RESEARCH PAPER 05/41
9 JUNE 2005

The *National Lottery Bill*

Bill 6 of 2005-06

The *National Lottery Bill* was published on 24 May 2005 and is due to receive its second reading on 14 June 2005. It is very similar to a bill published in the last session, but which was never debated.

The Bill provides for the legal framework of the Big Lottery Fund, which is one of the distributors of National Lottery money to good causes. The BLF already exists, in fact though not in law, following an administrative merger last year between the Community Fund and the New Opportunities Fund. The BLF will distribute half of all National Lottery funds for good causes. The Conservatives have pledged to abolish the Big Lottery Fund. There has been controversy about the degree of control the Government will have over it.

The Bill also contains powers to deal with what the Government perceives as the problem of excessive balances held by Lottery distributors. This also caused some controversy, and the Government has made changes to this provision since the last bill was published.

There is also a reserve power to allow the Secretary of State to break up the existing licence structure if this fails to generate effective competition to run the National Lottery.

Pat Strickland

HOME AFFAIRS SECTION

HOUSE OF COMMONS LIBRARY

Recent Library Research Papers include:

05/26	The *Public Services Ombudsman (Wales) Bill [HL]* [Bill 76 of 200-405]	23.03.05
05/27	Direct taxes: rates and allowances 2005-06	24.03.05
05/28	The *Equality Bill* [Bill 72 of 2004-05]	24.03.05
05/29	The Middle East Peace Process: prospects after the Palestinian Presidential Elections	29.03.05
05/30	The Quango Debate	05.04.05
05/31	The *International Organisations Bill [HL]* [Bill 2 of 2004-05]	06.04.05
05/32	Unemployment by Constituency, March 2005	13.04.05
05/33	General Election 2005	17.05.05
05/34	By-election results 2001-05	11.05.05
05/35	Unemployment by Constituency, April 2005	18.05.05
05/36	The *Transport (Wales) Bill* [Bill 4 of 2005-06]	23.05.05
05/37	The *Consumer Credit Bill* [Bill 2 of 2005-06]	01.06.05
05/38	*Crossrail Bill* [Bill 1 of 2005-06]	01.06.05
05/39	The *Natural Environment and Rural Communities Bill* [Bill 3 of 2005-06]	02.06.05
05/40	Economic Indicators, June 2005	06.06.05

Research Papers are available as PDF files:

- *to members of the general public on the Parliamentary web site,*
  URL: ***http://www.parliament.uk***
- *within Parliament to users of the Parliamentary Intranet,*
  URL: ***http://hcl1.hclibrary.parliament.uk***

Library Research Papers are compiled for the benefit of Members of Parliament and their personal staff. Authors are available to discuss the contents of these papers with Members and their staff but cannot advise members of the general public. Any comments on Research Papers should be sent to the Research Publications Officer, Room 407, 1 Derby Gate, London, SW1A 2DG or e-mailed to PAPERS@parliament.uk

ISSN 1368-8456

Summary of main points

The National Lottery started in 1994. Its aim was to raise money for good causes which the Government would otherwise not be able to fund – a principle known as "additionality". Since its introduction, the Lottery has paid out around £17 billion to good causes - which have been the arts, sports, charities, heritage, millennium projects (though these are now being phased out) and, since 1998, education, health and the environment. This money is given out through fifteen distributors who are at arm's length from the Government, although they operate within a framework of legislation and directions.

Despite the success of the Lottery, there have been a number of concerns in recent years. These have included:

- Negative publicity over certain grants, most notably grants by the Community Fund to the National Coalition of Anti-Deportation Campaigns
- Falling ticket sales between 1997/8 and 2002/3 (although this trend has been reversed in the last two years)
- Lack of competition for the licences to run and promote the lottery in 2001. The only compliant bid to rival Camelot's was from Sir Richard Branson's consortium, The People's Lottery.
- The size of distributors' balances
- Insufficient public awareness of good causes supported by the lottery
- Lack of access to funding, particularly for smaller organisations

The Government instituted two reviews of the National Lottery in 2002, one looking at funding issues and the other at licensing. The conclusions were issued in two "decision documents" in 2003.

The main proposal on funding was that two of the distributors, the Community Fund and the New Opportunities Fund (NOF), should be merged to form a new distributor responsible for allocating half of all lottery money for good causes. The new fund would also take on the residual commitments of the Millennium Commission. An administrative merger between the Community Fund and the NOF took place in June 2004, and the new organisation is called the Big Lottery Fund. However, this does not yet exist in law.

The main proposal in the 2003 licensing document was to break up the single operator licence – held by Camelot since 1994 - to allow greater competition. This decision was criticised in two select committee reports in early 2004, which led to led to a rethink by the Government. A fresh decision document in November 2004 proposed that the single licence should be retained and that other ways should be found of encouraging competition. However, it also said there should be a reserve power to create a multiple licence system if the existing structure failed to generate enough competition.

This Bill introduces most of those provisions in the decision documents which require primary legislation. These include:

- The establishment in law of the Big Lottery Fund and the reapportioning of money to good causes to allow it to distribute 50% of this money. The Bill also provides for the dissolution of the Community Fund, the New Opportunities Fund and the Millennium Commission

- A reserve power to allow the Secretary of State to break up the existing licence structure. The Government has said it would use this power only if it considered that the current licensing structure had failed to create an effective competition.

- A new power to reallocate funds from one distributor to another – which, again, the Government says would only be used as a last resort if the distributor had failed to reduce balances.

- A new way of calculating interest on lottery balances, also to discourage distributors holding what the Government regards as excessive amounts.

A very similar Bill was published in the last session on 25 November 2004, but never received a second reading. The main difference concerns the power to reallocate funds between distributors. Unlike its predecessor, this Bill makes it clear that reallocation could take not take place between one good cause and another. This was in response to concerns raised with the Government, particularly by the Heritage Lottery Fund.

Some groups have raised concerns about the extent to which the Big Lottery Fund must comply with directions issued by the Secretary of State in exercising its functions. Similar provisions currently apply to the New Opportunities Fund, introduced in 1998, but not to other distributors, who only have to comply with directions about what they have to *take into account* when allocating funds.

The Conservatives have pledged to abolish the Big Lottery Fund and "restore the independence of the Community Fund". The Liberal Democrats also want to "restore" the independence of Lottery funds.

The Bill extends to the whole of the United Kingdom, and the Big Lottery Fund will also have the power to make grants to the Isle of Man.

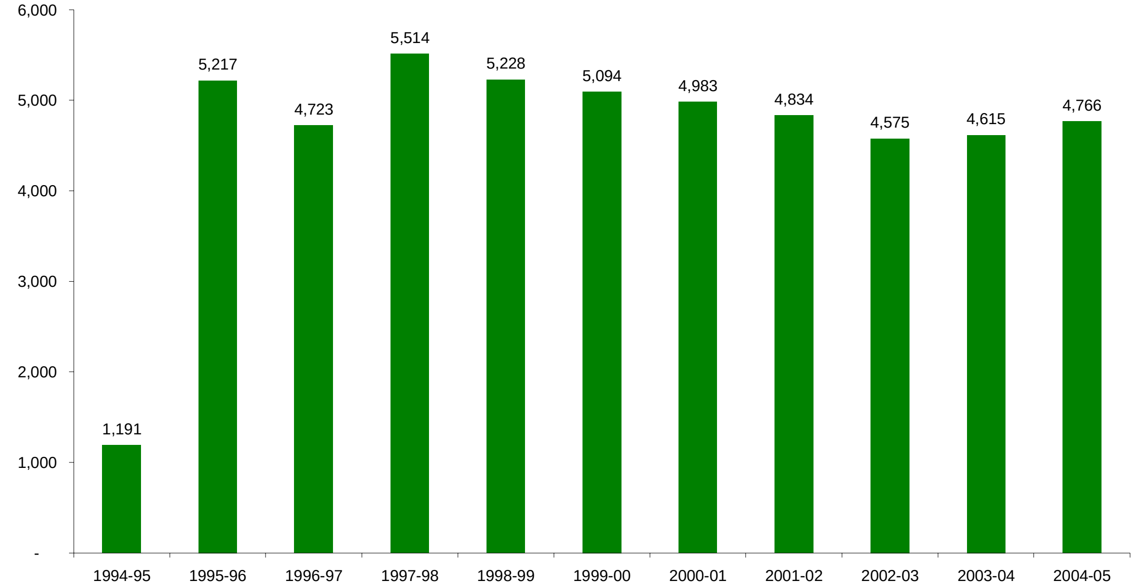
CONTENTS

I Introduction

The National Lottery was established by the *National Lottery etc Act 1993*, and began life on 14 November 1994. Since then, it has become a national institution. Camelot, the private company which runs the Lottery, now operates a wide variety of lottery games, ranging from the draw-based games, such as *Lotto*, *Daily Play* and *Thunderball*, to scratch cards and interactive internet games. Camelot estimates that 70% of the adult population play at least one National Lottery game regularly.[1]

Trends in ticket sales since the Lottery's introduction are shown in the chart below:

National Lottery Ticket Sales, £m



Source: www.camelot.gov.uk

There were concerns about the reduction in ticket sales after the peak of 1997-98, as this was reducing the amount of money available for good causes. This is discussed in more detail in Library Research Paper 03/94. However, as the chart shows, this trend has been reversed in the last two years. Camelot attributes this to its strategy of bringing in new games and improving access to games through new channels of distribution.[2]

