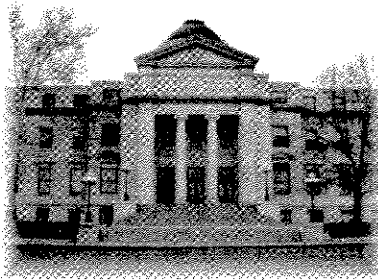


STATE OF IOWA



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DES MOINES, IOWA 50319

October 5, 2007

Dr. Edward Stanek, CEO
Iowa Lottery
2323 Grand Avenue
Des Moines, IA 50312

Dear Dr. Stanek:

Earlier this year, I read with great interest the ombudsman investigative reports on possible retailer fraud involving the provincial lotteries in Ontario and British Columbia. Those investigations were triggered by media reports that retailers, and their employees, were winning major lottery prizes at a much higher rate than others. This raised the issue of potential retailer fraud – whether some were using their status as “insiders” to manipulate the process to their own personal advantage, up to and including theft of some customers’ winning tickets.

The media reports said some store clerks were able to fool customers into thinking they had won a minor prize, when in fact they had won a large prize. The most infamous case involved a retailer who reportedly cheated an elderly man out of a winning ticket worth \$250,000 (in Canadian dollars), by falsely telling him that he had won a free ticket.

A similar scheme was described in the British Columbia report, which quotes a retailer:

If the player doesn't understand how to play the ticket, it's quite easy for the retailer to look at the ticket and tell them it's not a winner, throw it into their garbage or recycling, and retrieve it later and validate it.

The British Columbia report found at least 21 retailers and retailer employees had been repeat winners of major prizes between 1999 and 2007. Included were individuals who won:

- 13 prizes, each over \$3,000, in one year.
- 11 prizes in five years for a total of more than \$300,000.
- Over \$10,000 every year for four years.

In addition, the Ontario ombudsman found that the lottery paid \$12.5 million to the sister of a convenience store manager, despite several inconsistencies in her answers to investigators’ questions.

CANADA: INSUFFICIENT SAFEGUARDS

Based on their extensive investigations, the ombudsmen in Ontario and British Columbia concluded that their lotteries did not have sufficient safeguards to ensure that prize monies were going to the rightful owners of winning tickets.

An editorial in the *National Post* stated:

The new report on the Ontario lottery scandal from Ontario provincial ombudsman Andre Marin is not just a jolt to the moral and statistical conscience: It is also a sobering education in the way a public agency conducts itself when it is given a legal monopoly over a particular service.

Marin's investigation of the Ontario Lottery and Gaming Corporation (OLG) has yielded tales of awful customer service, dodgy record-keeping, laughable investigative procedures and above all a near-total disregard on the part of OLG for the essential condition of its business model – the customer's expectation that a winning ticket will be properly honoured.

In the aftermath of the reports, the chief executives of both lotteries were fired, and lottery agencies from the Canadian Atlantic to the Canadian Pacific have since undertaken similar examinations.

For your information, the Canadian ombudsman investigative reports can be found on the Internet as follows:

- www.ombudsman.on.ca/UploadFiles/File/PDF/OLG%20report%20ENG.pdf
- www.ombudsman.bc.ca/reports/Special_Reports/Special%20Report%20No%20-%2031.pdf

REVISITING MY PREVIOUS CONCERNS

As you may recall, Assistant Ombudsman Jeff Burnham raised the possibility of retailer fraud with you a decade ago, during an investigation triggered by a complaint about a terminal that misidentified a winning ticket as a non-winning ticket. You confirmed that terminals could err, but you said it was an extremely rare occurrence. You also said that customers should not be relying on terminals to see if their ticket is a winner, and you noted that a clerk could make a mistake as well.

It was at that point that Mr. Burnham theorized, in a letter to you, about potential retailer fraud, and recommended that the Iowa Lottery tell its customers about the various risks and how to avoid them, so that they could make informed decisions about how to spend their money on your games. You objected, and in doing so, you persuaded me that Mr. Burnham's recommendations were overbroad. I found your assertion to be reasonable, particularly since we were not aware of any other problems, at that time.

This led to our 1998 agreement, which detailed several steps your agency would take to better inform customers – especially an advisory stating that customers are responsible for determining whether a ticket is a winner. The agreement did not require the Lottery to specifically advise against terminal reliance, or to mention any of the potential risks.

In light of the major developments out of Canada, I directed Assistant Ombudsman Burnham several months ago to review the Canadian investigative reports and provide a preliminary assessment regarding whether the Iowa Lottery has sufficient safeguards to ensure that prize monies are going to the rightful owners of winning tickets.

Mr. Burnham recently completed his assessment and reported his findings in a memo (a copy is enclosed). As you will see, the memo identifies a number of potential risks to customers. This includes the potential for retailer fraud in Iowa, as well as a preliminary finding that the Iowa Lottery has not been complying with the terms of our 1998 agreement.

[NOTE: Please be advised that I consider the attached memo to be a confidential record that is part of an open Ombudsman investigation, pursuant to Iowa Code section 2C.8 and our administrative rules; and I therefore ask that you treat it as a confidential record.]

NOTICE OF INVESTIGATION

Pursuant to Iowa Code Chapter 2C, I am therefore initiating an Ombudsman investigation of these issues. This investigation will focus on, but not necessarily be limited to, the following issues:

1. Whether the Iowa Lottery has been operating with integrity and dignity, as required by Iowa Code Chapter 99G.
2. Whether the Iowa Lottery has acted reasonably in ensuring that retailers and retailer employees don't take advantage of customers who entrust them with a ticket.

I am assigning this investigation to Mr. Burnham. After the information is gathered and reviewed, I will report my findings and any recommendations to the Lottery. If I decide to publish the report I will consult with any official who might be criticized and allow them an opportunity to respond before announcing any conclusion and/or publishing a report. Any response will be attached unedited to the report.

Pursuant to our investigation, we have a number of information requests (listed below), divided into two groups:

- Information requests that are, most likely, more appropriately responded to in written format.
- Questions which Mr. Burnham will pose to you in the format of a taped interview (along with other questions that may arise in the time being and/or during the interview).

Media reports in September stated that you will be retiring on October 31. If those reports were accurate, I recognize that your ability to respond to all of these requests before your retirement may be compromised. As a result, I am asking that you contact me or Mr. Burnham at your earliest convenience so that we can make arrangements to ensure that the interview occurs prior to your retirement.

Regarding the other requests, I would prefer that you oversee whatever work is involved in preparing those responses. If that is not practical, I would ask that you delegate those responses to other senior management. Regardless, I am requesting to receive those responses within 30 days of your receipt of this letter.

If you have any questions or concerns about these requests, or the deadlines for responding, please contact me.

Information requests

1. Does the Iowa Lottery have any policies or procedures similar to the Ontario lottery's "Insider Win Policy"? If so, please provide copies.
2. What are the Lottery's policies and procedures for receiving and handling complaints by or on behalf of customers?
3. Please provide the amounts of unclaimed prizes for each of the last five fiscal years, including the portion attributed to Powerball.

4. Please submit a blank copy of the written agreement for retailers authorized to sell Iowa Lottery products.
5. If the Iowa Lottery ever used the Spectra, Spiffany or Tiffany classes of GTECH terminals, please submit copies of any written communications, especially from the year 2000 or previously, regarding the Iowa Lottery and the phenomenon of duplicate transactions – including but not limited to, efforts to determine the scope and impact on customers and/or retailers.
6. Please make available, for our review, all of your agency's investigative files and/or records for calendar years 2006 and 2007 concerning reviews (whether triggered by a customer complaint or not) involving the actions of retailers, retailer employees and Lottery terminals. This would include, but not be limited to, logs and/or notes of a customer's initial attempt to express a concern to the Lottery.

Questions

1. Did the Iowa Lottery investigate any of Linda Rost's prize claims, particularly the one for \$250,000? If so, what were the findings and disposition?
2. Has the Iowa Lottery been tracking – and investigating – the prize claims of retailers and retailer employees who make major prize claims, including but not limited to multiple such claims? If so, what does the information show?
3. What are your thoughts regarding whether retailer fraud has been occurring in the Iowa Lottery?
4. Iowa Code section 99G.31 states in part, "A prize shall not be paid arising from claimed tickets that are stolen." How do you reconcile this requirement with the language in the administrative rules – including sub-rule 20.11(1), which states, "A ticket or share is owned by its physical possessor until a signature is placed on the back of a ticket in the area designated for signature"?

5. If a customer presents an unsigned ticket to a store clerk for validation, and the clerk obtains the ticket without the customer's knowledge or consent, do you believe that is theft? If so, explain how the Iowa Lottery would respond if that customer filed a complaint.
6. In that same hypothetical, if the clerk signs the ticket and submits a prize claim, please explain whether the Lottery should honor that claim. For example, do you believe the "bearer instrument" standard would effectively require the Lottery to honor the store clerk's claim?
7. If your answer to the previous question is "no," please explain your answer, and also comment on how the clerk's actions would be discovered, especially if the winnings are less than \$600 and the clerk pays himself or herself in the store.
8. If a customer alleges that a store clerk fraudulently obtained his winning ticket, and if the prize payment has already been made to the clerk, does the Iowa Lottery investigate the customer's complaint? If so, please provide examples from actual complaint files.
9. Do you continue to believe that customers should not be relying on terminals to determine if a ticket is a winner? If so, what do you think of the "Check-A-Ticket" devices that seem to be popular in a number of lotteries across the United States and Canada? Have you shared your concerns with administrators of those lotteries?

