. However, actual sales have varied between £4.5 and £5.6 billion over the first licence period.<sup>5</sup> They are currently running at some £5 billion a year.

20. The Commission considers that both bidders are over-optimistic about the level of sales that they would achieve. Neither bidder has in the Commission's view satisfactorily addressed the question of how far sales of new games would displace sales of existing games. Nor have they satisfactorily addressed the issue of competition from outside the National Lottery. Having considered the evidence, including that in the bidders' proposals, the Commission is not persuaded that there is likely to be a step-change in sales over the next licence period. It has concluded that sales are more likely to be within the range achieved during the first licence period.

21. The Commission regards the level of potential sales by The People's Lottery as more uncertain than is the case with Camelot. The People's Lottery has the potential to increase sales by relaunching the National Lottery but its game plan relies heavily on the success of the matrix change and the early introduction of new games. The Commission found The People's Lottery's market research and overall marketing plan to be less convincing than Camelot's. The research provided by The People's Lottery does not in the Commission's view support its claim that by not itself taking profit it would produce a significant increase in sales. The Commission has concluded that Camelot is, on balance, likely to deliver more sales over the licence period than The People's Lottery.

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<sup>5</sup> Based on a 52 week moving average.

### ***Contributions to the NLDF***

22. At the same sales levels the commitments offered by The People's Lottery would lead to larger contributions to the NLDF than would Camelot's. At the bidders' principal forecasts, in which The People's Lottery's sales figures are higher than Camelot's, The People's Lottery would contribute some £160 million more a year than Camelot. At sales of £5 billion a year The People's Lottery would contribute some £110 million more a year than Camelot. These figures are based on the bidders' own cost assumptions. They would be affected by The People's Lottery's cost performance, as they take account of a secondary contribution to the NLDF that consists of any surplus that The People's Lottery generates.<sup>6</sup>

23. Although the differences given above are substantial in themselves, they are small in relation to the range of uncertainties surrounding the projections and the total amounts at stake. Relatively small movements in sales by either Camelot or The People's Lottery would lead to a reversal of the ranking.

### ***Costs***

24. The costs that The People's Lottery has included in its bid are significantly lower than those included by Camelot. In absolute terms, the biggest difference is for IT systems. The Commission accepts that this difference is explicable.

25. However, having examined the cost proposals of both bidders, the Commission considers that there is a risk that The People's Lottery may have underestimated other costs, particularly at lower levels of sales. In addition, The People's Lottery's proposed provision for expenditure on new media appears to be low. The Commission's concerns are increased because The People's Lottery has not made express provision for contingencies, which would be usual in such circumstances.

26. If the Commission's concerns proved well founded, the effect would be to reduce the extent to which Camelot needs to generate higher sales than The People's Lottery to produce the same amount of contributions for the NLDF. It would also increase the prospect of The People's Lottery going into financial deficit.

### ***Financial soundness***

27. The Commission considers that Camelot would be profitable on all the sales scenarios that the Commission has examined and that the risk of it becoming loss making is low.

28. Once The People's Lottery has repaid its initial term loan, it intends to pass all accounting profits to the NLDF year by year. There is no provision to build up reserves as a cushion against any future deficits.

29. The additional £50 million facility obtained by The People's Lottery since August provides it with increased headroom to deal with short-term cashflow requirements and

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<sup>6</sup> Camelot proposes to pay a secondary contribution equivalent to one half of any excess of after-tax profits over the level in its principal forecast.

could help The People's Lottery in lower revenue scenarios. However, the facility would only give limited assistance if there were continuing losses.

30. Given The People's Lottery's commitments to the NLDF, there is a much greater risk than with Camelot that its financial position would become vulnerable at low levels of sales or if there were unplanned costs, such as those that might arise from unexpected problems in start-up. The full extent of the risk cannot be evaluated with precision. The Commission considers, however, that at levels of sales not far below £5 billion a year there is a real risk that The People's Lottery could incur losses which would not be sustainable within its proposed financial structure. The critical point would be reached at a higher level of sales if there were unexpected costs.

### *Conclusion*

31. In the light of the considerations set out above, the Commission has concluded that the prospects of maximising the likely proceeds for the NLDF are greater with Camelot's bid than with that of The People's Lottery.

National Lottery Commission  
19 December 2000