The Government describes the Lottery as "a huge success story which has transformed the lives of thousands of people in the UK".[3] Good causes receive 28% of total revenues from sales, and by January 2005, £16.8 billion had been raised.[4] The distribution of the proceeds is shown in the chart below:

---

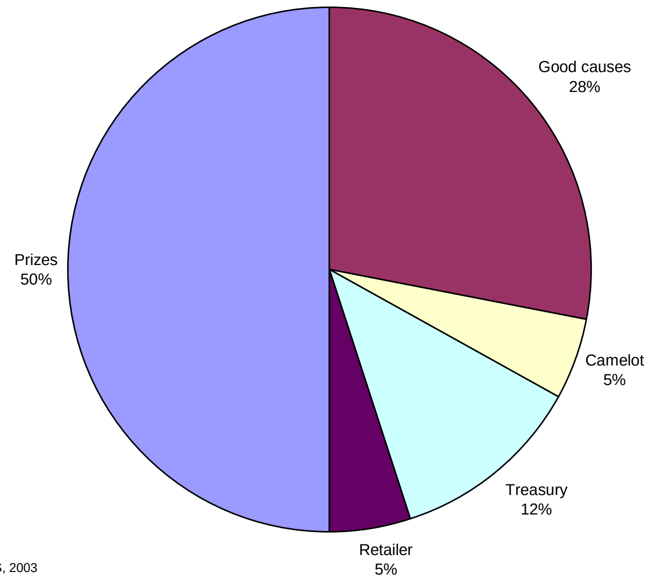
1 Defined as at least once a month:, http://www.national-lottery.co.uk/player/p/about/respAddictive.do

2 Camelot Press Release, *National lottery sales growth accelerates*, 23 May 2005

3 DCMS, *National Lottery Funding Decision Document*, July 2003, p3

4 http://www.culture.gov.uk/national_lottery

Distribution of lottery proceeds



Source: The National Lottery Leaflet, DCMS, 2003

However, despite the success of the National Lottery in raising funds for good causes, there have been a number of concerns in recent years. Apart from the issue of falling ticket sales, these have included:

- Negative publicity over certain grants
- Lack of competition for the licences to run and promote the lottery in 2001.
- The size of distributors' balances
- Insufficient public awareness of good causes supported by the lottery
- Lack of access to funding, particularly for smaller organisations

The Government set up two reviews of the Lottery in 2002. One of these concentrated on licensing issues, which are dealt with in section III of this paper. The other looked at funding issues, which are covered in section II below.

II Funding issues

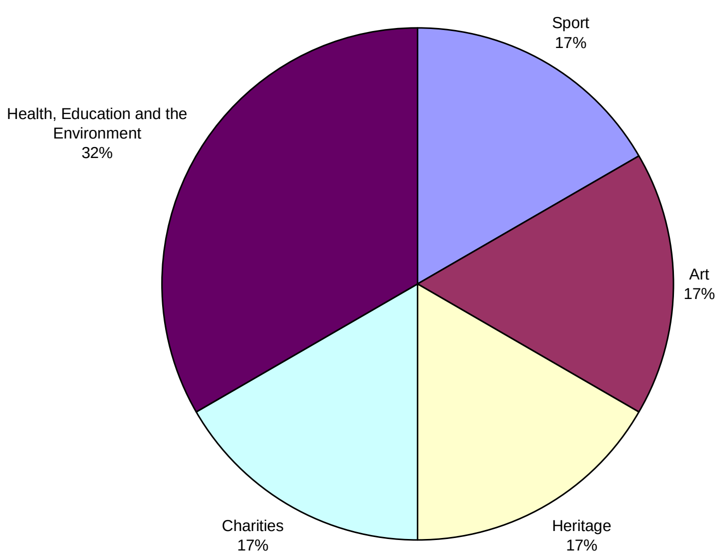
The National Lottery was introduced to raise money for good causes which would not be funded by government. Therefore it is perhaps not surprising that, while there has been some controversy over licensing issues, it is the funding aspects of the Government's review which have aroused the most interest and comment. Debates on Lottery funding tend to raise interrelated issues such as the extent to which it is genuinely additional to government spending, the extent to which the people – whether Lottery players or the general public – should have a say in where the money goes, the amount of money which should go to "unpopular" causes and how much control the Government should have over distribution.

A. The current system

Originally when the National Lottery was established in 1994, there were five good causes: arts, sport, heritage, charities and the celebration of the millennium. A sixth good cause – covering health, education and the environment through the New Opportunities Fund – was set up under the *National Lottery Act 1998* and started inviting applications for grants in January 1999.

The money in the National Lottery Distribution Fund (apart from that required for certain expenses) is allocated as follows:[5]

Distribution amongst good causes



Source: The National Lottery Leaflet, DCMS, 2003

The responsibility for distributing proceeds from the Lottery rests with 15 independent distributing bodies. These are:

- The four national Arts Councils
- The four national Sports Councils
- UK Sport
- the Heritage Lottery Fund
- the Community Fund
- the New Opportunities Fund
- the Millennium Commission
- the UK Film Council
- Scottish Screen

There is a sixteenth body - the National Endowment for Science, Technology and the Arts (NESTA) which is sometimes called a distributor, although it operates on a quite different basis and is covered by separate legislation from the others. It was set up by the *National*

5 Section 22(3) of the *National Lottery Act 1998* (as amended)

Lottery Act 1998, given a core endowment and charged with using the income from this to support innovation and creativity in the UK.

B. The "additionality" debate

It has always been a central tenet of the National Lottery that spending on good causes from Lottery funding should be additional to, rather than a replacement for, government funding. The 1992 White Paper which proposed the Lottery stated that it would fund projects which would not otherwise be funded through general taxation, and should not be a substitute for existing expenditure programmes under the control of the Exchequer. [6] Governments of both parties have consistently maintained that they fully adhere to this principle; the present Government stated in a written answer in January 2005 that it remained "committed to the principle of additionality – that Lottery money should add to, and not substitute for, services already provided by the Government."[7] Nevertheless, commentators and pressure groups have often argued that the principle is being eroded.

The problem is that this is rather an elastic concept which usually has a hypothetical element to it. The debate can cover not only what is actually in current spending plans, but also what might be in future plans, what would have been in spending plans if the National Lottery had not existed, and even what people feel should be covered by government spending. This issue has been explored in a number of reports by the Culture, Media and Sport committee. In a 1999 report on the Heritage Lottery Fund[8], the Committee cited a Government statement that "there is… no evidence of which the Government is aware to support any conclusion that the availability of Lottery funding has had any direct effect on decisions about Exchequer funding". The Committee went on to observe dryly that "evidence about the inner workings of the Treasury and the public expenditure round is rarely forthcoming".[9]

In recent years, there have been two major developments in Lottery policy which have resulted in heated debates about the additionality principle. The first was the introduction of the New Opportunities Fund, (NOF) which funds health, education and environment related projects, and the second was the *Horserace Betting and Olympic Lottery Act 2004*, which would introduce a new game to contribute to the costs of hosting the Olympic Games should the UK win the bid.

The NOF was introduced following the Government White Paper, *A People's Lottery*.[10] The then Culture Secretary Chris Smith, presenting the proposals to Parliament, was careful to spell out that the Fund would "support specific initiatives, additional to core programmes funded through taxation to support our priorities of health, education and the

6 *A National Lottery raising money for good causes*, Cm 1861, March 1992, paragraph 41
7 HC Deb 17 January 2005 c716W
8 Culture, Media and Sport Committee, *The Heritage Lottery Fund*, HC 195-I, 1998-99, paragraphs 24-30
9 paragraph 25

environment."[11] But because those sectors are closely associated with public funding, this has given rise to accusations that it erodes the principle of additionality. John Major, who was Prime Minister when the National Lottery was introduced, was particularly hostile in an article in October 2004:[12]

> He told the Sunday Times that Labour has abandoned the lottery's original aim.
>
> "Labour has raided the lottery fund for programmes which historically have been met out of central taxation," he said. "Overall Labour's behaviour has been nothing short of grand larceny."
>
> He added: "I established the Lottery to provide the good causes with large sums of money with the express will of Parliament that this funding would be in addition to whatever sums government itself had been able to allocate".

One issue is that if the public is given a greater say in lottery funding, which the Government is determined it should have,[13] then they may well support similar priorities to those which they feel deserve government spending as well. A Mori survey from 2000 found that, when asked to identify the two or three most important areas of Lottery funding, 69% mentioned health and 55% education.[14] These results echo another Mori poll which found that, when prompted with a range of options for other ways to fund the NHS, 74% of respondents opted for the Lottery.

A YouGov poll for the Community Fund conducted in early 2003 found that 77% of respondents would like to be able to indicate on their lottery tickets where their good cause money goes. Charities/community groups and the New Opportunities Fund good causes (health, education and the environment) were the two most popular groups of good causes.[15] If given a say in deciding which good cause should benefit from their ticket purchase 37% said health, education and the environment and 34% charities and community groups.[16]

The Culture, Media and Sport Committee in a 2004 report condemned the erosion of the additionality principle which it felt was illustrated by the Government's plans for an Olympic Lottery. They called for an annual statement to Parliament on how the principle was applied:[17]

---

10 Cm 3709, July 1997

11 HC Deb 21 July 1997 c685

12 "Major charges Labour with 'lottery larceny'", *Sunday Times*, 24 October 2004

13 See the section IIE of this Research Paper below

14 Culture, Media and Sport Committee *The operation of the National Lottery*, HC 56-II 2000-01 Memorandum submitted by the New Opportunities Fund

15 Community Fund press notice 27 February 2003 *New research for the Community Fund finds the public wants an independent lottery free from government control*

16 *Plea for independence: Brittan seeks guarantees when lottery funds merger*, The Guardian Society Pages February 26 2003.

