APPENDIX

State of New Jersey

Department of the Treasury

Division of the State Lottery

November 24, 2015

Opening Statement of Executive Director Carole Hedinger, CPA

Before the Senate Legislative Oversight Committee

Good morning Mr. Chairman and members of the committee.

I am pleased to be here today to provide the committee with an update on the state of the New Jersey Lottery and to address questions you may have about our partnership with Northstar.

Before I start, I do have some news with respect to the amount of revenue the Lottery generated for the State budget in Fiscal Year 2015. The revenue that Lottery produced in 2015 was $960 million – just a half percent less than the previous year's total of $965 million. Much lower amounts for FY15 were reported in the press. However, those were unaudited figures and did not account for final adjustments.

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While we all would prefer to see a revenue increase year over year, I would like to place the $960 million in 2015 revenue in the context of a national trend in which many lotteries across the country are experiencing poor results due to changes in consumer behavior beyond anyone's control.

As I think most members of the Committee are aware, there has been a severe nationwide decline in consumers playing the big multistate jackpot games – Mega Millions and Powerball. This change in customer purchasing behavior is a function of market forces beyond any state's control, and as you would expect, it impacted every state's bottom line. In New Jersey, it resulted in approximately $112 million of fewer sales of Mega Millions and Powerball tickets in 2015.

To be clear, the reduction in ticket sales means the State collected approximately $45 million less from these two games in Fiscal Year 2015.

Thankfully, a $45 million loss of revenue in 2015 did not occur. Nor did the sort of revenue losses that occurred in other States' comparable lotteries.

There is one crucial reason for our success in combatting a debilitating nationwide trend and staving off the losses that impacted other states: A successful partnership with Northstar.

Please, allow me to tell you why I believe that partnership has improved our lottery.

I don't mean to suggest for a moment that either the Lottery or its partner, Northstar, believe flat revenues are where we want to be. But achieving flat revenues, in the face of incredibly challenging national trends that no one foresaw when our agreement with Northstar was executed, is an accomplishment nonetheless.

Let me walk you through what our partnership with Northstar has helped us accomplish; something we could not have come close to achieving without them.

As you know, only sales and marketing functions (not all of Lottery's responsibilities) were contracted out to Northstar. From the day the contract was signed on June 21st to October 1st of 2013, the Lottery and Northstar engaged in a transition period. At the time of the agreement, approximately half (64 out of 130) of Lottery's employees were involved with the Sales and Marketing Departments. By the conclusion of the transition period in late 2013, many of these employees, though not all, became part of Northstar's greatly enhanced private sector sales and marketing force of 133 people. While doubling the size of marketing and sales support was important, the professional experiences, strengths, and talents brought to the table by Northstar were equally important.

The transition period officially ended on October 1, 2013, with Northstar assuming responsibility to provide sales and marketing services to the Lottery. Management and oversight of all Lottery operations remain with State Lottery officials. That critical function has never been privatized, as some media have erroneously reported. In other words, Northstar cannot do anything without our approval.

Lottery and Northstar have operated as a partnership with the common goals of increasing sales and revenue, providing better service to our retailers, expanding sales channels by engaging large retail chains such as Wawa and Rite Aid, improving our game portfolio to add new and exciting games to attract and retain our players, and providing much needed technological improvements to enhance our ability to operate. As an example, Northstar provided the technology and machinery to allow partial-pack instant game returns that addressed a long-standing complaint from retailers. This allowed retailers to better manage their instant game inventory and carry more instant games – providing their customers with more choices. Along with new customer-facing ticket dispensers provided by Northstar, our footprint at retail has greatly expanded. With these tools and a larger sales force supporting the retailers' efforts, we have seen record growth in instant ticket sales which are now – through October - more than 10% higher than the prior year. In addition, our in-state daily games are more than 9% higher than this time last year. This growth in areas not subject to uncontrollable national trends has been essential in efforts to stem what would otherwise be enormous losses in State revenue – losses from unavoidable Mega Millions and Powerball declines.

