

Chapter

Overview of the Lottery

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2 Overview of the Lottery

2.1 Introduction

This chapter sets out background information on the Lottery. It covers the key elements relating to the way that the Lottery is structured and highlights key considerations that Bidders will need to be aware of when submitting a Bid. It also provides a description of the Draft Licence and the key provisions contained therein.

Bidders should note that the contents of this chapter are not intended to be comprehensive. Bidders are reminded that their proposals will need to comply with the requirements of the Draft Licence and any relevant legislation.

2.2 Background to the Lottery

2.2.1 Social policy

The Lottery was created under UK legislation as a National Lottery, with a dedicated regulator responsible for oversight of the way it operates. The National Lottery Act creates an exception to the general principle under UK law that lotteries are unlawful, by providing that lotteries which form part of the National Lottery are permitted⁶. For a lottery to form part of the National Lottery, it must be licensed by the Commission. The Lottery is reserved for generating funds for good causes.

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 in the Lottery 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's primary responsibilities therefore relate to propriety and player protection. A great deal of its regulatory activity focuses on these areas.

The licensing structure and regulatory regime requires the Commission to uphold high standards of propriety and player protection. These are paramount under the UK regime; the Commission must be satisfied that these standards are met before it considers the question of returns for good causes. As a result, the Lottery has a very low incidence of problem gambling. The Commission believes that social costs associated with the Lottery are minimised, and that this takes precedence over the generation of returns.

Whilst much of this ITA is concerned with returns for good causes, Bidders should be clear that propriety and player protection are paramount. If a Bidder is unable to demonstrate to the Commission's satisfaction that the Required Standards will be met, then its Bid will be unacceptable regardless of the returns it offers to good causes.

2.2.2 Competition

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. Most interest to date has come from the private sector, looking to make a return on its investment over the Licence Period, although the Commission has also received 'not for profit' bids. The Competition is not restricted to UK organisations. In the past, the Commission has welcomed bids from overseas organisations, and the Current Operator has shareholders from France and Japan, and has had shareholders from the USA in the past.

⁶ The Gambling Act 2005 also permits 'society lotteries', which are regulated by the Gambling Commission. The size of such lotteries is limited by regulation.

Whilst the Commission has an interest in the continued sustainability of the Lottery over a longer period, the interests of a Licensee will be restricted to the period for which it holds the Licence. From the perspective of the Licensee, there may well be sound commercial reasons for seeking to create a value over the life of the Licence Period which can be exploited at the end of that period; either by sale of assets to a successor or by use of assets for alternative purposes. Such an approach may well not be in the longer-term interests of the Lottery. The Commission therefore takes the view that Bidders should structure their Bids to generate a return for their organisations over the life of the Licence for which they are bidding, and should not expect residual value beyond the Licence Period. The Competition and Draft Licence have been structured accordingly, and Bidders should note this when preparing their Bids.

2.3 Key institutions

2.3.1 Government

The Lottery was established by the National Lottery Act. The National Lottery Act provides that the Secretary of State has an overriding duty to exercise her functions relating to the licensing and regulation of the Lottery in accordance with the three overriding duties set out in 2.2.1 above.

The Secretary of State:

- May make Regulations in relation to the promotion of constituent lotteries. It is an offence, in certain circumstances, not to comply with the Regulations;
- May issue Directions to the Commission with which it must comply. These typically deal with matters that the Commission must consider when deciding whether to issue a licence and what conditions should be contained within licences;
- May direct the Commission to provide her with information relating to the Lottery;
- Appoints the members of the Commission.

The current Regulations and Directions are available on the Regulating the Lottery section of the Commission's website⁷.

2.3.2 The Commission

The regulator of the Lottery was established by the National Lottery Act. Initially, the regulator was the Director-General of the National Lottery, who ran the Office of the National Lottery (OFLOT). The National Lottery Act was amended in 1998 and established the National Lottery Commission as the new regulator. The Commission assumed all of the regulatory functions of the Director General in April 1999, and OFLOT staff became Commission employees.

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.

The Commission comprises five Commissioners appointed by the Secretary of State. The five Commissioners are: Dr Anne Wright CBE (Chair), Robert Foster, Timothy Hornsby, Brian Pomeroy CBE and Sarah Thane CBE. The members of the Commission select one of their number to be chairman and such appointment is to be for no longer than twelve months⁸. A chairman cannot be reappointed until a period of time equal to his/her chairmanship has passed. The Commissioners appoint the Chief Executive of the Commission who is responsible for the day-to-day operation of the Commission and, in so far as these have been delegated to him, the exercise of the Commissioners' functions and powers.

⁷ www.natlotcomm.gov.uk

⁸ Section 2.7 sets out the changes that may arise as a result of the National Lottery Bill.

The National Lottery Act provides that the Commission may issue a licence to operate the Lottery, and only one body may be licensed to do so at any one time. The Commission may also issue licences to promote lotteries as part of the Lottery. In granting such licences, the Commission must be satisfied that its statutory duties are complied with. In addition, the Commission may not grant a licence unless it is satisfied that the applicant is fit and proper. In coming to its decision, the Commission may take into account whether the individuals running or benefiting from the applicant's business are fit and proper.

2.3.2.1 The Project Board

In order to meet the specific needs of the Competition, the Commission has established a Project Board. The Project Board is an executive committee with decision-making powers, and is comprised of two members of the Commission, Robert Foster (Chairman) and Brian Pomeroy, and the Chief Executive, Mark Harris. Others who attend the Project Board do so in an advisory capacity. Further information on the Project Board, including its terms of reference are available on the Commission's website.

2.3.3 The licensee

The current holder of the Section 5 licence (see section 2.4.1) to operate the Lottery is Camelot Group plc (the Current Operator). The Current Operator was awarded the second Section 5 licence in 2002 and is the only holder of licences to promote lotteries as part of the Lottery granted under Section 6 of the National Lottery Act. Camelot has five shareholders: Cadbury Schweppes plc; De La Rue Holdings plc; Fujitsu Services Limited; Thales Electronics plc; and Royal Mail Enterprises Limited.

2.3.4 Distributing bodies

The proceeds of the Lottery are passed to the National Lottery Distribution Fund (NLDF) and the Olympic Lottery Distribution Fund (OLDF). The NLDF and OLDF, administered by the Department for Culture, Media and Sport, pass the money to the Lottery distributors. Any NLDF and OLDF balances that have not been drawn down by distributors are invested by the National Debt Commissioners for the benefit of the NLDF and OLDF.

The beneficiaries of the funds are known as the good causes, and they are specified in the National Lottery Act, as is the proportion of the distribution fund that is allocated to each of them. The good causes are the arts, for which there are six distributing bodies; sport, for which there are five distributors; the national heritage; expenditure which is charitable or connected with health, education or the environment; and projects to mark the year 2000 and the start of the new Millennium. The Millennium good cause has not received an income stream from Lottery proceeds since 2001. Each distributing body is independent of Government but has to follow statutory duties established in the National Lottery Act and is required to comply with policy and financial directions given by the Secretary of State for Culture, Media and Sport under the National Lottery Act, when deciding who should receive Lottery money. These bodies make their grant decisions independently of Government and of the Department for Culture, Media and Sport. They also make their decisions based on the published criteria of each of their different Lottery funding programmes.

There are currently 14 independent distributing bodies responsible for awarding Lottery grants. These are: Sport England; Sport Scotland; the Sports Council for Wales; the Sports Council for Northern Ireland; UK Sport; Arts Council England; Arts Council of Wales; Arts Council of Northern Ireland; Scottish Arts Council; Scottish Screen; the UK Film Council; the Millennium Commission; the Heritage Lottery Fund and the Big Lottery Fund. Following the announcement that the Olympic Games will be hosted by London in 2012, an additional distribution body has been established – the Olympic Lottery Distributor.

Bidders should note that the licensee has no ability to influence the way in which funds for good causes are distributed. There is no intention that the regulatory regime be amended to permit this.

2.3.5 Other bodies

2.3.5.1 *The Courts*

The National Lottery Act makes express provision for the High Court⁹:

- To consider applications from the Commission for injunctions or orders under Section 9;
- To hear appeals under Section 10B against proposals by the Commission to impose financial penalties; and
- To hear appeals against a decision by the Commission to revoke a licence under Section 10 and Schedule 3.

The grounds and procedures for such appeals are set out in the National Lottery Act.

2.3.5.2 *The National Audit Office*

Section 33 of the National Lottery Act provides the Comptroller and Auditor General, the head of the National Audit Office, with certain rights in relation to its audit of the NLDF and OLDF. These rights give the NAO access to any documents that it reasonably requires for the purpose of auditing the NLDF and OLDF and which are in the custody or control of the Section 5 licensee.

The NAO has the right to obtain an explanation of, and information relating to, such documents from officers and employees of the Section 5 licensee and from its auditors. The NAO does not have statutory audit or inspection rights in respect of the licensee's own accounts or its arrangements for securing value for money.

2.3.5.3 *The National Lottery Promotions Unit*

The National Lottery Promotions Unit (NLPU) is a joint venture between the Current Operator, the Lottery distributors and the Department for Culture, Media and Sport. It was set up to raise positive public awareness of, and support for, the benefits of Lottery funding and promoting loyalty and participation.