17 Culture, Media and Sport Committee, *Reform of the National Lottery*, HC 196-1, 2003-04, 9 March 2004

> A new good cause is being established by the Government through primary legislation. This is estimated to generate £750 million between 2004/05 and 2011/12 for staging the 2012 Olympic Games should, of course, London's bid be successful. Up to 59% seems likely to arise from a switch of play from existing Lottery Games to a new family of Olympic Lottery products. When taken in conjunction with other calls upon Lottery funds resulting from a range of prospective measures, including a Government fiat directed at the sports distributors, the Olympics becomes a huge potential drain on all the existing good causes which must be carefully monitored and remedial action taken if necessary. Provision has been made for Ministers to transfer resources directly from the mainstream National Lottery fund to the Olympics fund "in exceptional circumstances". We believe that, conversely, the National Lottery should be in the position of a 'preferred creditor' if, as confidently predicted by the Government, the eventual call on the public's money is significantly less than provided for under current arrangements.
>
> The principle of "additionality" - whereby Lottery resources are not supposed to be used by Ministers to replace Government spending - is being eroded, especially in the light of contingent plans for staging the Olympics. We deplore this. We regard the £1.5 billion earmarked by the Government as the Lottery's overall contribution to the Olympics as a straightforward raid. We will consider returning to examine additionality in more detail before the end of this Parliament. In the interim, we recommend that the Secretary of State make report to Parliament each year setting out how the additionality principle has been applied.

In its response, the Government rejected this recommendation:[18]

> We do not accept that the principle of additionality has been eroded at all. The principle has most recently been underlined in the new, streamlined Financial Directions currently being rolled out to distributing bodies, which call on distributors to "have regard to… additionality principles". We have not attempted to formulate a rigid definition of additionality in the directions because we want to allow individual distributors some flexibility, given the widely differing natures of the sectors in which they operate. However, we are considering whether guidance to distributors on the interpretation of 'additionality' can be drawn up.
>
> Additionality has never meant that Lottery projects should be completely divorced from public services and existing Government initiatives. They must be additional and they can be additional in many different ways. The Millennium celebrations and projects to mark the new Millennium are perhaps the most obvious example of a major national endeavour in which the Government was a

---

[18] DCMS, *Government Response to the Culture, Media and Sport Select Committee Report on the National Lottery Session 2003-2004*, Cm 6232 May 2004

> partner but which was also new and would not have happened on anything like the successful scale they achieved without a major contribution from the Lottery. The Millennium dimension was planned from the very start of the Lottery to be a part of the scene. The initiatives which have been launched in experimental form with Lottery funds and since been mainstreamed by the Government as part of wider public services are another example of this. The child care, fruit in schools, out of school hours learning and school sports coordinators initiatives are all examples of this. If the flow is in this direction we are confident it is a proper and effective use of Lottery funds.
>
> Ever since the Lottery was introduced, there has been a healthy debate about where the boundary lies between Government responsibilities and expenditure and what projects the Lottery should support. We remain committed to the principle that Lottery money should add to, and not substitute for, services already provided by Government. Lottery funding must allow things to happen which simply would not have taken place if they had depended on Government funding alone. We believe that the staging of an Olympic and Paralympic Games clearly falls within this category. We will certainly justify to Parliament every change of policy or administration where the additionality principle is at stake. We have done this in detail in bringing forward the legislation for a new Olympic good cause, and we will do so in consulting on the work of the new distributor, but we do not intend to report specifically on this issue in the abstract.

C. The Big Lottery Fund

The Big Lottery Fund was launched following an administrative merger between the New Opportunities Fund and the Community Fund in June 2004. However, in law both these funds still exist. The Bill will provide the statutory basis for the new fund, and will wind up the Community and New Opportunities Funds. It will also wind up the Millennium Commission, as the Big Lottery Fund is due to take over its residual responsibilities and its share of income arising from the sale of the Millennium Dome from 1 April 2006.[19]

1. The old distributors

a. The Community Fund

The Community Fund, which is the name by which the National Lotteries Charities Board is known, was set up as one of the original distributors in 1994 to distribute funding to charities and voluntary and community groups throughout the UK. It also ran specialist programmes for research and international development projects. The Fund awarded grants to projects which help those at greatest disadvantage and improve the quality of life in the community.[20]

---

19 DCMS, *National Lottery Funding Decision Document*, July 2003 p23

20 The Fund's grant programmes are now in the process of closing to make way for the Big Lottery Fund's programme – see below.

In recent years, the Fund received has hostile press coverage, particularly in the *Daily Mail*, for a number of its awards which the paper judged to be overly "politically correct".[21] The awards which caused most controversy were grants in 1998 and 2002 to the National Coalition of Anti-Deportation Campaigns, an organisation which provides help and advice to people appealing against deportation. There were particular concerns about material on the organisation's website. The *Mail* ran a story headlined "Is this the barmiest lottery handout of them all?" criticising the group and the Fund.[22] Ministers subsequently asked the Community Fund to review the legality of the 2002 award, and as a result the Fund asked the Campaign to remove what was felt to be political and doctrinaire material, but it continued to post such material on its website. Reports by the National Audit Office[23] and the Public Accounts Committee[24] were critical of the Fund's procedures, particularly in evaluating bids from organisations which, like the NCADC, were not charities and therefore not subject to the monitoring regime of the Charity Commissioners.

b. The New Opportunities Fund

As already noted, the New Opportunities Fund (NOF) was established by the *National Lottery Act 1998*. As the chart on page 9 makes clear, this cause now receives a third of the money set aside for good causes, while the other causes (arts, sport, heritage and charities) receive a sixth each.

c. The Millennium Commission

The Millennium Commission was one of the original distributors under the *National Lottery etc Act 1993*, but unlike the others was created as a short life organisation to fund projects to celebrate the end of the second millennium and the start of the third. It stopped receiving money in 2001, and its grant giving functions are due to be completed by March 2006. After this, however, it will still have some residual functions.

2. The merger

The Government's 2002 consultation document on funding sought views on reducing the number of distributors. One option suggested was creating a single umbrella distributor to encourage a more coordinated approach and give the people a single point of contact.[25]

---

[21] See for example, "An insult to decent values: How the Fund squanders your money", Daily Mail, 23 October 2002

[22] "Is this the barmiest lottery handout of them all?" *Daily Mail*, 10 August 2002

[23] National Audit Office, *Community Fund: Review of grants made to the National Coalition of Anti-Deportation Campaigns* Report by the Comptroller and Auditor General HC 519 *Session 2002-2003, 2 April 2003* http://www.nao.org.uk/publications/nao_reports/02-03/0203519.pdf

[24] Public Accounts Committee, *Review of grants made to the National Coalition of Anti-Deportation Campaigns*, HC 305, 2 March 2004

[25] DCMS, *Review of Lottery Funding*, July 2002 p31

Responses to this document were generally against this approach, because it would mean losing the specialist knowledge and expertise of distributors who work with a particular sector. In July 2003, the Government issued a "Decision Document" which acknowledged these concerns and therefore rejected a single distributor. However, it considered that there was a case for merging the Community Fund and the New Opportunities Fund:[26]

> Despite their different approaches to funding, there is a significant overlap between the work of the Community Fund and the New Opportunities Fund and there is an opportunity by merging these two bodies to create a new dynamic distributor which will take on the functions of the Community Fund and the New Opportunities Fund. The new distributor will continue funding for charities and the voluntary sector and health, education and the environment, but will also assume the Millennium Commission's ability to fund large scale regenerative projects. It will also be able, by agreement, to handle non-Lottery funds to build a genuine community development role.

The document proposed that the new body would:[27]

- Lead on best practice
- Provide a single point of entry for new applicants unsure of where to seek advice
- Be the first port of call for applicants who feel their project does not fit neatly with other distributors' terms of reference
- Develop pre-application support and common standards of service

3. Commentary on the merger

The DCMS summary of responses to the 2003 Decision Document noted "broad support for the proposal for a single community distributor, with many welcoming the benefits of larger economies of scale." However it went on to say that the voluntary sector was more divided, and were particularly concerned that the merger would mean a loss of independence in decision making.[28]

The Culture, Media and Sport Committee in its March 2004 report outlined the advantages which had emerged as it had taken evidence:[29]

> **Advantages**
> 115. There are clearly some potential advantages to the merger, which are primarily the increased simplicity of applying and the creation of economies of

[26] DCMS, *National Lottery Funding Decision Document,* July 2003, p20
[27] ibid, p21
[28] DCMS, *National Lottery Funding Decision Document-Key points arising from the consultation*
[29] Culture, Media and Sport Committee, *Reform of the National Lottery*, HC 196-1, 2003-04, 9 March 2004

scale due to the amalgamation of staff and resources from the two organisations. The new body will be able to distribute a range of funds of different sizes from very small to major capital projects, helping a large number and range of applicants and it will have the ability to handle non-Lottery funds for joint-funded projects. It will also be responsible for disseminating best practice to all distributors, helping to increase cooperation between them.