Northstar provided the Lottery with the technology and software for a new and modern claims and payment system that has made processing and payment of winners' claims quicker and more efficient. This new system replaced outdated and unsupported technology that was increasingly subject to failure, which could have led to a total breakdown in our ability to pay claims and the loss of our players' faith in the integrity of the Lottery's systems.

To date, Northstar has expanded the retail network by 823 locations to 7,201, compared to when it first assumed responsibility for retailer recruitment. That's a 13% increase. Northstar has invested millions of dollars in equipment and communication costs to acquire these new retailers.

In addition, Northstar has deployed 426 full-service Gemini ticket vending machines throughout the state.

It is important to note that the 239 Wawa locations would not be selling Lottery without these Gemini full-service machines. Northstar also provided Wawa with a back office reporting system that was instrumental in forming its decision to take on our Lottery products. So far, Wawa alone has generated more than $100 million in Lottery sales.

It is difficult for me to imagine how the Lottery alone would have been able to acquire the necessary equipment and engineer a back-office reporting system to get these new retailers online with the speed and efficiency that Northstar has been able to achieve.

Currently, Northstar is working with us to develop a modern, automated licensing system to replace the largely manual and paper-driven process we have now. These improvements are all due to the commitment of Northstar to provide the highest level of service to the Lottery.

The Lottery is a retail business competing in the market place for a share of the discretionary dollars people spend on games and entertainment. In spite of increasing gaming competition and the national decline in sales of multi-state jackpot games, the Lottery has achieved record growth in sales. For the first time in its 45-year history, the Lottery achieved more than $3 billion in sales in FY15 – a growth of more than 3% over FY14. That success never would have happened without a partnership with Northstar. In fact, without Northstar, the Lottery would be reporting tens of millions of dollars of less revenue.

Northstar's hard work to mitigate Mega Millions and Powerball losses by developing new games and promoting current games more effectively is continuing into 2016. Through November, sales of our daily games are up 9.4%, and sales for instant games are up 10.2%. These efforts, in conjunction with an economy that is steadily improving along with decreasing gas prices that give consumers more discretionary dollars to spend at convenience stores where tickets are sold, provide encouraging signs that Lottery revenues are growing again.

The Lottery and Northstar work together in a partnership with goals that are aligned with yours – to maximize revenue for the State budget and to offset the cost of important services we all support. To be successful, our efforts must be coordinated – working together as a team to achieve a common goal. Retail expansion occurs with both Northstar's efforts and Lottery's Administration, Security, Licensing and other back office services. New games are being developed and deployed with both Northstar's research and technology and Lottery's Financial, Security and Drawing Units. We have worked hand in hand with Northstar to create a $3 billion retail sales organization with more than 7,200 retail points of sale that is the envy of much of the lottery industry.

To achieve a successful partnership we communicate daily and we work well together.

I am very pleased with Northstar's performance because I know the challenges the entire industry faces. I know how difficult it is to expand retailer points of sale, maintain a trained sales staff sufficient to support the retailers, secure adequate advertising resources, gather meaningful research and procure the necessary technology to support a multi-billion dollar business while having the agility to respond to market demands. I know because I've been engaged in that struggle for many years. I now feel comfortable that the New Jersey Lottery has the human, economic and technical resources necessary to meet the challenge – and that is because of the partnership with Northstar.

The New Jersey Lottery is one of the top-ranked lotteries in the world in terms of government revenue transfers. We rank third among U.S. lotteries in revenue transfer per capita, trailing only Massachusetts and New York.

Before I conclude my remarks, I would like to clarify the origins of our Partnership with Northstar. It has been erroneously referred to as a 'no-bid contract' more than once.

There was a public Request for Proposals (RFP) for Lottery Growth Management Services. It was issued to broadly solicit proposals from qualified and interested bidders to provide certain services and equipment for the sales and marketing functions of the NJ Lottery.

The State's intention in seeking these services was to strengthen and maximize future revenues in support of the State budget and important services.

The RFP was publicly advertised and displayed on the State's website. More than 36 people from various organizations and companies attended a mandatory conference and site visit.

In spite of the large interest in the RFP and the large number of submitted questions, the State received only one response, which was submitted by Northstar New Jersey Lottery (Northstar), a joint venture between GTECH Corporation, SCI Games, Inc., and OMERS, the Ontario

Municipal Employees Retirement System. Both GTECH and SCI Games are two of the top gaming companies in the world today.