2.3.5.4 *The Responsibility in Gambling Trust*

The Responsibility in Gambling Trust (RiGT) is an independent Trust set up to research and limit problem gambling. It is funded by voluntary contributions from the gambling industry. The Current Operator makes voluntary contributions and the Commission would expect the Licensee to continue making voluntary contributions. Bidders should note that the Gambling Act 2005 includes reserve provisions for the Secretary of State to impose an annual financial levy on gambling operators, to be used for alleviating problem gambling. If this provision was exercised, the Act also includes provision for the levy to be extended to the Lottery.

2.4 Licensing regime

2.4.1 Background to the National Lottery Act

The National Lottery Act established the present Lottery licensing structure. It anticipated that a private sector operator would run the Lottery, with the possibility of individual lotteries being promoted by other parties. It does not prescribe the design or detail of lotteries forming part of the Lottery but instead sets out the control framework that must be complied with in order for a lottery to be regarded as part of the Lottery. The National Lottery Act therefore divides the operation of the Lottery into two, separating the functions of running the Lottery from promoting lotteries as part of it.

Under Section 5 of the National Lottery Act the Commission may issue a licence to run the Lottery (a Section 5 licence). Only one Section 5 licence may be issued at any one time. Any person wishing to promote a game that forms part of the Lottery (e.g. Lotto or a scratchcard game) must be licensed to do so under Section 6 of the National Lottery Act (a Section 6 licence). That promoter may be the Section 5 licence holder or an organisation other than the Section 5 Licence holder, (but only with the agreement of the Section 5 licence holder).

⁹ Or, in Scotland, the Court of Session.

Before the Commission may issue either type of licence, it must receive an application in writing from the prospective licensee and must be satisfied that the prospective licensee is fit and proper to hold such a licence.

The Commission may only issue licences in respect of lotteries. It has no power to authorise gaming and betting. So, when it considers applications for Section 6 licences, the Commission must be satisfied that the game in question is a lottery. The Gambling Act 2005 has, for the first time, provided a statutory definition of a lottery. This is set out below.

2.4.2 Definition of a lottery

Section 14 of the Gambling Act 2005 defines that an arrangement is a simple lottery if:

- Persons are required to pay in order to participate in the arrangement;
- In the course of the arrangement one or more prizes are allocated to one or more members of a class; and
- The prizes are allocated by a process which relies wholly on chance.

2.4.3 Regulations

Regulations lay down the way in which tickets and chances in Lottery games may be promoted. In summary, they provide that:

- Lottery tickets may not be sold to someone who is under 16 years of age;
- Lottery tickets may not be sold in the street;
- A person shall not be invited to purchase a Lottery ticket in any licensed betting office, approved racecourse or licensed track, premises used wholly or mainly for providing amusements in the form of amusements with prizes or of amusements by means of slot machines or in any bingo or gaming club; and
- Lottery tickets may not be sold by means of an unattended vending machine. Sales are permitted where a vending machine is attended by a person authorised by a Section 5 or Section 6 licence holder and where that person is in a position where he can control the operation of the machine and in particular take action to prevent the purchase of tickets by any person whom he believes is not at least 16 years of age.

The Regulations can be found on the Commission's website under the Regulating the Lottery section¹⁰.

2.4.4 Directions

The Secretary of State has directed that the Commission must:

- Not authorise the promotion of a lottery which encourages excessive participation or does not allow for sufficient controls to prevent underage play;
- Ensure that no licence is granted which allows more than one draw to take place in any period of one hour. This applies to lotteries authorised to be promoted under a single licence or under more than one licence relating to associated lotteries, but does not apply where a prize is allocated to a ticket before sale, or is pre-determined at the point of purchase;
- Not grant a licence for a lottery for which the price of tickets or plays is unreasonably high;
- Ensure that every lottery provides for a reasonable period in which prizes can be claimed;
- Include a condition in every licence which provides that unclaimed prizes are paid to the Secretary of State for the benefit of the good causes;
- Ensure that all licences include conditions that have the effect that:
 - the Commission can inspect all forms of records relevant to Lottery contracts or operations held by the licensee or its significant contractors;
 - the Commission has the power to approve any party to a significant contract with the licensee;

¹⁰ www.natlotcomm.gov.uk

- information for participants as to whether they have won a prize is available without payment or undue inconvenience; and
- no tickets or plays are given away free unless either: (a) the price of the ticket is paid in full by another person, such that the value of the ticket is counted fully when calculating the licensee's primary contribution; or (b) the Commission has given its consent, such consent not to be given unless the Commission is satisfied that the proposal will not encourage excessive or underage play and that it is likely to increase overall returns to good causes;
- Not amend the extract from its publication 'Financial Penalties: Principles and Procedures' (which is attached to the Directions) without first obtaining the consent of the Secretary of State;
- Establish and publish appropriate performance standards; and
- Facilitate the operation of the National Lottery Promotions Unit; and
- Not determine the proportion of proceeds of lotteries that form part of the Lottery that are attributable to Olympic Lotteries without first having obtained the approval of the Secretary of State.

The Directions can be found in full at on the Commission's website under the Regulating the Lottery section¹¹.

2.4.5 The Section 5 licence

What is involved in operating the Lottery is not specified in legislation. The details of the conditions with which the Section 5 licensee must comply are set out in the licence itself. A fee is payable on the grant of the licence.

The National Lottery Act provides that the Section 5 licence must contain a condition that requires the licensee to pay sums out of the proceeds of the lotteries which form part of the Lottery to the Secretary of State, to be held within the NLDF and the OLDF. Proceeds held within these funds are then distributed by the distribution bodies. Section 7 of the National Lottery Act sets out various other conditions that the Commission may include in a Section 5 licence.

The current Section 5 licence covers ten core regulatory areas:

- Commencement of Lottery sales;
- Operations (including conditions relating to the testing of equipment used in Lottery draws, security);
- Consumer protection (including advertising, performance standards and reporting);
- Distribution (including conditions in relation to player access to Lottery tickets and terminals);
- Financial (including conditions in relation to banking and record keeping, security of funds and payments to good causes);
- Corporate (including conditions in relation to the use and ownership of the Lottery brand);
- Arrangements with shareholders and group companies (including prohibition on activities not related to the Lottery);
- Information (including conditions in relation to the Commission's access to certain information of the licensee);
- Independent Section 6 licensees (including conditions in relation to how to deal with applicants for a Section 6 licence other than the Section 5 licensee); and
- Termination (including conditions in relation to what happens on revocation or expiry of the Section 5 licence).

In addition to the conditions contained in the Section 5 licence, with which the licensee must comply, certain conditions of the Section 5 licence require the licensee to issue and comply with codes of practice, strategies or procedures. These are subject to the approval of the Commission.

¹¹ www.natlotcomm.gov.uk

2.4.6 Section 6 licences

Section 6 of the National Lottery Act allows the Commission to licence a body corporate to “promote” lotteries as part of the Lottery. Such a licence will be granted for each Lottery game (e.g. Lotto or Thunderball) which itself usually comprises a series of lotteries (in that each draw is legally a separate lottery). Section 6 licences may also be granted for Lottery generic games (e.g. scratchcards). Section 6 licensees are responsible for the design, promotion and conduct of the games provided that each game is consistent with the overall structure and systems established by the Section 5 licensee. A fee is payable on grant of each Section 6 licence.

Each Section 6 licence describes the lotteries for which it authorises promotion. Section 7 of the National Lottery Act sets out various other conditions that the Commission may choose to include in a Section 6 licence.

The conditions contained in a Section 6 licence will vary according to the type of game that it authorises but the various licences have common elements. For example, the contractual terms governing player participation in the various games (e.g. game rules and procedures and, in certain cases, interactive account terms and conditions) are annexed to the Section 6 licence¹². The licensee must adopt, maintain and comply with those contractual terms. Before such terms are annexed to the licence, they are subject to the prior written approval of the Commission and any changes to such terms are also subject to such approval.

All Section 6 licences are for a finite period – typically shorter than the length of the Section 5 licence. Section 6 licences may be held by bodies other than the Section 5 licensee but only with the Section 5 licensee’s agreement. There is no restriction on the number of bodies that can hold Section 6 licences, although there has only ever been one holder of a Section 6 licence that has not also been the Section 5 licensee.

The Successful Bidder will be invited to submit provisional applications for Section 6 licences on the game plan provided in its Bid as soon as possible after the Commission confirms its intention to award the Licence. Additional Section 6 licences may be granted by the Commission, following an application from the Licensee, at any time during the Licence Period.

2.4.7 Penalties and sanctions

2.4.7.1 Revocation

The Commission has the power to revoke a licence granted under Sections 5 or 6 if it is satisfied that the licensee no longer is, or never was, a fit and proper body to run the Lottery.

The National Lottery Act also specifies grounds on which the Commission may revoke a licence granted under Sections 5 or 6. These include the grounds that:

- A condition in the licence has been contravened; or
- Information given by the licensee was false in a material particular; or
- The licensee is insolvent; or
- Any person managing part or all of the business or benefiting from it is not fit and proper to do so.

The National Lottery Act sets out, in Schedule 3, the procedures that the Commission must follow in revoking a licence. These include:

- The requirement that the Commission must serve a formal notice on the licensee giving its reasons for a proposal to revoke a licence;
- The rights of the licensee to make written or oral representations. The procedure for hearing oral representations is laid down in Regulations made by the Secretary of State; and
- The rights of appeal to the High Court¹³ against a final decision by the Commission to revoke a licence. The possible grounds for an appeal against a finding that a licensee has contravened a condition of a licence are that the Commission has made an error as to the facts; that there was a material procedural error; or that the Commission has made some other error of law.