10. Was the Lottery Commission's 2000 decision to move away from GTECH in any way related to the duplicate transactions investigations in the United Kingdom, New Hampshire and Texas?
11. Has the Iowa Lottery done anything to address the software bugs which you acknowledged in your January 31, 2003 letter of response to Mr. Burnham? If so, please explain.
12. When was the last time the Iowa Lottery provided retailers with the stickers and brochures that you promised to distribute in our 1998 agreement?
13. Regarding the information that is statutorily confidential pursuant to Code sub-sections 99G.34(3) and (4), have there ever been any independent reviews of this information (i.e., by the Office of State Auditor or other outside entities)?
14. Has the Iowa Lottery acted pursuant to the authority granted by Code section 99G.35 (to report any suspected violations of Chapter 99G to the appropriate county attorney or the attorney general) and/or Code section 99G.36 (which identifies several acts as a Class D felony; includes "steal a ticket," "attempt to steal a ticket," and "influence the winning of a prize through the use of coercion, fraud or deception")? If so, please explain.
15. Code section 99G.11 states in part, "A member of the board, any officer, or other employee of the authority shall not directly or indirectly, individually, as a member of a partnership or other association, or as a shareholder, director, or officer of a corporation have an interest in a business that contracts for the operation or marketing of the lottery as authorized by this chapter, **unless the business is controlled or operated by a consortium of lotteries in which the authority has an interest.**" [emphasis added]

Regarding the language in bold, what is your interpretation of its affect on the other language?

16. Does the computerized draw for the \$100,000 Cash Game rely on a "pseudo random" number generator or a more sophisticated hardware random number generator?

Thank you for your assistance. As stated above, please let me know if you have any questions or concerns.

Sincerely,



William P. Angrick II

WPA/jbc

cc: Iowa Lottery Board (Chairperson Timothy Clausen; and Board Members Elaine Baxter, Mary Junge, Mike Klappholz, Tom Rial and Michael L. Fitzgerald)

022823d.jeb

Memorandum



TO: Bill Angrick
FROM: Jeff Burnham
RE: Lottery issues – preliminary assessment
Date: October 3, 2007

INTRODUCTION

This preliminary assessment is based on my recent review of a fair amount of information involving lotteries, mainly from four general categories:

1. The Canadian ombudsmen's reports regarding potential retailer fraud.
2. The Iowa Lottery's authorizing statute and administrative rules.
3. Our files from two previous complaints involving the Iowa Lottery (██████████ in 1993; ██████████ in 2001).
4. Additional information obtained recently, mostly from the Internet – including the websites for the Iowa Lottery and other lotteries, as well as media archives.

In a profound way, it could be argued that the ombudsmen in Ontario and British Columbia may have saved those lotteries from self-destruction. Across Canada, but especially in Ontario and British Columbia, it appears government officials and retailers have come to realize that government-owned lotteries need their customers more than their customers need them.

The Ontario ombudsman's report quotes the provincial lottery's chief executive:

The business is built upon confidence, trust, integrity.... At its simplest level, you give me a dollar, I give you 50 cents and you smile; you give me a dollar, I give you 50 cents and you smile – and we keep doing that and you enjoy it, only as long as you believe one of these times I'm going to surprise you and give you \$100. The moment you don't think I'm going to do that, it's not fun and you don't play.

This point was expounded upon in the Ontario ombudsman's report, which asserts:

[L]otteries are a game of trust and without trust, players will simply take their marbles and go home, depriving the province of important revenue....

When that underlying trust is shaken, the government funding structure based on lottery revenue is placed at risk. **That affects not only lottery participants, but everyone.** [emphasis added]

Canadian retailers seem to be on board as well. In a letter to the editor, the president of the Ontario Convenience Stores Association called the reports of retailer fraud “intolerable” and added:

Even one customer being cheated out of their ticket is one too many, and we pledge to work with the government to root out dishonest retailers....

[A]ny retailer found to have committed wrongdoing should be held accountable and denied the privilege of selling lottery products....

And in the latest annual report for the British Columbia lottery, its interim president and chief executive wrote:

We acknowledge that our performance in these procedural areas must be improved. BCLC [*British Columbia Lottery Corporation*] has accepted all of the Ombudsman’s recommendations and is moving to implement them....

While British Columbia’s lotteries have operated consistently with commonly accepted standards and practices of lotteries throughout North America, **the industry knows that it must now meet a higher standard of player protection.** [emphasis added]

It is worth noting that much of the criticism of the Canadian lotteries was for not adequately enforcing their policies regarding “insider wins” – major prizes claimed by retailers and retailer employees, among others. So far, I’ve found no indication that the Iowa Lottery has such a policy.

Overall, the Canadian ombudsman investigations show that maintaining a lottery’s integrity is vital to the interests of the government as a whole.

Here in Iowa, maintaining the Iowa Lottery’s integrity is vital to the state’s interests – and required by law:

The general assembly finds and declares ... [t]hat lottery games shall be operated and managed in a manner that provides continuing entertainment to the public, maximizes revenues, and ensures that the lottery is operated with integrity and dignity and free from political influence. [emphasis added]

Iowa Code section 99G.2(3)

The statute does not explicitly state a preference between maximizing revenues and operating with integrity. However, it may be instructive to consider that the phrase “maximizes revenues” appears in Chapter 99G once, while “integrity” is mentioned 16 times.

The need to ensure integrity also applies to retailers and their employees, pursuant to Iowa Code section 99G.24(1):

The general assembly recognizes that to conduct a successful lottery, the authority must develop and maintain a statewide network of lottery retailers that will serve the public convenience and promote the sale of tickets or shares and the playing of lottery games **while ensuring the integrity of the lottery operations, games, and activities**. [emphasis added]

The remainder of this memo will focus on two central issues with the Iowa Lottery:

1. There are several potential risks to customers' interests, including but not limited to the risk of retailer fraud.
2. How the Iowa Lottery is performing in protecting customers from those potential risks.

POTENTIAL RISKS TO CUSTOMERS' INTERESTS

Retailer Fraud

[C]lerks see so many players who don't check their tickets so they have found a new way to make money. In other words, they collect the winnings themselves while telling players that they didn't win. You need to STOP allowing clerks to steal from you!
-- Dawn Nettles, Texas lottery blogger, May 27, 2005

Reports around the United States

While two Canadian lotteries have been the subject of major investigations into possible retailer fraud, there have not been any similar investigations in the United States.

This could create the impression that the threat of retailer fraud is a distinctly Canadian problem. But that impression is contradicted by media reports over the past several years. In fact, in early September 2007, a 7-Eleven clerk in California was charged with grand theft in connection with a winning ticket worth more than half a million dollars. The *Sacramento Bee* reported:

The female clerk told the customer he won \$4 ... and then pocketed his winning ticket worth \$555,000.

However, the clerk's alleged scheme fell apart after the unnamed victim became suspicious and called lottery officials.

Media reports show that such incidents are not uncommon in the United States. A ticket worth \$1.4 million was involved in a similar incident involving an Arizona store clerk in 2005.

In the midwest, there have been newspaper articles with these headlines:

- “Store clerk charged with lottery fraud” (Minnesota)
- “Store clerk accused of stealing lottery winnings” (Wisconsin)
- “Cops: Clerk stole thousands in lottery tickets” (Illinois)
- “Store clerk lost gamble on lottery” (Kansas)

NOTE: These are incidents where the clerk was caught and prosecuted. It stands to reason that there likely are other such incidents that go undetected, especially if the customer is unaware of the risk of retailer fraud (and also if the customer doesn't notice a clerk who manipulates the process).

The Kansas incident prompted the following editorial in *The Topeka Capital-Journal*:

Clerk robs customer? Scratch off some more credibility....

[A] store clerk in Topeka tried to cheat a ticket buyer out of -- gulp! -- a quarter-million-dollar jackpot.

The clerk ... told the Kansas Cash ticket-holder that he had won \$100 when, in fact, the ticket was worth \$255,626....

Yet, the lottery needs to guard its credibility jealously. This is not someone else's problem -- in other words, just some rogue clerk. To think that would be missing the point. Certainly buyers need to beware. But any system that would nearly let a clerk rob a customer of a quarter-million is questionable.

The lottery has various levels of security procedures in place, but they need to be rethought. Officials can't sit back and chalk this up to just another criminal in their midst. They need to do everything possible to prevent this kind of thing from happening again.

It's more than the customer's money that's at stake; it's also the lottery's credibility.

How much is that worth?

I have not found any similar reports involving Iowa store clerks being charged with trying to steal a customer's winning ticket. This could mean that the phenomenon of retailer fraud does not exist in Iowa.

Another possible explanation: It has been happening in Iowa, but has not led to criminal charges for various reasons that will be explored later in this memo.

Retailer claims for major prizes

Both of the Canadian investigations focused on major prize claims submitted by retailers and retailer employees. The information currently available to me is rather limited regarding such claims by Iowa retailers and retailer employees.

However, I did find a report where an Iowa store clerk won a Powerball jackpot worth \$15.9 million – with a ticket that he claimed he had sold to himself while working at the store. It occurred in February 1999 and the winner was [REDACTED], a cashier at an Urbandale Coastal Mart.