After significant vetting of that proposal, a review committee, with an impressive depth of experience, issued a report that unanimously determined that the award of a contract to Northstar "...would provide the State with proven and diversified lottery management capabilities, comprehensive U.S. and international lottery experience, expertise within the lottery industry, and a management team with extensive New Jersey and global lottery-industry experience."

The process, challenged in court by the CWA, was upheld by the Appellate Division. The Court ruled that the contract was properly awarded. The procurement process was lawful. It was public. It was transparent. And most importantly, it resulted in a partnership that has helped to combat a national trend in which many consumers have stopped playing the highly profitable Mega Millions and Powerball games. The partnership has not resulted in the revenue goals envisioned at the time the agreement was reached. But the partnership has been good for New Jersey's budget, which has benefited from enhancements to counter revenue losses attributable to sales trends that have been damaging throughout the lottery industry. The partnership has been good for retailers who have received higher commissions and improved services for small and large businesses alike in the form of marketing and sales support as well as technical improvements. It has been good for the players themselves, who have won more prizes and received a broader array of games from which they can choose.

For those who advocate terminating this contract, please recognize that those efforts would end a partnership that protects State revenues in support of critical services for veterans, college students, school nutrition programs for our children and the disabled. The Lottery was not better off on its own. We needed a strong, experienced partner to modernize our systems, our marketing and our retail distribution. Northstar provides the resources we need, and together we will see the

Lottery grow in a secure manner into the future as the investments now being made bear fruit.

Mr. Chairman, I would now respectfully request that Northstar be permitted to testify about the services it delivers and to provide information about the industry and their efforts to help New Jersey in offsetting revenue losses from multistate games.

Thank you.

REQUEST FOR INFORMATION

INCREASING NET REVENUES AT NJ STATE LOTTERY

PURPOSE

The State Treasurer is seeking ideas and information to increase net revenues generated to the State by the New Jersey State Lottery (Lottery). The State seeks recommendations to improve any or all aspects of the Lottery's operation including: sales and marketing strategies and functions; product offerings; back office operations; information technology; and financial management. Any proposed services or solutions may include the use of third party providers.

BACKGROUND

The Lottery is a division of the Department of the Treasury and was established on February 16, 1970 pursuant to N.J.S.A. 5:9-1 et seq. This legislation also created the Lottery Commission, the body that promulgates rules and regulations governing the establishment and operation of the Lottery. The first tickets were sold on December 16, 1970 and the first lottery drawing was held on January 7, 1971.

The Lottery has a staff of approximately 150 employees organized around seven work functions, including: Administration; Operations; Management Information Systems; Marketing; Sales; Security, Audit, Licensing; and Finance. For additional details regarding the Lottery's current structure and operations, please go to www.state.nj.us/lottery and see the attached document "New Jersey Lottery - Selected Observations " prepared by Macquarie Capital.

The Lottery's present vendors are as follows:

Advertising: Brushfire, Cedar Knolls, NJ

http://www.state.nj.us/treasury/purchase/noa/contracts/t0654_09-x-39622.shtml

Instant Game: Pollard Banknote Ltd., Manitoba, Canada
GTECH Printing Corporation, Plant City, FL
Scientific Games International, Alpharetta, GA

http://www.state.nj.us/treasury/purchase/noa/contracts/t0566_02-x-33519.shtml

Online Games: GTECH Corporation, West Greenwich, RI

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http://www.state.nj.us/treasury/purchase/noa/contracts/t1320_08-x-39707.shtml

During Fiscal Year 2011 (7/1/2010-6/30/2011), the following Lottery games were in operation:

- Pick-3
- Pick-3 Instant Match
- Pick-4
- Pick-4 Instant Match
- Jersey Cash 5
- Jersey Cash 5 Instant Match
- Pick-6 Lotto
- Mega Millions (Multi-State Game)
- Powerball (Multi-State Game – Started 1/31/2010)
- Various Instant Scratch Off games

Sales revenues for these games totaled over $2.6 billion for the fiscal year ending June 30, 2011. For the same period, administrative expenses totaled $22.3 million; sales commissions totaled $147 million, vendor fees totaled $33 million, and prize expenses totaled $1.544 billion. As a result, the Lottery was able to contribute $930 million to education and institutions on a net revenue basis.