¹² Bidders should note that certain of these common elements have been moved to within the Draft Licence for the purposes of the next Licence.

¹³ Or, in Scotland, the Court of Session.

2.4.7.2 *Enforcement of licence conditions*

Section 9 of the National Lottery Act provides that if:

- a. There is a reasonable likelihood that a person will contravene a condition in a licence granted under sections 5 or 6; or
- b. A person has contravened such a condition and there is a reasonable likelihood that the contravention will continue or be repeated; or
- c. A person has contravened such a condition and there are steps that could be taken for remedying the contravention;

then the Court may, on the application of the Commission, grant an injunction restraining the contravention or make an order requiring the licensee, and any other person who appears to the Court to have been party to the contravention, to take such steps as the Court may direct to remedy it¹⁴.

2.4.7.3 *Financial penalties*

The National Lottery Act provides that, if the Commission is satisfied that a person has contravened a condition in a licence under Sections 5 or 6, it may impose a financial penalty on that person in respect of the contravention.

The matters to which the Commission may have regard in imposing a financial penalty include the desirability of both deterring persons from contravening conditions in licences, and recovering any reduction in the sums paid to the Secretary of State for the benefit of the good causes which resulted from the contravention.

The Commission is required under Directions made by the Secretary of State to act in accordance with the principles included in a statement entitled "Financial Penalties: Principles and Practice" made by then Director General of the Lottery in May 1998. Details are attached to the Directions¹⁵.

Section 10A of the National Lottery Act allows a licensee to make written or oral representations on a proposal by the Commission to impose a financial penalty, including on the amount of the proposed penalty. The Secretary of State has made regulations governing the procedure to be followed if a licensee wishes to make oral representations. A copy of the Regulations can be found on the Commission's website¹⁶.

Section 10B of the National Lottery Act allows a licensee to appeal to the High Court¹⁷ against a decision by the Commission to impose a financial penalty, or against the amount imposed. The possible grounds for an appeal against a finding that a licensee has contravened a condition of a licence are that: the Commission has made an error as to the facts; that there was a material procedural error; or that the Commission has made some other error of law. An appeal against the amount of a penalty can be on the grounds that it is unreasonable; that there was a material procedural error; or that the decision was based on a manifest material misapprehension as to the facts.

2.4.7.4 *Minor breaches of licence conditions*

Where the Commission considers that a condition of a licence has been breached, but that the breach is not sufficiently serious to justify any of the penalties set out above, it will usually record the breach in writing and publish details on its website and in its annual report.

2.4.8 **Licence fees**

A licence fee is payable when a licence is granted. Fees are set by the Secretary of State by Regulation. The fees are designed to reflect the costs to the Commission of granting the licence for which an application has been made¹⁸.

¹⁴ Similar provisions apply where the case falls under the jurisdiction of the Courts in Scotland.

¹⁵ www.natlotcomm.gov.uk

¹⁶ www.natlotcomm.gov.uk

¹⁷ Or, in Scotland, the Court of Session.

¹⁸ Section 2.7 sets out the changes that may arise as a result of the proposed National Lottery Bill.

2.5 Key features of the Commission's regulatory regime

2.5.1 The Commission's approach

In April 2006, the Commission published a paper on its approach to regulation. This summarised its current approach as follows:

- The Commission has sought to develop and evolve its approach to regulation by focusing on the objectives and outcomes of its decisions. The Commission distinguishes between its social regulation responsibilities such as the prevention of underage or excessive play and its commercial regulation responsibility to maximise returns to good causes. In some commercial areas it has attempted to move away from the detailed control of inputs, which require consent or approval in advance. For example, it has moved away from the licensing of individual scratchcard and interactive instant win games and now grants class licences. These, while setting out defined terms, allow the operator to launch certain types of games without further consent. Unusual or complex games, which may have a more significant impact upon player protection, continue to require individual licences.

The paper sets out a series of proposals that, if implemented, will represent an evolution of the Commission's approach to regulation. The Commission has invited views on the proposals. The full paper can be found on the Commission's website.

The proposals are set out below:

- The Commission will establish a formal evidence-based framework for assessing risk, which it will apply to the range of its work to ensure that it continues to regulate proportionately;
- The Commission will work with its stakeholders, including the licensee, to identify opportunities to relax its regulation of regulatory inputs and define appropriate outcomes that can be measured and enforced;
- The Commission will adopt a clear policy for publication of its regulatory decisions and set out its plans for improving the transparency with which it fulfils its responsibilities;
- The Commission will review its approach to monitoring compliance and performance, to ensure that its resource continues to be targeted appropriately;
- The Commission will review its application of sanctions for non-compliance and publish the outcome of that review; and
- The Commission will consider how it can best integrate regulatory impact assessments into its policy making process in a manner which adds value, but does not lead to undue delays in regulatory decision making.

Bidders should note the comments regarding the Commission's ability to vary the terms of the Licence set out in section 2.8 below.

2.5.2 Approving new games

When considering whether to licence any new game, the Commission considers a number of factors in order to ensure that, in licensing the game, it will meet its statutory duties. These include:

- Controls over underage play;
- Aspects that might give rise to concerns about excessive play;
- Whether the game rules and procedures are clear and accurate;
- Conformity with any relevant codes of practice;
- The price of tickets;
- The underlying prize structure, payout ratios and claim period;
- The general design and accuracy of wording contained on the ticket;
- The fit with overall game development strategy and proposals;
- The marketing and advertising strategy;
- Issues surrounding use of trademarks;
- Compliance with Directions and Regulations; and
- The overall business case from the perspective of returns to good causes.

Having considered the application in full, the Commission will decide whether or not to grant a Section 6 licence and will notify the applicant accordingly. Typically, the grant of a licence will include a number of matters which require the Commission's approval before the game can be launched (i.e. go on sale). Typically these include completion, by the applicant, of any relevant checks and audits, and the implementation of such procedures as may be required by the Commission.

The time necessary for the process for approving games depends upon whether the game is entirely new in concept, the level of complexity involved in the new game and as a consequence the specific concerns that may need to be addressed. The Commission is happy to discuss new games that raise issues of principle at an early stage in their development and prior to receipt of an application in full. This gives the opportunity for novel or complex issues to be dealt with early in the game development process, and for the licensee to develop an application that is likely to be acceptable to the Commission.

2.5.3 Forms of prizes

In most games, players receive lump sum cash prizes. However, the Commission has licensed games in the past that offer annuity based prizes (e.g. a fixed sum over a given period, or for life) or products such as cars or holidays. The Commission is concerned that the value of any non-cash prizes should be fairly reflected within the prize structure of the game and any advertising associated with the game, including detail, given on tickets.

2.5.4 Payments by the licensee

2.5.4.1 *Payments to the Secretary of State*

The Section 5 licensee is required to make payments to the Secretary of State, who holds them in the NLDF and OLDF on behalf of good causes. The main types of payments (defined in the Section 5 licence) are in respect of:

- Primary contributions;
- Secondary contributions;
- Ancillary activities; and
- Unclaimed prizes.

The main payment made is the primary contribution. This is calculated with reference to the retention structure set out in the Section 5 licence, which gives effect to the proposals made by the licensee in the previous licence competition¹⁹. At present, this payment is made weekly on a Tuesday based on sales and prizes up to the previous Saturday. The Commission does not expect any change in this arrangement for the Licence.

Payments in respect of secondary contributions under the present licence are due annually²⁰.

Payments in respect of ancillary activities under the present licence are due quarterly on account²¹.

Payments in respect of unclaimed prizes are paid within the weekly Tuesday payment immediately after they fall due. The Commission does not expect any change in this arrangement for the Licence.

The current Section 5 licence also requires the licensee to make payment to the Secretary of State in the event that it does not meet the committed minimum marketing expenditure for the relevant financial year.

The licensee is responsible for managing its cash flows to take account of the timing of payments received or made. Payments due to the Secretary of State are due irrespective of whether the licensee has taken control of the funds (e.g. collected cash from retailers) in respect of all relevant sales. Late payment is a breach of the licence and attracts interest at penalty rates (3 per cent over clearing bank base rate).

¹⁹ See chapter 15 for details on how these will be bid in the present Competition.

²⁰ Under the next licence timing of payments will depend on the proposals made by the Successful Bidder.

²¹ Under the next licence timing of payments will depend on the proposals made by the Successful Bidder.

2.5.4.2 Trust arrangements

The Current Operator has entered into security trust arrangements to protect players' funds. The Current Operator was required to pay into a security trust out of its own funds the sum of £20 million on or before the commencement of the licence. Regular payments to the security trust are made in respect of purchases (including advance purchases and subscriptions for future draws). These payments are made every Wednesday.

The Current Operator pays prizes to players from its own funds. It recovers the value of prizes it has paid from the security trust on a daily basis.

Funds payable to the security trust accounts must be free from prior claims and cannot be used for the purposes of funding the licensee's working capital or other obligations. The trustee has first ranking security over the monies in the trust to ensure that any shortfall in funds paid into the security trust accounts can be met in the event of an operator default.

The Commission expects that arrangements under the Licence will give at least an equivalent degree of security for players' funds. Ideally, these will replicate the current arrangements. Further details of the current arrangements are provided at Appendix G.

