



National Lottery
Commission

Statement of Main Principles

A Lottery for the future

November 2005

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Purpose

This document sets out the principles we, the National Lottery Commission, have decided to adopt to structure the competition for the third licence to operate the UK National Lottery. It is based on extensive analysis, both by ourselves and by the interested parties with whom we have consulted. We have conducted a thorough consultation process and we are grateful to all those organisations that have contributed.

We have sought throughout to find solutions that should attract potential bidders and that will generate maximum returns for the good causes that the Lottery supports.

The launch of this document marks the start of the competition process. We aim to give those interested sufficient clarity about the intended structure of the competition to enable them to decide whether to participate and to find partners with whom to work.

From now on, we will be undertaking the work necessary to convert these principles into a full Invitation to Apply (ITA). We expect to issue a draft ITA in April 2006, to allow time for those interested to comment, before finalising the ITA in June 2006. In the meantime, we would be happy to discuss the principles set out in this document, and the bidding opportunity more generally.

Foreword



"I believe that the competition structure should be genuinely attractive to the market and capable of encouraging innovative and realistic proposals."

The Statement of Main Principles marks the formal start of the competition to award the next licence to run the National Lottery – one of the most successful lotteries in the world.

We publish here the principles that will underpin the competition and ensure a fair and transparent process.

Our aim is to design a framework that supports good causes, protects players and attracts the market. An integral part of striking this balance has been allowing greater flexibility in a number of areas in order to encourage competition.

This commitment to flexibility is evident in our decision to award a ten-year licence and the possibility of further extensions. This longer licence period will enable the operator to recover its initial investment and to make substantial further investment over the ten-year term. It should therefore be beneficial to the growth of the National Lottery and have a positive impact on the returns to good causes.

The publication of this document marks the end of a period of open consultation, which has generated a stimulating and informative debate. Our dialogue with a wide range of interested parties has given us an invaluable insight into how we can design a process that will encourage a vigorous competition that delivers for good causes.

I would like to extend my thanks to everyone who has engaged with us. We will continue to listen and consider feedback until we issue the final Invitation To Apply in June 2006.

I believe that the competition structure should be genuinely attractive to the market and capable of encouraging innovative and realistic proposals.

I look forward to hearing from you.

A handwritten signature in black ink that reads "Robert Foster". The signature is written in a cursive style with a horizontal line underneath.

Robert Foster
Chairman of the Project Board



Summary

Summary

The UK National Lottery

The UK National Lottery is one of the most successful in the world. In 2004, it was the fifth largest lottery in terms of sales. Private sector expertise has delivered a Lottery that operates within a framework of careful regulation which ensures propriety and protects players. Competition to operate the National Lottery lies at the heart of its success.

Since it was established in late 1994, the National Lottery has become a national institution. Over 70% of people play the Lottery regularly and 95% of people instantly recognise the Lottery brand. It has paid over £25 billion in prizes and made 1,700 people millionaires or multi-millionaires.

More importantly, the proceeds of the National Lottery support good causes. These cover the arts, heritage, sport, charities and community and voluntary groups as well as supporting projects concerned with health, education and the environment. The good cause distributors have made over 180,000 grants. Since it started, the Lottery has raised over £17 billion in funds for them, including £1.3 billion in the last financial year alone. These funds support projects large and small and provide opportunities for people all over the UK – from staging the forthcoming 2012 Olympic Games to the construction of the Eden Project. Because of the national importance of these funds, we aim to run a competition that attracts the very highest quality bidders.

We are preparing to award a single ten-year licence to operate the UK National Lottery, commencing in February 2009. The competition starts now, with this Statement of Main Principles.

Our objectives

Our objectives are:

- to ensure that the Lottery is run with all due propriety;
- to ensure that players' interests are protected; and
- subject to these, to select the bidder that is best able to maximise the income for good causes.

In order to achieve these objectives, we have sought to create an environment that will attract high quality bids and stimulate vigorous competition.

We have consulted extensively with the market and published two consultation papers: *A Lottery for the future: Shaping the structure of the third competition* (January 2005) and *A Lottery for the future: Summary of responses and areas for further analysis* (July 2005). We are alive to the concerns of potential bidders and, together with our team of advisers, have analysed them carefully. We set out below the key principles we have adopted in order to encourage competition and ensure the Lottery continues to meet the needs of both players and good causes.

Key principles

We are adopting the following principles to create a strong competition that is fair for all:

- We are offering a ten-year licence, with the possibility of extensions¹, to increase the attractiveness of the opportunity (see page 21);
- The competition will be based on a one-stage process because we believe this is most suited to achieving our objectives and generating high quality, competitive bids (see page 13);
- In their proposals, bidders will need to demonstrate that they have the full capability to manage the operations of an undertaking the size of the UK National Lottery and deliver their proposed solution (see pages 13, 30-32);
- We will be encouraging bidders to be innovative by emphasising the outcomes – or results – the Lottery needs, rather than using prescriptive specifications (see pages 13 & 17);
- We are simplifying our requirements where practicable, and will provide guidance in various areas such as propriety and player protection (see pages 13, 30 & 31);
- We will be amending the retention structure by allowing it to vary by class of game to provide better incentives across the game portfolio (see pages 21 & 22);
- There will be a demanding output-based performance specification; hence we will expect the operator, from the start of the third licence, to make use of modern technology that is flexible and adopts open systems principles, including appropriate interoperability standards (see page 17);
- All suppliers and contractors, including suppliers of equipment, gaming related software, scratchcard providers and retailers, will be able to participate in more than one bid where they wish to do so (see page 14);
- In order to qualify for participation in the competition, bidders will need to certify that no restrictive contractual arrangements have been entered into from the date of this document. Any such agreements that pre-date this document will have to be disclosed. We are taking this step to ensure that competition for the third licence is not unfairly or artificially reduced (see pages 14 & 15);
- The evaluation will be simplified to increase the transparency of the process, and will assess a number of areas by reference to required standards (“hurdles”). These will be evaluated separately from the assessment of likely returns to good causes (see pages 7 & 29-33);
- We will take steps designed to ensure that sales projections are realistic and comparable, whilst also taking account of bidders’ own forecasts (see page 15);
- We accept that there is some risk inherent in the transition process. We will require all bidders to meet a defined hurdle. We must be satisfied that a bidder has a comprehensive transition plan that convinces us that the bidder has the ability to effect transition successfully, identifying the associated risks and mitigating them appropriately. Once a bidder meets this requirement, we will not take any further differential between its transition risk and that of other bidders into account in assessing returns to good causes (see page 31);
- We will permit the use of the Lottery infrastructure for other purposes (e.g. payment of utility bills) and take account of the returns this will generate for good causes in our evaluation (see pages 22 & 23);
- We will introduce arrangements to encourage investment during the licence period, where this will increase returns to good causes (see pages 22 & 23);
- The process anticipates a transition period of 20 months (see page 15);
- We are seeking to make available to bidders all the information about the Lottery they are likely to need to compile their bids (see page 18);
- We are considering requiring that the next licensee make provision to transfer its assets and contracts at the end of the licence period to a new operator for a fixed period, to ensure handover can be even smoother following a fourth licence competition. Where assets and contracts include technology, the design of that technology should not inhibit such transfer (see page 25); and
- We do not propose to provide assistance with bid costs (see page 13).