REQUIRED INFORMATION

In accordance with the provisions of this Request for Information, you are requested to provide written responses to the following:

1. To what extent, and in what areas, could current resources or alternative private parties be used to increase annual Lottery net revenue to the State?
2. Are there any new or alternative business/financial models, possibly involving the use of private parties, which could help maximize Lottery net revenues to the State?

Responses should include, but not be limited to, proposals that speak to risk shifting, forms of financial guarantees, income targets, and incentive compensation.

Please include the following in all responses:

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- A description and incremental cost of any alternative compensation plans you may recommend for any private party which would be necessary to maximize Lottery net revenue to the State.
- A legal and financial analysis as to the impact of current contracts supporting the operations of the Lottery on any options or possible alternative business/financial models.
- A legal analysis as to the application of existing federal and state law upon each option or possible alternative business/financial model. Responses may provide business/financial models that contemplate changes in federal or state law but such models should be separated from those models that assume no change in federal or state law. All responses must identify any legal assumptions clearly.
- A statement of prior experience in providing any proposed services or solutions, results attained, and references with contact information.
- Cost estimates for proposed services or solutions and any related assumptions.

PLEASE NOTE

Responders agree that all documents are subject to public disclosure. A responder may designate specific information as not subject to disclosure pursuant to the exceptions to OPRA found at N.J.S.A. 47:1A-1.1 or the common law Right to Know, when the responder has a good faith legal and or factual basis for such assertion. The State reserves the right to make the determination as to what is proprietary or confidential, and will advise the responder accordingly. The location in the response of any such designation should be clearly stated in a cover letter. The State will not honor any attempt by a responder to designate its entire proposal as proprietary, confidential and/or to claim copyright protection for its entire response. In the event of any challenge to the responder's assertion of confidentiality with which the State does not concur, the responder shall be notified and shall be solely responsible for defending its designation.

These proposals shall become the property of the State once submitted.

ANALYSIS AND EVALUATION

The Department of the Treasury's analysis and evaluation process will include direct meetings in January or February 2012 with some or all respondents.

RFI RESPONSES

Please email responses to: Margaret.Quinn@Treas.State.NJ.US

Responses are requested by January 17, 2012.

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NEW JERSEY LOTTERY

SELECTED OBSERVATIONS

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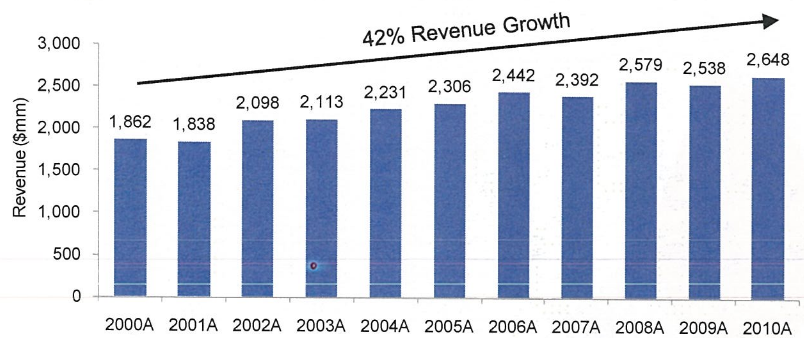
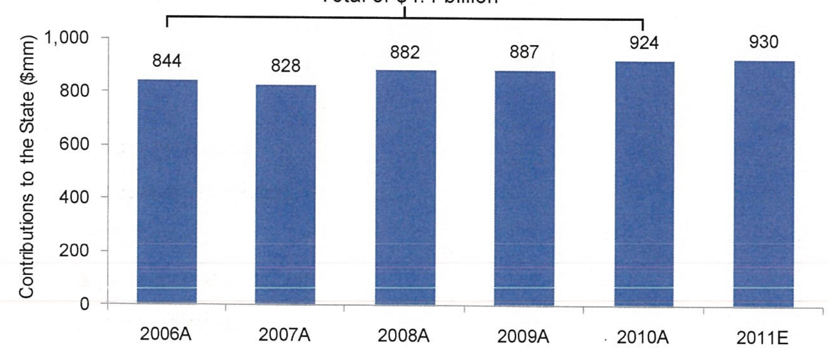
Lottery Strengths and Comparative Performance