2.5.4.3 Arrangements in the event of a default

In the event of a licensee default (eg. where the licensee is placed into administration) the trustee responsible for players' funds needs to be certain that it has the facilities available to it to pay all outstanding prizes, reimburse outstanding wallet balances and reimburse the value of tickets purchased for a lottery where the draw does not take place. The trustee will need to be able to make full or partial payments on any or all of these items. The trustee will also need to be able to verify the validity of prizewinning tickets. Under the present licence, the licensee is required to arrange placement of software into escrow which, in the event of a default, will be available to the trustee to enable it to meet these obligations. Such activities need to be undertaken in a controlled manner.

The Commission will require Bidders to provide a similar degree of security in this respect, although the means of achieving it may be different from those in place under the present licence. For the avoidance of doubt, Bidders are required to provide a system for enabling relevant payments to be verified and made, as well as access to the relevant data and software, or provide an alternative solution that enables trustees (or equivalent) to make such payments to players. Bidders should note that their proposals in this respect will be incorporated into the Licence.

2.5.4.4 Unclaimed prizes

An unclaimed prize is a prize that has not been claimed by a person entitled to do so within the time period allowed by the rules of the constituent lottery. For draw-based games, the period within which a prize may be claimed expires on the hundred and eightieth day after the relevant draw. For scratchcards the period within which a prize may be claimed expires on the one hundred and eightieth day after the closing date of the particular game.

The Current Operator is required to pay to the Secretary of State for the benefit of the NLDF and OLF any prizes that are unclaimed. The requirement is contained in a Direction from the Secretary of State, with which the Commission must comply. Unclaimed prizes cannot be used for any other purpose.

2.5.5 Retailers and commission rates

Retailers collect and hold funds on behalf of the Current Operator, who is responsible for making arrangements for the security and collection of these funds. The trustee has a first charge over these funds so that, in the event of default by the Current Operator, the funds can be secured on behalf of players. The Commission will require Bidders to provide a similar degree of security in this respect.

Retailer commission rates are those bid by the Current Operator in the last competition. They are 5 per cent of the value of each ticket sold by the retailer, and 1 per cent of the value of prizes between £10 and £200 paid out by the retailer on behalf of the Current Operator. Under the current licence, these rates may not be varied without the consent of the Commission²².

2.6 Other considerations

2.6.1 Commitments to the London 2012 Olympic and Paralympic Games (the "2012 Games")

Provision is made in the Horserace Betting and Olympic Lottery Act 2004 for dedicated Olympic Lottery games to be promoted as part of the Lottery. Bidders should also be aware that the Olympic Symbol etc. (Protection) Act 1995 and Schedules 3 and 4 to the London Olympic Games and Paralympic Games Act 2006 provide for controls over association with the Olympics, the Paralympics and the 2012 Games. The Commission supports the association of the Lottery with the 2012 Games and anticipates that it will have a positive impact on the Lottery.

A total of up to £1.5 billion of Lottery funding will contribute to the costs of London holding the 2012 Games. Of that, £750 million will be raised through dedicated Lottery games. The first such game, the Go For Gold scratchcard, went on sale on Thursday 28 July 2005. Subsequent scratchcards released as designated Olympic Lottery games have included Win Gold, Bee Lucky and a £100k game. The Current Operator plans to launch a new draw-based game called Dream Number in the summer, and this will also be a dedicated Olympic Lottery game, subject to regulatory approval.

To fulfil the Lottery's commitment to support the staging of the Olympic and Paralympic Games in London in 2012, Bidders will be expected to include details of designated Olympic Lottery games as part of their sales and marketing plans for the Licence Period. The promotion and licensing of these games will be subject to the same statutory and regulatory requirements as other Lottery games. The Current Operator estimates the following profile of contributions to the OLFDF:

Table 4. Estimated contributions to the OLFDF (financial years)

Year	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12	2012/13
Contribution (£m)	14	96	113	125	115	125	124	37

Source: DCMS Freedom of Information Case no. 23744, available at: www.culture.gov.uk

For the purposes of structuring their Bids, Bidders should assume that these estimated targets are met so that 47 per cent of the total commitment of £750 million will have been delivered up to the end of the current licence period. The remaining £401 million is to be delivered from the beginning of the Licence Period up to the start of the 2012 Games. Section 5.5 provides further detail on the use of intellectual property relating to the 2012 Games, and the associated guidance that Bidders must take into account when structuring their Bids.

While the Lottery will have an association with the 2012 Games through its raising of funds, this does not presume a sponsorship relationship for the Licensee with the 2012 Games. Should the Licensee wish to enter into a commercial sponsorship, it would need to negotiate the terms with LOCOG, (London Organising Committee of the Olympic Games) in the same way as any other commercial organisation.

²² See section 2.7.12 for changes to the treatment of retailer commissions in the Draft Licence.

2.6.2 Taxation regime

Lottery Duty is currently set by Parliament at 12 per cent, and is payable on all tickets sold²³ in the Lottery before deduction for any expenses or commissions. The Finance Act 1993 requires that Lottery Duty is payable monthly²⁴, fifteen days in arrears of the closure of the monthly accounting period.

There is no liability to VAT on the sale of a ticket in the Lottery. HM Revenue and Customs (HMRC) has advised that the Lottery will be treated for VAT purposes in accordance with existing legislation on lotteries. Further information is contained in Public Notice 701/28/97, which is available on the HMRC website.

In the event of a change to Lottery Duty, the Commission will ensure that the effect on the Licensee is neutral.

2.6.3 Overseas play

The Commission's jurisdiction is limited to the UK and the Isle of Man, so it cannot fulfil its regulatory function of protecting players outside of these territories²⁵. The Commission actively discourages all play of the Lottery through unauthorised agents. However, this does not mean that such play is necessarily unlawful.

Lottery tickets are only available for sale from authorised retail outlets and via interactive channels, which presently include the Internet, mobile phones and interactive digital television.

All retail outlets are based in the UK or the Isle of Man. The standard agreement signed by Lottery retailers at present includes a prohibition on selling tickets to anyone who the retailer knows, or reasonably ought to know, is likely to resell them by way of trade.

Prizes won on tickets purchased in the UK or the Isle of Man by tourists who later claim from abroad are valid, if purchased from an authorised retail outlet. Prizes of over £10,000, however, must be claimed by personal visit to a Lottery regional centre. Prizes over £500 require a claim form to be completed that includes a section about entitlement to claim. It is also possible to claim by post.

It is also possible to play the Lottery from overseas through interactive channels. However, in order to register for an account, participants must have a UK bank account and a UK residential address.

The Current Operator is not obliged to pay a prize won on a ticket purchased on re-sale from an agent, no matter where that ticket was purchased.

2.6.4 Intellectual property

The transfer of certain intellectual property is, and will continue to be, a key provision of the conditions of licensing under which a licensee can operate the Lottery. Given the structure of the Lottery, the Commission must ensure that intellectual property that is specific to the Lottery should be secured for future use, since whilst the Lottery will continue, the identity of the operator may change. These considerations extend to intellectual property held by third parties, such as suppliers, where it is reasonable to do so.

Section 5.5 provides further information about the intellectual property and rights that are available for use by the Licensee, whilst section 2.8 of the ITA and condition 21 of the Draft Licence describe the obligations of the Licensee to ensure that relevant intellectual property rights are assigned to the Commission.

²³ Specifically, Duty is payable at 12 per cent on all stake money paid in an accounting period and payable, but not received, in an accounting period where the draw took place in the accounting period.

²⁴ This may be a 4 or 5 week period, as appropriate, ending on the last Saturday of each month.

²⁵ Some of the Channel Islands are currently seeking to be included in the jurisdiction of the Lottery.

2.6.5 Broadcast rights

Broadcasting is defined in the current licence as an ancillary activity. The Current Operator is required to obtain the Commission's consent before permitting any party to broadcast a Lottery draw. Currently there are two agreements in place:

- The BBC broadcasts Lotto, Lotto Extra and Thunderball draws on Wednesdays and Saturdays. The NLDF receives 90 per cent of net receipts. The Current Operator provides an annual budget for the BBC draw showing forecast income and costs; and
- Challenge TV is currently broadcasting EuroMillions. Whilst this is an ancillary activity, no payment is due because the Current Operator does not receive any income from this activity.

There have been significant changes to the broadcast regulation regime overseen by Ofcom. This has resulted in a relaxation of the restrictions on undue prominence as it relates to the Lottery. The guidance notes of the Ofcom Broadcasting Code, which came into effect in May 2005 state that "Ofcom recognises the national and statutory status of the Lottery in programming and will apply an appropriate degree of flexibility in interpreting and applying this rule in the context of references to the National Lottery in programming". However, possible applications under the revised Ofcom Broadcasting Code are as yet untested.

2.6.6 System function proving tests

If directed by the Commission, the Licensee shall arrange for a third party, appointed by the Licensee and approved by the Commission, to conduct system function proving tests ('SFP tests') in relation to all or any part of the Technology Solution. This test is in addition to the testing the Licensee is expected to carry out as a part of its normal systems development cycle.

The current intention of the Commission is that SFP tests will be conducted on systems or subsystems that support critical Lottery operations i.e. those which, if they failed or performed poorly, could have an adverse impact on the integrity of the Lottery, players' interests or returns to good causes. Generally systems or subsystems will be subject to SFP tests whenever they are changed i.e. when a constituent component is introduced, updated, or replaced, and the Commission considers that the change could have a significant impact on the Lottery operations. A component could for example be a game, software or operating program, or item of equipment.