¹ Our ability to offer licence extensions is subject to the passage of the National Lottery Bill

Evaluation

We recognise that bidders will wish to understand the basis on which their bids will be evaluated. We intend to deliver a simplified and transparent evaluation process. This should give confidence that the process will be conducted fairly.

We will adopt required standards (“hurdles”) in certain areas. Our assessment of each hurdle will take into account all relevant areas of the bid, and bidders will need to satisfy us as to their ability to meet the required standards. The assessment of each hurdle will not impact upon our evaluation of the overall returns to good causes or be used as a comparator between bids.

We will also make an assessment of a bidder’s ability to maximise returns to good causes. Bidders will be required to propose retention rates, which in turn will determine the amounts available for good causes (contributions to the National Lottery Distribution Fund and the Olympic Lottery Distribution Fund). We will analyse the present value of the expected contributions to these funds over the life of the licence under a number of scenarios. These will include a common sales scenario, which we will provide to bidders, and bidders’ own sales scenarios.

During the evaluation, we would intend to give bidders the opportunity to address any concerns which, if not addressed, might prevent their bid passing any hurdle tests. In respect of aspects of the evaluation that are not subject to hurdle tests, we may decide to give bidders the opportunity to address any deficiencies in their bid. If we decide to do so, all bidders will be given an equal opportunity. However, no amendment, either upwards or downwards, to bid retention rates and returns to good causes will be permitted.

Once the evaluation is complete and the licence terms finalised, we will award the third licence.

Competition timetable

The planned timetable is as follows:

Timetable	Elapsed months	End date
Statement of Main Principles		November 2005
Preparation of draft ITA	5	April 2006
Finalise and issue ITA	2	June 2006
Bids prepared	4	October 2006
Bids evaluated	5	March 2007
Licence finalised and awarded	2	May 2007
Transition period	20	January 2009
Start of third licence		1 February 2009

Conclusion

This Statement of Main Principles marks the beginning of the third National Lottery licence competition. Bidders who have questions on the Statement of Main Principles or the structure of the competition are invited to contact us. In addition, we will be arranging for our lead advisers, Rothschild, to highlight this opportunity further in a series of meetings around the globe. If you would like them to visit you or provide further information, please let us know. Our contact details are provided on page 34.



The competition process

The competition process

Our objectives

This Statement of Main Principles marks the start of the third licence competition.

Our objectives are:

- to ensure that the Lottery is run with all due propriety;
- to ensure that players' interests are protected; and
- subject to these, to select the bidder that is best able to maximise the income for good causes.

We have structured a competition framework and approach that we believe will achieve:

- a vigorous competition for the third licence, on the basis that this is the best means to generate the greatest returns to good causes;
- a level playing field for all bidders; and
- greater incentives to increase returns to good causes.

The remainder of this document explains in greater detail how the competition will be structured, and how our objectives will be reflected in the evaluation criteria that are set.

The licensing system

The Lottery is governed by the National Lottery etc. Act 1993 as amended by the National Lottery Act 1998. The 1993 Act divides the operation of the Lottery into two, separating the functions of operating the Lottery from the promotion of lotteries as part of it. Section 5 of the 1993 Act allows us to grant a single licence to operate the Lottery for a set period². This is the licence to which this Statement refers. Section 6 of the 1993 Act allows us to grant licences to promote lotteries as part of the National Lottery. Every game promoted as part of the Lottery must be authorised by a Section 6 licence. We can grant Section 6 licences to organisations other than the holder of the Section 5 licence, but only where the holder of the Section 5 licence agrees. Whilst we regulate the operation of the Lottery, we play no part in the distribution of the funds that it generates for good causes. This is the responsibility of the distribution bodies. Further detail on the licensing system can be found in the annex to this document.

The successful bidder for the Section 5 licence will be invited to submit provisional applications for Section 6 licences on the game plan provided in its bid as soon as possible after we confirm our intention to grant the Section 5 licence. Additional Section 6 licences may be granted at any time during the life of the Section 5 licence.

The process before submission of bids

We are planning to receive proposals from bidders in October 2006. In advance of this, we will be setting out our requirements in much greater detail and specifying the form and content of bids in the draft and final ITAs, which we expect to make available in April and June 2006 respectively. We will also be providing the information required for bidders to assess the Lottery opportunity in detail and further information on the evaluation criteria that we will use to assess bids.

The ITA will be made available publicly and without charge. However, where necessary, we will be putting in place arrangements to protect commercially sensitive information that is not in the public domain to ensure that the interests of the Lottery are protected. We may require written confidentiality undertakings and/or the provision of a deposit.

² The current version is available on the Commission's website at <http://www.natlotcomm.gov.uk/Licensing>

Communications with the Commission

In the meantime, we expect to build on the momentum generated so far. Although the formal consultation period is now at an end, bidders who have questions on the Statement of Main Principles or the structure of the competition are invited to contact us. In addition, we will be arranging for our lead advisers, Rothschild, to highlight this opportunity further in a series of meetings around the globe. If you would like them to visit you or provide further information, please let us know. Our contact details are provided on page 34.

We are designing a programme of communications activities to support the release of the draft and final ITAs. We expect that this will include the opportunity to talk further with us about the various aspects of the statutory and regulatory environment that relate to the competition and the operation of the Lottery. For example, we would expect to provide clarity to potential bidders on how they can meet our requirements for the demonstration of propriety and protecting the interests of players. We will make clear the type of lottery products that are acceptable under the current legislation and the considerations to be taken into account in licensing them. Any interested parties who would like to participate in such briefings should contact us. Potential bidders may wish to suggest other areas where we might provide clarification.

After the release of the final ITA and up to the closing date for bids to be submitted in October 2006, we anticipate that interaction with us will be limited to clarification of the final ITA. Any additional information made available as a result of this clarification process will be posted on our website and drawn to the attention of anybody who has made their interest known to us, to ensure that all potential bidders are aware of it.



**Encouraging
a vigorous
competition**

Encouraging a vigorous competition

A single-stage competition for a single licence

The competition for the third licence will be a one-stage competition because we believe this is best suited to achieving our objectives and generating high quality, competitive bids. We have considered the use of a process with a pre-qualification stage. However, we have concluded that any benefits associated with such a process (including reducing the costs of bidding) are likely to be marginal, and are outweighed by the disbenefits.

Similarly, we have decided not to implement a dual competition whereby a preferred bidder is selected and then runs its own competition for key suppliers. We believe that the technology and operations of the Lottery are closely interconnected. Having separate competitions for the two elements might not only reduce the expertise available to operators to the detriment of the competition, but would raise significant difficulties in evaluating the components and increase the risks inherent in the transition.

