Economic Impact Analysis
Virginia Department of Planning and Budget

11 VAC 5-31 – Licensing Regulation
State Lottery Department
March 6, 2012

Summary of the Proposed Amendments to Regulation

The State Lottery Department (the department) proposes amendments to: 1) establish a new "special retailer" license, 2) allow the department to change initial and annual renewal license fees up to certain limits, 3) authorize the department to set retailer compensation at lower rates, 4) remove the limits of what the department may require in terms of retailer bonding amounts, and 5) allow retailers to offer cash in lieu of traditional bonding instruments.

Result of Analysis

The benefits likely exceed the costs for establishing a new "special retailer" license and allowing retailers to offer cash in lieu of traditional bonding instruments. Allowing the department to change initial and annual renewal license fees up to certain limits, authorizing the department to set retailer compensation at lower rates, and removing the ceiling on required retailer bonding amounts may create unintended costs due to added uncertainty. However, the proposed change for retailer compensation may also allow the department to compensate retailers commensurate with their performance. A different design would likely yield the same benefits at lower cost for these three proposed changes.

Estimated Economic Impact

The proposed regulation would establish a new "special retailer" license for retailers doing business on a seasonal or temporary basis such as those catering to specific sporting, charitable, or social events. Currently, there is one type of retailer license which is typically issued to permanent stores providing a full range of services, e.g. offering online and scratch games and redeeming winning tickets up to a certain amount. The department expects approximately 50 retailers to be licensed as special retailers. These retailers are expected to sell mainly scratch games. The average annual scratch ticket sales per retailer in 2011 was $147,981 resulting in $7,399 in sales commissions. If the 50 expected special retailer licensees experience daily volume of business similar to their full time counterparts and operate about a month on average, in a given year, approximately $608,141 in total sales and $30,406 in total commissions could be expected to all of the 50 retailers combined.[1] However, any of these assumptions could greatly vary in reality.

One of the proposed changes will allow the department to increase the initial license fee from $50 to "up to $100" and the annual renewal fee from $35 to "up to $70." Based on the number of initial and renewal applications in Fiscal Year 2011, approximately $37,740 in additional revenues from initial applicants and $177,625 from renewal applicants are expected per year if the department charges the maximum amount allowed under the proposed changes.[2] The department's administrative processing costs are estimated to be $209,909 and $419,113 for initial and renewal applications, respectively.[3] Thus, the additional fees will increase the percentage of actual costs paid by applicants from 16% to 32% for initial applications and 42% to 84% for renewal applications. This change would add to the fee revenue collected by the department while increasing the fees paid by the retailers. In addition, the department would have the flexibility to change fees in the future to any amount between $0 and $100 for initial applications and between $0 and $70 for renewal applications. The flexibility to set fees within a range may be beneficial to the department, however, it adds the element of uncertainty regarding compliance costs for retailers.

Another proposed change would change retailer compensation. Currently, retailer compensation rates are set at the fixed amounts of "5% of net sales" and "1% of cash value of prizes" paid. Under this regulatory proposal, retailer compensation would be set at "*up to* 5 %" of net sales and "*up to* 1 %" of cash value of prizes paid (emphasis added). In 2011, the department paid approximately $81.7 million in sales commissions and $7.4 million in cash prize commissions to retailers (approximately $15,749 and $1,436 per retailer, respectively).

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[1] ($147,981/365)*30*50= $608,141; ($7,399/365)*30*50= $30,406.

[2] 755 initial applications at $50 each and 5,075 renewal applications at $35 each.

[3] Initial application processing costs are based on 755 applications per year, 7 hours of staff time at $40 per hour, 755 credit reports at $10.84 per application, and 755 background checks at $15 per application. Renewal application processing costs are based on 5,075 applications per year, 2 hours of staff time at $40 per hour, 507 credit reports at $10.84 per application, and 507 background checks at $15 per application.

According to the department, flexibility is needed in order to pay lower commissions to the new "special retailer" licensees who are not expected to offer the full range of lottery services on a full time basis like regular retailers. For example, the department may offer a special retailer 2.5 % of net sales and 0.5 % of cash value of prizes paid as compensation.

With the proposed change, the department would have the authority to change the compensation rate for regular retailers and special retailers from anywhere between 0% to 5% of net sales and anywhere between 0% and 1% of the cash value of prizes paid at anytime. This change would afford flexibility to the department and allow the department to compensate stores commensurate with their performances. A compensation structure based on performance would help improve overall retailer performance. However, it also adds some uncertainty for retailers who may prefer to have a fixed amount of compensation for special retailers and a fixed amount of compensation for regular retailers.