The changed systems or subsystems will have to pass SFP tests with no significant errors before they can be put into live service. Bidders should therefore take this into account when planning for the introduction or change of such systems or subsystems.

2.7 Anticipated changes to the current environment

2.7.1 The Commission

The National Lottery Bill, presently before Parliament, currently includes provision for there to be at least five Commissioners, to permit the appointment of a chairman for a fixed term (to be appointed by the Secretary of State) and to permit the appointment of the Commission's Chief Executive and another employee as Commissioners.

2.7.2 Licence holders

The National Lottery Act presently requires that the Section 5 and Section 6 licence holders be bodies corporate. The National Lottery Bill would remove this requirement.

2.7.3 The National Lottery Promotions Unit

At present, the Current Operator makes a contribution of around £1 million annually towards the costs of the NLPU and is responsible for its administration. The Big Lottery Fund will be responsible for the NLPU's administration should the National Lottery Bill be enacted, although governance will continue to be by a management board of stakeholders. The Licensee will be encouraged to participate in the work of the NLPU. It will not be required to make a direct financial contribution to the work of the NLPU, but may be encouraged to do so.

2.7.4 Definition of a lottery

Section 14 of the Gambling Act 2005 provides that an arrangement is a complex lottery if:

- a. persons are required to pay in order to participate in the arrangement;
- b. in the course of the arrangement one or more prizes are allocated to one or more members of a class;
- c. the prizes are allocated by a series of processes; and
- d. the first of those processes relies wholly on chance.

These arrangements will be applicable to lotteries forming part of the Lottery, and so the Commission will be capable of licensing complex lotteries. The provisions relating to complex lotteries are not expected to come into force until September 2007 and as such have not yet been tested with the Commission in respect of licensing games. Bidders are encouraged to discuss any proposals with the Commission in advance of submitting a Bid.

2.7.5 Regulations and Directions

Regulations and Directions may be reviewed and amended from time to time. The Commission recently proposed that the Regulations relating to unattended vending machines (and the related Direction about sales in public places) be amended to allow such machines to be used where the Commission is satisfied that they contain adequate controls to prevent underage and excessive play. The Secretary of State for Culture, Media and Sport recently confirmed that there will be no change to the current Regulations in this regard.

The Commission plans to notify Bidders of any changes to Regulations or Directions, or other aspects of the regulatory environment which it considers relevant, through the issue of further information on the Commission's website.

2.7.6 The Licence

The National Lottery Bill would allow the Commission the power to grant extensions to the Licence, with the maximum duration of the Licence, including any extensions, being set at 15 years. The Commission has drafted this ITA with regard to this proposed power.

2.7.7 The Commission's jurisdiction

Bidders should note that some of the Channel Islands are currently seeking to be included in the jurisdiction of the Lottery. In the event that any of the Channel Islands are included the Commission will require the Licensee to extend its operations to include those Channel Islands. Any additional costs that the Licensee may incur must be met through the retention structure proposed in the Bid. However, for the purposes of submitting a Bid, Bidders should assume that the Channel Islands, and therefore any associated revenues, are excluded.

2.7.8 Performance monitoring

The Commission is considering the scope of the sanctions available to it in the light of the recent report of the Better Regulation Executive²⁶ and its intention to increase the degree to which licence conditions are output based.

The Commission, therefore, is introducing new measures into the next Licence. These are as follows:

- If the Commission concludes at any time that the Licensee's performance in any area of its operations does not meet the standards expected of it, the Commission will have the right to require the Licensee to commission a third party expert to undertake an independent review;
- The purpose of the review will be to assess whether the Licensee's performance in the area of concern could be improved and, if appropriate, to provide recommendations. If the review indicates that the Licensee is under-performing, and provides recommendations, the Commission will be entitled to give notice to the Licensee requiring it to comply with any or all of those recommendations within a specified, reasonable period of time;

²⁶ Better Regulation Executive. *Regulatory Justice: Sanctioning in a post-Hampton world*.

- The identity of the third party expert and its terms of appointment will be proposed by the Licensee, but will be subject to the approval of the Commission. The independent review will be at the Licensee's cost, but the Commission will be entitled to a copy of the review and will have the right to publish the whole or any part of it; and
- Failure to comply with a notice issued to the Licensee requiring it to comply with any or all of those recommendations within a specified, reasonable period of time will constitute a licence breach.

2.7.9 Payments in the event that not all intended facilities and/or games are available at any time within the first five weeks of the Licence

Under Condition 3.1 of the Draft Licence, in the event that the Licensee does not fulfil its Bid proposals and have all the facilities in place or all the games available (which will be set out in the Licence) at any time during the first five weeks of the Licence, it will constitute a breach of the Licence. The Commission will not, however, revoke the Licence for a breach of this condition.

If the Licensee breaches Condition 3.1 of the Draft Licence then the Commission may impose a financial penalty on the Licensee in accordance with the process in Section 10A of the National Lottery Act and the matters in Schedule 2, Part 2 of the Draft Licence. However, Bidders should note that no other financial penalty would be imposed on the Licensee in addition to the financial penalties at Schedule 2 Part 2 (unless the Bidder is in breach of Condition 3.5 of the Draft Licence).

Bidders should note that the Commission has determined that the maximum financial payments that the Licensee may be required to make for a breach of Condition 3.1 will be capped at £10 million per week for a maximum period of 5 weeks. This is because the Commission recognises that if the total of the payments to be made by the Licensee under Schedule 2 Part 2 of the Draft Licence matched the potential loss to good causes, then this would be likely to materially threaten the Licensee's financial soundness, particularly during the early period of the Licence.

In determining what (if any) payments are to be made by the Licensee under Schedule 2 Part 2 of the Draft Licence, the Commission will have regard to the following factors:

- Where retail coverage is less than the minimum set out in the Licence on the date of the Licence or within the first five weeks of the Licence:
 - The proportion of the minimum number of retailers not able to provide service on each day; and
 - Whether some turnover may come from distribution channels other than the retailers;
- Where the number of facilities and/or games on the date of the Licence, or at any time within the first five weeks of the Licence, is less than the minimum set out in the Licence:
 - The proportion of revenue that the Commission had expected to be contributed to good causes by the facilities and/or games that had not started on the date of the Licence or were not in place at any time within the first five weeks of the Licence; and
 - Whether the sales of another game may be higher as people who would have played the game which was not available have instead played another game which is available;
- The extent of disruption caused by the delay, for example whether the delay affects all or part of the Lottery, and whether this is in all or part of the UK;
- The extent to which the delay was caused by circumstances within the Licensee's control;
- The extent to which the delay was reasonably foreseeable and/or potentially preventable;
- The extent to which the Licensee notified the Commission promptly of the risk of delay; and
- The extent to which the Licensee took all appropriate actions to mitigate the consequences.

Where the Licensee is required to pay a financial penalty, the Commission may permit the Licensee to spread the payments over the duration of the Licence. Interest on these payments would be charged on the amounts in accordance with the Schedule 2 Part 2 of the Draft Licence. Bidders are referred to the Draft Licence for further details.

Under Condition 3.5 of the Licence, if the Licensee does not have the facilities in place or all the games available, (which will be set out in the Licence), within 5 weeks of the date of commencement of the Licence, then the Licensee will be in further breach of the Licence. The limit of the financial penalty discussed above does not apply to a breach of Condition 3.5. In the event of a breach of Condition 3.5, the Commission may impose a further financial penalty on the Licensee in accordance with Section 10A of the Act and the Commission is also entitled to revoke the Licence.

2.7.10 Licence fees

The National Lottery Bill provides for the payment of annual fees to the Commission by the holders of Section 5 and Section 6 licences. These fees would be prescribed in Regulations issued by the Secretary of State. Fees would reflect the costs incurred by the Commission in exercising its statutory functions (such as granting new licences, considering new games, monitoring the licences).

2.7.11 Taxation regime

HM Treasury has reviewed the taxation of lotteries and the possible replacement of Lottery Duty by a tax on gross profits. The Pre Budget Report 2005 announced that the current tax regime would be maintained for the foreseeable future.

2.7.12 Treatment of retailer commission

The Commission has modified the retention structure under the Draft Licence in respect of retailer commissions. This covers payments to newsagents, supermarkets and other distributors who have direct (and usually face-to-face) contact with individuals who buy Lottery tickets (including Scratchcards as well as tickets for Lotto and other draw-based games)²⁷. It includes commissions paid on sales and commission paid on payment of prizes to participants.

Under the Draft Licence, retailer commission payments will be treated in the same way as prize payments or Lottery Duty are at present in that they will be deducted from the value of sales before the Net Sales Retention is applied. Instead of Bidders needing to estimate retention rates in order to recover the costs of retailer commissions, actual amounts will be recovered automatically in the same way that prize payments and Lottery Duty are at present²⁸.

The level and structure of retailer commissions set out in a Bid will become a Licence commitment. The Licensee will need to obtain the Commission's approval if it wishes to make any subsequent change to the level or structure of retailer commissions. In considering any such requests, the Commission will need to be satisfied that any proposed change is in the interests of good causes.