- As we discussed during our prior meeting, the Lottery is a valuable asset and has been a meaningful source of revenue for the State of New Jersey (the "State")

Total Revenue

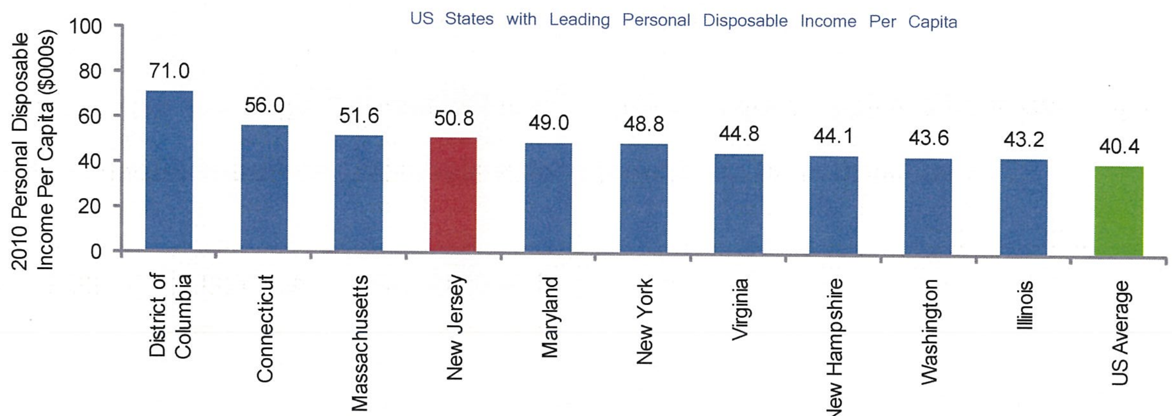


Contributions to the State



- Moreover, there are demographic attributes of New Jersey that provide a solid environment for the Lottery, including high per capita income and the propensity to game

US States with Leading Personal Disposable Income Per Capita



Source: New Jersey Lottery Annual Reports, Bureau of Economic Analysis

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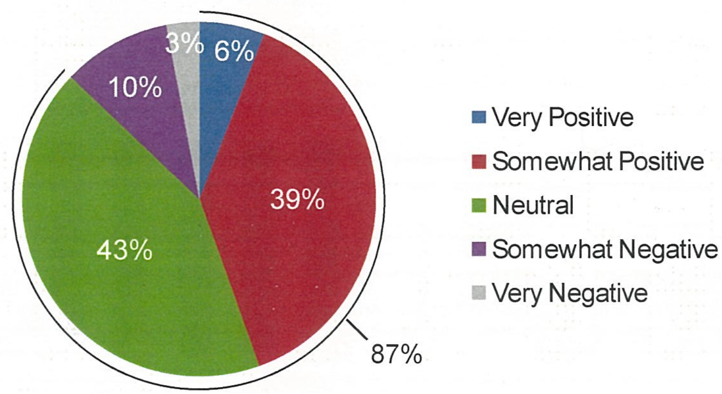
Lottery Strengths and Comparative Performance

- The Lottery exhibits several strengths that create a solid foundation for improvement
  - With a forty year history, the Lottery is well regarded in the industry and by the population of New Jersey

Opinion of the New Jersey Lottery (2011)



  - The recently appointed Executive Director and Deputy Executive Director bring business and industry experience to their roles, have adopted a collaborative approach to rebuild employee morale and engagement and have commenced an effort to improve performance management and measurement and long-term planning at the Lottery
  - The Lottery has long serving staff with extensive institutional knowledge

