

July 8, 1999

Dale L. McDonnell, Legal Counsel
Minnesota State Lottery
2645 Long Lake Road
Roseville, Minnesota 55113

RE: Review of Adopted Permanent Rules of the Minnesota State
Lottery for Rules Relating to Lottery Prize Payments, Minn. R. Ch.
7857.
OAH Docket No. 11-4000-12175-1.

Dear Mr. McDonnell:

This is to inform you that the above-referenced rule has been approved as to legality on July 8, 1999. The approval for legality includes a finding of harmless error for two procedural errors. The Minnesota State Lottery's SONAR is dated on the same day as the agency's Notice of Intent to Adopt Rules, Dual Notice. Pursuant to Minn. R. 1400.2070, subp. 3, the SONAR must be prepared before the agency orders publication of its dual notice. In this case, the agency repealed Minn. R. 7857.6010. This rule part, however, was not cited in the agency's Notice of Intent to Adopt Rules, Dual Notice, as required by Minn. R. 1400.2080, subp. 2, item D. The administrative law judge has determined that the above omissions did not deprive any person or entity of an opportunity to participate meaningfully in the rulemaking process and this constitutes harmless error under Minn. Stat. § 14.26 (3)(d)(1).

In addition, the agency's Dual Notice did not specifically state that the public has 30 days to comment on the rule as required by Minn. R. 1400.2080, subp. 3, item A. The ALJ finds that this omission does not rise to the level of a harmless error because the recommended dual notice form, contained in Minn. R. 1400.2540, does not include this specific language. It is recommended, however, that the agency include the language in Minn. R. 1400.2080, subp. 3, item A in future rulemaking notices.

The agency received one comment with regard to the proposed rules. The comment was submitted by the National Association of Lottery Purchasers (NALP), a trade association whose members are specialty finance companies that purchase cash flow streams resulting from lottery prizes that are being paid by state lotteries over a period of years. NALP objects to the proposed rules and

argues that they: are beyond the statutory authority of the agency; will expose the Minnesota lottery to significant liability and financial risks; lack consumer protection measures and precision in its wording, inviting legal action; and will be costly to Minnesota taxpayers due to lost tax

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revenue in future years. In addition, NALP argues that the possibility of future changes to the new federal tax accounting rule supports deferring approval of these rules. NALP's arguments are set forth below, along with the agency's response and the ALJ's findings. Because the commenter raised specific legal arguments, they are addressed in this approval letter.

Statutory authority

NALP contends that the agency lacks the statutory authority to adopt these rules. NALP argues that Minnesota law does not permit voluntary assignment of lottery prize absent a court order. It states that "[t]he Rule proposal does not require a court order before a winner will, in effect, assign his or her rights to the State in return for a lump-sum payment."

In its Order Adopting Rules, the agency addressed the issue of statutory authority. It contends that the proposed rules do not affect an assignment of a lottery prize. An assignment involves a transfer of future payments to another, and the proposed rules do not involve such a transfer. The ALJ is persuaded by the agency's argument. An assignment is defined as "[t]he act of transferring to another all or part of one's property, interest, or rights."¹ The proposed rules do not contemplate transferring to another all or part of a winner's property. Consequently, no court order is required in order for the lottery to offer a winner the option to receive a lump-sum payment.

The NALP argues that the agency lacks statutory authority to adopt the rules because Minn. Stat. § 349A.05 does not specifically grant the lottery authority to offer lump sum payments to past winners. It cites Minn. R. 7857.6000 which states, in part, that "[t]he payment of a prize may not be accelerated before the normal date of tender or payment . . . for any reason." That rule applies only to prizes payable after death of the winner, however. The ALJ is not convinced by NALP's argument because general authority does exist.

Minn. Stat. § 349A.05 allows the lottery director to adopt rules governing "payment of [lottery] prizes"² and "other rules the director considers necessary for the efficient operation and administration of the lottery."³ The proposed rules

¹ Black's Law Dictionary 119 (6th ed. 1990)

² Minn. Stat. § 349A.05 (8).