2.8 Description and summary of the Draft Licence

This section sets out a high-level summary of the Draft Licence in order to assist Bidders. It is necessarily not comprehensive and Bidders are recommended to read the Draft Licence in full. In the event of any discrepancy between this summary and the Draft Licence, the Draft Licence shall take precedence. Definitions used in this section are provided in Schedule 1 to the Draft Licence.

In formulating the Draft Licence, the Commission has sought to build on its experience of regulating the Lottery over the past 12 years and also to conform to the evolving regulatory environment and the principles set out in the Commission's recent review of its regulatory approach. The Draft Licence is based on the current licence. Existing conditions have been amended where necessary to improve the Commission's ability to regulate the Licensee effectively and, where appropriate, move the regulatory regime more towards output-based regulation.

²⁷ It does not cover, for example, costs or royalties incurred in relation to tickets sold or games played over the Internet, by mobile phone or interactive television.

²⁸ To the extent that the Licensee incurs similar costs in relation to tickets sold or games played by other means (Internet, mobile phone, etc), these costs will need to be recovered through the retention rates specified in the Bid. The Commission will expect Bidders to use the Gross Sales Retention for this purpose.

For example, this means that in certain areas the Commission has moved away from direct control but has retained the right to specify reports if it deems it necessary and appropriate. This should allow the Licensee a greater degree of commercial freedom, in the context of balancing the Commission's social regulation responsibilities such as the prevention of underage or excessive play and its commercial regulation responsibility to maximise returns to good causes. Bidders will also note that in some cases, such as handover at the end of the Licence Period, it has adopted arrangements to reflect the fact that the Commission has an interest in the continued sustainability of the Lottery over a longer period than the Licensee.

Bidders should note that the National Lottery Act provides for the Commission to vary the conditions of the Licence, either with the Licensee's consent or without its consent (where the Licensee has been given an opportunity to make representations). The Commission may not vary conditions of the Licence without the Licensee's consent where such variation would result in the transfer of property or rights or where the Licence provides that the condition may only be varied with the Licensee's consent. In addition, the Commission may, if appropriate (for example, as a consequence of its ongoing regulatory review), vary a condition of the Draft Licence without the consent of Bidders during the Competition or the Preferred Bidder prior to commencement of the Licence Period.

Condition 1 – Grant of Licence

This condition grants the Licence to the Licensee, subject to the terms and conditions set out in the Licence.

Condition 2 – Definitions and interpretations

This condition, in conjunction with Schedule 1, contains the definitions and interpretations that apply to the Draft Licence. Definitions set out there are also intended to apply to this ITA where relevant.

Condition 3 – Commencement

This condition, in conjunction with Schedule 2, sets out any payments that may be made in the event that the Licensee fails to have in place the required facilities or games at any time within the first five weeks of the Licence Period. A fuller description is provided in section 2.7.9 above.

Condition 4 – Handover from the previous Licensee

This condition, in conjunction with Schedule 3, sets out the matters relating to handover from the previous licensee. Chapter 5 of this ITA sets out further information on a number of key issues that will be relevant in the event that a Bidder other than the Current Operator wins the Competition.

Condition 5 – Service requirements

This condition sets out the Licensee's obligations regarding the following:

- An overall requirement to run the Lottery (including Licensee Assets and its Technology Operation) in a manner that is fit for purpose for the Lottery. In broad terms this means that the Licensee's operations and assets must remain compliant with the terms of the Licence and must also provide the envisaged services or outputs to the required specifications throughout the Licence Period;
- Compliance with Standards and codes of practice – detailing the Standards or codes that the Licensee must comply with;
- Maintenance of Licensee Assets – including specific requirements to ensure that Licensee Assets accord with the fit for purpose requirements, are supported, and are not disposed of during the Licence Period unless in the ordinary course of business. In addition, Bidders should note the requirement for the Licensee to ensure that its assets have a life expectancy of two years after the end of the Licence Period;
- Testing, Processes and Procedures. The condition sets out the detailed obligations, but Bidders should note the general requirement to ensure that all Processes and Procedures are fit for purpose;
- Independent Verification System – Bidders should note the requirements in relation to an Independent Verification System, which include provisions that each Bidder shall, at its own cost:
 - Establish, operate and maintain its own Independent Verification System;
 - Establish, operate and maintain a separate copy of the Independent Verification System for the Commission's use (which possesses the functionality specified by the Commission);

- Provide the Commission with hardware, communications links etc. to allow the Commission to operate its own copy of the Independent Verification System; and
- Ensure that the Commission and its representatives and advisers have access to the Bidder's Independent Verification System;
- Security – dealing with the detailed obligations to ensure that Lottery operations are kept secure;
- Business continuity and disaster recovery – dealing with the requirements surrounding related plans;
- Secure Areas – dealing with what is defined as a Secure Area and setting out the controls to be put in place regarding access by personnel to such areas;
- Player access – detailing the obligations on the Licensee to have a minimum number of Retail Outlets in operation throughout the Licence Period, and to have Retail Outlets in each Postcode District (being a postcode e.g. RH15 or W4 with a minimum number of residents of 2,000);
- Compliance with Law;
- Property – which sets out that the Commission must approve any operational premises occupied by the Licensee; and
- Technology Maintenance – setting out the requirements on the Licensee to develop and update a Technology Maintenance Plan, which sets out the proposed replacement cycles for the Technology Operation. Bidders should note that they will be asked to identify any new or potential improvements or opportunities in relation to its Technology Operations.

Condition 6 – Prohibition of activities not relating to the National Lottery

This condition, in conjunction with Schedules 4 and 5, sets out the restrictions on the Licensee's ability to carry out any activity without the prior approval of the Commission, other than the running of the Lottery.

Condition 7 – Consumer protection

This condition, in conjunction with Schedules 6,7 and 8, sets out the obligations of the Licensee in respect of protecting the interests of players. Bidders should note these requirements in particular for their responses to chapter 8 of this ITA, where they are also referred to in more detail.

Condition 8 – Distributor Commission and Distributor Management

This condition sets out the requirement for the Licensee to obtain approval prior to agreeing to pay or change the remuneration or commission paid to distributors. It further sets out the obligations relating to the ways in which retailers are selected. Bidders should note that this condition also contains the requirement to undertake tests to establish whether sales have been or are likely to be made to those under the age of 16.

Condition 9 – Independent section 6 licence applicants

This condition, in conjunction with Schedule 7, sets out the conditions concerning the Licensee's approach to handling proposals submitted by third parties for games for inclusion in the Lottery and applications to the Licensee for agreement under section 1(3)(b) of the National Lottery Act for an application to be made to the Commission for a licence under section 6 of the National Lottery Act.

Condition 10 – Information and reporting

This condition, in conjunction with Schedule 9, sets out the detailed obligations of the Licensee in relation to the provision of information to the Commission. Bidders should note the following:

- The general obligations require that the Licensee shall provide the Commission with such Licensee Information as it shall require in order to carry out its statutory duties, including in connection with any competition or tendering exercise;
- The Commission shall have the right to use or publish any such information; and
- The Licensee must obtain such third party consents as are required to allow such Licensee Information to be available to the Commission and published, as required by the Commission.

The condition also sets out the Licensee's obligation in respect of:

- Monitoring and reporting incidents;
- Licensee Subcontractors, and in particular providing access to Subcontractor premises, employees and information relating to Subcontractors;
- Provision of facilities for Commission employees or its advisers and representatives;
- Provision of specific management and operational information, which for the avoidance of doubt shall include any information that the Commission may from time to time specify;
- Performance standards, describing the implementation and obligations relating to performance standards and targets. The Commission may, after consulting with the Licensee, specify performance standards in respect of any matter related to the operation of the Lottery. The performance standards set for the Current Operator are available in the Commission's Annual Reports;
- Maintenance and procedures in respect of banking records, and in conjunction with Schedule 9 the presentation of management and financial accounts; and
- Maintenance and procedures in respect of player correspondence.

Condition 11 – Payments to the Secretary of State

This condition, in conjunction with Schedules 5, 8, 10 and 11, sets out the payment mechanics and associated obligations in relation to the payments to be made to the Secretary of State.

Condition 12 – Shareholders, other Connected Parties and debt providers

This condition covers a number of areas. Firstly, it sets out the obligations that apply to the Licensee in terms of its constitutional documents and capital structure. The Licensee must ensure that the constitutional documents that were agreed by the Commission prior to the commencement of the Licence are in force upon commencement. They may only be amended with the consent of the Commission. Similar conditions apply to the Licensee's shareholder and financing agreements.

The capital structure of the Licensee at the commencement of the Licence must also be consistent with the structure approved by the Commission. Any material change to the Licensee's paid-up capital and any restructuring of debt facilities, must also be approved by the Commission.

The condition also sets out the obligations in respect of provision of information relating to any person who is managing the Licensee's business or for whose benefit the Licensee's business is being carried on or who is otherwise connected to the Licensee so that the Commission may be satisfied that such persons are fit and proper.

The condition also obliges the Licensee to ensure that the Licensee's Connected Parties are the same upon commencement of the Licence as those approved by the Commission, and may not be, in certain circumstances, changed without the prior consent of the Commission. The condition sets out a definition of Connected Party.

Condition 13 – Personnel Security Codes of Practice

This condition, in conjunction with Schedule 7, sets out the entitlement of the Commission to conduct investigations as may be required to ensure that employees or intended employees engaged or employed (or to be engaged or employed) by the Licensee in connection with the Licensee's business of running the Lottery are fit and proper. It also sets out the requirement for the Licensee to maintain and adopt a Personnel Security Code of Practice.