His claim generated some public interest, particularly when it was reported that an underage co-worker said she paid for half of the ticket and was therefore entitled to half of the jackpot.¹ A February 27, 1999 article in *The Des Moines Register* stated:

... Iowa's lottery chief believes that retail workers should still be able to sell themselves lottery tickets.

“Something like this could have happened between two customers on the other side of the cash register,” said Iowa Lottery Commissioner Ed Stanek. “**It is inconsequential that employees were involved.**” [emphasis added]

But Stanek acknowledged that to avoid any conflict of interests, a host of other people – including Iowa lottery employees and contractors plus their immediate families and household members – are banned from buying lottery tickets.

Those are the only public comments by Dr. Stanek, that I've been able to find, regarding the issue of retailers claiming major prizes.

Repeat Winners

The British Columbia investigation, in particular, focused on store clerks who won major prizes multiple times. This was made possible because the provincial lottery kept data on major prize claims, including those by retailers and retailer employees.

It is unclear whether the Iowa Lottery tracks such data. Nonetheless, using information on the Iowa Lottery website (which currently lists people who submitted prize claims of \$1,000 and more from April 2, 2007 to September 25, 2007), I have compiled a list of people who submitted multiple prize claims of \$1,000 during that period.

This list reveals that at least 30 individuals won two or more major prizes (\$1,000 or more) over the approximate five-month period ending September 25, 2007. Most notably, this list shows:

- One individual won \$1,000 in April, \$10,000 in May, and \$1,000 in August, playing the same instant ticket game ([REDACTED]).
- One individual won \$7,500 in May; \$1,250 in June; \$3,000 in July; and \$3,750 in September playing the Pick 3 and Pick 4 games ([REDACTED]).
- Two individuals each claimed five \$3,000 winning tickets in the Pick 4 game, at the same store and on the same day – i.e., each person won a total of \$15,000, at the same store, on the same day, playing the same game ([REDACTED] and [REDACTED]).

¹ The underage co-worker subsequently dropped her claim that she was part owner of the ticket.

I don't know how many of those on the list are retailers or retailer employees, as the Lottery website does not provide winners' occupations. However, after compiling the list of repeat winners, I subsequently found that one was the subject of a Lottery press release dated January 2, 2007:

██████████ of Lake Park won \$10,000 playing the "\$35 Million Cash Spectacular" instant-scratch game. She purchased the winning ticket at Stan's Corner, 301 Market St. in Lake Park and claimed her prize at the Iowa Lottery's regional office in Storm Lake.

██████████ **who had scratched her winning ticket while on break working at Stan's Corner**, couldn't believe it when she hit the \$10,000 prize. [emphasis added]

I later found that she was also the subject of an article in the February 19, 2007 edition of the Iowa Lottery's newsletter to retailers:

Lucky Lake Park Woman Wins Second Big Prize

She won \$10,000 late last year, and now a Lake Park woman has won \$250,000 playing the same scratch ticket, purchased at the same store!

██████████ of Lake Park claimed the \$250,000 top prize playing the "\$35 Million Cash Spectacular" scratch game. She purchased the winning ticket at Stan's Corner, 301 Market St. in Lake Park.

This is ██████████ second big winner purchased from Stan's Corner in less than a month. In December, she claimed a \$10,000 prize in the same game from a ticket she also purchased at Stan's Corner!

The Lottery website shows ██████████ later won \$1,000 three different times playing instant ticket games. Combined, she had a rather amazing run over eight months:

1. December 2006: Won \$10,000 (said she bought the ticket at the store where she works).
2. January 2007: Won \$250,000 (said she bought the ticket at the store where she works).
3. June 2007: Won \$1,000.
4. August 23, 2007: Won \$1,000.
5. August 23, 2007: Won \$1,000 a second time that day.

That comes out to five winning tickets worth \$263,000 over eight months for a person who works at a store that sells lottery products. (And it's worth noting that I don't know whether ██████████ had any other major wins previously.)

Is ██████████ incredibly lucky? Is her string of winning tickets while working at a lottery retailer just an amazing coincidence? The best way to find out would have been for the Iowa Lottery to thoroughly investigate each claim, as she made them – especially her claim for \$250,000, which was only about a month after her claim for \$10,000.

This raises several questions:

1. If a glimpse at only some of the major winners in 2007 uncovers a retail store employee with five wins totaling more than a quarter of a million dollars, what would a review of all major winners for the past several years (or more) reveal?
2. Has the Iowa Lottery been tracking – and investigating – the prize claims of retailers and retailer employees who make multiple claims for prizes of \$600 or more (which must be submitted to the Lottery on an official claim form)?
3. What if we could review all prize winners – not just those who win \$600 or more? To illustrate, the British Columbia ombudsman found that smaller prizes account for the vast majority of total winnings paid out, and suspected that some store clerks had learned that they had a better chance of going undetected by claiming smaller prizes, i.e. those claims which don't have to be reported to the lottery.

The Iowa Lottery reports that approximately 2,600 retailers are licensed to sell its products. I don't know if the lottery has data regarding the statewide number of retailers and retailer employees who handle lottery-related functions. I don't believe it's unreasonable to suggest that the number likely approaches, or even exceeds, 10,000 individuals.

Certainly, there isn't enough information at hand to show that any of the above-mentioned repeat winners won prizes fraudulently. At the same time, it's also clear that it would be naïve to assume that retailer fraud has not been occurring in the Iowa Lottery, without further investigation.

Bearer Instrument standard: "Finders keepers"

A store clerk intent on obtaining customers' winning tickets might actually have an easier time in Iowa as compared with Ontario and British Columbia (before the ombudsmen investigations that found widespread retailer fraud).

This is largely because the Iowa Lottery follows a "bearer instrument" standard for tickets – essentially holding that until a ticket is signed, it is owned by the person who has it.²

The Iowa standard is set out in two administrative rules³ promulgated by the Iowa Lottery:

- **11.4(99G) Ticket is a bearer instrument.** A ticket is a bearer instrument until signed in the space designated on the ticket for signature if a signature space is provided. The person who signs the ticket is thereafter considered the owner of the ticket. Payment of any prize may be made to the physical possessor of an unsigned ticket or to the person whose signature appears on the ticket. All

² Neither the Ontario nor British Columbia lotteries have had a "bearer instrument" standard. Their rules require prize claimants to warrant that they are the "lawful bearer" of the ticket – an acknowledgment that the physical possessor of a ticket might not be the lawful owner.

³ These rules are based on language in Iowa Code section 99G.31, which states, "The chief executive officer shall award the designated prize to the holder of the ticket or share upon presentation of the winning ticket or confirmation of a winning share" and "The prize shall be given to the person who presents a winning ticket."

liability of the state, the lottery authority board, the lottery authority, the chief executive officer, and the employees of the lottery terminates upon payment.

- **20.11(99G) Ticket or share ownership and prize entitlement.**

20.11(1) A ticket or share is owned by its physical possessor until a signature is placed on the back of a ticket in the area designated for signature. When a signature is placed on the back of the ticket or share in the designated space, the person whose signature appears in the designated space is the owner of the ticket or share and is entitled to any prize attributable to the ticket or share.

20.11(2) Notwithstanding any name or names submitted on a claim form, the lottery shall make payment to the person whose signature appears on the back of the ticket or share in the designated space.

Iowa's "bearer instrument" standard has significant ramifications. This is illustrated by a passage in the Ontario ombudsman's report, which referred to a memo written by an Ontario lottery manager:

The manager also recommended that the Corporation stop asking for purchase details, moving to "a Bearer (Holder) Policy," allowing the Corporation to simply pay whoever presented a winning ticket."

Another manager subsequently responded:

If we move to a pay-the-bearer policy, Prize Office staff will no longer make efforts to determine if a ticket is being presented [for] payment by the proper parties. If we don't ask basic questions to determine ownership at the time of redemption it will have implications with respect to stolen tickets ... insider wins... Our ability to deal with these issues will be eroded... [emphasis added]

Here we have an Ontario lottery manager, asserting that the lottery's ability to investigate potential retailer fraud would "be eroded" by switching to a "bearer instrument" standard – the same standard the Iowa Lottery has gone by since at least the early 1990s. And keep in mind, the Ontario lottery was found to have significant problems, even without a "bearer instrument" standard.

This standard may be the chief reason why there does not appear to be any cases of an Iowa store clerk being charged with fraud or theft in connection with a customer's winning lottery ticket. In order for such a charge to be possible, two things would typically need to happen:

1. The customer would need to realize that he or she was victimized. The Canadian reports found that it's not difficult for some clerks to trick customers out of their tickets, without the customers realizing it – especially those who aren't familiar with the rules of the game.
2. The customer would likely need some proof that it was his or her ticket. Ideally, the customer's signature might be sufficient. But once again, the Canadian reports found that many customers were not aware of the importance of signing their ticket before handing it to a store clerk. (A clerk engaging in fraud and/or theft could simply focus just on those tickets that don't have a signature.)

While the statute and rules do prohibit theft of tickets, the “bearer instrument” standard raises a question of whether a store clerk taking a customer’s winning – and unsigned – ticket is engaging in theft. Sub-rule 20.11(1) states, until a ticket has a signature, it is “owned” by its “physical possessor.”