116. The Coalfields Community Campaign (CCC) was very keen to see this single point of entry for all Lottery applications and sufficient development support to enable their communities, and many others like them, to apply for Lottery grants without having to spend money on advice or be put off by the complicated processes in place. The CCC welcomes the new distributor's roles in these areas, as does the Committee.

117. Overall, the new distributor is supposed to be more than the sum of its parts. The Department envisages it as "a true community distributor, funding projects to revitalise and regenerate communities." We believe that the distributor has the potential to improve the distribution of funds within its area of responsibility.

Disadvantages

118. Much of the evidence we have received has welcomed the merger. However, there have been a few key concerns raised through the course of the inquiry principally by some of the specialist distributors: Sport England, Arts Council England and the UK Film Council. They are worried that the new body may take over as the centre of excellence managing major projects and coordinating cross-cutting projects, roles which they have traditionally carried out. The established distributors have had a large amount of experience managing these projects and have gained skills and built up relationships with many of the key organisations in their specialist fields. They do not wish to see the new distributor taking over the management of projects which they have administered in the past as this would ignore the skills currently available and be an unnecessary duplication of effort. Mr Stephen Dunmore, Chairman of the New Opportunities Fund and the community Fund, believes that a variety of distributors are needed and that they must continue to work closely together to achieve common aims rather than further reducing the number of distributors. However, he believes that it is right for the new distributor to take a lead role in some areas such as transformational projects and helping other distributors to learn from each other and work together. **We believe that the new body could usefully take on an overarching role, coordinating efforts in cross-cutting projects, but should also allow those distributors with established skills, experience and relationships to take the lead on projects whenever appropriate. The Department must take steps to allay the fears of some of the specialist distributors over the role of the new body as a 'centre of excellence', making clear to everyone the exact role that the merged body will take on and how this will combine with the work already undertaken by others.**

119. Another concern is that the merger will not actually create any extra funds for good causes because the costs associated with the extra responsibilities of the

new body will eradicate any savings made through economies of scale. The Secretary of State told us that she expected the merger of the NOF and the CF to create savings "within a range of 10 to 20%"'However, she confirmed, this may not bring about extra grants. The new distributor would provide extra services and take on an increased role, being more proactive, building capacity in poor communities, supporting applicants, providing a single point of entry for all applications and managing transformational and cross-cutting projects. The NCVO stressed to us that it is important that any costs associated with the extra roles and responsibilities of the new distributor do not "eat into the fund for the good causes." **We agree that the extra services provided under the merged body will enhance the distribution process but very much hope the cost of these will not erode the grants given by the new body. DCMS must ensure the merger of the New Opportunities Fund and the Community Fund is properly managed so that expertise is not lost and maximum savings are achieved.**

In the run up to the June 2004 merger, Stephen Dunmore, who had been the NOF's Chief Executive, became the Chief Executive of the Big Lottery Fund. Some press commentators have seen the merger as a "takeover" of the Community Fund by the NOF, as for example this article in the *Guardian* in January 2005:[30]

> The concern is that the government and the Big Lottery feel they cannot afford to offend the values and prejudices of middle England. Anything that might do this, such as giving grants to causes deemed unpopular by the Daily Mail and its readers, has to be stopped. Which is why, ever since the Community Fund awarded a £340,000 grant to the National Coalition of Anti-Deportation Campaigns in 2002, sparking a furious onslaught by the Mail, its days were numbered.
>
> Its so-called merger with the New Opportunities Fund (Nof) - set up to channel lottery cash into government priorities such as heath and education - is a takeover in everything but name, a move that all but extinguishes the original values of the Community Fund. Despite months of lobbying by the voluntary sector for cast-iron guarantees that the merged lottery distributor, the Big Lottery Fund, be independent of government, it should come as no surprise that a clause in the recent national lottery bill ruled this out.

In a letter to the *Guardian*, Stephen Dunmore refutes this:[31]

> Alison Benjamin's polemic against the Big Lottery Fund (Playing populist politics with lottery money, Society, January 19) was good for conspiracy theorists. The facts are less exciting.

[30] "Playing populist politics with lottery money is a dubious strategy", Guardian, 19 January 2005
[31] "Popular, not populist", *Guardian* 27 January 2005

> The bringing together of the new opportunities and community funds is a genuine merger of two distributors with much in common - both were focused on tackling social disadvantage, both were prepared to fund what some might regard as less popular projects and both were substantial funders of the voluntary and community sector.

The Conservatives have pledged to abolish the Big Lottery Fund. This is set out in section IIF of this Research Paper below.

4. Cost savings from the merger

The Explanatory Notes to the Bill estimates that the replacement of the old distributors with the Big Lottery Fund "is expected to achieve savings of between 10 and 20 per cent of expenses per year from 2005/06 onwards which equates to between £6 million and £12 million per year. This will result in more Lottery money being distributed to good causes."

5. The Bill

Clauses 13 and schedule 2 provide for the establishment in law of the Big Lottery Fund, and clause 14 for its functions. One provision which has caused controversy is a requirement for the BLF to comply with any directions given to it when exercising its functions.[32] There is a similar broad requirement for the New Opportunities Fund to comply with any directions from the Secretary of State in exercising its functions.[33] By comparison, distributors generally have to comply with Secretary of State's directions "*as to the matters to be taken into account*" when determining who will get money, for what purposes and under what conditions, people who will get money and what conditions.[34] Unlike the current provisions for the NOF, the clause goes on to specify what the directions may, in particular, cover. This includes specifying persons to whom, or purposes for which, grants may or may not be made.

NCVO is concerned about the implications for the independence of the BLF:[35]

> The BLF will be required to comply with directions from the Secretary of State, which may be in respect of who is being funded, what is being funded and funding processes. Such directions may also apply to the internal functions of the BLF board, such as employment of staff and preparation of annual accounts. NCVO is concerned that the BLF will have to *comply with* such directions, whereas the Community Fund was only required to *take account of* such directions. This fundamental distinction has important implications for the

---

32 In new section 36E which clause 14 would insert into the 1993 Act.
33 Section 43C *National Lottery etc Act 1993* as amended
34 Section 26
35 NCVO, *Briefing on the Revised National Lottery Bill*, June 2005

independence of the BLF. The new distributor must be free to set its own strategic direction and makes decisions without interference.

D. Management of lottery balances

One of the issues raised in the funding review was the management of balances. Lottery money remains in the National Lottery Distribution Fund - the National Lottery's "bank account" until it is required by distributors. The balances in the NLDF increased steadily - from the start of the Lottery in 1994 - peaking in July 1999 at £3.7 billion.[36] This was due to the time lag between the money being paid into the NLDF and being awarded to and drawn down by recipients. As the distributors have no control over the amount of money being put in the NLDF, the main ways of reducing balances are either to make more commitments to pay grants or to speed up the process by which recipients draw down the funding. It can be difficult to achieve this, particularly when the grants are high value ones for large projects which can take a long time to complete. Distributors also face uncertainties about future income and distribution arrangements.

In March 2002, the Secretary of State for Culture, Media and Sport, Tessa Jowell, announced a target for the balances in the National Lottery to halve from just over £3.5bn (where they then stood) by 2004.[37] The July 2002 Funding Review consultation document set out the concerns which had been raised about the level of balances:[38]

> Concern has been expressed over the relatively high levels of funds which have been raised by the Lottery for good causes and yet have not been distributed. Part of the problem is that there is often a gap between a project or organisation being awarded Lottery funding and being in a position to use the money. This can be for very good reasons they may be awaiting partnership funding, they may wish to take time to develop a full project plan, or the project itself may be scheduled to run from a specific future time period. In fact, although the NLDF balance stood at £3.53 billion at the end of December 2001, distributors had commitments totalling £3.82 billion, some £290 million more than was actually available. And interest earned on the money is simply added to the total available for good causes.
>
> However the Government is working with distributors considering how to allow committed funds to be transferred more quickly. Possibilities include permitting advance payments for low-risk projects, introducing a more flexible approach to partnership funding and releasing more funding for project planning.

---

36 National Audit Office, *Managing National Lottery Distribution Fund balances*, HC 875 2003-04, 21 July 2004, http://www.nao.org.uk/publications/nao_reports/03-04/0304875.pdf

37 DCMS Press Notice, *Tessa Jowell proposes changes to cure the Lottery's seven year itch*, 20 March 2002

38 DCMS, *Review of Lottery Funding A consultation paper on Lottery distribution policy*, July 2002, p32

According to the DCMS summary of the 400 responses to the consultation document, many saw the Government's proposals for reducing balances as useful. Advance payments were particularly welcomed as easing the strain on recipients. However, other respondents saw the high balances as a matter of little importance, and even a sign of good housekeeping.[39]

In July 2003, the DCMS published a *National Lottery Funding Decision Document* which made a wide ranging series of proposals, including merging the Community Fund and the New Opportunities Fund. This noted that distributors had achieved "some success" in reducing balances, but that the target of halving them was "unlikely to be met".[40] So the document announced that the Government would:

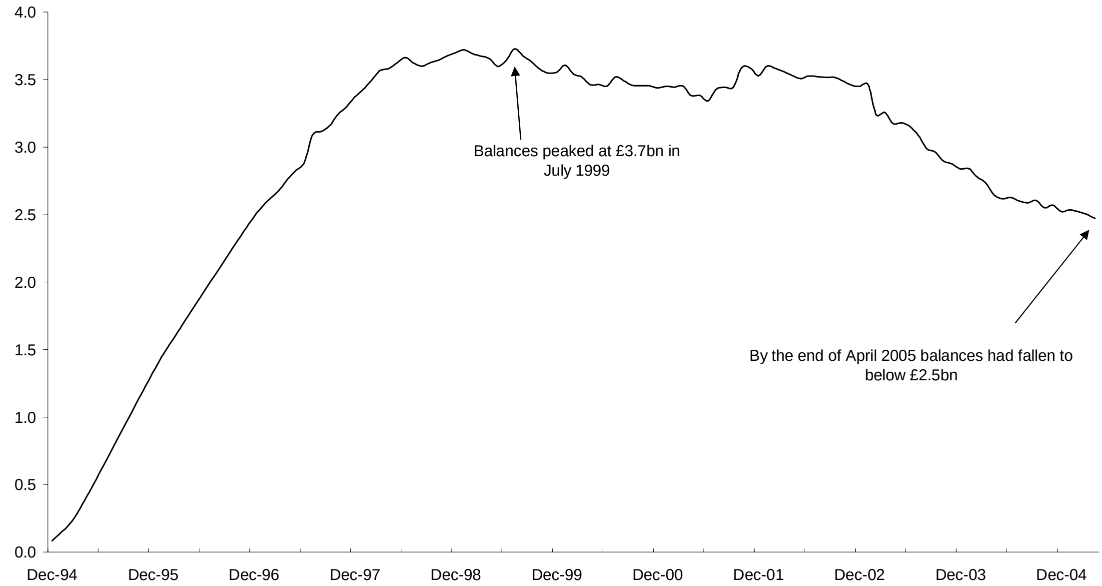
- Carry out a fundamental review of the Financial Directions, to make sure they are not unduly conservative, and do not inhibit "properly managed creativity";
- Issue guidance to all Lottery distributors for speeding up the funding of projects;
- Make distributors responsible for setting "rigorous individual targets for their balance levels".

The document went on to point out a "perverse incentive" to retain high balances, in that those distributors with the highest balances get the most interest added to their good causes. As a result the Government would introduce legislation to remove this incentive by providing that interest on balances would be shared in the same proportion as proceeds from Lottery games rather than directed to those with the largest balances. The Government also said that the legislation would create a "reserve power" to reduce balances where they appeared to be excessive.

By the end of April 2005 balances had fallen to from £3.7 billion at their highest to below £2.5 billion:

[39] DCMS, *Review of Lottery Funding: Summary of analysis of responses to the consultation paper on Lottery Distribution Policy*, January 2003, p40
[40] paragraph 5.4

National Lottery Distribution Fund Balances, £bn



Sources: HC Deb 26 March 2003 c274w; DCMS official

1. The National Audit Office report

The National Audit Office produced a report on the issue in July 2004.[41] This noted that different distributors have different approaches to balances of funds in the NLDF. Five were not prepared to make grant commitments exceeding the level of funds they hold, six were prepared to do this, but subject to a maximum level of over-commitment, and three have no specified maximum level of commitments.[42] The report found that there was scope for distributors to reduce balances by making more grant commitments, and more limited scope for reducing balances by increasing their rate of spending:[43]

> **4** There is scope for the National Lottery Distribution Fund balances to be reduced further, in particular by distributors making more commitments to pay grants to deserving projects. But significant reductions in balances could take time. There can be considerable time lags between distributors making commitments to pay grants and the grants actually being paid. This is especially the case with high value grants as these are often for large projects which can take a long time to complete and involve the payment of grant over a number of years. There is though scope to speed up payments, which can also help to reduce balances.

41 National Audit Office, *Managing National Lottery Distribution Fund balances*, July 2004, http://www.nao.org.uk/publications/nao_reports/03-04/0304875.pdf

42 Totalling 14 distributors. The Millennium Commission was not included because it no longer receives Lottery money

43 p3

> **5** However, distributors face uncertainties about future lottery distribution arrangements, income levels and expenditure. These uncertainties are important because each distributor must keep sufficient money in the National Lottery Distribution Fund to be able to meet its commitments and manage its business, and is not underwritten by other distributors or the Department.

2. The Culture, Media and Sport Committee

The Committee issued a report on the Government's National Lottery reforms in March 2004.[44] The report drew on evidence from distributors, particularly the Heritage Lottery Fund:

> 121. The distributors argue that most of the money held in the NLDF is already allocated. We have received evidence from the Heritage Lottery Fund (HLF) which states that all of the money they are at present holding in the NLDF, and £188 million extra, is not being badly managed but has already been allocated to specific heritage projects that are underway but not completed. The HLF emphasises that all of the interest earned on the balances whilst held in the NLDF is also committed to projects, many of which are major capital works that take a long time to complete and require the commitment of Lottery funding, but not the cash itself, before they can secure any matched or additional funding that is needed. The HLF evidence, and other written evidence that we have received from HLF-funded organisations, all stress the importance of long term funding for many heritage projects, meaning that NLDF balances are unavoidable. The HLF has suggested a number of possible ways that it could reduce balances so that the funding is not taken away for use on other projects. These include: encouraging speedier draw-down by recipients; allowing 50% of smaller grants to be paid up front; and taking advantage of its cash flow flexibility by over-committing funds at prudent levels ahead of time. Although these measures will ensure that Lottery money will reach projects more quickly, they also create the risk that the HLF may not being able to cover its commitments in the future if Lottery revenues fall, with the inevitable loss of some funds that have been paid up front.

The report concluded:

> 123. We believe that long term or future projects should not suffer from this policy change and that NLDF balances should not be reduced just for the sake of it. If money is found not to be flowing effectively to worthy projects through the distributors then this must be dealt with. However, if funds need to be held for legitimate reasons then they should certainly be held in the NLDF where they earn higher interest, tax free, than in the accounts of individual distributors or projects. There are, presumably, significantly fewer risks associated with money

[44] Culture, Media and Sport Committee, *Reform of the National Lottery*, HC 196-I ,2003-04, 9 March 2004

> being held centrally in the NLDF rather than dissipated amongst the many bank accounts of projects with variable degrees of governance and experience.

3. The Bill

Clauses 8 and 9 of the Bill would introduce the changes which the Government proposed in the July 2003 decision document. Clause 8 would allow the Secretary of State by order to reallocate these sums from one Lottery distributor to other distributors. The Secretary of State would be required to consult with any body mentioned in the order and also the devolved administrations. The Explanatory Notes state:

> In practice, the Secretary of State would only use this as a last resort in the event that a distributor was considered to have failed, signally, to reduce balances to a reasonable level and there were serious concerns about the ability of a distributor to act economically and effectively.

The order would be subject to affirmative procedure.

However, there is an important difference between the wording of this clause and the corresponding clause in the *National Lottery Bill* which was published (but never debated) in the 2004-05 session. Under the current Bill, reallocation can only take place between distributors, but not between good causes. So, for example, money for heritage would not be reallocated to sport or charities.

This followed a campaign particularly by the Heritage Lottery Fund, which had particularly concerns because it has one of the biggest balances. The Culture, Media and Sport Committee, which took evidence from the HLF for its March 2004 report, was concerned that the measures would have implications for long-term projects:[45]

> 123. We believe that long term or future projects should not suffer from this policy change and that NLDF balances should not be reduced just for the sake of it. If money is found not to be flowing effectively to worthy projects through the distributors then this must be dealt with. However, if funds need to be held for legitimate reasons then they should certainly be held in the NLDF where they earn higher interest, tax free, than in the accounts of individual distributors or projects. There are, presumably, significantly fewer risks associated with money being held centrally in the NLDF rather than dissipated amongst the many bank accounts of projects with variable degrees of governance and experience.

In a briefing to Members of Parliament in December 2004, the HLF said that the provisions on reallocation of funds would force it to retract grant offers or even close its doors to new applications altogether, and the provisions on investment income would reduce the HLF's income by around £15 million each year – equivalent to the amount

[45] Culture, Media and Sport Committee, *Reform of the National Lottery*, HC 196-1, 2003-04, 9 March 2004

awarded to an English region each year. It went on to cite the reports by the National Audit Office and the Culture Media and Sport Select Committee: [46]

> The National Audit Office and the Culture, Media and Sport Select Committee examined the issue this year and found that:
>
> • *'the build up of balances at the start of the National Lottery reflected the inevitable time lag between money being paid into the National Lottery Distribution Fund and it being awarded and drawn down by grant recipients… **large projects can take a long time to complete and involve the payment of grants over a number of years**. [As a result] there can be considerable time lags between distributors making commitments to pay grants and grants actually being paid.' [Managing National Lottery Distribution Fund Balances, NAO, HC 875 Session 2003-04: 21 July 2004]*
>
> • Furthermore knowing that they have committed funds in the bank allows major capital projects to commence expensive planning work and draw together complex funding packages
>
> • HLF does not have any unspent money – **every single penny held by the Heritage Lottery Fund in its account has already been committed to projects** and is simply awaiting requests for payment, once projects are ready to do so under Treasury rules
>
> • far from being underspent, HLF is over-committed by £175million
>
> • **action had already been taken by distributors to reduce balances**, both by over-committing available funds and by speeding up payments when grantees request them
>
> • HLF now makes payments to grantees on average within six days of a payment request being made
>
> • action can be taken to reduce balances further but *'distributors face a range of uncertainties and risks in* managing their National Lottery Distribution Fund balances' that makes this difficult. [NAO]

The then Arts Minister, Estelle Morris, responded to the HLF briefing in a letter to Members of Parliament on 15 December 2004, announcing that money would not be transferred to non-heritage distributors:

> In 2001 when the Secretary of State drew attention to this issue, and called for action, the balance of the HLF stood at £930million. This October it still stood at

[46] HLF, National Lottery Bill Briefing, December 2004

> £913million. We still believe that HLF can and will reduce their balances but we cannot be sure of that so we are proposing a fall back power to reallocate some of the money to a distributor which can spend it more quickly.
>
> Our only concern is to get more projects up and running faster in constituencies throughout the country.
>
> There is no question whatsoever of reallocating money in a way that would endanger the commitments made to existing projects. I want to make that quite clear both for the three projects they have singled out for special mention and to any other project in your constituency.
>
> We have been in close contact with the Heritage Lottery Fund to address their concerns. The Secretary of State has decided to go further than our assurance in the Explanatory Notes to the Bill. We say now that, if Parliament approves these powers, we would ensure the money reallocated would still go to heritage projects but would be allocated to a different distributor to get on with it.