Condition 14 – Control environment

This condition, in conjunction with Schedule 7, sets out the Licensee's obligations in relation to corporate governance, internal control systems and risk management procedures. Bidders may wish to refer to these when responding to chapter 7 (Propriety) and chapters 9 and 13 (Transition and Operational risk management respectively).

Condition 15 – Contractors

This condition, in conjunction with Schedule 12, sets out a number of obligations relating to the Licensee's subcontractors. The condition requires the Licensee to manage any subcontractors in a way that will ensure compliance with the Licensee's obligations under the Licence.

The condition also deals with a number of specific areas with respect to subcontracts as follows:

- The Licensee is obliged to notify the Commission of each proposed Licensee Subcontract falling within the category of subcontracts determined by the Commission.
- The condition designates what are termed Key Licensee Subcontracts. These relate primarily to services:
 - Of a value of at least £3m; and/or
 - Relating to information technology services (i.e. relating to the Technology Operation);
 - Relating to marketing and/or promotion of the Lottery;
 - Relating to business continuity and disaster recovery plans;
 - Relating to property interests;
 - Relating to intragroup Licensee Subcontracts; and
 - Any other category of arrangement which the Commission may specify from time to time.
- The Licensee is obliged to submit to the Commission any proposed Key Licensee Subcontracts and it must make any amendments the Commission request before the subcontracts are signed. Final copies of such contracts must be lodged with the Commission;
- The condition also sets out the obligations the Licensee must ensure are contained within Key Licensee Subcontracts in respect of corporate governance arrangements; and
- The condition also sets out the contractual provisions that the Licensee must ensure are in place within Licensee Subcontracts, Series Subcontracts or Sub Series Subcontracts (Mandatory Flowdowns). These relate primarily to:
 - The ability of the Commission directly to enforce rights under the Contracts (Rights of Third Parties) Act 1999;
 - The Commission's ability to obtain information from Subcontractors;
 - The Commission's ability to direct such contracts to be novated, terminated or assigned; and
 - Compliance with the Data Protection Act and any equivalent legislation.

The condition further sets out the terms that the Licensee is under reasonable endeavours to impose on Licensee Subcontracts, Series Subcontracts or Sub Series Subcontracts (reasonable endeavour flowdowns).

The condition gives the Commission the ability to terminate, assign or novate Licensee Subcontracts, Series Subcontracts or Sub Series Subcontracts. It further provides that neither the Licensee, nor any of its subcontractors, may terminate, assign, novate or vary any terms or grant any waiver under such contracts without the Commission's prior written consent.

The condition also sets out the process for which the Licensee is obliged to follow for variation and renewal of Key Licensee Subcontracts.

Condition 16 – Employees

This condition sets out certain obligations in respect of Licensee Staff.

The condition sets out certain restrictions that apply to the terms of employment or engagement of Licensee Staff during the Licence Period. Bidders should note the following:

- Restrictions are placed on the ability to provide any payment or benefit that falls due beyond the Licence Period;
- In the last two years of the Licence, certain restrictions are placed on the Licensee's ability to vary existing terms of employment or engagement, its ability to recruit staff on terms and conditions materially different from existing equivalent Licensee Staff, and its ability to vary overall staff numbers and costs.

The Licence also places restrictions on the Licensee in respect of the employment of Commission staff.

In respect of any redundancy costs incurred in the first year of the Licence Period, the condition also allows for the Licensee to recover any such costs necessarily, reasonably and properly incurred as a result of taking up the Licence, subject to approval by a third party expert appointed by the Commission. The details of this are set out in more detail in section 5.6.

Condition 17 – Performance monitoring

This condition sets out the obligations of the Licensee in respect of independent reviews of its performance. This is set out in further detail in section 2.7.7 above.

Condition 18 – Handover on expiry or revocation of the Licence

This condition, in conjunction with Schedules 12 and 14, sets out the obligations on the Licensee in respect of handover to a fourth licensee after the Licence Period, or upon revocation of the Licence. It requires the Licensee to co-operate with the Commission in making available any information deemed necessary to undertake a competition or tender for the licence, including making such information available to potential bidders.

This condition also sets out the obligations on the Licensee to co-operate with a successor licensee, in particular with regard to information to be made available.

The condition also sets out the Licensee's obligation to develop a Transition Plan. This details how the Licensee intends to comply with its obligations in the event of any handover.

In the event of a handover, the Licensee is obliged to novate its interest under any Licensee Subcontracts. On expiry, it is also obliged to transfer any Transferring Assets for nil value, other than in respect of Scratchcard Lottery Tickets, in respect of which amounts payable shall be agreed between the Licensee and the Successor Licensee, failing which by an independent expert. On revocation, it is obliged to transfer any Transferring Assets at market value. At any time during the handover period, the Commission may require the Licensee to carry out an independent survey as to the condition of any Licensee Assets. The Licensee is also obliged to assign any Lottery Intellectual Property and Property Interests.

In the event that the Commission so decides, the Licensee must also transfer and co-operate in the transfer of any Continuing Obligations or disputes.

Condition 19 – Security for Players' funds

This condition, in conjunction with Schedule 8, sets out the prize payment security obligations relating to the Licensee. The obligations set out here assume that the Licensee will maintain materially the current structure. However, Bidders should note that they are free to propose other structures that materially maintain or exceed the current protections afforded. Bidders may wish to consider, in conjunction with this, the information provided in Appendix G. Bidders may wish to consider this information in relation to their responses to chapter 8.

Condition 20 – Confidentiality and freedom of information

This condition sets out the obligation on the Licensee not to disclose confidential information (subject to certain exceptions). It also sets out the Licensee's acknowledgment that the Commission is subject to the freedom of information regime, and details the Licensee's obligations in respect of any requests for information that the Commission may receive under that regime.

Condition 21 – Intellectual property

This condition, in conjunction with Schedule 13, sets out the licence of Lottery intellectual property granted by the Commission to the Licensee for the duration of the Licence, including the Licensee's obligation to comply with Lottery intellectual property guidelines.

This condition further sets out the Licensee's obligation in respect of intellectual property. In summary it requires that intellectual property that is specific to the Lottery should be secured for future use by the transfer or licence of intellectual property to the Commission or its nominee. This obligation extends to a best endeavours obligation to procure the transfer or licence of intellectual property held by third parties, such as suppliers, to the Commission or its nominee.

The condition also sets out restrictions in the use of Lottery-related Intellectual Property, requirements relating to its registration and obligations on the Licensee to pursue any enforcement action necessary in the event of any infringement of Lottery-related intellectual property.

Condition 22 – Data protection

This condition sets out the obligations relating to the protection of personal data, and the extent to which this extends to the Licensee Subcontractors. Bidders should note that the Licensee is required to ensure and procure that any Licensee Subcontractor ensures that appropriate consents are obtained to enable such information to be transferred to or accessed by the Commission or to its appointed nominee e.g. a successor licensee.

Condition 23 – Licence extensions

This condition, in conjunction with Schedule 14, sets out the obligations surrounding the extension of the Licence. It provides that by mutual agreement, the Licence may continue for a maximum period of five years on the same terms as set out in the Licence or on such terms as the Licensee and the Commission may agree.

It also includes provisions relating to extensions of the Licence, of up to five years, in the event that the Commission determines that Licence extensions are an appropriate mechanism to allow the Licensee to recover certain costs relating to significant, unanticipated investment opportunities arising during the Licence Period that may have the capacity to enhance the Lottery in a way that benefits both good causes and the Licensee and which would not be undertaken in the absence of a Licence extension granted in accordance with this condition. (For the avoidance of doubt, such an investment opportunity would not include any investment or expenditure required to ensure the Licensee's compliance with the terms of the Licence).

Finally, it sets out the ability of the Commission to extend the Licence in order to facilitate a handover. The Commission may extend the Licence in such circumstances for a period of up to two years, in six monthly increments. The condition provides for the Licensee's reasonably and properly incurred costs over and above those that it was incurring prior to the extension of the Licence.

Condition 24 – No waiver

This condition provides that no failure or delay by the Commission in exercising its rights under the Licence shall prejudice any rights or remedies as may be available to it.

Condition 25 – Severability

This provides that in the event that a condition within the Licence is held to be illegal, void or unenforceable, it shall not invalidate the remaining provisions of the Licence.

Condition 26 – Governing Law and jurisdiction

The Licence shall be governed by English law and the English courts shall have exclusive jurisdiction in relation to any legal action or proceedings arising under the Licence, save that the Commission shall be entitled to bring proceedings in any other court or courts having jurisdiction.

Condition 27 – Third party rights

This condition provides that a person who is not a party to the Licence shall have no right under the Contracts (Rights of Third Parties) Act 1999 to enforce any of its terms.

Condition 28 – Notices

This condition sets out the procedure for serving Notices under the Licence.

Condition 29 – Survival

This condition sets out the conditions of the Licence that shall survive its expiry or revocation.

The current Lottery

Chapter

3

3 The current Lottery

3.1 Introduction

This chapter sets out a brief description of the current Lottery operations, describing the games and the ways in which they can be played. Bidders should note that more detailed information, particularly relating to historic Lottery performance and market research is provided in the data room (see section 4.3). A summary of the categories of information contained in the data room is also provided at Appendix D.