To illustrate the importance of signing tickets before handing them over to a store clerk, consider the comments of a former British Columbia lottery administrator, quoted in a newspaper after the provincial ombudsman’s investigative report:

Mr. Simonis said those who get cheated are inept, arguing that the overwhelming majority check to see if they have winning numbers before they take tickets to the store. **“Of course, it's possible retailers cheated players of their prize money, but only if you're a fool.”** [emphasis added]

Those who ask retailers for results should initial or sign the back of their tickets first, he said. **“If you give an undocumented ticket to a retailer, you're asking for trouble.”** [emphasis added]

Further, both Canadian investigations found that customers who didn’t sign their ticket, and later complained to the lottery that a clerk stole the ticket, were effectively scolded. The British Columbia report stated:

We found a common response to calls from players who felt they were victims of retailer fraud was to tell them if their ticket had not been signed then it was as if they had lost cash. The implication there was that the player had been negligent and there was nothing BCLC could do. One player was told that if the ticket was not signed then there was no way for her to prove the ticket was her father’s.

Other information reinforces the sense that customers are “on their own” when it comes to protection from potential retailer fraud. First, Code section 99G.31 states in part, “The authority is discharged of all liability upon payment of a prize pursuant to this section.”

Second, anyone claiming a prize of \$600 or greater must sign a “Winner Certification” claim form which states in part:

I certify that I am the sole owner of the lottery ticket submitted with this form, or that I have been authorized by all other owners of this ticket to claim the prize on their behalf.

I also certify that ... this ticket is not stolen.

Under penalties of perjury, I declare that to the best of my knowledge and belief that the information supplied on this form is true and correct and that I have correctly identified any other person who is entitled to these winnings.

Combined, this seems to indicate that if it has made payment of a prize to a store clerk, the Lottery might view any dispute between a customer and that clerk as entirely a civil matter, essentially out of the Lottery’s hands.

Handing unsigned ticket to clerk could be risky

Given these provisions, any customer who hands over an unsigned ticket to a store clerk is especially at risk, and could potentially be handing over thousands or even millions of dollars.

This includes the customer who has already verified, on his or her own, that the ticket is a winner. The Canadian ombudsmen investigations show that if the clerk switches that ticket with another, the player is often hard-pressed – without a signature on the ticket – to prove that the clerk committed fraud or theft. Iowa’s “bearer instrument” standard would seem to make that customer’s challenge all the more difficult, if not impossible.

This also includes, and even more so, the customer who has not checked whether the ticket is a winner. Dr. Stanek may again assert that any customer who hands a ticket to a clerk without knowing whether it’s a winner is not “playing the game” (as he asserted in the 1990s).

If so, I would respond by pointing out that our 1998 agreement with the Iowa Lottery presented an opportunity for the agency to improve its performance in providing customers with basic information about how to play the games, without specifically advising them about any of the risks (including the admonition to not rely on terminals). As will be detailed later in this memo, I have found information that indicates the Iowa Lottery has largely been failing to honor the terms of the 1998 agreement, which itself was somewhat of a compromise.

In other words, the Iowa Lottery has had nearly 10 years to improve its performance in this area, and has not taken advantage of that opportunity. It must be noted that it is going to be rather difficult for lottery customers to meet expectations that have not effectively been communicated to them.

Handing signed ticket to clerk could also be risky

Anyone who hands over a signed ticket to a store clerk might think they are completely protected. But if they do so without first establishing, on their own, whether the ticket is a winner, they could also be victimized.

Consider, for example, what could happen if such a customer hands a signed ticket over to a clerk who “palms” the ticket – a process described in the Canadian reports whereby, without the customer’s knowledge, the ticket scanned through the terminal is one that the clerk has already determined to be a non-winner.

In that scenario, the customer would walk away thinking his ticket was a non-winner. The clerk, meanwhile, could later validate the customer’s ticket; and if it’s a winner for \$600 or less, the clerk could then pay himself the prize winnings from the store cash register.⁴

⁴ Iowa Lottery rules require that prizes of \$600 or more can only be paid by the Lottery; prizes below that threshold can be paid by the retail store.

Other risks (beyond retailer fraud)

Terminal validation errors

Not only do clerks steal players' winnings but lottery terminals err too.

A double whammy for players.

-- Dawn Nettles, Texas lottery blogger, June 1, 2005

In 1993, our office received a complaint alleging that a lottery terminal in Iowa City misidentified a winning ticket as a non-winning ticket. In the ensuing investigation, Dr. Stanek confirmed that terminals could err, but cited a lack of customer complaints as evidence that it was an extremely rare occurrence.

While he expressed strong confidence in the terminals, Dr. Stanek never made a guarantee that they were free from error. Sprinkled in with his confidence were comments like, "As with any mechanical device, errors can occasionally occur," and "There are no absolutes when dealing with things mechanical or human."

Dr. Stanek also said that players should not be relying on terminals to see if their ticket is a winner. He said terminals are "not provided as a tool to the player" and that relying on them "is not 'playing the game.'" He acknowledged that a mistake would not be obvious to any customer who relies on terminals, but also stated, "Such is the player's responsibility."

It became apparent that he was making a critical assumption, that many customers whose tickets are scanned through the terminals already know whether the ticket is a winner or not. But such an assumption is belied by simple observation at any store, whether in the 1990s or even today.

We responded:

If, as you state, the terminal is not provided as a tool to the player, why not communicate this to the player? While you are correct that Lottery materials do not suggest using terminals for this purpose, neither do Lottery materials indicate customers should **not** use the terminals. By making the terminals available to players for the purpose of determining whether a ticket is a winner, I believe the Lottery has created the mistaken perception that the terminals are a tool for players.⁵

We buttressed our suggestion by noting:

- Many customers were relying on terminals for this purpose;
- Those customers would not know if the terminal made a mistake;
- And so the relative lack of complaints – part of Dr. Stanek's argument -- didn't necessarily mean it wasn't happening to others.

⁵ In 2002, while making inquiry into a separate complaint about the Iowa Lottery, a lottery employee told me that most people don't have time to check tickets themselves. I asked if that was OK and she said "yes." I asked if that was "playing the game" and she said "yes."

I also reviewed data about millions of dollars in unclaimed prizes, and pointed out that there could be a connection between some unclaimed prizes and terminals erring.

Dr. Stanek was unable to refute any of these points. But he objected to the suggestion that the Lottery tell its customers not to rely on the terminals, primarily on the basis that it would “raise unwarranted concerns about the integrity of the Lottery’s computer system, which is the repository of our official business records.”

During that investigation, my concerns evolved. In the end, I saw that case as having less to do with terminals erring, and more to do with the appearance that the Lottery has been keeping important information from customers and retailers.

It is worth noting that 14 years have passed since I received that complaint from Mr. [REDACTED], and in that time, our office has not received any other similar complaints involving Iowa Lottery terminals. I don’t know whether the Lottery itself has received any further complaints of terminals misidentifying a winning ticket as a non-winner.

On the other hand, I have since obtained information indicating that terminal validation errors have also been reported in other state lotteries, particularly Florida and Texas.⁶ A 2002 article in *The Miami Herald* reported:

Lotto Letdown

Machines could err, so check numbers before tossing tickets

Have you checked your Fantasy 5 or Lotto jackpot ticket at a lottery machine recently and gotten the message that you're not a winner?

Don't trash your ticket just yet. You might want to double check it.

One state lottery official estimated the machines have a .01 percent chance of giving a false reading on a winning ticket....

Sumire Sugimoto of Weston, who spends \$4 a week on the Florida Lotto, was shocked recently to find that the machine at her local Publix didn't register her winning ticket....

Sugimoto ... has 180 days from the date of the draw to claim her prize – \$4.50.

And in 2006, television station KPRC in Houston, Texas had a report on its website:

Texas Lottery Winners Denied Prize

Local 2 investigates why hundreds of lottery winners aren't getting their money. We discovered players across the state being turned away when they try to cash their winning ticket....

Local 2 Investigates talked with frustrated lottery winners and went to the Lottery Commission in Austin. While officials there know about the problem we discovered little is done to prevent winning tickets from turning up as losers....

⁶ Based on a review of audit figures, it appears that neither the Florida or Texas lottery experienced a decline in sales following the disclosure of terminal validation errors.

Turns out, it happens often. Records obtained by Local 2 Investigates from the Texas Lottery Commission shows in the last four years nearly 1,000 people filed complaints about winning lottery tickets being denied. Fewer than half of these people ever got their money....

"This is not uncommon," says Leticia Vasquez, with the Texas Lottery Commission. "It has happened in the past quite a bit."

Vasquez blames the complaints on store employees. She says they aren't trained on how to use the machines, but Vasquez says the Lottery Commission can't force the retailers to take the state's training....

We discovered only about 40 percent of the complaints are followed up with a formal investigation. According to state records, most of the investigations into these complaints end because of "insufficient evidence."

The question the Lottery Commission can't answer is how many people has this happened to who didn't realize it or just didn't want the same hassle Mullen went through....

The problem has also caught the attention of Nettles, the self-described watchdog of the Texas lottery. In a 2002 blog entry, she wrote:

A vast majority of lottery tickets are checked by the terminals only ... So players never know when the terminals misread their tickets. How can players complain about something they have no knowledge of? Could this be why [*there are hundreds of thousands in unclaimed prizes*]. Wouldn't that be a blessing for the state?