In their submissions, bidders will need to show that they have the full operational, financial and technical capability to run the Lottery. They will also need to demonstrate that they are capable of meeting the evaluation criteria, which will be based upon our objectives for fitness and propriety, player protection and, subject to these, maximising returns to good causes.

Wherever possible, we will be stating our requirements in relation to the outcomes, or results, that the Lottery requires rather than using prescriptive specifications. We will do this to allow bidders to be innovative in the solutions that they adopt, enabling them to meet our needs in the way that is most appropriate for their own bid and plays to their own strengths.

We need to be confident that a bidder can deliver the proposed solution for an undertaking of this size. As a result, bidders will need to have consortium members and key suppliers in place when they submit their bids. Accordingly, partial bids that do not specify key suppliers are unlikely to meet our evaluation requirements.

With the help of our advisers, we will evaluate the bids against the requirements set out in the final ITA. After finalising terms, a single licence will be awarded to the operator that, having met our requirements, is judged to be most likely to generate the highest returns to good causes.

Bid costs

Based on the responses to our consultation and further analysis that supports the view that the costs of bidding will not deter serious bidders, we do not propose to provide assistance with bid costs.

We set out later in this paper how we intend to conduct and evaluate the competition. We believe that the simplification of the process, coupled with greater provision of information to bidders through, for example, workshops, should help reduce the costs of bidding.

Consortia arrangements

We recognise that there is a limited supply of key technology providers (particularly gaming systems and related software) and scratchcard providers. We will therefore be allowing providers to participate in more than one consortium if they wish to do so. If such providers are also bidders, or members of a bidding consortium (e.g. as a shareholder or a partner), they should not be capable of exercising control over more than one bidder³. However, it is not our intention to force providers into supplying, or participating in, more than one consortium. The decision will depend upon each party's own commercial assessment of the relevant opportunities.

We will be requiring that bidders and consortium members provide an undertaking in their bids that they have not entered into any restrictive contractual arrangements, (as discussed below), from the date of this document. Our purpose is to reduce the risk of market distortions that might unfairly reduce the competition for the third licence. However, we do recognise that bidders may choose to work with only one supplier for any particular service based on their own commercial assessment of the situation. Our approach should not stop bidders from also putting in place confidentiality agreements with their partners or suppliers to protect information relating to their proposals. This should provide perfectly adequate protection.

Accordingly, in order to qualify for participation in the competition, bidders, or members of their consortia, may not enter into any agreement:

- (a) with any supplier of equipment, gaming related software and/or scratchcards if the agreement would, in the opinion of the Commission, have the effect of restricting that supplier's ability to supply any relevant equipment, gaming related software and/or scratchcards to any other bidder and/or consortia;
- (b) with any supplier of equipment, gaming related software and/or scratchcards if the agreement would, in the opinion of the Commission, have the effect of restricting that supplier's freedom to set prices, or of restricting its freedom to determine any other terms or conditions that it might wish to agree with any other bidder and/or consortia;
- (c) with any retailer if the agreement would, in the opinion of the Commission, have the effect of restricting the retailer's freedom to offer distribution channels to other bidders and/or consortia;
- (d) with any retailer if the agreement would, in the opinion of the Commission, have the effect of restricting the retailer's freedom to determine the terms and conditions on which the retailer might offer distribution channels to any other bidder or consortia;
- (e) that contains any restriction similar or analogous in nature to those described in (a)-(d) above and which, in the opinion of the Commission, would have the effect of materially restricting the freedom of any supplier of equipment or any retailer to reaching agreement with any other bidder or consortia in connection with the competition for the licence;
- (f) which would prevent disclosure of any agreement of the kinds referred to in (a)-(e) above.

If a bidder or member of a consortium has entered into any agreement of a kind referred to at (a)-(f) above:

- (i) at a time before the publication of this document; or
- (ii) where circumstances subsequently changed in such a way as to render an agreement entered into prior to publication of this document an agreement of a kind referred to in (a)-(f) above;

³ A full definition of exercising control will be included in the draft ITA.

that bidder or member of a consortium must disclose the existence of the agreement to the Commission and provide details of the relevant restriction contained in the agreement.

In light of these prohibitions, and the fact that we will have to form a view as to whether an agreement falls within (a)-(f) above, it is strongly recommended that bidders or members of consortia discuss with us any proposal to enter into an agreement that might fall within (a)-(f) above. Bidders responding to the final ITA will be required to certify that they have not entered into any agreement of the kind referred to at (a)-(e) above that has not been disclosed to us. We may grant an exemption from the requirements relating to prohibited agreements where necessary to ensure that they do not result in a bidder or member of a consortium being unfairly excluded from the competition.

Transition period

Although we originally indicated that the transition period was likely to be between 14 and 18 months, we have decided to provide for a period of 20 months in order to smooth transition to the third licence. This decision is based both on further research and on the experience of overseas lotteries that have managed similar transitions.

Realism of bids

We will be providing a common sales scenario to prospective bidders. Since this is only intended to assist us in evaluating bids and will not represent our view on what likely sales may be, bidders will also be able to provide their own estimates of sales achievable under their business plans. Bidders' own estimates must be supported by clear justification to demonstrate why their levels of sales are achievable and realistic, and what factors might cause them to vary their estimates. We believe that this should discourage over-optimistic bids and provide a sound benchmark for evaluation.

Structure of bidders

Bidders will need to be corporate bodies⁴. We will retain the requirement for bidders to be single purpose entities in order to ensure as far as possible that the incentives of the operator and good causes are aligned, and that the operator focuses fully on the successful operation of the Lottery. This will not prevent bidders undertaking ancillary activities, although these will be subject to regulatory control (see page 23).

Bidders may have a range of financial structures, including not-for-profit structures. We will make our assessment on the expected returns to good causes as long as the required standards ("hurdles") are met, and not on the structure of the bidder as such. We would expect not-for-profit bidders to retain sufficient reserves during the licence period to provide them with financial stability, or to make alternative provision to achieve this.

Overseas operations

We recognise that bidders and/or consortium members may be based outside the United Kingdom. We also recognise that we may be receiving bids that include proposals to base operations partly outside of the United Kingdom. In such cases, bidders will need to demonstrate that our ability to carry out our regulatory duties will not be impaired.

⁴ It should be noted that the clause 3 of the National Lottery Bill would replace the requirement for "body corporate" with "person". Further details on the Bill are provided in the annex to this Statement.



A level playing field

A level playing field

We set out here the steps we plan to take to ensure that all bidders have a fair chance to secure the licence. We are clear that this should not be achieved by disadvantaging the present operator. We believe that the measures set out below are in the best interests of the Lottery in the longer term.

Technology for the third licence

We will set a demanding output-based performance specification. Hence, from the start of the third licence, we will require the operator's technology solution to be flexible and up-to-date, particularly as the next licence period will be ten years. We want to ensure that technology systems provide players with an enhanced and attractive Lottery and have the flexibility to enable innovative and exciting new games to be introduced and brought to market rapidly. We also want to make sure the operator is able to take advantage of any opportunities for developing existing and new sales channels, including with third parties, and that the technology is sufficiently flexible to support this.