Source: Crestwood Associates' Attitude and Usage Study dated March 23, 2011

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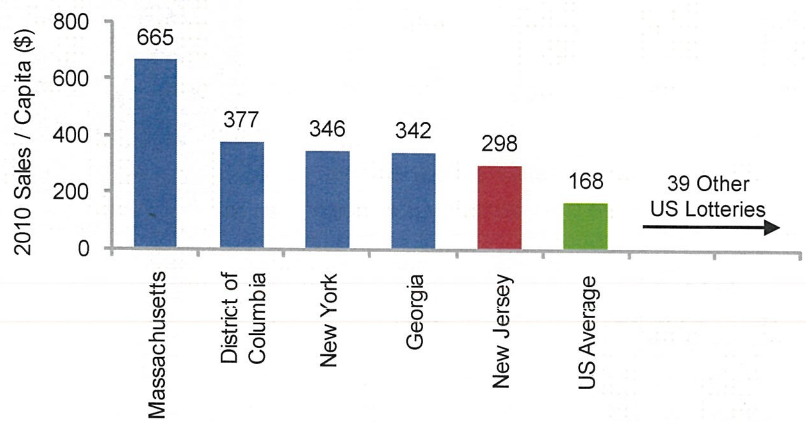
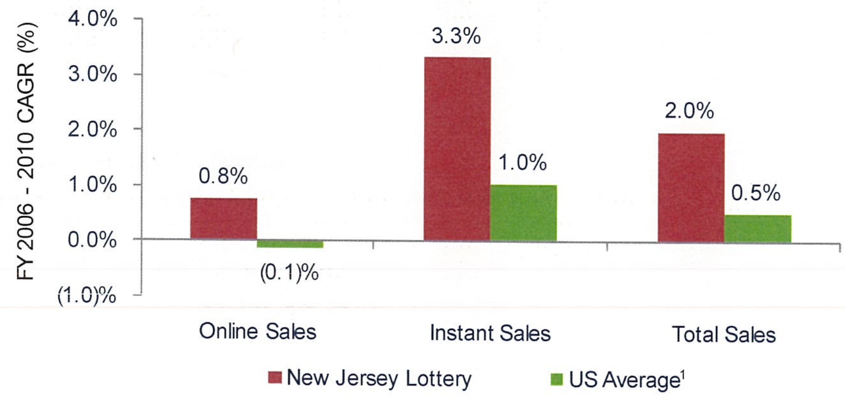
Lottery Strengths and Comparative Performance

- These factors have contributed to performance that is consistent with the better performing US lotteries

5th among 44 US Lotteries in Sales Per Capita

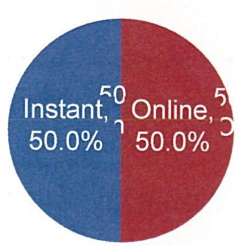


Faster Than Average Growth in Online and Instant Sales

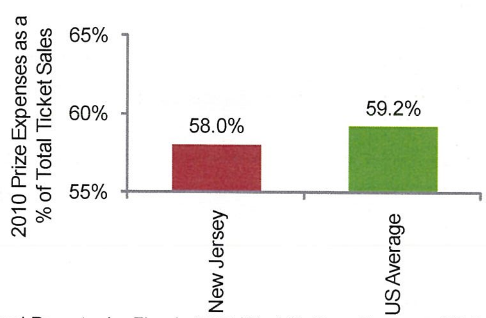


Balanced Portfolio and Relatively Low Prize Payout Ratio

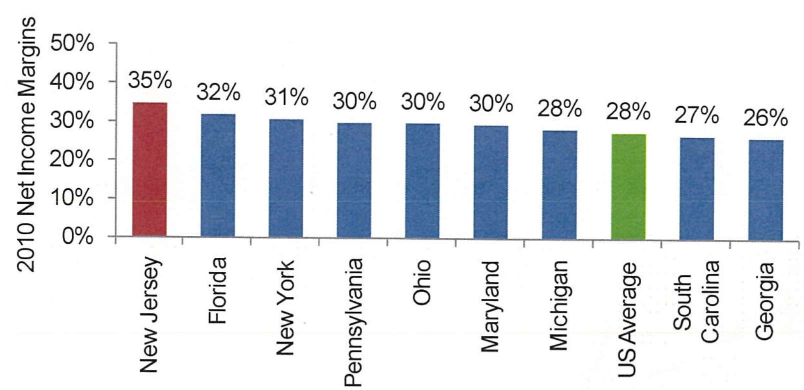
Breakdown of FY 2010 Ticket Sales



Prize Payout Comparison



Efficient Lottery with High Net Income Margin



Source: New Jersey Lottery Annual Reports, La Fleur's 2011 World Lottery Almanac, US Census Bureau
1. Exclude US lotteries (Arkansas, North Carolina, North Dakota, Oklahoma, South Carolina and Tennessee) that began operations after 2001