Speaking of which: In 2003, a \$30 million Powerball jackpot sold in Indiana went unclaimed. The money reverted back to the individual states where the tickets had been sold -- the Iowa Lottery received about \$1.2 million in one-time income, and those funds were subsequently transferred to the state's general fund.

Is it possible that the owner of that ticket relied on a terminal and the terminal erred?

Unnatural duplicate plays

██████████ bought two Powerball tickets from the same Des Moines terminal within a 24-hour period in 2002. Each ticket had three "plays" -- three rows of six numbers -- so each ticket had 18 Powerball numbers. All six plays were for the same drawing.

After the drawing, she checked the tickets and found that none of the plays was a winner. That's when she noticed it: The tickets had exactly the same numbers; all 18 were identical.⁷ This stunned her, because she bought the plays using "Easy Pick," where the computer is supposed to randomly select the numbers.⁸

⁷ A copy of the tickets shows the first was printed at 3:55 a.m. on September 9, 2002; and the second was printed at 3:48 a.m. the next day.

⁸ The Lottery's administrative rules define "Easy Pick" as "the random selection of ... a valid play."

█ subsequently filed a complaint with our office and I in turn made inquiry with Dr. Stanek. His written response acknowledged the existence of a problem with the “Easy Pick” program. He suggested that this was probably what occurred in this case, and said the same terminal “generated another pair of tickets with duplicate plays over a four-day period.”

More specifically, based on Dr. Stanek’s written response, it appears that:

- There are bugs involving the “seed software,” which helps the computer pick random numbers.
- Such a bug can be present even in a terminal that is operating correctly and issuing random plays as designed.
- These bugs increase the likelihood that an “Easy Pick” play will have the same numbers of a previous “Easy Pick” play.⁹ It is worth noting that approximately 75 percent of online plays are “Easy Picks,” according to the Lottery’s “2007 Media Fact Book.”
- Though Dr. Stanek believes this is a rare event, there is no way to determine its frequency.
- **As a result, the degree to which this phenomenon has been impacting customers’ prize winnings is unknown – and unknowable.**

His letter made no mention of considering or exploring ways to resolve this problem, or to minimize its frequency and impact.

His letter also implied I was suggesting that lottery terminals should be prevented from ever issuing duplicate plays. But that is not the case. I believe duplicate plays are an inherent and natural occurrence in any truly random system. An important distinction can be made between duplicate plays which occur naturally (as part of a truly random system) and those that occur unnaturally (i.e., due to software bugs).

Further analysis reveals that █ did not get what she paid for – six random shots at the jackpot (only got three). Nobody will ever know whether she might have won the jackpot had she received the random plays that she paid for.

It also meant that there may have been three fewer chances of a jackpot winner for that drawing. Historically, jackpot rollovers lead to increased sales and increased net income for the Lottery – indirectly benefiting the state’s general fund.

Those potential impacts – negative for the customers, positive for the state – are conceivably present any time the phenomenon of unnatural duplicate plays occurs.

Assuming Dr. Stanek is correct and this doesn’t happen very often, I submit that it’s extremely unlikely that any two customers would be aware that the computer gave them the same numbers.

⁹ Such an occurrence would appear to be inconsistent with the administrative rule definition of “Easy Pick.”

Keep in mind that the incident involving ██████████ was brought to light only because several steps occurred:

1. The two plays went to the same customer. Had either play gone to another customer, it's unclear how this would have been discovered.
2. She discovered they were identical only inadvertently – she could have easily missed this fact and thrown the ticket away.
3. After her discovery, she realized that the chances of this happening were extremely small.
4. She filed a formal complaint with an agency independent of the Iowa Lottery.

Had any of those four steps been missed, we probably would not be dealing with this issue. This raises the prospect that the relative lack of complaints doesn't mean this isn't happening to other customers.

It appears that another version of this phenomenon may have been occurring in the Texas lottery. A 2002 press release referred to a "ticket-printing glitch" that occurred infrequently until 1998:

That glitch ... resulted from a memory allocation problem which allowed the terminal to produce two consecutive Quick Pick Lotto wagers with the same numbers, under certain conditions, when multiple Quick Pick wagers were made in rapid succession.

And Dawn Nettles, the Texas lottery blogger, has also discussed this phenomenon, and has routinely advised players not to allow the computer to pick the numbers. In a May 9, 2003 post she wrote:

For years I've taken complaints from players who repeatedly say they always get duplicate numbers when buying QP. For the most part, I have passed this off as just "random numbers and rotten luck on the players part."

However, about two or three months ago, I received some information, from what I consider to be a very reliable source, that was extremely disturbing about the Quick Pick process and "programming software." Since then I have learned that there is no such thing as having a computer or program that would generate truly "random" numbers....

Too many tickets contain duplicate numbers.

Computerized draw software issues

When we hear the word lottery, it's not uncommon to conjure an image of bouncing balls being pulled from a machine on TV. But those images may be slowly coming to an end.

Primarily as a way to save money, some lotteries have been moving towards a system in which a computer selects the winning numbers. I've found information indicating about 12 state lotteries use computerized draws for all their games.

While the Iowa Lottery uses the bouncing balls for most of its lotto-format games (i.e., Powerball), it did switch to a computer-draw system several years ago for the \$100,000 Cash Game. This was mentioned in the Lottery's 2003 annual report, in a message by Board Chairman Tim Clausen:

Also, in order to save money, the board decided the lottery should initiate computerized drawings for the \$100,000 Cash Game and Freeplay Replay.¹⁰ Of course, security is of the utmost importance, and all agreed this drawing method is very secure.

A Web-based search reveals, however, that several state lotteries have had problems with computerized draws. Specifically, some such drawings turned out to be flawed, due to computer programming errors. **This caused some of the sold tickets to have absolutely no chance of winning – so some customers lost money as a result.**

The earliest report I've found was of a 1998 problem with the Arizona lottery, according to an article from the CNN website:

In 1998, the Arizona Lottery discovered that no winning number in its Pick 3 game had ever included a single numeral 9. It turned out that the pseudorandom number generator algorithm had an elementary programming error.

A similar problem hit the California lottery in 2005, according to an article in *The Los Angeles Times*:

Computerized lottery drawings the culprit in flawed results

Dave Andres, an insurance underwriter from Altadena, California, thought he alone was in the habit of scanning hundreds of winning numbers in the lottery's least-popular game, Daily Derby.

He assumed no one else noticed that for 100 days running this winter, none of the winning times in the horse race-themed game had numbers that were repeated.

He knew that players had to not only pick the right horses but also the last three digits of the winner's finishing time. And he saw that those numbers were always like 3.70 and 4.23, and never 1.33 or 4.24 — even though the statistical probability is that duplicate numbers should appear 27% of the time.

But Andres was not alone. An equally sharp-eyed Walnut man who noticed the same aberration described it in a letter to lottery officials last month. That led to the discovery of a computer software glitch that had denied 650 players a chance to win the game's grand prize over six months.

... California lottery officials traced the problem to November, when a contractor was replacing the 7-year-old computer hardware and software that draws the winning numbers each day.

¹⁰ The Lottery has since discontinued the "Freeplay Replay" game.

The programmer inadvertently copied a line of software code that kept horses from appearing in more than one winning spot per race.

The most recent problem with computerized draws hit the Tennessee lottery in August 2007, and has prompted state legislators to call a special meeting of their Lottery Oversight Committee. An editorial in *The Tennessean* newspaper stated:

Any game of chance needs a high level of trust.

Trust was missing during a recent stretch in the Tennessee Lottery when players who bet on digits showing up more than once were literally shut out of a chance to win because of a computer glitch. The glitch meant that people who bet on repeating numbers in the Cash 3 and Cash 4 games, such as 3-8-3 or 4-4-7-9, had no chance of winning. Repeated digits are supposed to be able to win.

... Lottery officials uncovered the problem, which had occurred when an employee from a third-party company working with the lottery typed a "u" for unique instead of an "r" for repeat in the computer code. The lottery is offering double refunds or two free plays to people who were shut out if they return signed tickets.

... Part of the level of trust in the game before it went to a computerized version was that people could actually see balls with numbers chosen for the winning combinations. They could watch the action for themselves. But they have to trust a computer blindly. **The biggest error might have been shifting to a computer system.** After all, the computerized method did not prove to be absolutely trustworthy. [emphasis added]

Incorrect winning numbers posted

The Iowa Lottery's website has an FAQ section (frequently asked questions), which includes the following question and answer:

If the numbers are wrong in the paper, what happens if my numbers match?

Occasionally, incorrect numbers appear in various postings. While the lottery regrets that errors in posting may occur, incorrect postings do not reflect the official numbers required for payment of prizes. Prizes can be paid only for tickets bearing those numbers drawn and certified as official numbers by the independent auditors who audit all Lottery drawings.

The website also has the following disclaimer:

Neither the Iowa Lottery nor the State of Iowa, nor any of their employees or agents make any warranty, express or implied, including warranties of merchantability and fitness, for a particular purpose or assumed liability for the accuracy, completeness or usefulness of information from this server or the links to servers on the Lottery's home page.

That disclaimer appears to indicate that the Iowa Lottery does not guarantee the accuracy of, among other things, winning numbers posted on its website.