We recognise the value of systems that conform to modern design principles, including use of appropriate open and industry standards, in order to provide flexibility in interfacing to sales channel partners, suppliers, ourselves and other third parties. This should also ensure that the technology is sustainable over a ten-year licence period. We will require all bidders to provide such systems, which will need to be in place from the commencement of the licence.

Where technology assets may be required to be transferred at the end of the licence period, we would not wish such transfer to be inhibited by designs that preclude easy integration of that technology with a future operator's solutions. Again, we recognise the value of modern design principles and adoption of appropriate standards in reducing this risk and assisting any transition at the end of the next licence.

We will require all bidders to provide assurance that their technical solutions will be secure, resilient and offer the required capacity; and that the design, implementation, maintenance and operation of those technical solutions is undertaken to appropriately high professional standards.

Information

Alongside the ITA, we will make available the detailed information required for bidders to assess the Lottery opportunity adequately. We took significant steps to strengthen the relevant conditions in the present licence in order to ensure that sufficient information would be available to potential bidders. This includes: sales information by game, geography and channel to enable bidders to understand the dynamics of the opportunity; information relating to the distribution and retail base; and other performance metrics and related data.

Where information made available is commercially sensitive and is not already in the public domain, or where its wider public release may otherwise be harmful to the interests of the Lottery, we will ensure that adequate arrangements are in place to safeguard it. This might include the use of confidentiality undertakings and/or the provision of a deposit.

The third licence will include provisions relating to the transfer of intellectual property and information that are similar to those contained in the present Section 5 licence. Therefore, the third licensee will be required to assign all intellectual property rights to us, apart from any proprietary software-related intellectual property. We will also review licence provisions relating to our ability to obtain and publish information for regulatory purposes, including in support of any future licence competition.

Handover arrangements

Co-operation with a new licensee

The present operator is obliged, under its existing licence, to co-operate with any incoming licensee. In the two years preceding the expiry of this licence, the present operator is obliged, as and when required by the Commission, to assist and co-operate with an incoming licensee in the establishment of facilities necessary for the operation of the Lottery. Any costs incurred by the present operator in doing so will be shared with the incoming licensee under mutually agreed terms, or, failing that, by arbitration. We are currently discussing areas of co-operation with the present operator.

Provision of the existing operator's assets and contracts

The existing licence gives an incoming licensee the option of taking the present operator's existing base of terminals for a minimum price of £10 million. It also allows the present operator the option of specifying assets and contracts that it might make available to an incoming licensee once that licensee has been appointed as the preferred bidder. The present operator has no obligation to provide information at the bid stage on what those assets and contracts might be or to confirm whether such assets and contracts will be made available at all. We therefore consider it likely that bidders will choose to bid on the basis that there is no transfer of assets or contracts and that they will be putting in place their own, separate Lottery operations that go live on the first day of the third licence term. However, there is nothing that precludes them from seeking to agree terms with the present operator for transfer of assets or contracts at any stage in the process.

Transfer of existing licence obligations

The existing licence requires that certain obligations relating to payment of outstanding prizes from the second licence period will fall to the third licensee. This means, in particular, that the third licensee will need to validate claims and make payments up to the end of the normal 180-day claim period. The current licence imposes an obligation on the outgoing licensee to transfer a sum sufficient to cover all outstanding prizes to the incoming licensee in order to cover these claims.

The licence also provides for payment of reasonable costs by the outgoing licensee to the incoming licensee to cover any commission to be paid to retailers, the software costs associated with converting winners' files to an agreed format, legal costs associated with the transfer of the relevant prizes into the prize security arrangements established under any new licence and other professional costs charged in respect of such transfer.

We are currently investigating, in further detail, with the present operator the information and mechanisms required to ensure a seamless transition for retailers and players alike.

TUPE

In the United Kingdom, a change in the ownership of a business or a change in service provider can attract the application of the Transfer of Undertakings (Protection of Employment) Regulations 1981 ("TUPE"). Revised TUPE regulations are due to be laid before Parliament later in 2005 and are expected to come into force on 6 April 2006. Bidders, including overseas bidders, will need to form their own view on whether TUPE will apply.



**Greater incentives
to increase returns
to good causes**

Greater incentives to increase returns to good causes

Licence duration

We have decided to increase the term of the licence to ten years from the present seven. This will allow bidders a longer period of time over which to recover their initial investment and to make substantial further investment over the ten-year term.

We will be reserving a right to grant extensions to the licence, which, under the National Lottery Bill, if enacted, could be for a period of up to a further five years (see the annex for further details). Although we cannot at this stage pre-determine the circumstances under which an extension may be granted, we can see four possible scenarios where this might be justified: as a reward for good performance; as an incentive to provide further investment; in the event that at the end of the next licence the market environment is not conducive to a competition; and as a contingency requirement to ease handover into the fourth licence.

Contributions to good causes

Bidders will be asked to specify their expected contributions to good causes based on three key elements:

- primary contributions – this will be a function of total ticket sales and the proportion that is available for good causes after deducting prize payments, Lottery duty and the operator's own retention;
- secondary contributions – a proposed share of any surpluses generated from running the Lottery which are beyond those originally forecast and which might be considered windfall profits; and
- ancillary activity payments – a proposed share of net revenues from any ancillary activities.

Primary contributions

Primary contributions will be based on the "gross profit" earned from operating the Lottery; that is, the value of ticket sales less prize liabilities and Lottery duty (currently 12% of gross sales). Bidders will be asked to identify the proportion of the remaining proceeds that they will retain in order to cover their costs, including any profit element. The balance will form the primary contribution, which will be paid to good causes.

We intend to introduce different retention structures for different classes of game. This will allow bidders to structure retentions for games with lower prize payouts and lower variable costs (such as Lotto) differently from retentions for games with higher prize payouts and higher variable costs (such as scratchcards). This will give the operator similar incentives to grow sales across all classes of games. We expect to limit the differential structures to three or four, grouping together games of a similar type.

We are concerned that the retention structure should be as simple as possible and align as closely as possible the operator's returns with those of good causes. We will be giving further consideration to how this might best be achieved. We will determine our views in time for the draft ITA.

Bidders should note that there is no restriction on the prize payout ratio under the Section 5 licence. The retention structure is designed to accommodate variations in prize payouts. Prize payouts by game are governed by the terms of the Section 6 licences. We would expect the operator to propose the prize payout for each game in its application for a Section 6 licence. It is envisaged that, in contrast to the current arrangements, any superdraw⁵ funding that bidders anticipate in their proposals will be financed through the prize payout percentage for the game, and not through specific variations on a draw-by-draw basis.

We will be requiring bidders to commit to a minimum marketing expenditure. Under the current licence, this is set as a percentage of sales, with any underspend transferred to the good causes. We are presently reviewing both the definition and calculation of the minimum marketing expenditure. We will determine our views in time for the draft ITA.

