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## A review of the South Carolina Education Lottery and its oversight of retailers and players : summary

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## SUMMARY



# A Review of the South Carolina Education Lottery and Its Oversight of Retailers and Players

### FREQUENT REDEMPTION OF WINNING LOTTERY TICKETS

#### BACKGROUND

The South Carolina Education Lottery (SCEL) is a state government enterprise created to generate additional revenue for education.

SCEL sells lottery tickets through a statewide network of retailers.

In June 2018, we published a report on the appropriation and use of lottery revenues. From the inception of the lottery in FY 01-02, through FY 17-18, \$5 billion in net lottery proceeds have been appropriated by the General Assembly, primarily to higher education and K-12 programs.

In FY 17-18, total lottery revenues were \$1.754 billion, yielding \$438 million in net income.

In conjunction with our 2018 review, we conducted a management performance review of SCEL's operations, whose results are presented here. We conducted this review in accordance with generally accepted government auditing standards.

Frequent redemption of winning lottery tickets with prizes greater than \$500 is highly improbable and may be an indication that claimants purchased the tickets through transactions not authorized by state law. Tickets with prizes greater than \$500 represent just 0.03% of all winning tickets. We identified 18 individuals who claimed 50 or more prizes greater than \$500 from November 2008 – November 2017, 10 of whom are listed below. Although SCEL had previously identified these individuals, it had not formally calculated the improbability of their prize claiming patterns.

With computer code from Professor Philip Stark, a statistician at the University of California, Berkeley, we calculated the minimum that each of South Carolina's five million residents would have had to spend on lottery tickets over nine years for any of them to have a 1-in-10 million chance of winning as often as the frequent claimants in our analysis. This analysis, which SCEL does not conduct, was based on conservative assumptions, producing results that are understated. It is important to note that the improbability of frequent claiming patterns is not necessarily an indication of wrongdoing by retailers or players but could be used as a basis for and a component of further and more effective investigation and for administrative actions.

#### LAC ANALYSIS OF THE TEN MOST FREQUENT LARGE PRIZE CLAIMANTS NOVEMBER 2008 – NOVEMBER 2017

CITY OF RESIDENCE OF THE CLAIMANT	TICKETS REDEEMED	TOTAL PRIZE AMOUNT	NUMBER OF INDEPENDENT TICKETS ANALYZED*	CONSERVATIVE ESTIMATES OF THE MINIMUM EVERY RESIDENT OF S.C. WOULD NEED TO SPEND FOR A 1-IN-10 MILLION CHANCE THAT ANY OF THEM WOULD WIN AS FREQUENTLY AS THE CLAIMANT **
Simpsonville	61	\$85,765	53	\$2,060,205
Lamar	118	\$217,540	111	\$1,019,728
Charleston-B	122	\$205,014	102	\$797,158
Lake City	62	\$71,994	54	\$389,787
Charleston-A	125	\$289,045	77	\$317,275
Charleston-C	59	\$83,594	45	\$224,585
Georgetown	80	\$202,273	46	\$171,228
Sumter	92	\$129,040	71	\$127,062
Kingstree	51	\$63,410	35	\$124,353
Hanahan	53	\$130,015	36	\$120,608

Retailers active during or prior to December 2017 are highlighted in green.

\* To account for data limitations on draw game tickets, we made conservative assumptions that resulted in conservative calculations of the minimum spend amount. As a result, the number of winning tickets we analyzed was less than the number of winning tickets redeemed.

\*\* Based on a U.S. Census Bureau estimate that S.C. had 5,024,369 residents as of July 1, 2017.

JUNE 2019

## RESALE MARKET FOR WINNING TICKETS

Individuals who frequently redeem winning lottery tickets for prizes greater than \$500 may not be buying their tickets from SCEL but in resale transactions from individuals seeking to avoid redeeming their winning tickets at the SCEL claims center in Columbia.

### BUYERS OF WINNING TICKETS

The buyers in resale transactions may pay discounted prices in relation to the prize amounts, seeking net profits when they redeem the tickets with SCEL. In some instances, the buyers may be seeking to launder money earned from criminal activity.

### SELLERS OF WINNING TICKETS

From the perspective of the sellers, the incentive to engage in resale transactions may be to avoid having their prize winnings reported to the South Carolina and federal governments because of past due debts.

When prizes are less than \$5,000, players may resell their tickets to avoid having their winnings reported to state and federal tax agencies. The threshold for reporting to the South Carolina Department of Revenue is \$500, while the threshold for reporting to the federal Internal Revenue Service is \$600.