3.2 The current Lottery operations

Since it was established in late 1994, the Lottery has become a national institution. Over 64 per cent²⁹ of people play the Lottery regularly and 89 per cent³⁰ of people instantly recognise the Lottery brand. As at the end of the 2004/2005 financial year it had paid just under £25 billion³¹ in prizes and raised over £17 billion in funds for good causes.³²

3.3 The Lottery licence

Camelot Group plc was awarded the first 7-year licence to run the Lottery in May 1994. The second licence was awarded to Camelot in December 2000, commencing in January 2002. The second licence is due to end on 31 January 2009.

3.4 The game portfolio

There are currently eight different types of game in the portfolio. These are shown in Table 5. Chart 1 (page 48) shows the breakdown of sales for each of these games, or groups of games, for the financial year 2004/2005. Further up-to-date information on the split of sales by game type is provided in the data room.

²⁹ Source: National Lottery Commission.

³⁰ Source: National Lottery Commission.

³¹ Source: National Lottery Commission: Annual Report and Accounts 2004/2005.

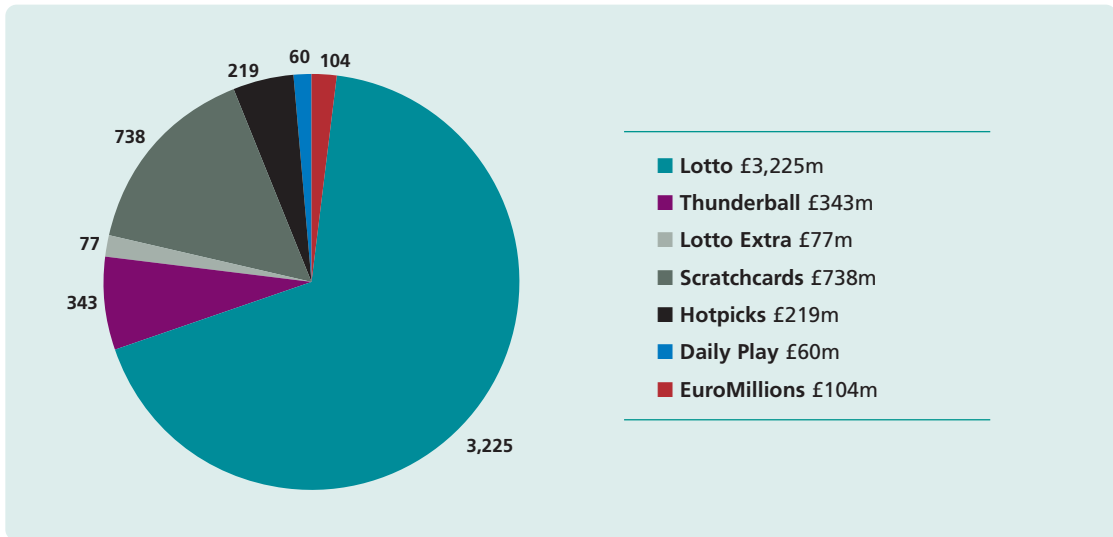
³² Figures relate to the last year for which audited figures are available.

Table 5. Current portfolio of games³³

	Lotto	Thunderball	Hotpicks	Lotto Extra ³⁴	Daily Play	EuroMillions	Scratchcards	IIWGs
When launched	Saturday draw: November 1994. Wednesday draw: February 1997	Saturday draw: June 1999. Wednesday draw: October 2002	Hotpicks 2,3 and 4: July 2002 Hotpicks 1 and 5: October 2005	November 2000	September 2003	February 2004	March 1995	February 2003
Price	£1 (same price since launch)	£1	£1	£1	£1	£1.50	£1, £1.50, £2, £5	From 25p to £2
How to play	Players match 6 out of 49 numbers. A maximum of 7 lines of numbers can be played per playslip.	Players match 5 out of 34 numbers and 1 Thunderball from numbers 1 to 14. A maximum of 5 lines of numbers can be played per playslip.	Made up of 5 different games: Pick 1, Pick 2, Pick 3, Pick 4, Pick 5. For Pick 3, players pick 3 numbers from 1 to 49. A maximum of 5 lines of numbers can be played per playslip.	Players must first buy a ticket for the main Lotto draw and then match 6 out of 49 numbers to win.	Players must first choose which days to play, then match 7 numbers from 1 to 27. A maximum of 4 lines of numbers can be played per playslip.	Players must match 5 numbers from 1 to 50, and 2 Lucky Stars from 1 to 9. A maximum of 4 lines of numbers can be played per playslip.	A set of varied themes and playstyles.	A set of varied themes and play styles.
Top prize	Jackpot game	Fixed prize game; top prize of £250,000	Fixed prize game; top prize £130,000	Jackpot game	£30,000 (for matching 7 out of 27 numbers)	Jackpot game	Up to £2 million	Up to £100,000
Frequency	Twice weekly on Wednesdays and Saturdays	Twice weekly on Wednesdays and Saturdays	Twice weekly on Wednesdays and Saturdays	Twice weekly on Wednesdays and Saturdays	Draws are held Monday through Saturday, excepting Christmas Day.	Once weekly on a Friday		
Other points of interest	Highest Jackpot was £42,008,610 won in January 1996.			Highest Jackpot was £21,118,407 won in August 2004.		Record 11 series rollover and jackpot of £126,059,632 in February 2006		

³³ Lucky dip feature applies to all draw-based games.³⁴ During 2006/07 Lotto Extra will be replaced by Dream Number as the Lotto add-on game; Dream Number is a Joker-style Lottery game.

Chart 1. Sales of Lottery Games (£m)



Source: National Lottery Commission Annual Report and Accounts 2004/2005

3.5 Distribution channels

Players can currently participate in the Lottery through the following channels:

Table 6. Current Lottery distribution channels

Channel	Description
Retailers	<p>Via around 26,000 online terminals (OLTs), selling draw-based tickets and Scratchcards</p> <p>Around 1,500 Scratchcard only terminals (GVTs)</p> <p>Electronic Point of Sale (EPOS) terminals</p> <p>Independent retailers – c. 60% of all outlets by number</p> <p>Multiples (such as supermarkets) – c. 40% of all outlets by number</p>
Internet	<p>Players are able to play games including Internet-only games</p>
Interactive digital television (IDTV)	<p>Through Sky Active</p> <p>Players can purchase up to 8 weeks worth of tickets via an individual user account</p>
Mobile telephones	<p>Players can participate via text message on mobile phones</p>
Subscriptions	<p>A subscription service is also available through the Internet, by post and by telephone.</p>

Source: National Lottery Commission

Notes:

1. EPOS sales are currently only available through Tesco.
2. Further detail on split of sales will be held in the data room.

3.6 Players

The Lottery has a wide participation in the UK, with the demographic profile of players resembling closely the overall demographic of the UK. During recent research over 70 per cent of adults over the age of 18 claimed to play a Lottery draw based game at least once a month³⁵. In addition, 17 per cent of Lotto players claimed to play as part of a syndicate³⁶. The National Lottery name is instantly recognisable to 89 per cent of the UK population³⁷.

An up-to-date quantitative segmentation analysis of consumers in the UK Lottery market is available in the data room, and provides further information on players of the UK Lottery, including:

- The relative size and estimated volume contribution to Lottery revenues;
- Current Lottery playing behaviour including: frequency of play; level of spend; syndicate membership; types of products played; whether same or different numbers played in draws; retail channels used (including virtual channels) and reasons for channel choice;
- Motivations and reasons for playing or not playing the Lottery;
- Attitudes and opinions towards the Lottery and related issues, such as good causes, gambling, enjoyment of the Lottery, ease of playing the Lottery;
- Demographic profile: age, social class, gender, family status, working status, ethnicity; and
- Other contextual behavioural information e.g. media consumption, leisure activities, usual shopping channels, use of Internet and other forms of technology, other gaming or betting behaviour.

3.7 Syndicate play

Players are able to play via syndicates. Syndicates are simply a group of participants who choose to pool their ticket funds in order to purchase a greater number of ticket combinations than they would otherwise do on their own, and as such to increase their chances of winning.

Anybody who joins a club or syndicate has no entitlement to a prize claimed direct from the operator of the Lottery even if the numbers they entered are drawn. It is only the holder of the ticket that has the entitlement to claim that prize. Club or syndicate members must therefore rely on their contract or agreement with the club or syndicate for any financial returns. The Current Operator provides assistance to syndicates, for example, by suggesting the key terms of any syndicate agreement governing how the syndicate plays.

3.8 EuroMillions

EuroMillions is run by the Current Operator as a Lottery game in the UK and the Isle of Man. All prizes at each level of the game are pooled, in effect, and shared between the winning players in the participating countries.

In terms of the structure and arrangement in place with the European partners, a limited liability company (SLE) was established in Belgium to provide common services necessary to the operation of the game (e.g. operating and administering the draw). Each participating lottery operator holds shares in SLE either directly or via an affiliate.

Bidders should note that they are strongly encouraged to continue participation in EuroMillions and will be required to provide reasons if they choose not to continue with the UK's participation. Bidders are referred to section 5.4 for further details on the handover of the shares in EuroMillions.

³⁵ Source: National Lottery Commission.

³⁶ Source: National Lottery Commission. Syndicate figures refer to the first quarter of 2004.

³⁷ Source: National Lottery Commission.