This is reflected in the new wording of clause 8, so that funds can only be reallocated between distributors, not causes.

In a January 2005 briefing, the HLF was still unhappy with the proposal:[47]

> In a letter to Members on 15 December, the Arts Minister stated that money would not be reallocated in a way that would endanger projects and that any money reallocated would still go to heritage projects.
>
> This could mean either, that commitments to existing projects would be transferred to another distributor alongside any money transferred, or that money could be transferred to another distributor to allocate to new heritage applications, leaving HLF to pay existing commitments from on-going income.
>
> Under the first scenario, the only way to speed up the process is for the new distributor to pay against requests more quickly than HLF's current six day average. This is not realistic and the impact on balance reduction would be minimal.
>
> Under the second scenario, HLF would have to rely on future (and therefore uncertain) income to meet existing commitments. The National Audit Office report into the balances identified that distributors face a number of uncertainties (ticket sales, impact of the Olympic lottery should the London 2012 bid be successful, share of income post 2009 etc) that mean that they cannot know with absolute certainty what future income will be. It is possible that requests for payment from grantees could exceed income in any given future year, forcing HLF to renege on commitments already made.

[47] Heritage Lottery Fund, *Lottery Bill Briefing*, January 2005

> Furthermore, another distributor – with no experience of assessing heritage applications, of awarding heritage grants or monitoring heritage projects – would, under either scenario, be responsible for distributing funds to heritage projects. HLF's ten-year experience of funding the heritage would also be lost.

However, the National Council for Voluntary Organisations, in a June 2005 briefing on the current Bill, welcomes the revision "as it reduces the scope of such intervention to reallocate funds".[48]

Clause 9 provides that proceeds from investment are allocated according to the same percentage shares as money entering the Distribution Fund rather than the current arrangement where returns are allocated to distributors in proportion to their share of money already held in the Distribution Fund on their behalf.

The Heritage Lottery Fund argues that this will result in damaging budget reductions:[49]

> (The clause) would, automatically and on a regular basis, re-distribute the interest on balances to all distributors according to the distribution formula (instead of it going to the distributor on whose balance it was earned, as is currently the case). The National Audit Office has calculated that this would have reduced HLF's income by £15.7million in 2003-04. The UK's heritage can ill afford this reduction in funding – for example, £1 billion is needed to restore historic parks, £800million to improve museums and galleries, £400 million to repair Grade I and II* listed buildings (in England alone).

E. Consultation and publicity

A major theme of the 2003 Decision Document was the importance of getting the public more involved in priority setting and decision taking:[50]

> Lottery distributors already consult on their strategies as they are developed. This gives people an opportunity to have their say on the priorities for Lottery funding. But the results of our policy review suggest that in practice this is still not really bringing in the views of Lottery players and members of the public in the way we believe is right. So we have decided to go further and to ensure that views are sought more actively and that distributors act upon them.

The document envisaged a particular role for the Big Lottery Fund in consulting people on decision making:[51]

---

48 NCVO, *Briefing on the Revised National Lottery Bill*, June 2005, p3
49 Heritage Lottery Fund, *Lottery Bill Briefing*, January 2005
50 DCMS, *National Lottery Funding Decision Document*, July 2003, p27
51 DCMS, *National Lottery Funding Decision Document*, July 2003, p27

> The new distributor will also pioneer new ways of consulting local people about particular local decisions. Although there are practical challenges around any arrangement which seeks to involve the public in deciding local priorities we do not accept that they need be insuperable. Local government has pioneered many blue prints here for how this should be done but we have decided that it should be an early priority for the new distributor, working closely with Camelot, to experiment with ways of engaging people in decisions and that this should include experimenting with simple tick box consultation slips made widely available, particularly through Lottery ticket retailers.

Clause 10 gives distributors the power (but not a duty) to "consult any person" or take account of opinions expressed to them or information submitted to them in determining how to distribute money. The Explanatory Notes say this is to remove any doubt about whether they have this power.[52] NCVO are concerned about "how the commitment to increase public involvement sits with the lack of requirement to consult with anyone outside government in the Bill".[53]

Similarly clause 11 is intended to remove any doubt about the powers of distributors to publicise general information about the work of all Lottery distributors.

F. Conservative and Liberal Democrat Lottery policy

The Conservatives, in their 2005 manifesto accused Labour of "raiding the Lottery":[54]

> In 1997 Tony Blair said, 'We don't believe it would be right to use Lottery money to pay for things which are the Government's responsibilities.' In 1998, Labour diverted 13.3% of all good cause money to the New Opportunities Fund (NOF) – to pay for Health, Education and the Environment – and cut funding to four of the original good causes, charities, sports, arts and heritage. In 2001 Labour increased NOF's proportion of Lottery income to 33.3%.
>
> Labour has consistently used Lottery funds to pay for areas of regular Government expenditure. The Lottery has become another Labour stealth tax. Since 1998 charities, sports, arts and heritage have lost over £3 billion in Lottery funding. Labour have merged the New Opportunities Fund with the Community Fund (the distributor of charities funding) to create the Big Lottery Fund – giving Ministers control of 50% of all Lottery proceeds. It is time to take the Government's hands out of the Lottery till.

52 paragraph 22

53 NCVO, *Briefing on the Revised National Lottery Bill*, June 2005, p4

54 Conservative Party, *Action on the Lottery*, a document which formed part of the 2005 Conservative Manifesto

The manifesto went on to pledge that a Conservative government would abolish the big Lottery fund:[55]

> We will abolish the Big Lottery Fund, restore the independence of the Community Fund (the distributor of charitable funding), and release an extra £450 million for charities, sport, arts and heritage. We will complete the funding of all existing NOF projects and commitments.
>
> Labour refuses to guarantee that sport, arts and heritage will continue to benefit substantially from the Lottery when current licences expire in 2009.
>
> We will guarantee that sports, arts, heritage and charities each receive 25% of Lottery funding after 2009. Over a licence period of seven years, our Lottery policy should provide charities, sports, arts and heritage with over £8 billion.

In their 2005 manifesto, the Liberal Democrats pledged to:[56]

> (…) restore the National Lottery funds' independence by ensuring that never again can Government dictate which schemes lottery players' money is spent on and requiring the Department for Culture to clearly separate Government spending from Lottery spending in its annual reports.

III Licensing issues

A. The licensing framework

The *National Lottery etc Act 1993* envisages that the operation of the National Lottery will be in the hands of private sector companies. It provides for two types of licence:

- One licence to run the whole Lottery, providing the technical, retail and marketing infrastructures (section 5); and
- Licences to run and promote the individual games (section 6)

Section 6 licences may be held only with the agreement of the section 5 licence holder.

The National Lottery Commission (NLC) replaced its predecessor, Oflot, in 1999. The Commission awards the section 5 and 6 licences, and regulates the licence holders. It must exercise these functions in a way which it considers most likely to:[57]

- ensure the propriety of the Lottery;

---

55 Ibid

56 Liberal Democrats, *General Election 2005: Liberal Democrats manifesto for Culture, Media, Sport and Tourism*, http://www.libdems.org.uk/media/documents/policies/CMSmanifesto.pdf

57 Section 4, *National Lottery etc. Act 1993* as amended

- protect the interests of participants; and
- maximise returns to good causes.

B. The competitions for licences

Camelot won the first "section 5" licence for a seven year term in 1994, and then in 2001 won the second, to last from January 2002 to January 2009. Camelot also holds all of the "section 6" licences itself. During the first licence period Vernons Pools were granted one of these to operate one game, but since then Camelot has held them all. The National Lottery Commission expects to issue invitations to apply for the new licences at the start of 2007.

There were eight applications for the first seven-year licence, and the National Audit Office subsequently concluded that the process was well-run.[58]

However, there were problems with the second competition. There were only two compliant bids – Camelot, and The People's Lottery, a consortium led by Sir Richard Branson which aimed to run the lottery on a not-for-profit basis. Allegations that one of Camelot's key suppliers had covered up technical problems resulting in underpayments to prize-winners led to the NLC deciding to negotiate exclusively with The People's Lottery. Camelot sought judicial review of this decision, and the court found that there had been procedural unfairness.[59] This led to the resignation of the Chair of the NLC. Revised bids were submitted, and the licence was awarded to Camelot.