When prizes are \$5,000 and greater, players may resell their winning tickets to avoid having their winnings withheld by SCEL to settle debts, such as past due taxes, student loans, child support, or other court-ordered payments.

A SCEL official stated that some resale transactions may occur to accommodate individuals who are unable to travel to Columbia to collect their prize winnings. Columbia is the only location at which a ticket with a prize greater than \$500 may be redeemed. It is important to note, however, that tickets with prizes up to \$100,000 may be redeemed by mail without traveling to Columbia.

## SCEL'S ENFORCEMENT OF PROHIBITIONS AGAINST THE RESALE OF WINNING LOTTERY TICKETS

Because SCEL does not interpret state law as prohibiting the resale of winning lottery tickets (see next page), it does not attempt to discourage or otherwise prevent the practice by *regular players*.

Separate from the law, SCEL requires that *retailers* sign a contract that prohibits them from purchasing winning tickets from customers for less than the prize amounts.

### SCEL'S OVERSIGHT OF LOTTERY RETAILERS

We found:

- No policy of vetting all lottery prize claims made by retailers and their employees, who are better positioned to engage in misconduct than regular players.
- No continual undercover checks of retailer compliance with the prohibition on purchasing winning tickets from customers for less than the prize amounts.
- No probability analysis to quantify the chances that frequent prize claiming patterns of individuals were based on tickets purchased for the face value of the tickets from licensed retailers acting on behalf of the South Carolina Lottery Commission.

## RESALE OF WINNING TICKETS MAY BE ILLEGAL

It is our interpretation of state law that the resale of winning lottery tickets may be illegal. SCEL, however, states that it “has never interpreted” the law to prohibit the resale of winning tickets.

### STATE LAW

State law requires that lottery tickets be sold only at prices approved by the South Carolina Lottery Commission through licensed retailers acting on behalf of the Commission at licensed retail locations.

The 2000 Lottery Act defines a lottery ticket as:

...tangible evidence issued by the South Carolina Lottery Commission to provide participation in a lottery game.

The resale process is characterized by lottery tickets being sold for prices lower than the prize amount, as noted above, and for significantly higher than face value. Resale transactions also include sellers who may not be licensed lottery retailers and who are not acting on behalf of the lottery.

In addition, state law prohibits the evasion of unpaid student loans, taxes, child support, and other court-ordered payments.

### SCEL’S INTERPRETATION AND LAC RESPONSE

SCEL’s interpretation of state law is that the resale of winning lottery tickets is legal.

#### PRIZE, TICKET, OR BEARER INSTRUMENT

The agency has stated that what appears to be the resale of a winning ticket is not the resale of a ticket but, rather, the sale of the prize associated with the ticket or the sale of a bearer instrument, which may be redeemed by the holder of the instrument.

It is our interpretation that a winning ticket is not a prize under state law, but allows the holder to obtain a prize. We agree that a winning lottery ticket is a bearer instrument under state law but believe it is also a ticket as defined by state law.

#### GAME OF CHANCE

SCEL also cites a 1939 South Carolina Supreme Court ruling that defines a lottery as a game of chance, among other characteristics.

SCEL contends that, because the resale of a *winning* ticket does not contain an element of chance, it is not a lottery ticket under state law.

It is our interpretation that the purchase of a winning lottery ticket allows the purchaser to participate in the redemption portion of a game of chance and that the ticket remains a lottery ticket as defined by state law.

#### ROLE OF SCEL IN INTERPRETING STATE LAW

SCEL also states that the LAC “cannot substitute its interpretation of the Lottery Act or regulations for that of SCEL.” The agency refers to:

...South Carolina’s deference doctrine, [under which] courts defer to an administrative agency’s interpretations with respect to the statutes entrusted to its administration or its own regulations ‘unless there is a compelling reason to differ.’

However, 2014 S.C. Supreme Court case, *Kiawah Development Partners, II v. S.C. Department of Health and Environmental Control* states that:

Interpreting and applying statutes and regulations administered by an agency is a two-step process. First, a court must determine whether the language of a statute or regulation directly speaks to the issue. If so, the court must utilize the clear meaning of the statute or regulation.

It is our interpretation that state law does address the resale of lottery tickets and that the clear meaning of the law is that this practice is illegal. Thus, SCEL’s interpretation to the contrary might not be owed deference by a court.