³ Minn. Stat. § 349A.05 (10).

affect payment of lottery prizes because they allow the lottery to offer lump sum payments of lottery prizes to winners. The agency, therefore, has the statutory authority to adopt the proposed rules.

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The NALP also contends that the agency does not have the authority to alter the terms of an existing contract between previous lottery winners and the State of Minnesota. It argues that the proposed rules would have retroactive effect. Since Minnesota law makes a presumption against retroactive effect, the rules could be held invalid.

In its Order, the agency argues that the proposed rules do not alter the existing contract between lottery winners and the State; rather, the rules require the agency to offer a winner the option to amend the contract. If a winner ignores the offer to amend, the existing contract remains in force. If a winner accepts the offer to amend, s/he will receive one cash payment based on the present value of the future payments. The agency also argues that the proposed rules do not have retroactive effect because they do not effect the obligations of either party from the date the prize was won until the option is accepted under the rules. For the reasons stated by the agency, the ALJ agrees that the proposed rules do not alter the existing contract between a lottery winner and the State. Because the proposed rules do not alter an existing contract, they do not have retroactive effect.

Exposure to significant liability and financial risks

The NALP argues that the lottery may face substantial financial exposure if the proposed rules are approved and adopted. It contends that if the lottery attempts to change the contract terms regarding prize obligations in a way that is directly contrary to the lottery's rules, the lottery could face the same situation that the Kentucky lottery faced in two court cases: Kentucky Lottery Corp. v. Casey, 862 S.W.2d 888 (Ky. 1993), and Brown v. Kentucky Lottery Corp., 891 S.W.2d 90 (Ky. Ct. App. 1995). The ALJ, however, finds that these cases are differentiated from the situation presented by the proposed rules.

In Casey, the prize winner brought suit against the Kentucky lottery contesting the method of payment used, which reduced his \$666,666 prize share down to present value. The Supreme Court of Kentucky ruled in favor of the prize winner, holding that the Kentucky regulation used by the commissioner to reduce the prize amount to present value failed to expressly provide for this

reduction.⁴ As a result, the Kentucky Lottery had to pay the prize winner a single cash payment in the amount of the full value of the winner's winning ticket. In the present case, however, the Minnesota Lottery has avoided the issue in Casey because the proposed rules expressly provide for the reduction of the prize amount to present value.

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The same Kentucky regulation at issue in Casey is at issue in Brown. In Brown, the prize winner brought suit against the Kentucky Lottery contesting the method of payment used, which reduced her \$500,000 prize share down to present value. The Lottery Corporation tried to distinguish the facts in Casey by arguing that the prize winner, Ms. Brown, signed two forms stating that the Kentucky Lottery was released from future liability upon payment of the prize. The Supreme Court of Kentucky ruled in favor of Ms. Brown, holding that it found no difference between the releases signed by Ms. Brown and the fact that, in Casey, the prize winner cashed the prize check made out for the reduced amount.⁵ For the same reasons Casey is distinguishable, the Brown decision is also distinguishable from the situation presented by the proposed rules. The ALJ finds that the language in the proposed rules avoids the issues faced in the two Kentucky cases.

The NALP argues that the proposed rules will expose the lottery to significant financial risks because of volatile interest rates. Volatile interest rates will cause the present value of the future payments to rise and fall. As a result, it is difficult to calculate the value or worth of the stream of future payments. By using different interest rates, the NALP presents several examples illustrating fluctuations in calculations of the present value of future payments. It argues that, due to the calculation fluctuations, if a lottery winner inquires about the worth of his/her prize and the lottery quotes a dollar amount, the lottery could face significant financial risk. The ALJ is not persuaded by the NALP's arguments.