So if the winning numbers listed by the media could be wrong, and the Iowa Lottery can't guarantee the accuracy of the numbers on its website, is it unreasonable to wonder if this might be another explanation for some of the millions of dollars in unclaimed prizes over the years?

This is not just a theory. This problem hit the Indiana lottery in August 2007, as reported in the *Indianapolis Star*:

Hoosier Lottery finds \$13k mistake

Winning Hoosier Lottery tickets totaling \$12,935 may have been mistaken for non-winning tickets after two drawings this summer because of a data entry error, the lottery said today.

The mistake concerns ticket holders with "4 of 6" or "5 of 6" winning numbers in the Hoosier Lotto drawings of June 23 and Aug. 8. The error means that some of those tickets would have shown as non-winning entries when presented for redemption.

"This error occurred when the vendor entered an incorrect draw date identification number," a lottery news release said today.

The mistake could affect 201 tickets, most for amounts of \$41 or \$44.

It also happened earlier this year in British Columbia, as reported in the *Vancouver Sun*:

Software glitch may have hidden lottery wins

Thousands of disappointed B.C. lottery players were confronted by full-page newspaper ads Thursday suggesting they may have been robbed of past winnings.

While discovering they didn't win Wednesday's \$38-million Lotto 6/49 jackpot, they also learned they could have held winning tickets for lotteries between Feb. 8 and March 30 and been told they were not winners.

A consumer advisory said a software update to the Internet Number Checker inadvertently prevented draw results from being presented correctly by secondary B.C. Lottery Corp. Web addresses.

The glitch is believed to have affected about 2,800 customers who requested draw results between Feb. 8 and March 30 using the Internet Number Checker from Web addresses other than www.bclc.com.

“Phantom” duplicate transactions

Hence, the integrity of the lottery was compromised.
UK National Lottery Commission, August 23, 2000
report on investigation into the “phantom transaction” phenomenon

From the early 1990s until mid-2001, the Iowa Lottery’s online system (i.e., lotto games) was managed by GTECH Corporation.¹¹

In 2000, the United Kingdom’s lottery reported on a software “code error” problem involving GTECH’s terminals that caused errors in thousands of prize payments between 1994 and 1998. While GTECH had apparently corrected the problem in 1998, it did not come to the attention of British lottery officials until they received a letter from a whistleblower – a former GTECH employee.

That same year saw reports that the problem had also affected the Texas and New Hampshire lotteries. I have not been able to establish whether this phenomenon affected the Iowa Lottery, which was also using GTECH’s terminals until July 1, 2001.¹²

GTECH issued a press release on May 30, 2000 stating:

GTECH Announces Lottery Terminal Software Review

GTECH ... announced today that in light of an ongoing inquiry into a lottery terminal software malfunction in the United Kingdom, the Company has initiated a review to identify to what extent the specific malfunction may have occurred elsewhere in the world. The Company is verifying its terminal software applications for each of its lottery customers and the initial review shows that only a minority of other GTECH customers are or may have been affected.

... The Company is notifying all its lottery customers and is making every effort to fully understand and resolve all issues as soon as possible. Detailed terminal software examinations continue in all other jurisdictions and the Company anticipates the review in those jurisdictions will be completed in the next two weeks. The Company will stay in constant contact with its customers to apprise them of the results of our review.

A good description of the problem came in an August 23, 2000 report by the United Kingdom’s National Lottery Commission:

In certain limited circumstances, it caused duplicate transactions to be recorded on the gaming systems, with only a single ticket being produced.

This resulted in an overcharge to retailers and, if the ticket were a

¹¹ In September 2000, Iowa’s lottery board approved a seven-year contract with a different vendor, Scientific Games, which took over management of the online games on July 1, 2001.

¹² This is relevant because the other lotteries were able to rule out significant problems only after conducting extensive investigations. If this problem affected the Iowa Lottery, and if such an investigation didn’t occur, it would mean that Iowa retailers may have been overcharged; any impact on customers would depend on whether there were any pari-mutuel prizes offered before June 2000.

prize-winner, errors in the distribution of the prize fund between the prize-winners of the draw.

A May 20, 2000 press release by the British lottery stated:

[A]ll winning tickets during the period in question received prizes, and ... no one has missed a prize which was due to them.

That press release also stated that the problem had only affected winning prizes that were less than 50,000 pounds – all prizes above that amount had been correctly paid.

More information was revealed in an August 23, 2000 report:

GTECH, the supplier of lottery gaming systems to Camelot, had identified a software fault and had corrected that fault secretly [*in 1998*], in breach of established software change control procedures and without disclosing it to Camelot or the Commission's predecessor, OFLOT.

One consequence of this decision [*to correct the fault secretly*] was that no action could be taken to check the impact upon prize-winners and retailers, and make arrangements for restitution where appropriate.

Hence, the integrity of the lottery was compromised. [emphasis added]

The National Lottery Commission released its final report on the investigation on April 10, 2001. Here are the highlights:

1. The decision to conceal was taken at the highest level within GTECH, by the then Chairman and Chief Executive.
2. The result [of the problem] was that the retailer was charged twice for what was, in reality, a single transaction.
3. **It was purely fortuitous that the impact on prize-winners was so limited.**
4. If a duplicate transaction had won a major prize, this would have reduced significantly the prizes allocated to genuine winners. The Commission's immediate concern was to verify whether this had happened. This was checked by comparing all prizes over 50,000 [pounds] against unclaimed prize records.
5. Camelot's analysis concluded that 156,493 duplicate transactions resulted from the software defect over the period November 1994 to July 1998; some 0.001% of all transactions.

These resulted in underpayment to prize-winners in some nine draws totaling 56,839 [pounds] and affecting 55,858 prize-winners.

No prize-winner was underpaid by more than 3 [pounds], and the vast majority were underpaid by only 1 [pound].

6. Very few prize-winners who were underpaid can be identified.

In June 2000, the New Hampshire lottery announced that this phenomenon had also affected its online games from January 1994 through May 2000. A public statement reported:

The problem ... was associated with the use of the pre-printing feature on certain classes of terminals (Spectra, Spiffany and Tiffany) using a particular Motorola microprocessor....

The potential consequences of these duplicate transactions in New Hampshire are:

- A slight overstatement of sales figures.
- A small number of retailers were swept for ticket revenues that they did not actually receive.¹³

In November 2000, the New Hampshire lottery accepted GTECH's offer of \$27,027 in restitution -- representing the amount of overcharges to retailers.

In July 2000, the Texas lottery announced it also had experienced "phantom" duplicate transactions. According to a press release, the problem affected Texas lottery games from November 1992 until December 1994, at which time the software glitch was discovered and fixed.¹⁴

It's not clear from the press release, but apparently the Texas lottery did not investigate the impacts to customers and retailers until the British lottery announced the problem in May 2000 -- nearly six years after it was discovered and resolved in Texas.

The July 2000 press release stated that:

- 5,035 Texas retailers were overcharged an average of \$3.76.
- GTECH had been overpaid by \$756.
- Approximately \$5,675 in additional funds were transferred to the Texas general fund.

It also stated that there had been no impact on customers' prize winnings, noting that such a conclusion was possible only through a thorough investigation.

¹³ The New Hampshire reports don't make any mention of an impact on prize winnings. If the New Hampshire lottery doesn't have any pari-mutuel games (where a particular prize depends on the number of winning tickets), then that would mean there could not have been any impact on prize winnings.

¹⁴ Apparently news of the Texas lottery's 1994 discovery and resolution of the problem was not received by other lotteries operated by GTECH.

Potential Risks -- Overview

Imagine a stack of office paper 9.2 miles high. One of them holds a set of winning numbers.

Then consider how challenging it would be to pick the winning sheet of paper out of the 9-mile-high stack. That is similar to the chances of winning the Powerball jackpot, where the odds are about 1 in 146 million.

Those odds, which are infinitesimal, can be made even smaller by:

1. Retailer fraud
2. Terminal validation errors
3. Computerized draw software issues
4. Incorrect winning numbers posted
5. Unnatural duplicate plays

These phenomena involve basic functions at both ends of the process – affecting customers making a good-faith effort to play the game at both the front end (buying ticket) and the back end (trying to find out if ticket is a winner).

With the exception of retailer fraud, these phenomena involve computer software “bugs.” Given this, how reasonable is it to assume that there aren’t other problems that haven’t yet come to public light? What else do we not know about lottery computer systems and how they can impact customers?

Consider the following point, from a recent report by the California Secretary of State, regarding potential problems related to electronic voting:

Systems that are architecturally unsound tend to exhibit “weakness in-depth”— even as known flaws in them are fixed, new ones tend to be discovered.

In our two previous inquiries with Dr. Stanek, he has made effective arguments by relying on two assertions, generally along these lines:

1. These phenomena occur so rarely as to be practically irrelevant.
2. There have been remarkably few complaints by customers, which is tantamount to “real life” proof that there are no significant problems.

Regarding the frequency of these risks: I don’t necessarily disagree with Dr. Stanek. But I have come to the conclusion that the term “rare” is somewhat meaningless in the context of an enterprise with annual sales in the tens of millions. A hypothetical problem that occurs only once in every 10,000 tickets sounds rare – until you consider that it would be happening thousands of times a year.

Moreover, this “hypothetical” describes what British lottery officials found in their investigation of the phantom duplicate transactions. Their final report stated that about 156,000 such transactions occurred, and said this was “around 0.001% of all transactions over a four year period. I would submit that most people would agree that an event that occurs 0.001% of the time is “rare.”