The National Audit Office[60] and the House of Commons Public Accounts Committee[61] both reviewed the competition. Both reports found many constraints which had deterred potential bidders, including:

- the costs of mounting the bid
- the "all or nothing" result
- a lack of information about the lottery infrastructure
- a shortage of suitable technology service suppliers

The PAC concluded that there was "a real risk" that there would be "no effective competition for future licences to run the National Lottery".[62]

58 National Audit Office, *Evaluating the Applications to Run the National Lottery*, HC 569 1994-5, 3 July 1995, pp 1-2
59 Times Law Report, "Lack of fairness in lottery decision", 12 October 2000
60 National Audit Office, *Awarding the new licence to run the National Lottery*, HC 803, 2001-02, 10 May 2002
61 Public Accounts Committee, *Awarding the new licence to run the National Lottery*, HC 881, 2001-02, 4 November 2002
62 paragraph 4

The House of Commons Culture Media and Sport Committee also published a report on the operation of the National Lottery in March 2001 which raised similar concerns:[63]

> Lotteries are a natural monopoly. We consider it very likely that, unless further legislative action is taken, the National Lottery will become a perpetual private monopoly for the licensee. If this situation is to be avoided, it is likely that there will need to be a move away from a single licence towards separate licensing processes for different parts of the Lottery operation.

A number of changes were made to the terms of the second licence to try to remove potential barriers to entry for new bidders when the new licence competition is launched in 2007. These included:

- A requirement for the operator to work with the subsequent licensee on Lottery operations for a period of two years preceding the expiry of the licence
- Provision for transfer of assets, such as terminals, at a fair valuation
- Extensive rights for the NLC to request that the incumbent transfers intellectual copyright to it
- Provisions to allow the NLC to make management and marketing information available to bidders

C. The first licensing review

As a result of the National Audit Office's concerns over the future prospects for competition, the Government decided to conduct a review of lottery licensing, and published a consultation document in June 2002.[64] The aim was to consider whether there might be scope for more competition to run the lottery, or for more companies to participate in it.

The review set out four options:

- Separation of the infrastructure and Lottery products
- NLC to run the lottery through the private sector
- Maximum flexibility – i.e. removing section 5 and 6 licensing requirements and giving the NLC discretion to decide on the approach
- A permanent private sector operating company, but with periodic competitions for who should run this

[63] Culture, Media and Sport Committee, *The Operation of the National Lottery*, HC 56-1, 2000-01, 7 March 2001, paragraph 115

[64] DCMS, *Review of Lottery Licensing and Regulation Consultation Document*, June 2002 http://www.culture.gov.uk/national_lottery/QuickLinks/consultations/default.htm?properties=2002+closed+consultations%2C%2C

There were only 10 responses to the review, and there was no support for the first or second of these options. Most respondents also opposed the fourth option, and opinion was divided on the third, although there was limited comment. Some said that it could create scope for more competition, and others saying that it could equally create uncertainty which would discourage competition.

In a "decision document" published in July 2003, the Government announced that it had decided to go for the something broadly in line with the third option, by breaking up the single operating licence and allowing the NLC to offer new style licences covering different aspects of lottery delivery and marketing.[65] These licences could be of different duration, moving away from the single major licence competition every seven years.

D. Economic analyses of lottery competition issues

The Government's aim in its review of the licensing system is to ensure that the National Lottery is run as efficiently and effectively as possible in order to maximize the money raised for good causes. There is generally a presumption that competition will create efficiency, by forcing companies to constrain costs, improve productivity and innovate, and thus that costs for consumers will be reduced. However, there is a debate around the extent to which this presumption can apply to the Lottery. This is partly because the aim of any competition in this context is to raise as much money as possible for good causes, rather than, say, reduce ticket prices or increase prizes for the players. The main "Lotto" game is often described, including by the Government, as a "natural monopoly", mainly because of economies of scale necessary to provide prizes large enough to sustain high levels of ticket sales. The question which arises (as it has in the utility sector, with industries which are also often characterised as "natural monopolies") is the extent to which elements of competition can nonetheless be introduced.

There is a distinction to be drawn between competition between bidders for the licence, and possible competition between different operators for customers. Greater competition in the tendering process might be expected to lead to sales increases from greater innovation or to redistribution between profits, prizes and returns which would be more advantageous for good causes. More controversial is the likely effect of competition between different lottery operators in the operation of the games. This could result in greater innovation which would increase sales, and therefore funds for good causes. Conversely, it could lead to less co-ordination and greater "cannibalisation", whereby some games flourish at the expense of others, which could reduce funds for good causes. Similarly there is controversy over the way in which competition *within* the National Lottery market might affect competition *for* that market. One the one hand, breaking the

---

65 DCMS, *National Lottery Licensing and Regulation Decision Document*, July 2003, paragraph 4.4, at http://www.culture.gov.uk/NR/rdonlyres/eq5jn4o6tolw7ldleaskec4ijfptkpizyjzzpqv2quplrtun7eok4hdubke7olb5sdkeujiwoery7wi2yogqiij3hya/LotteryLicensing.pdf

licences up might attract smaller bidders, who would be unwilling to bid for the whole lottery. One the other, it might create more uncertainties which could discourage bidders.

A problem in evaluating these arguments is that these are questions which simply do not arise in most other countries, where the national lottery is administered by the Government, or by a Government agency, rather than regulated by a quango and administered by the private sector.

Camelot commissioned Frontier Economics Ltd (FE) to carry out an economic assessment of the Government's proposal to allow a multiple licence model.[66] The main conclusions were as follows:[67]

- Multiple licence holders competing "within the market" could reduce funds for good causes, because of cannibalisation, lack of coordination over product launches, loss of economies of scale and under-investment.

- Moving to this model might not increase competition "for the market" as increased uncertainty and a more complex strategic environment might deter bidders for the licences

- There could be alternative ways of increasing competition for the licence within the current system, for example by allowing the operator to select different suppliers during the licence period, and underwriting the costs of bidding.

- Offering multiple licences would be a complex option with significant risks and no clear benefits to good causes.

The NLC responded by commissioning its own study from National Economic Research Associates (NERA).[68] This made a number of criticisms of the FE report, arguing:

- It did not distinguish between awarding only one licence for each different type of lottery product, and more than one licence being awarded for each type of product. It argued that the NLC envisaged reducing cannibalisation and the problems of uncoordinated launches by splitting the licence by game type and awarding distinct non-competitive areas to different operators.

- It ignored the benefits of competition which could lead to increased returns to good causes, such as innovation of game design and marketing, and cost reduction

---

66 The executive summary of this report was reproduced at Appendix A of the Culture, Media and Sport Committee's report, *Reform of the National Lottery*, HC 196-1, 9 March 2004.

67 Ibid, Appendix B

68 Ibid, Appendix B

- It assessed the risk of the proposals, but not that of maintaining the status quo

- It undervalued the role that NLC regulation can effectively play to avoid undesirable outcomes.

E. Select committee criticisms of Government proposals

The Government's decision to choose a multiple licence option was criticised by two Commons committees –the Culture Media and Sport Committee, and the Joint Committee on the Gambling Bill.

The Culture, Media and Sport Committee heard evidence that the introduction of a multiple licence system would in fact stop prospective bidders, including The People's Lottery (TPL), from bidding for the third licence:[69]

> When considering the advantages and disadvantages involved with the retention of the present system or evolution to a multiple licence system, Mr Simon Burridge representing TPL made a clear and bold statement to the Committee that "faced between the choice of Camelot in perpetuity and the Government's new proposals, with the greatest reluctance I think I would volunteer for Camelot in perpetuity as the lesser of two evils." Looking at the evidence presented to us in this inquiry, including on the limitations of the NLC, we have to agree.

The Committee urged the Government to consider fully all of the implications of introducing a multiple licence system against alternative solutions available and consider examples of overseas lotteries.

The Joint Committee on the draft Gambling Bill also examined the proposals, which it had been thought would have been introduced as clauses to that Bill, and also recommended that the DCMS reconsider this policy.[70]

F. The second licensing review

The Government's response to the Culture Committee agreed that further work was required before the third licence competition:[71]

> As part of this, the Department and the NLC will undertake additional research on the options. As part of this work, account will be taken of changes in the UK lottery and gambling market and of international experience. The Government will also have full regard to the evidence provided to the Committee, including

69 Ibid, paragraph 84
70 House of Lords/House of Commons Joint Committee on the Draft Gambling Bill, *Draft Gambling Bill*, HL 63-1/HC 139-I 2003-04, paragraph 112

> the work undertaken by Frontier Economics (for Camelot) and NERA (for the NLC). Following this further work, the Government will produce a report on how to maximise funds for good causes in future.

Accordingly, a further consultation document was published in May 2004 seeking views from previous and potential bidders and from other interested parties.[72] It asked about the circumstances under which organisations would be willing to bid for a single licence, and for multiple licences. This time there were eighteen responses. Consideration of these, and further work on international comparisons, and an economic assessment by the DCMS of the effects of competition on the National Lottery[73], resulted in a fresh "Decision Document" in November 2004.[74]

The document proposed that the single licence should be retained, and that the NLC should encourage competition in other ways. However, the Government also proposed that it should have a reserve power to bring in a multiple licence system in case these efforts did not prove sufficiently effective:[75]

> The Government considers that the current system for awarding a single licence has served the Lottery well in the past and should do so again. The Government's preferred way forward is a single licence. Therefore the Government wants to see whether the potential improvements to the bidding process can be made to provide an effective competition for a single licence. The challenge will be for the NLC to work to deliver a level playing field for the competition, which also addresses the concerns expressed by potential bidders about the advantages of the incumbent operator.
>
> However, the Government is also mindful of the concerns expressed by potential bidders and the Committee of Public Accounts that the improvements the NLC could make to the arrangements for selecting a National Lottery operator may not be enough to ensure that there is effective competition next time. The Government's key objective is to make sure that the Lottery licensing process maximises returns to good causes. It has therefore decided that if this is not possible through a single licence it needs to take a reserve power in a situation where the competition for a single licence is considered not to be capable of maximising returns to good causes. If the only way of maximising returns to good causes is to offer for competition more than one licence, the Government will take up the reserve power but this is not its preferred option.