The NALP bases its argument on the assumption that the agency will quote, and thereby promise, a certain dollar amount to an inquiring prize winner. The agency indicated that the present value of a lottery prize will be determined by the market on the cash-out date (i.e., it will be determined by what the market can bear). This will assure that the State will not be exposed to financial risk. The agency also indicated that the Internal Revenue Code requires that the

⁴ Kentucky Lottery Corp. v. Casey, 862 S.W.2d 888, 889 (Ky. 1993) (noting that "[l]ottery regulations in other states have not neglected to expressly provide for reduction to present value or provide a formula by which such reduction must be computed.").

⁵ Brown v. Kentucky Lottery Corp., 891 S.W.2d 90, 92 (Ky. 1995).

methodology used to determine the present value of the prize be explained to the winner at the time the offer is made. The record therefore indicates that the rule is reasonable.

Consumer protection standards

The NALP argues that the proposed rules lack consumer protection standards because they do not require a court order “to approve the assignment to the Lottery of the winner’s right in return for a lump sum payment.” As stated above, the ALJ finds that the proposed rules do not affect or involve an assignment of a lottery prize. Consequently, no court order is required.

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Wording of proposed rules

The NALP contends that the proposed rules do not provide protection to the State from claims by secured creditors, spouses, minor children of winners, and others who may assert a right in a lottery prize. Also, the NALP argues that the proposed rules are not consistent with IRS code section 451 (h) because the rules allow a winner to “elect” a lump sum payment instead of stating it as an “option.” Again, the ALJ is not convinced by the NALP’s arguments.

Minnesota Rules chapter 7857 and Minnesota statutes provide safeguards or protection from claims made by individuals asserting a right to a lottery prize. In particular, other rule parts in chapter 7857 sufficiently address to whom lottery prizes may be paid, and how and to whom payments are made if a prize winner dies. Additionally, the ALJ concludes that the nominal difference between the definitions of “elect” and “option” do not make the proposed rules illegal for vagueness or other reasons.

Cost to Minnesota taxpayers

The NALP argues that a lump sum payment would reduce tax revenue to the State in future years. The agency addresses this issue in its SONAR. It states that if previous winners elect to receive a lump sum payment in lieu of future payments, state revenue will be slightly reduced in future years. If previous winners make this election, however, state revenue in 2000 – 2001 will increase. The agency provides that the State may realize up to \$4 million in additional revenue in the next biennium. Consequently, while the proposed rules may reduce state revenue in future years, this will not occur without the State realizing an increase in its revenue in the near future. The rules are reasonable in this respect.

Possibility of future change to the new federal tax accounting rule

The NALP states that, currently, "there are reports that Congress is again looking at the lottery tax accounting rules." It submits that action on the proposed rules should be deferred due to the possibility that future changes might be made to the federal tax accounting rules. The ALJ declines to disapprove the proposed rules because there is a possibility that Congress may make changes to the lottery tax accounting rules sometime in the future. If changes are made to the federal tax accounting rules that affect the proposed rules, the Minnesota State Lottery may be required to, or may elect to, modify the proposed rules at that time.

With the approval of the adoption of the rule, our office has closed this file and is returning the rule record to you so that your agency can maintain the official rulemaking record in this matter as required by Minn. Stat. § 14.365. Our office will file two copies of the adopted rule with the Secretary of State, who will forward one copy to the Revisor

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of Statutes. You will then receive from the Revisor's Office three copies of the Notice of Adoption of your rule.

Your next step is to arrange for publication of the Notice of Adoption in the State Register. You should submit two copies of the Notice of Adoption that you received from the Revisor's Office to the State Register for publication. A permanent rule without a hearing does not become effective until five working days after a Notice of Adoption is published in the State Register in accordance with Minn. Stat. § 14.27.

If you have any questions regarding this matter, please contact Catherine Anderson at 612/341-7666.

Sincerely,

GEORGE A. BECK
Administrative Law Judge
612/341-7604

Enclosures

cc: Office of the Attorney General
Legislative Coordinating Commission
Revisor of Statutes