Another proposed change in this regulatory proposal is to remove the maximum limit for how much bonding the department can require a retailer to have. Current regulations set the maximum amount of bonding for retailers who sell instant games at $50,000 and online games at $100,000. However, the department indicates that retailers sell both instant and online games simultaneously. Actual amounts of bonds currently required vary from $20,000 to $100,000 based on the retailer's sales volume and department's potential exposure. According to the department, most retailers are required to post about $20,000 in bonds at an estimated cost of approximately $66 - $68 with good credit. The total amount of surety provided by all retailers is approximately $107 million.

The department proposes to remove the maximum limits on bonding because it anticipates that at some time in the future, a retailer will outperform current top performers and the department will want to raise the bonding limit to an amount greater than what is set now. This change, however, has the potential to introduce additional costs on retailers in terms of costs associated with required bonding beyond current limits. The amount of the compliance costs would depend on the specific actions of the department and is not known at this time. This change may create some uncertainty about the future compliance costs that a retailer would face and discourage some retailers because the department would be able to require any retailer to post surety greater than current limits at any time. This uncertainty may be eliminated or reduced by keeping in the regulation some sort of limit on the maximum amount of bonding that could be required.

The proposed changes would also allow retailers to offer cash in lieu of currently required traditional bonding instruments. As mentioned before most retailers with good credit pay approximately $66 - $68 for $20,000 in surety bonds. According to the department, in the last several years it has become increasingly difficult for retailers to obtain bonding through traditional instruments. This change would provide an alternative to current bonding requirements. Retailers who stand to gain from this option are expected to utilize it while having no adverse affect on the department's exposure to risk.

The remaining proposed changes to this regulation represent clarifications and reorganization of current requirements and deletion of obsolete forms and are not expected to create any significant economic effects.

Businesses and Entities Affected

Currently, this regulation applies to 5,191 licensed retailers.

Localities Particularly Affected

The proposed regulation applies throughout the Commonwealth.

Projected Impact on Employment

Approximately 50 special retailers are expected to be licensed. Ticket sales by these retailers would represent new business activity and are expected to have a direct positive impact on employment.

On the other hand, the potential for increasing license fees, lowering compensation of current retailers, and increasing bonding amounts can add to the compliance costs and/or uncertainty depending upon their implementation. Increased compliance costs and uncertainty may have a negative impact on business activity and employment which could potentially offset the positive impact of establishing the new "special retailer" license.

Effects on the Use and Value of Private Property

The proposed changes are not expected to have a direct impact on the use and value of private property. However, the proposed new license class is expected to generate some asset value in terms- of new retailers joining lottery. However, the asset value of existing retailers may be reduced due to additional compliance costs and/or uncertainty stemming from increasing license fees, lowering compensation of current retailers, and increasing bonding depending on their implementation.

Small Businesses: Costs and Other Effects

Nearly all of the 5,191 licensed retailers are believed to be small businesses. Therefore, all of the costs and other economics effects discussed above apply to small businesses.

Small Businesses: Alternative Method that Minimizes Adverse Impact

The additional compliance costs on retailers will increase if and when the department increases license fees, lowers compensation for existing retailers, and increases bonding amounts. To minimize the impact, these increases should be kept as low as possible.

Beyond the actual amounts of fees, compensation, and bonding chosen to be implemented, the proposed changes provide authority to the department to reduce retailer compensation and increase bonding requirements by unspecified amounts. These two changes may create uncertainty for retailers. This uncertainty may be eliminated or reduced by adopting regulatory language that includes maximum amounts with respect to bonding requirements and specifying special retailer compensation separately from the compensation rate that will be awarded to regular retailers.

Real Estate Development Costs

No significant effects on real estate development costs are expected.

Legal Mandate

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.H of the Administrative Process Act and Executive Order Number 14 (10). Section 2.2-4007.H requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. Further, if the proposed regulation has adverse effect on small businesses, Section 2.2-4007.H requires that such economic impact analyses include (i) an identification and estimate of the number of small businesses subject to the regulation; (ii) the projected reporting, recordkeeping, and other administrative costs required for small businesses to comply with the regulation, including the type of professional skills necessary for preparing required reports and other documents; (iii) a statement of the probable effect of the regulation on affected small businesses; and (iv) a description of any less intrusive or less costly alternative methods of achieving the purpose of the regulation. The analysis presented above represents DPB's best estimate of these economic impacts.