### CONCLUSION

Because SCEL interprets state law to allow the resale of winning lottery tickets, and because the practice is not *explicitly* prohibited by state law, we conclude that an opinion from the Office of the Attorney General on the legality of purchasing and selling winning tickets in resale transactions could help clarify the issue.

If the Office of the Attorney General concludes that state law allows resale transactions, we are recommending that the General Assembly amend state law to explicitly prohibit them.

## STATE LAW INADEQUATE REGARDING WITHHOLDING LOTTERY PRIZES FOR PAST DUE DEBTS

The prize amount above which lottery winnings are withheld for past due debts is significantly higher in South Carolina than in other states.

For prizes \$5,000 or greater, South Carolina law requires that the winnings be withheld to settle certain debts of \$100 where the state is either the creditor or a collection agent for creditors. These debts could include, but would not be limited to, past due taxes, student loans, child support, and other court-ordered payments.

In North Carolina and Tennessee, when lottery prize winnings are \$600 and greater, they are withheld to settle debts greater than \$50 and \$100, respectively. In Florida, when lottery prize winnings are greater than \$600, they are withheld to settle a debt of *any* amount.

If South Carolina were to lower its withholding threshold to \$500, total lottery receipts potentially subject to withholding would increase from approximately 17,000 individuals to 124,000 individuals.

## ENFORCEMENT OF STATE LAWS SPECIFIC TO LOTTERY RETAILERS

We reviewed South Carolina law, regulation, and SCEL policies and practices that are specific to retailer misconduct other than the resale of winning tickets, including:

- Selling tickets to minors.
- Securing ticket inventory.
- Operating illegal gambling machines.
- Unpaid retailer debts.
- Accepting only cash as payment for tickets.

We found that, in some instances, SCEL has not established formal policies, and, in other instances, has not promulgated its policies and practices in state regulation as required by state law. SCEL has not consistently enforced these legal requirements, and when it has imposed penalties against retailers, they have been limited in scope and less likely to deter future misconduct among retailers.

## NO SPECIFIC STATE LAW REGARDING ANONYMITY OF PRIZE CLAIMANTS

In the absence of a specific statute, South Carolina's lottery has used its discretion in recent years to keep anonymous the identity of prize claimants. This discretion has been upheld by a court ruling. A specific state statute would ensure that South Carolina's policy has been formally considered and debated by lawmakers.

There are alternatives that can achieve the benefits of public disclosure of prize claimant identities while mitigating its negative effects. Examples include confidentiality for claimants who can demonstrate potential harm, public disclosure of prize claimants after a mandated cooling off period, and public disclosure only of claimants who have won smaller prizes.

### PUBLIC DISCLOSURE ARGUMENTS

#### PROPOSERS

- The general public can observe that lottery prizes are being awarded.
- Allows the general public to observe whether persons not eligible to play, such as lottery employees, are playing.
- Allows the public to identify frequent prize-claiming patterns over time that would be highly improbable if the tickets were legally purchased at face value from licensed retailers.
- Gives creditors of winning players the ability to identify newly-acquired assets.

#### OPPOSERS

- Claimants experience reduced privacy.
- Claimants may become victims of the financial schemes of predators who seek out individuals with newly-acquired winnings.
- Claimants may become victims of violent attacks. In the worst of cases, lottery winners have been killed.

## SCEL HAS TWO CONFLICTING INCENTIVES ESTABLISHED IN STATE LAW

Under the authority of state law, SCEL sells lottery tickets through a statewide network of retailers licensed by the agency. The agency is authorized to market, advertise, and promote the lottery and its games.

State law also grants SCEL the authority to oversee lottery retailers and regular players for misconduct.

When any organization has the authority to sell a product and the authority to oversee retailer and customer misconduct, over the long term, there may be reduced incentive to address misconduct that does not negatively affect sales.

There also may be reduced incentive to take actions that may reduce sales.

The South Carolina Department of Revenue licenses and oversees retailers of alcohol, tobacco, and bingo—from which the state receives tax revenues—but does not sell, market, or advertise these products.

In Ontario, Canada, lottery retailers are regulated by a separate and independent entity that does not sell lottery tickets.

## OPERATING A STATE LOTTERY VERSUS ALTERNATIVE SOURCES OF REVENUE

Section 2-15-50(b)(2) of the S.C. Code of Laws requires the Legislative Audit Council to indicate in its audit reports whether “organizations, programs, activities, or functions should be continued, revised, or eliminated....”