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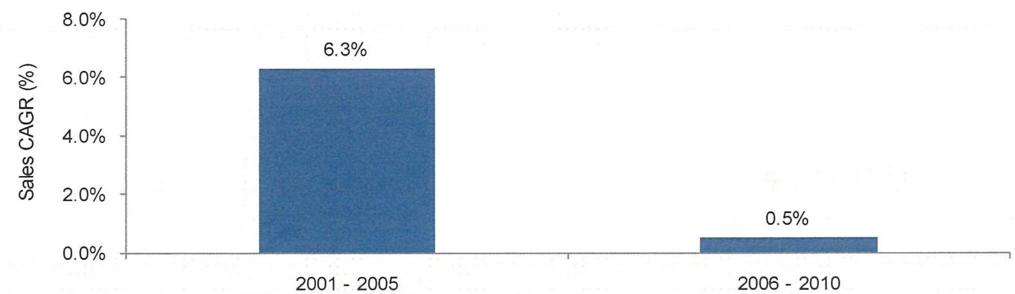
Lottery Industry Context

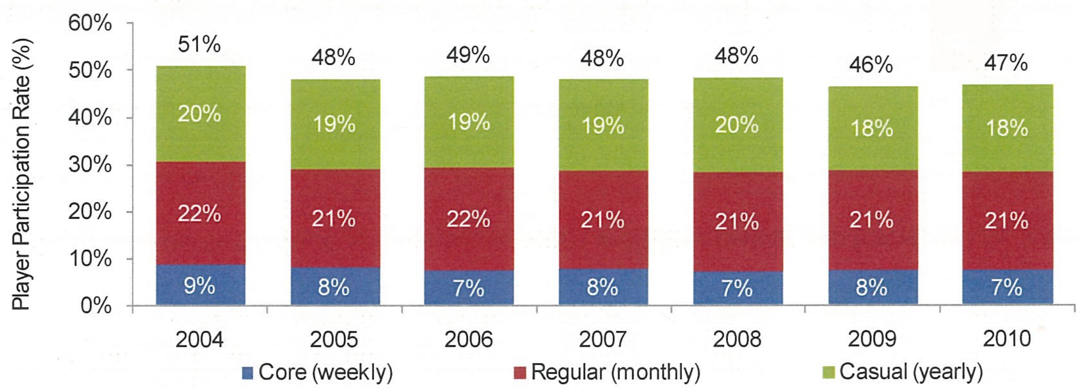
The Lottery operates in an industry that is maturing and experiencing sales growth decline and uncertain prospects in the context of several challenges and threats

US Lottery Sales Growth Rate (2001 – 2010)[1]



Consumers

- Lottery participation rate among Core and Regular players (those who play weekly or monthly) is low
- Core and Regular player base is gradually declining over the long term



- Large percentage of population does not or rarely plays

Source: La Fleur's 2011 World Lottery Almanac, annual reports for US State Lotteries, Experian Simmons
1. Exclude US lotteries (Arkansas, North Carolina, North Dakota, Oklahoma, South Carolina and Tennessee) that began operations after 2001