The Government has signalled that the tax treatment of the Lottery will be looked at carefully alongside other gambling sectors in the context of wider work on gambling taxation and reform of gambling regulation. In particular, there will be consideration of whether a gross profits tax structure would be more economically efficient, and put the Lottery on a stronger footing for growing sales and increasing funds for good causes in the future. We intend, in so far as we are able, to design a retention structure which can accommodate such changes without having a perverse impact on the operator's incentives.

We expect the primary contribution to provide the greatest element of returns to good causes. This is because it will be structured to align incentives, by providing the best return to the operator where the return to good causes is maximised.

Secondary contributions

We expect to invite bidders to propose a share of any surpluses generated from running the Lottery which are beyond those originally forecast and which might be considered windfall profits. This is intended to safeguard the interests of the good causes where an operator generates additional returns as a result of extraneous factors rather than its own efforts.

Secondary contributions also provide a means for not-for-profit bids to return any surpluses to good causes. We will allow not-for-profit bidders to structure such contributions in a way that allows them to build up reserves to support their financial stability, with the balance being passed to the good causes at the end of the licence period.

Returns from ancillary activities

In addition, we will invite bidders to identify the contribution to good causes that they would expect to be generated from any ancillary activities that they plan to undertake (see page 23).

Encouraging investment

Whilst we expect the bidder to make provision for both the initial investment and any expected continuing investment during the term of the licence, we can see arguments in favour of arrangements that provide support for substantial new investment opportunities that become available during the term of the licence, where these were not provided for in the operator's original bid. There is otherwise a risk that an operator may reject an emerging investment opportunity that would increase returns to good causes, but would not allow the operator to recover its costs during the remaining years of the licence.

5 A superdraw is the arrangement whereby a guaranteed jackpot is declared for a particular draw. The guaranteed jackpot is funded at present, at the Commission's discretion, by varying the prize payout percentage for that draw.

We have considered a number of options for aligning incentives. Given that it is difficult to predict investment opportunities that may arise during the course of the next licence, we will retain the discretion to apply variation mechanisms that will give the operator an appropriate incentive to make the necessary investment. These may take the form of an extension to the licence⁶ and/or an amendment to the retention structure. Before adopting any such mechanism, we will need to be satisfied of the validity of the proposed investment case from the perspective of returns to good causes.

Use of penalties

We consider that the arguments for financial penalties⁷ are not clear cut. On one hand, penalties can play an effective role in reducing the risk of technical failure or failure to meet performance standards and specifications. On the other, however, there is a risk that they may reduce innovation and put the continued existence of the operator at risk.

We believe that it is essential that any penalties are proportionate and do not act as a disincentive to bid. We will therefore determine, in advance of the competition, the basis on which penalties will apply so that bidders are clear on the extent to which a failure in performance will be penalised. Penalties need not consist of a lump-sum fine paid at the time of infringement, and where appropriate, we will consider implementing penalties through an adjustment to retention rates during the remainder of the licence period or a reduction of the licence term. This should reduce the risk of forcing the operator into financial difficulties. Further details will be published in the draft and final ITAs.

We expect to provide for penalties in relation to the failure to meet certain bid commitments, including prompt start-up. We do not anticipate imposing specific financial penalties in respect of lower sales than anticipated. This is both because it is difficult to isolate the causes of low sales and because such penalties may well work against the incentives already built into the retention structure. Rather, we expect to monitor sales levels and returns to good causes closely and make provision to hold the operator to account where we believe there is cause for concern.

Ancillary activities

We recognise that there are opportunities for the operator to enhance revenues through ancillary activities and we remain open-minded about the use of the Lottery infrastructure to generate additional revenues:

- related to Lottery activities, for example, broadcasting rights; and
- through non-competing uses, for example, utility bill payments.

Such activities will require our consent because we need to be sure that sufficient safeguards are put in place to protect the core Lottery business. We would, however, expect to give consent where we are satisfied that the ancillary activity can be managed by the operator without undue risk to the core business, and where a fair return is achieved for the good causes in making such use of the Lottery infrastructure. Bidders may contact us if they wish to discuss any proposals they might have for generating ancillary revenue.

⁶ Subject to the enactment of the provisions presently contained in the National Lottery Bill (see annex for details).

⁷ We refer here to penalties incorporated into the licence itself. Financial penalties (fines) for licence breaches are outside the scope of this section and will continue to be determined in accordance with the arrangements set out in Financial Penalties: Principles and Procedures. <http://www.natlotcomm.gov.uk/publications>



Other competition considerations

Other competition considerations

Transfer to a fourth licensee

We are considering requiring the third licensee to transfer material operating assets and contracts to its successor at the end of the next licence. We are conducting further work in this area and will provide additional detail on our requirements in the draft ITA. In practice, we may require that:

- any material assets owned by the existing operator be made available for transfer at the option of the incoming licensee at nil cost. They must be in sufficiently good condition, as determined at the end of the licence, to have a reasonable life expectancy of two years from the end of the third licence period;
- all material supply contracts be capable of novation at the option of the incoming licensee on existing terms for up to two years from the end of the third licence period;
- sufficient information be provided to all potential bidders for the fourth licence in order to allow them to take a view on what assets and contracts they might designate for transfer; and
- staff terms and conditions be controlled in the run-up to the end of the third licence.

These arrangements will also assist in managing the situation where an operator either withdraws or has its licence revoked.

We will also retain the ability, at our sole discretion, to implement an interim licence, in six-monthly increments, of up to two years in length based on the market environment and other considerations at the end of the third licence⁸. The latest date for requiring an interim licence will be six months before the end of the third licence period.

We recognise that these two options are alternatives. In either case, the third licensee will need to ensure that it has sufficient flexibility in its contracts, ability to retain staff, and expected life in its assets either to operate for a further two-year period after the end of the ten-year licence under the terms of the interim licence, or for a fourth licensee to take over designated assets and contracts for a period of up to two years from the end of the third licence.

⁸ Subject to a maximum licence term of 15 years, including all extensions.

Corporate governance

We expect bidders to satisfy high standards of corporate governance in line with generally accepted best practice. This is a key element in demonstrating that the Lottery will be run with all due propriety, that it will be well run and that it will be seen to meet its operating objectives.

Sound corporate governance arrangements will include transparency in relation to remuneration and incentives for both directors and staff to ensure that these are consistent with achieving the best possible returns to good causes. This aspect will be particularly important for not-for-profit operators, where profit-related incentives are inevitably less strong.

We will also need to satisfy ourselves that appropriate arrangements are in place with a bidder's suppliers, and particularly its shareholder suppliers, to ensure that those relationships are clear and are properly managed by the operator. We will require bidders to provide details or copies of material supply contracts, to the extent that they have been agreed, at the time of bidding. We will expect the operator to lodge current versions of material contracts with us at all times throughout the third licence term.

The Government believes that there is scope for greater public involvement in the operation of the Lottery⁹. We will ask bidders to indicate how they plan to achieve this. One element of their approach might be to incorporate best practice arrangements for the assessment of corporate social responsibility.

Retailers

While we expect retailers to continue to play a central role in the distribution of Lottery products, we will ask bidders to display an innovative approach to the use of alternative distribution channels, including the use of new technology, over the next licence period.