Due to the subjective nature of weighing the various pros and cons of using a lottery to raise revenue, we are providing this information to the General Assembly and the public for consideration, but we are not offering a recommendation on whether the lottery in South Carolina should be continued or eliminated. Throughout our report, we make recommendations on revising SCEL operations.

We found that:

- The lottery has generated over \$5 billion in revenue for education in South Carolina from FY 01-02 through FY 17-18.
- Unlike generating new funds through a pre-existing tax, such as income and sales taxes, generating revenues through a lottery has required the expense of creating and operating a separate state government enterprise.
- On a per capita basis, SCEL has relied disproportionately on the residents of lower-income counties for its customers.
- If South Carolina were to discontinue its lottery, a portion of its residents would likely purchase tickets in our neighboring states of Georgia and North Carolina

## POLITICAL CONTRIBUTIONS BY SCEL COMMISSIONERS

According to S.C. Code §59-150-40(L), members of the SCEL board of commissioners:

...shall not contribute to or make independent expenditures relative to the campaign of a candidate for the General Assembly or a statewide constitutional office; to a political party, as defined in Section 8-13-1300(26); or to a committee, as defined in Section 8-13-1300(6). *A member of the board who violates this section must be summarily dismissed.* [Emphasis added.]

We found that, in violation of state law, three members of the SCEL Commission made political contributions to candidates for the General Assembly or to political action committees. Total contributions by the Commissioners were \$100, \$950, and \$1,488.

After informing SCEL of these findings, two Commissioners obtained reimbursement for their donations and the third Commissioner resigned.

## IMPLEMENTATION OF PRIOR LAC RECOMMENDATIONS

We reviewed the implementation status of recommendations outstanding from prior LAC audits in 2003, 2005, 2010, and 2014.

STATUS OF RECOMMENDATIONS	NUMBER
Implemented	1
Partially Implemented	2
Not Implemented	5
Not Applicable	2
<b>TOTAL</b>	<b>10</b>

### RECOMMENDATIONS IMPLEMENTED

OCTOBER 2014

#### Recommendation 2

The South Carolina Education Lottery and the Board of Economic Advisors (BEA) should consider the results of additional methods when estimating unclaimed prizes for use by the General Assembly during the appropriations process.

### RECOMMENDATIONS PARTIALLY IMPLEMENTED

DECEMBER 2005

#### Recommendation 7

When the South Carolina Education Lottery advertises a top prize for any of its games on television or radio, it should verbally communicate in the ad the odds of winning a top prize.

DECEMBER 2005

#### Recommendation 9

The SCEL should obtain and follow advice from reading/literacy experts to ensure that written communications to lottery customers can be read by persons with moderate reading skills.



## RECOMMENDATIONS NOT IMPLEMENTED

OCTOBER 2014

### Recommendation 1

The South Carolina Education Lottery should submit a proposed regulation to the General Assembly to amend S.C. Reg. 44-40.10(C)(2) to state that once a retailer has been notified that the last top prize of an instant [scratch-off] game has been claimed, sales of those game tickets must be discontinued immediately.

DECEMBER 2005

### Recommendation 12

The South Carolina Education Lottery should submit a request to the General Assembly to amend S.C. Regulation 44-40.10(C)(2), so that lottery retailers are required to discontinue the sale of scratch-off tickets immediately after being notified that a game has been officially ended.

### Recommendation 18

The General Assembly should amend state law to authorize the SCEL to deny, suspend, revoke, or terminate the contracts of lottery retailers or applicants who have been found to have allowed illegal gambling on their premises, regardless of whether it is an administrative violation or a criminal conviction.

### Recommendation 19

The General Assembly should amend state law to authorize the SCEL to impose administrative fines against lottery retailers who have been found to have allowed illegal gambling on their premises, regardless of whether it is an administrative violation or a criminal conviction.

DECEMBER 2003

### Recommendation 6

The South Carolina Education Lottery should develop performance measures for all departments and include these measures in its annual report.

## NEW RECOMMENDATIONS PERTAINING TO PRIOR RECOMMENDATIONS

JUNE 2019

### Recommendation 31

The South Carolina Education Lottery should discontinue the practice of including the odds of *not* winning on its lottery tickets.

### Recommendation 32

The General Assembly should amend S.C. Code §59-150-60(A)(18) to no longer require that the odds of *not* winning lottery games be displayed at retailer points of sale.

FOR MORE  
INFORMATION

Our full report,  
including comments from  
relevant agencies,  
is published on our website.  
Copies can also be obtained by  
contacting our office.

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