And yet this “rare” event led to the following admissions by the British lottery:

- “Hence, the integrity of the lottery was compromised.”
- “It was purely fortuitous that the impact on prize-winners was so limited.”

Regarding the number of complaints: I’d like the opportunity to review the Lottery’s complaint files before acquiescing that customers have made remarkably few complaints.

Moreover, I would submit that these phenomena are not likely to be noticed by the typical customer, and people typically don’t complain about things they’re not aware of.

IOWA LOTTERY PERFORMANCE IN PROTECTING CUSTOMERS FROM POTENTIAL RISKS

Status of 1998 agreement¹⁵

In order to assess the Lottery’s performance in honoring the 1998 agreement, I have conducted two “spot checks” of Des Moines area retailers.

I conducted the first “spot check” in 2004, and I did the second this week at your direction. In each case, I simply drove randomly around the metro area, stopping in at any store that appeared to sell Iowa Lottery products. While these checks were non-scientific, the goal was to see if there are any trends or patterns.

At each store, both in 2004 and 2007, I checked the following items:

- Is there an informational sticker on or near the terminal?
- Is there a brochure which includes the specific language identified in the 1998 agreement?

While it was not part of the agreement, I also checked to see how clerks responded when I held out a Powerball ticket and asked, “How do I find out if this is a winner?”

¹⁵ The agreement was memorialized in Dr. Stanek’s January 9, 1998 letter, which was in response to recommendations in your December 4, 1997 letter to him. Copies of both letters are attached to this memo.

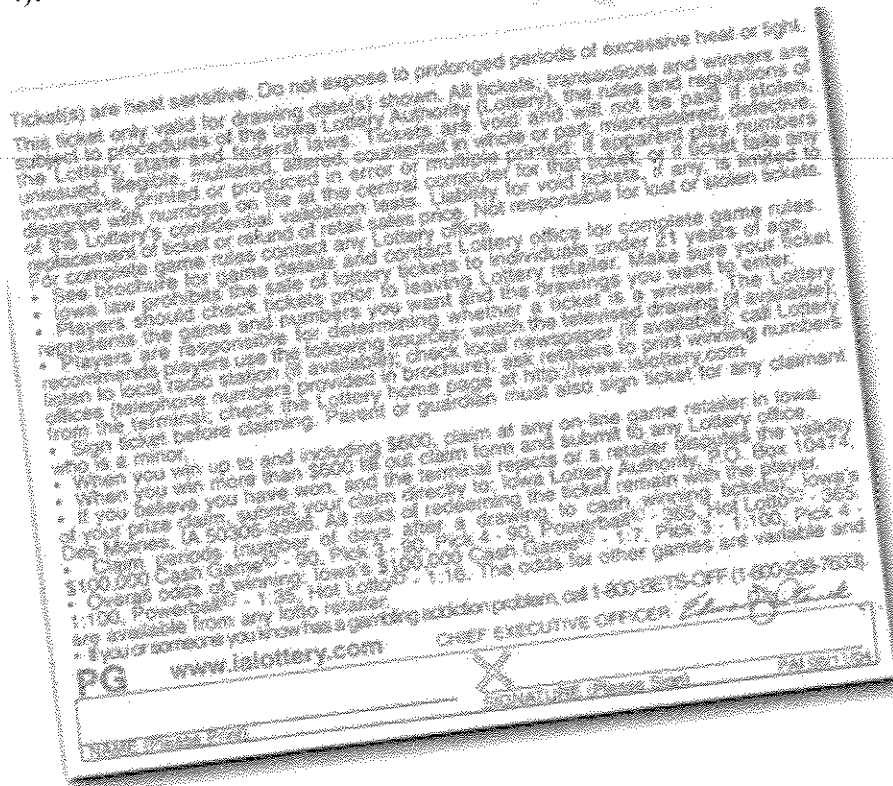
Here are the results:

- **STICKERS** – The Lottery agreed to ensure that informational stickers were placed on or near terminals. In 2004, I found that a sticker was visible at 11 of 34 stores visited. In 2007, I found that a sticker was visible at 1 of 15 stores visited.
- **BROCHURES** – The Lottery also agreed to produce and make available brochures which included specific language identified in the agreement. Both in 2004 and 2007, I was unable to find such a brochure at any of the stores I visited.
- **TERMINAL RELIANCE** – I showed clerks a Powerball ticket and asked how I should determine whether it was a winner. In 2004, every clerk but one responded by offering to scan the ticket through the terminal. In 2007, all clerks responded by offering to scan the ticket through the terminal. The vast majority of clerks seem to be unaware of Dr. Stanek’s admonition that customers should not be relying on terminals for this purpose.

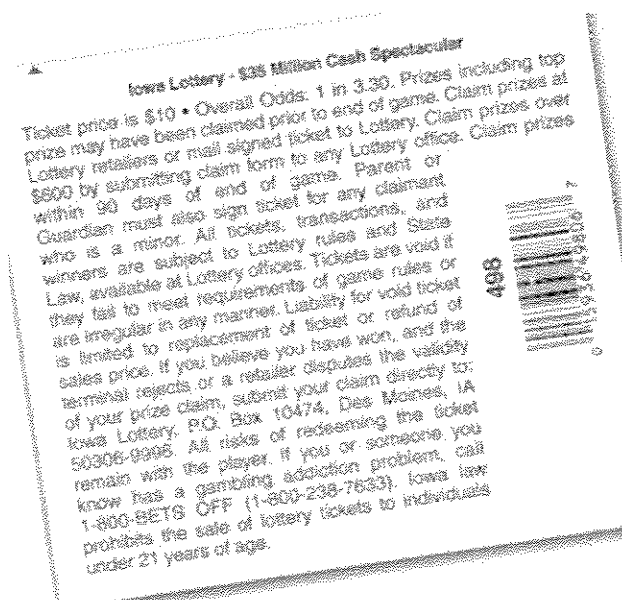
Overall, customers today don’t seem to be any better off than they were 10 years ago, in terms of receiving the information they need to make educated decisions about how to spend their money on Iowa Lottery products.

Information on tickets

The two pictures below represent the centerpiece of the Iowa Lottery’s efforts to educate its customers. The first picture shows the information printed on the back of lotto tickets sold in Iowa (for games like Powerball, \$100,000 Cash Game, Hot Lotto, Pick 3 and Pick 4):



The second picture shows the information printed on the back of instant-scratch tickets sold in Iowa:



It appears that this information has been on the backs of tickets since at least September 2002.

On the plus side, it is good to see the advisory, “Sign ticket before claiming.” The Canadian investigations showed how important it is for customers to sign their tickets before handing them over to a store clerk.

On the negative side, there are several problems with this information:

1. First and foremost, the text size is so small – and there is so much information crammed into the allotted space – that it’s reasonable to wonder how many customers have actually been able to read it. **I believe it would be difficult to overestimate the significance of this, particularly considering Iowa’s elderly population (as compared with other states).**
2. I have yet to see a lotto ticket where the back side starts with the line, “Tickets are heat sensitive,” as in the above example. Instead, every ticket I have come across starts somewhere in the middle of the message, increasing the challenge for anyone trying to read and understand the entire message. (I even have one lotto ticket, purchased in July 2007, which is missing the line, “Players are responsible for determining whether a ticket is a winner” – which was an important part of our 1998 agreement with Dr. Stanek.)
3. The statement, “Players are responsible for determining whether a ticket is a winner” is not specific enough to deter customers from relying on the terminal to see if a ticket is a winner – a practice that Dr. Stanek objected to in the 1990s.

By contrast, the Kansas lottery's website encourages customers to check their tickets for winners "*prior to presenting their tickets to a retail location for validation.*" That language is more specific and is therefore preferable.¹⁶

4. It's unclear why the instant-ticket information doesn't include the advisory, "Sign ticket before claiming." Instant tickets have a signature line, and therefore would appear to fall under the "bearer instrument" standard. The Canadian investigations indicated that instant-ticket customers are just as susceptible to potential retailer fraud as lotto-ticket customers.
5. Both messages include the warning, "All risks of redeeming the ticket remain with the player." The Ontario report found similar language and declared, "There is something deeply distressing when a public agent such as the OLG begins to use a 'buyer beware' policy against the very people whose interests it was created to protect."

It's unclear where this warning originated, as such language is not in the statute or the administrative rules. It appears that this warning was added to Iowa tickets between 1995 and 1997 (based on tickets in the file from those years). It has since been added to the website, in a section titled "Claiming Prizes."

Information on Iowa Lottery website

The available information indicates the Iowa Lottery website had little or no information on these issues prior to early 2000.

Then, from approximately April 2000 to approximately October 2003, the website included this statement (which was a summary of some of the information on the backs of tickets):

All tickets, transactions and winners are subject to Iowa Lottery rules and state law which are available at Iowa Lottery offices. Tickets are void if they fail to meet requirements of game rules or are irregular in any manner. Liability for a void ticket is limited to replacement of the ticket or refund of the sales price. If you believe you have won and the terminal rejects or a retailer disputes the validity of your prize claim, submit your claim directly to:

Iowa Lottery
PO Box 10474
Des Moines, IA 50306-9996

All risks of redeeming the ticket remain with the player.