This supports our decision to specify the outcomes the Lottery needs rather than using prescriptive specifications. However, in relation to retailers, bidders should note that whilst their business plans will be the primary driver of the overall retail strategy, including rollout and retailer selection, we nonetheless expect the retail coverage to be commensurate with a Lottery that offers truly national access. Further details will be given in the draft ITA.

Commitments to the 2012 Olympic Games

Provision is made in the Horserace Betting and Olympic Lottery Act 2004¹⁰ for dedicated London 2012 Lottery games to be promoted as part of the National Lottery. We support the association of the Lottery with the 2012 Games and anticipate that it will have a positive impact on the Lottery.

A total of up to £1.5 billion of National Lottery funding will contribute to the costs of London holding the 2012 Games. £750 million will be raised through dedicated Lottery games. £340 million will come from the Sports Lottery Fund, with a further amount of up to £410 million being taken from the proceeds of mainstream National Lottery games from 2009 onwards. The first dedicated Olympic Lottery game, the Go For Gold scratchcard, went on sale on Thursday 28 July 2005.

⁹ See paragraphs 4.15 and 4.16 of National Lottery Licensing and Regulation; Review Decision Document, published by DCMS in November 2004.

¹⁰ A copy of the Horserace Betting and Olympic Lottery Act 2004 can be found at: <http://www.opsi.gov.uk/acts/acts2004/20040025.htm>

Bidders will be expected to include, as part of their sales and marketing plans for the third licence period, details of dedicated Olympic Lottery games, to fulfil the National Lottery's commitment to support the staging of the Olympic Games in London in 2012. The promotion and licensing of these games is subject to the same statutory and regulatory requirements as other Lottery games.

National Lottery Promotions Unit

The National Lottery Promotions Unit (NLPU), is a joint venture between the present operator of the National Lottery, 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 across the UK, thereby contributing to the broad health of the National Lottery and promoting loyalty and participation.

A review of the NLPU will take place in early 2006 and may impact on the scope and role of the unit. However, the existing arrangement is that the operator provides funding in the region of £1.5 million per annum, offset against its minimum marketing expenditure. Bidders will be required to honour any commitments that may exist with regard to the NLPU. Further details will be given in the draft ITA.

The euro

In line with Government initiatives, bidders should ensure that their systems are compatible with the euro, so that in the event there is a decision by the UK to join the euro, a changeover would be implemented in a timely manner.



Evaluation

Evaluation

The evaluation process for the award of the third licence will be structured so as to ensure that we can fulfil our competition objectives and statutory requirements. There will be two parts to the evaluation structure:

- required standards (“hurdles”) which each bid will be required to meet; and
- returns to good causes which will be the basis of comparison between bids.

During the evaluation, we would intend to give bidders the opportunity to address any concerns which, if not addressed, might prevent their bid passing any hurdle tests. In respect of aspects of the evaluation that are not subject to hurdle tests, we may decide to give bidders the opportunity to address any deficiencies in their bid. If we decide to do so, all bidders will be given an equal opportunity. However, no amendment, either upwards or downwards, to bid retention rates and returns to good causes will be permitted.

Required standards (“hurdles”)

We will be structuring parts of the evaluation with reference to required standards or hurdle requirements. Our assessment of each hurdle will take into account all relevant areas of the bid, and bidders will need to satisfy us as to their ability to meet these requirements. The assessment of each hurdle will not impact upon our evaluation of the overall returns to good causes or be used as a comparator between bids.

Hurdles will be set for a number of key elements of the evaluation. We anticipate that these will include:

- propriety;
- player protection;
- management of transition risks;
- overall ability of management and capacity of organisational structure;
- financial soundness; and
- security, capacity, resilience and integrity of the technology design, its implementation and operation, and its suitability as a basis for a modern lottery.

We will provide greater detail about hurdles in the draft and final ITAs.

Propriety

In accordance with our statutory duties, we will be making an assessment of the probity of each bidder, including whether all who are likely to be concerned with managing the Lottery, or for whose benefit the business is likely to be conducted, are fit and proper. These requirements will apply throughout the term of the third licence, and, depending on the role of the individual or corporate entities concerned, a failure to meet these requirements may give grounds for revocation of the licence.

The requirement for a bidder to operate the Lottery business with due propriety extends to its key suppliers. We will need to be satisfied that sufficiently high standards of corporate governance are in place to ensure that any significant probity or regulatory issues, whether at operator or supplier level, are brought to our attention immediately.

We will therefore require bidders to submit sufficient information on both individuals and corporate entities to satisfy us that they are fit and proper. In particular, we will be investigating:

- directors;
- key employees;
- shareholders;
- key contractors and sub-contractors; and
- those with control over secure areas.

Further information on the current requirements for probity can be found on our website¹¹.

We will be conducting workshops to help prospective bidders find out more about how we will satisfy ourselves that the Lottery is likely to be conducted with all due propriety.

Player protection

We also have a statutory duty to ensure that the interests of participants are protected. Where practicable, we intend to simplify the process by requiring bidders to confirm that the necessary outcomes will be delivered. We will be publishing full details of these arrangements in the draft ITA. In summary, we will require bidders to demonstrate that they meet the following requirements:

- protection of players' funds – bidders will need to demonstrate that arrangements are in place that secure players' funds in such a way that there are no prior claims on those funds until players' rights are discharged in full;
- arrangements to check for excessive and underage play – we will be specifying our minimum requirements for checking underage play. This is likely to require the bidder to carry out, for example, a minimum number of anonymous checks upon retailers. To counter excessive play, measures will include a requirement to undertake statistical analysis on high-risk games to profile players' purchasing behaviour;
- arrangements to protect the interests of players – the successful bidder will need to adopt game rules for each type of game, and advertising and sales, and consumer codes of practice. These will be approved after the licence is granted, but we will wish to be assured that bidders are able to adopt appropriate provisions in these areas. Similar levels of protection will be required to those that are currently in place, and we reserve the right to improve these after dialogue with the bidder;

¹¹ <http://www.natlotcomm.gov.uk/Information>

- availability of comprehensive information – bidders will be required to make available to players similar information to that provided under the current licence;
- arrangements to protect winners – we will require that bidders have in place arrangements to offer major winners, free of charge, appropriate information and advisory services. Winners' identities must not be disclosed until they have given their informed consent. We will also be interested in arrangements to encourage players to claim the prizes due to them, for example through player registration or analogous schemes; and
- problem gambling – the present operator contributes to the Responsibility in Gambling Trust. Bidders will be expected to demonstrate how they will contribute towards action on problem gambling.

Further information on the current requirements for consumer protection can be found on our website¹². We will be conducting workshops to help prospective bidders find out more about how we ensure that the interests of players are protected.

Management of transition risks

We attach importance to the transition to the third licence taking place as smoothly as possible. We expect the successful bidder to avoid any interruption of service. The operator must have sufficient business, delivery and communications systems in place and operational at the commencement of the third licence period to ensure that players have convenient access as soon as operations begin, even though not all new distribution channels may necessarily be fully in place from the start of the licence period.