---

71 DCMS, *Government Response to the Culture, Media and Sport Select Committee Report on the National Lottery Session 2003-2004*, CM 6232, May 2004

72 DCMS, *National Lottery Licensing Consultation*, 25 May 2004, available at http://www.culture.gov.uk/NR/rdonlyres/e5vkecykewum3mtxcbs34qmh2kgc44uoz2h6y65crhh3raghiqhbyv4wuemwvtxawcmqlrpliwltz7rnenkysxtzsyd/LotteryLicensingConsultation2004.pdf

73 reproduced as appendix B to the Review Decision Document and at: http://www.culture.gov.uk/global/publications/archive_2004/assessment_effects_competition_national_lottery.htm

74 DCMS, *National Lottery Licensing and Regulation Review Decision Document*, November 2004

75 Ibid paragraphs 4.1-2

G. The Bill

This proposal is reflected in the Bill. Clause 6 contains the reserve power to bring a new multiple licensing structure into effect by order, subject to negative procedure.[76] The Explanatory Notes state that this separate commencement provision is "to reflect the intention that the Secretary of State will not commence Schedule 1 immediately but only if she considers that the current licensing structure has failed in creating an effective competition for the licence".[77]

The reserve licensing structure itself is set out in schedule 1. As has already been stated, currently there are two types of licence – a section 5 licence to run the lottery and a section 6 licence to promote individual lottery games. A section 6 licensee can only promote these games with the agreement of the section 5 licensee. The licence to run the lottery as a whole would be abolished, leaving only one type of licence – to promote individual lotteries or types of lotteries. This would mean that there could be multiple licence holders holding different kinds of licences. The NLC could require licence holders to work together with another for specified reasons (such as a joint promotion) and to provide information and make facilities available to other licence holders or potential bidders for licences.

There are also changes to the NLC's constitution under clause 1, particularly allowing it to expand beyond its current maximum membership of five. This reflects the fact that if the reserve power were to be used, the task of the NLC would become more complex. Instead of appointing one of their number as chair on a rotating basis, as happens currently, the Secretary of State would appoint a non-executive member as Chairman for a fixed term.

One proposal made by some respondents to the 2004 consultation exercise which they felt would encourage companies to bid for the licence was extending its length to allow the operator to manage capital outlays better.[78] Currently the *National Lottery etc Act 1993* does not state how long the licence should last. Clause 4 would require them to last for a maximum of 15 years.

---

[76] Further information on statutory instrument procedure is provided in Library Factsheet L7 available at http://www.parliament.uk/documents/upload/L07.pdf

[77] *National Lottery Bill Explanatory Notes*, 24 May 2005, paragraph 12

[78] DCMS, *National Lottery Licensing and Regulation Review Decision Document*, November 2004 paragraph 3.9

IV Devolution and human rights

The Bill extends to the whole of the UK. The 2003 Decision Document set out the Government's desire for the devolved administrations to have more influence in setting priorities and strategies:[79]

> Currently the devolved administrations in Scotland, Wales and Northern Ireland[2] can issue policy directions to the Arts and Sport Councils in their countries, subject to consultation with the Secretary of State. They can issue policy directions to UK-wide distributors in as much as they impinge on devolved matters, subject to the agreement of the Secretary of State. (Examples would be giving priority to particular categories of recipients, to recipients in particular parts of their countries, or to the Executive or Parliament/Assembly's policy objectives.) The Secretary of State retains the power to vary the shares of distribution fund money between the good causes; to vary the shares between the different distribution bodies within the good causes and to create new, or remove existing distribution bodies. Devolved administrations do not have the power to make decisions on the allocation of resources (percentage share) between their countries and other parts of the UK.
>
> Some responses to the consultation exercise, including those from devolved administrations, have suggested that Scotland, Wales and Northern Ireland should be given more direct influence over how Lottery money is spent in their countries. There are a range of views about how precisely this should be done and we will consider the options carefully.
>
> We are committed to preserving the overall integrity of the UK Lottery and hence our provisional view is that we should retain a UK structure for distribution, but that the devolved administrations in Scotland, Wales and Northern Ireland should have more influence in setting specific priorities and strategies, taking account of the needs and wishes of local communities and service providers there. We will legislate to achieve this if necessary.

Accordingly, the Bill makes a number of requirements for the Secretary of State to consult with devolved administrations.

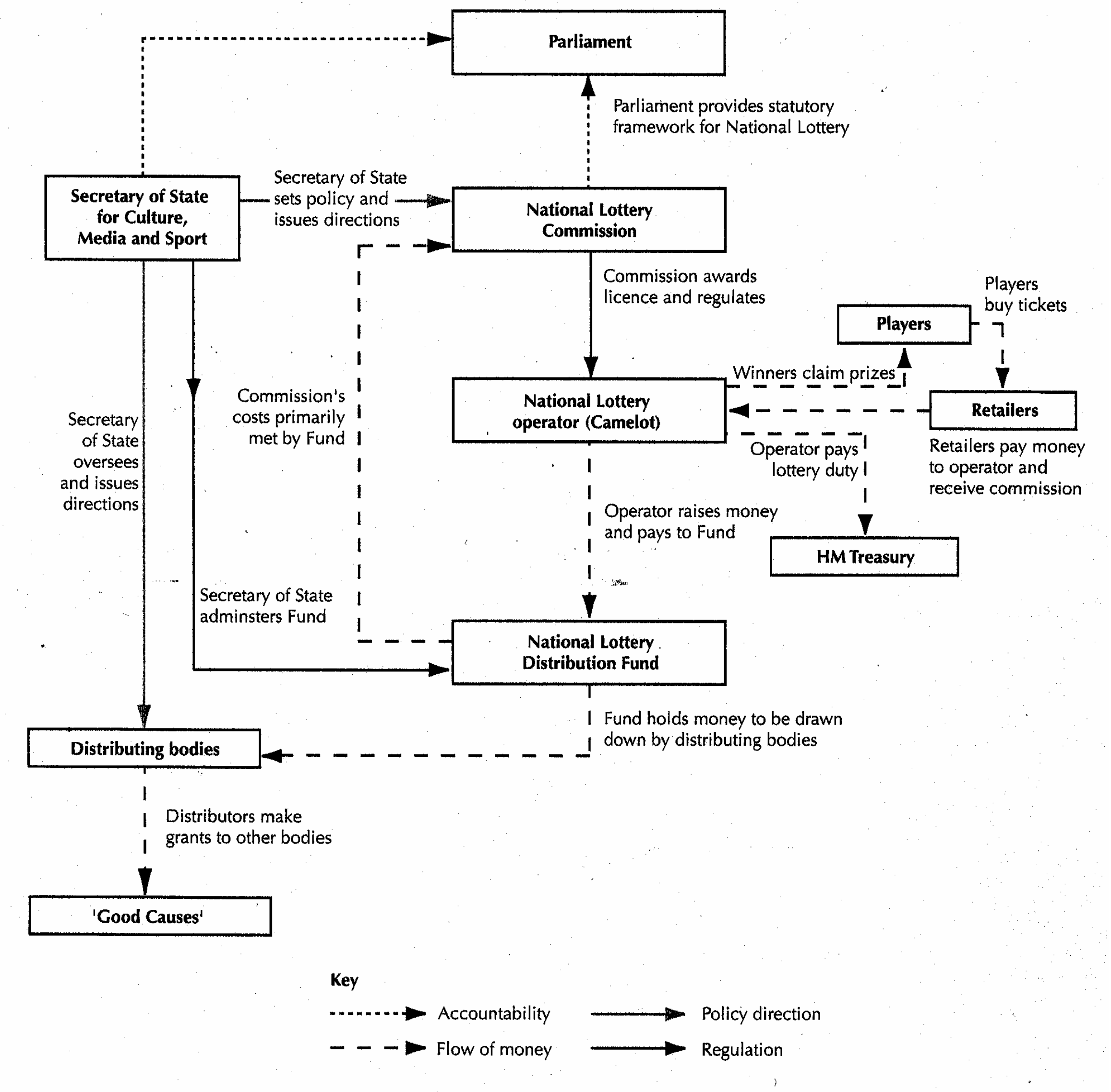
The Explanatory Notes state that the Bill's provisions are compatible with the European Convention on Human Rights. In its Eighteenth Report of 2004-05, the Joint Committee on Human Rights stated that two provisions engaged human rights but that they "do not give rise to any significant risk of incompatibility." [80]

---

79 DCMS, *National Lottery Funding Decision Document*, July 2003, p28

80 http://www.publications.parliament.uk/pa/jt200405/jtselect/jtrights/111/11127.htm

Appendix - National Lottery – funds and responsibilities[81]



81 This chart is reproduced from the National Audit Office's report, *Awarding the new licence to run the National Lottery*, HC 803 2001-02, 10 May 2002, p 12