From late October 2003 to the present, the website has had this statement (a slightly revised summary of some of the information on the backs of tickets):

Players are responsible for checking the accuracy of their ticket before leaving the store and for determining if the ticket is a winner. If you believe you have won and the terminal rejects or the retailer disputes the validity of your prize claim, you may submit your claim directly to

¹⁶ The Kansas lottery was subjected to intense scrutiny after the 2002 incident where a store clerk was charged with stealing a customer's winning ticket worth more than a quarter of a million dollars.

the Iowa Lottery for review. All risks of redeeming the ticket remain with the player.

In January 2007, shortly after the Canadian reports of potential retailer fraud were widely publicized, the Iowa Lottery added a new section to its website, entitled "Player Security." Under the heading "Player Security Reminders," it includes the following advisory (I have bolded those portions that appear to be new, i.e., were not previously found on the website or on the backs of tickets):

Security Tips at the Retail Level

The Iowa Lottery is committed to ensuring that all aspects of our games are conducted in a secure manner with fairness and integrity. Listed below are some suggestions to keep our games fun and safe.

- If you select your own numbers or use a play slip, always check your tickets at the time of purchase to make sure the numbers on them match the numbers you selected.
- **The Iowa Lottery has customer display units along with its sales and validations terminals in retail locations that sell lotto tickets. The customer display unit shows the results of a particular transaction, and players can see the information on the screen.** If you disagree with a retailer about a particular ticket when you are trying to have it validated, you can always ask for the ticket back and send it to the Iowa Lottery, where we will check it. In fact, Iowa Lottery customers at any time are welcome to send their tickets directly to the lottery, where lottery staffers can validate them.
- **If you purchase a scratch-off ticket, check it and make sure the latex has not been previously scratched anywhere on the ticket. If the ticket appears to have been tampered with, contact Lottery Security immediately.**
- **If you purchase a pull-tab ticket, check it to make sure the perforations along the paper tabs have not been broken. If the ticket appears to have been tampered with, contact Lottery Security immediately.**
- **It is illegal for Iowa Lottery retailers to charge a commission or fee for cashing a winning ticket. If this occurs, contact Lottery Security immediately.**
- **Only buy lottery tickets from authorized Iowa Lottery retailers. If you are approached by someone offering a "winning ticket" for cash, refuse the offer and contact Lottery Security immediately.**
- Always sign the back of your ticket. **This can help prevent someone from trying to cash it, in the event it becomes lost or stolen. If your ticket is lost or stolen, report the matter to Lottery Security and your local police or sheriff's office.**

These tips are overall pretty good, and certainly an improvement from what had been on the website previously. Unfortunately, when this information was put on the website in January 2007, it appears that little was done to highlight or draw attention to it:

- The “Player Security” link is one of more than 30 links on the main page.
- An archive of the website indicates nothing was put on the main page in January 2007 to highlight or draw attention to the new section.
- The newsletter targeted to retailers had an article on the new information. But the article did not mention the new security tips for customers playing Lottery games. Instead, the article stated that “these pages deal with Internet/e-mail security issues as well as information received through regular mail and by phone.”
- The quarterly newsletter targeted to “VIP” customers doesn’t appear to have ever made any mention of this new information. **It is unclear why this information was noted in the newsletter to retailers but not in the newsletter for customers.**
- The Iowa Lottery doesn’t appear to have issued any press releases drawing attention to the information at the “Player Security” link

For these reasons, it’s questionable whether many Lottery customers have even seen these new security tips.

Further, until this information was posted in January 2007, the Iowa Lottery’s website had less information about how to play the games than was on the backs of tickets. For example, it appears that the important statement “Always sign the back of your ticket” did not even appear on the website until January 2007. By contrast, the warning “All risks of redeeming the ticket remain with the player” first appeared on the website in 2000. **The “buyer beware” warning appeared on the website seven years before the “sign your ticket” tip.**

Telephone number for customers

On its website, Ontario’s lottery website has a section called “Managing Consumer Complaints.” It lists a toll-free telephone number for the “Customer Care Centre,” which is open 24 hours a day, 7 days a week.

By contrast, the Iowa Lottery does not have a toll-free phone number for customers. But it does have a toll-free number for retailers, and emphasizes this fact with the following statement on the web page devoted to retailers:

800 number is for retailers only

The Iowa Lottery’s 800 number is for retailer use only. It should not be given out to the public because the extra volume of calls can prevent us from responding as quickly to retail issues.

OVERALL RESPONSE TO YOUR REQUEST

Based on my review of the currently available information, I see several potential concerns regarding the Iowa Lottery's performance in protecting customers from potential risks.

Just as an example, the Iowa Lottery website includes a disclaimer, warning that it cannot guarantee the "the accuracy, completeness or usefulness of information" therein. Warning customers about the website, but failing to warn them about other risks, is a significant inconsistency.

More information is needed before conclusions can be properly reached. But I am particularly concerned about the combination of three apparent factors:

1. "Bearer instrument" standard for tickets – perhaps better described as "finders keepers, losers weepers."
2. The apparent absence of an "insider win" policy.
3. Customer education efforts that appear to be generally lacking. This includes game tips on the backs of tickets that are next to impossible to read and conclude with a "buyer beware" warning. There is reason to be concerned about how many Iowa Lottery customers are even aware that they should always sign their tickets before handing them to a clerk, and that they should not be relying on a store clerk to determine if a ticket is a winner.

The years-long combination of these factors could be the perfect recipe for potential retailer fraud. A typical customer is largely on his or her own – and may not even know that.

A thieving store clerk seems to have practically every advantage – especially a steady supply of customers who don't know how to protect themselves because the Iowa Lottery has not properly educated them.

The British Columbia report includes a relevant passage. After noting that it might be easier for a store clerk to obtain prizes that aren't reported to the lottery, it states:

The only effective payout protection for those prizes was a player's own knowledge, powers of observation, persistence and assertiveness and the inherent honesty of the individual BCLC [*British Columbia Lottery Corporation*] retailer or BCLC retailer employee validating the ticket.

BCLC only became involved in those prize payout procedures if a customer complained. BCLC put the onus on the player to protect him or herself. **A fatal flaw, however, was if the player did not know or observe enough to conclude he or she had been taken advantage of then he or she would not complain at all.** [emphasis added]

I am concerned that those comments may accurately describe the situation for all levels of prizes here in Iowa.

Consumer education

Secrecy prevents people from accurately assessing their own risk.
-- Bruce Schneier, internationally renowned security technologist and author

The cornerstone of the lottery business is honesty.
... State lotteries are public, not secret enterprises.
-- Dr. Ed Stanek, "A Critique of Lottery Critics"

We should consider whether the time has finally come for the Iowa Lottery to disclose these potential risks to customers, and how to avoid them.

It comes down to this: Why **not** tell customers about these risks – particularly if the Lottery's goal is to take every reasonable step to ensure that winnings go to the rightful customer? How does not telling them reconcile with the mandate to maintain integrity?

Consider these Canadian examples:

- British Columbia's lottery has now implemented a "Player First" program, described as "a program of major initiatives that put the interests of our players at the forefront of everything we do.... Player First will set new standards in North America for player service and protection."
- Ontario's lottery has implemented a "Lottery Prize Integrity" program. Under the heading of "Consumer Protection: Play Safely and Securely," its website says, "OLG takes a proactive approach to earning your trust" and down further has a link, "Follow OLG's tips for Playing Safely and Securely."

Consumer protection: Safeguards

Meaningful safeguards may be more important than educating customers, according to the British Columbia report:

While we agree that it is important for players to understand the actions that they can take to protect themselves, the onus is on BCLC, not on the player to ensure that the processes put in place by BCLC are fair and work for everyone.

Here are a few of the safeguards being used by the Canadian lotteries:

1. "Insider win" policy: Both of the Canadian lotteries have policies and procedures – which predated the ombudsmen investigations – designed to prevent "insiders" from manipulating the process to their own advantage.

The British Columbia ombudsman found that if the lottery is not tracking retailer winners – particularly those who submit multiple claims – and subjecting them to an appropriate level of scrutiny, then the lottery cannot confidently rule out fraud and/or theft.

2. Retailers prohibited from accepting unsigned tickets from customers, under threat of penalty.

3. Installing self-check machines at every lottery retail outlet to allow people to check their own tickets, which would tell them if they have won and the amount of their prize. (This appears to contradict Dr. Stanek's previously stated opposition to the practice of customers relying on terminals for this purpose.)
4. Enhancing the complaints and investigations process.

In perhaps the ultimate way of safeguarding customers, the Ontario government has accepted the ombudsman's recommendation to remove oversight functions from the provincial lottery, and to instead establish independent oversight of the lottery system.

On this point, the Ontario ombudsman's report stated:

The OLG had become fixated on profit rather than public service. It had come to define itself by its role as a cash cow....

My investigation has shown that the OLG is hopelessly conflicted – it cannot be expected both to increase lottery profits by working with retailers, while at the same time acting as the sole body responsible for regulation and policy enforcement to keep retailers honest....

As this report demonstrates, the lottery enterprise is too fraught with the risk of exploitation and is **too dependent on public trust to be treated as purely a business enterprise.** [emphasis added]

Whether that final assertion has relevance for the Iowa Lottery – which moved to a “business enterprise” paradigm, by statute, several years ago – is something we may want to consider as we pursue the investigation.