We will assess the risks contained in each bid that might cause a delay to the start of the third licence operations as a hurdle requirement. A bidder must have a comprehensive transition plan that fully satisfies us of that bidder's ability to effect the transition successfully, identifying the associated risks and mitigating such risks appropriately.

Each bidder will need to consider and demonstrate, amongst other things, how it intends to achieve a full and prompt launch of the Lottery; the project management skills it will put in place to achieve that objective; the interaction between the different technological elements of its bid, including systems testing and roll-out; and the systems integration skills that it will have available to support and manage the transition. A comprehensive and detailed analysis of the risks inherent in the transition will be required, together with credible risk management and mitigation plans.

Once bidders have fulfilled this hurdle requirement, we will not take transition risk further into account when assessing returns to good causes, or use it as a comparator between bids. All bidders will be treated equally by requiring them to pass the same hurdle.

¹² <http://www.natlotcomm.gov.uk/Information>

Overall ability of management and capacity of organisational structure

We will require sufficient information to demonstrate to our satisfaction that each bidder has the capacity and ability to plan, organise and operate an undertaking of the scale of the Lottery. While clearly this may include direct lottery experience, we will also consider relevant experience in planning and implementing projects, and conducting successful operation, of an undertaking of a similar nature, scale or complexity.

We will also be seeking confirmation from bidders that they have the appropriate corporate and legal structures in place to comply with the requirements set out in the ITA. This is likely to include, amongst other things, an assessment of corporate governance, internal audit, quality assurance, security, management and human resources.

Financial soundness

We will assess the financial soundness of each bidder. We will ask each bidder to set out its present and future financing arrangements, including its sources of finance, the flexibility of funding available and its capacity to finance any unplanned costs or shortfall in revenue. Our assessment will consider whether the bidder has the financial capacity and funding to deliver its commitments throughout the transition period. We will also consider whether the bidder will have sufficient funding in place to ensure financial stability throughout the period of the licence. We will require bidders to provide evidence of the funding commitments they have secured at the time of bidding.

Whilst financial soundness is primarily a hurdle requirement, it should be noted that financial soundness will be tested as part of the analysis of the robustness of business plans under various scenarios (see page 33). If a bid is not financially robust at any scenario that we consider realistic, then the hurdle will not be passed.

Security, capacity, resilience and integrity of the technology design, its implementation and operation, and its suitability as a basis for a modern lottery

The provision of flexible, modern and secure technology that is suitable to meet the requirements of the Lottery and remains so throughout the licence and at handover at the end of the licence, will be a hurdle requirement set at a required level for all bidders.

We will require bidders to provide assurance that their technical solutions will be secure, resilient and offer the required capacity and that their design, implementation, maintenance and operation of those technical solutions is undertaken to appropriately high professional standards. This will also be a 'hurdle' requirement.

However, we recognise that certain aspects of the technology proposed may be specific to individual bidders' gaming proposals and may therefore directly impact upon the level of returns to good causes (e.g. where a game concept is critically dependent upon the application of specific technology and issues with that technology may constrain sales). We therefore reserve the right to perform further evaluation of the technology proposed and factor that evaluation into our analysis of returns to good causes, where the technology proposed directly impacts upon those returns.

Returns to good causes

We will award the licence to the bidder that is able to support the greatest forecast returns to good causes, so long as we are satisfied that each of the hurdle requirements has been met. We expect to take into account elements including:

- the robustness of business plans under various scenarios;
- the attractiveness, level of innovation, competence and robustness of plans for game design, marketing and distribution;
- the ability to adapt and modify plans to deal with adverse developments so as to protect sales revenues and hence contributions to good causes;
- whether the proposed incentive structure will promote good performance throughout the licence period and encourage the pursuit of opportunities that will increase contributions to good causes; and
- the extent to which the proposed technology will limit the ability to deliver the business plan and respond to market opportunities, so constraining the maximisation of returns to good causes throughout the licence period.

The order in which the attributes are listed above is not intended to indicate their relative importance.

We will analyse the present value of the expected contributions to good causes over the life of the licence under a number of scenarios. We will provide a common sales scenario to prospective bidders. However, it should be noted that this is only intended to assist us in the evaluation of bids and will not represent our view on what likely sales may be. Bidders will also be asked to provide their own estimates of sales achievable under their business plans. Bidders will need to provide clear justification as to why their levels of sales are achievable and realistic. We will specify a range of sensitivity tests that we require bidders to include in their proposals. We will reserve the right to conduct additional sensitivity tests where we consider this necessary for a fully informed evaluation.

Further information

If you are seeking further information or wish to discuss the structure of the competition please get in touch with us at the address below:

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Annex: National Lottery regulation – statutory framework

Statutory framework – an overview

The core rules which relate to the operation and regulation of the National Lottery (“the Lottery”) are set out in:

- the National Lottery etc Act 1993¹³ (the “1993 Act”);
- the National Lottery Act 1998¹⁴ (the “1998 Act”);
- various Statutory Instruments of which The National Lottery Regulations (the “Regulations”) is the most relevant;
- the licences issued under Sections 5 and 6¹⁵ of the 1993 Act;
- Directions¹⁶ issued under Section 11 of the 1993 Act by the Secretary of State for Culture, Media and Sport (the “Directions”).

The National Lottery Commission

The Lottery, along with its regulator, was established by the 1993 Act. Initially, the regulator of the National Lottery was the Director General of the National Lottery who ran the Office of the National Lottery (“OFLOT”).

The 1998 Act amended the 1993 Act. It established the National Lottery Commission (the “Commission”) as the new regulator of the Lottery. The Commission assumed all of the regulatory functions of the Director General and OFLOT in April 1999.

The Commission is a statutory corporation; it is not a Government department. Schedule 2A of the 1993 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 members of the Commission select one of their number to be chairman and such appointment is to be for no longer than twelve months. 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 exercise of the Commissioners’ functions and powers.

¹³ A copy of the Act can be found at: http://www.opsi.gov.uk/acts/acts1993/Ukpga_19930039_en_1.htm

¹⁴ A copy of the Act can be found at: <http://www.opsi.gov.uk/acts/acts1998/19980022.htm>

¹⁵ Details of the current Section 5 and Section 6 licences can be found at <http://www.natlotcomm.gov.uk/Licensing>

¹⁶ A copy of the current Directions can be found at: <http://www.natlotcomm.gov.uk/Licensing>

Overriding duties of the Commission

Section 4 of the 1993 Act sets out the overriding duties of the Commission. These duties are, subject to any Directions, to exercise its functions in a manner which it considers most likely to secure that:

- the National Lottery, and every lottery that forms part of it, is run with all due propriety; and
- the interests of players are protected.
- subject to the two duties above, the Commission must also do its best to maximise the funds available to good causes from the proceeds of the Lottery.

Licensing structure

The 1993 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 which must be complied with in order for a lottery to be regarded as part of the Lottery. The 1993 Act therefore divides the operation of the Lottery into two, separating the functions of “operating” the Lottery from “promoting” lotteries as part of it.

Under Section 5 of the Act the Commission may issue a licence to “operate” the Lottery to a body corporate (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 and Thunderball) must be licensed to do so under Section 6 of the Act (a “Section 6 licence”). That promoter may or may not be the Section 5 licence holder.

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 a fit and proper to hold such a licence. The Commission’s vetting functions are discussed in more detail below.

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, in fact, a lottery. Section 14 of the Gambling Act 2005¹⁷ has, for the first time, provided a statutory definition of a “lottery”:

The Commission is reviewing its regulatory model and will be issuing proposals for discussion in the new year.

¹⁷ A copy of the Act can be found at <http://www.opsi.gov.uk/acts/acts2005>

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. Broadly speaking, it sets out the way in which, and the standards to which, the Lottery must be run. A fee is payable on grant of the licence.

The 1993 Act provides that the Section 5 licence must contain a condition which requires the licensee to pay sums to what are commonly known as “good causes” out of the proceeds of the lotteries which form part of the National Lottery. Good causes comprise the National Lottery Distribution Fund and the Olympic Lottery Distribution Fund.

Section 7 of the 1993 Act sets out various other conditions which the Commission may choose to include in a Section 5 licence. The current Section 5 licence covers eight core regulatory areas:

- commencement of Lottery sales;
- operations (e.g. conditions relating to the testing of equipment used in Lottery draws, security, consumer protection, advertising, performance standards and reporting);
- distribution (e.g. conditions in relation to player access to Lottery tickets and terminals);
- financial (e.g. conditions in relation to banking and record keeping, security of funds and payments to good causes);
- corporate (e.g. conditions in relation to the use and ownership of the Lottery brand, arrangements with shareholders and group companies, prohibition on activities not related to the Lottery);
- information (e.g. conditions in relation to the Commission’s access to certain information of the licensee);
- independent Section 6 licensees (e.g. conditions in relation to how to deal with applicants for a Section 6 licence other than the Section 5 licensee); and
- termination (e.g. 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 which are subject to the approval of the Commission. The following conditions, among other matters, require the licensee to issue and comply with codes of practice, strategies or procedures:

- condition 2 – procedures in relation to the implementation and testing of systems;
- condition 3 – arrangements for testing draw equipment;
- condition 8 – strategies to prevent underage and excessive play;
- condition 9 – code of practice concerning the availability of top and major prizes in scratchcard lotteries;
- condition 10 – code of practice in relation to advertising and sales promotion;
- condition 15 – criteria for the selection and de-selection of Lottery distributors;
- condition 21 – code of conduct regarding the ethical framework for business decisions;
- condition 23 – code of practice in relation to personnel security; and
- condition 33 – strategy for encouraging proposals by independent Section 6 licensees.

Section 6 licences

Section 6 of the 1993 Act allows the Commission to licence a body corporate to “promote” lotteries as part of the National Lottery. Such a licence will be granted for each Lottery game (e.g. Lotto or Thunderball) which itself usually comprises a series of lotteries. 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 the promotion of which it authorises. Section 7 of the 1993 Act sets out various other conditions which 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 do 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) will be annexed to the Section 6 licence. 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. There is no restriction on the number of bodies that can hold such licences – although if the Section 6 licensee is not also the Section 5 licensee, a licence can only be granted with the agreement of the Section 5 licensee.

Directions

The Secretary of State may from time to time issue Directions to the Commission in relation to the exercise of its licensing functions. The Commission must comply with those Directions.

In particular, the Secretary of State has directed that the Commission must exercise its licensing functions in such a manner as to ensure that no licence is granted which authorises the promotion of a lottery which encourages excessive or underage play. Another Direction provides that the Commission must ensure that ticket prices are not unreasonably high. There are presently 14 Directions to which the Commission has regard when exercising its licensing functions.

Statutory Instruments

The regulations were issued by the Secretary of State in 1994. They regulate the way in which ticket and chances in Lottery games may be sold. In summary, they provide that:

- Lottery tickets or chances may not be sold to someone who is under 16 years of age;
- Lottery tickets or chances may not be sold in the street;
- a person shall not be invited to purchase a Lottery ticket or chance in any betting office, racecourse or track, amusement arcade or bingo hall;
- Lottery tickets or chances may not be sold via an unmanned vending machine;
- Lottery tickets or chances may not be sold by visiting a person's home.

A breach of the regulations by a licensee is an offence and will have an impact on whether or not that licensee is fit and proper to hold a licence either to run the Lottery or promote a lottery which forms part of the Lottery.

There are in existence a number of other statutory instruments including those which relate to:

- the level of fees which the Commission may levy on the grant of Section 5 and Section 6 licences; and
- the procedures which must be followed by the Commission in relation to the imposition of financial penalties and in relation to the revocation of licences.

Vetting

As part of its licensing function, the Commission must ensure that the following are fit and proper:

- the body running the Lottery;
- any body promoting lotteries which form part of the Lottery;
- any person who manages or is likely to manage to such bodies; and
- any person who benefits from or is likely to benefit from the running of the Lottery or the promotion of lotteries which form part of the Lottery.

This means that the Commission undertakes various checks (e.g. criminal record and electoral role searches) in relation to certain personnel and contractors of the licensee.

Enforcement of licence conditions

The Commission may apply to the High Court to enforce the provisions of the licences which it issues. It may also impose financial penalties for breach of any of the conditions of such licences. As a last resort, the Commission also has the power to revoke such licences.

National Lottery Bill

In May 2005, the Government introduced in Parliament the National Lottery Bill¹⁸, which amends certain aspects of licensing and regulation of the Lottery. The key proposals include:

- enabling the Secretary of State to appoint a permanent chairman for the Commission (clause 1);
- replacing the requirement that Section 5 or Section 6 licensees must be a “body corporate” with “person” (clause 3);
- allowing licences to be extended, subject to a maximum term of fifteen years (clause 4); and
- running the competition for a single licence but introducing a reserve power to offer for competition a small number of licences to run different parts of the Lottery, which would come into play only if the single licence competition that the Government and the Commission wants to be successful became unworkable (clause 6).

Trust arrangements

In order to ensure that the interests of players are protected, it is a requirement of the present Section 5 licence that the licensee puts prize funds into trust. The aim is to keep those funds secure and separate from other funds. Very simply put, those funds are, in effect, ‘ringfenced’ as being for the benefit of players. Once in trust those funds are under the control of an independent trustee and are out of the hands of licensee. The licensee has appointed, under a security trust deed, which is subject to the approval of the Commission, Law Debenture as the independent trustee in respect of those funds. The trust arrangements have evolved over time (the security trust deed is now in its eighteenth iteration). The main reason for changes to the trust arrangements is to ensure that prize fund security is maintained when a new method play is introduced (e.g. play over the internet or via mobile phones).

Disclaimer

The contents of this annex are not intended to be an exhaustive account of the statutory and licensing requirements and should not be regarded as a complete or authoritative statement of the law.

¹⁸ A copy of the Bill can be found at: <http://www.publications.parliament.uk/pa/cm200506/cmbills/006/2006006.htm>

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