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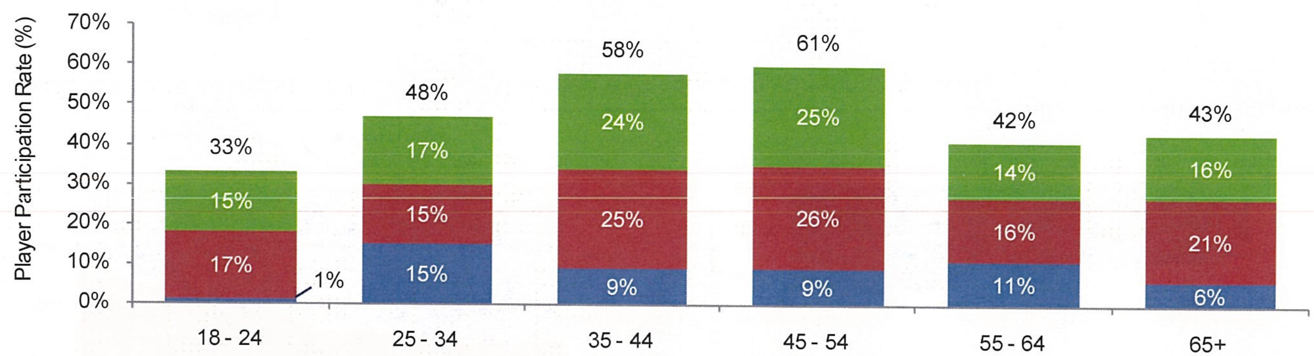
Lottery Industry Context

The Lottery operates in an industry that is maturing and experiencing sales growth decline and uncertain prospects in the context of several challenges and threats

Consumers

- There is lower participation among younger players

Participation Rate by Age for US Lotteries (play at least once a year)



- Innovation to address constantly changing consumer trends is limite
- Links between lottery and where the money goes are often not well understood or articulate
  - *"The importance of transparency and trust as essential underpinnings of support for a State or National lottery cannot be overstated. A study by Roy Morgan research illustrates the positive impact upon participation rates when the public clearly perceives the lottery as a funder/supporter of worthy causes." (Camelot Official Statement, August 19, 2010)*

Competition

- Competition from casinos, internet and other forms of entertainment is increasing

Source: La Fleur's 2011 World Lottery Almanac, annual reports for US State Lotteries, Experian Simmons

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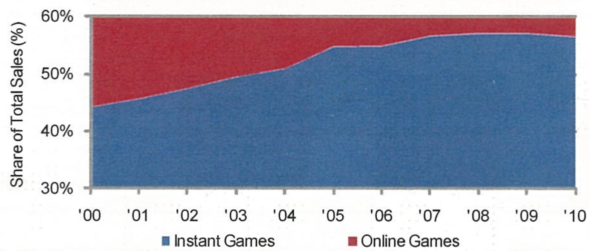
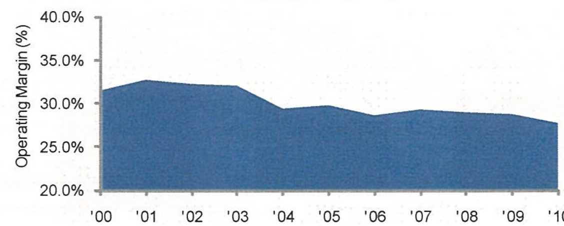
Lottery Industry Context

The Lottery operates in an industry that is maturing and experiencing sales growth decline and uncertain prospects in the context of several challenges and threats

Products

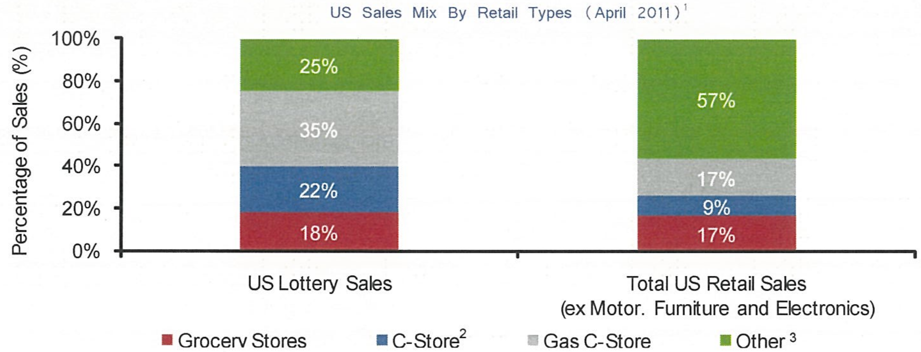
- Sales growth highly dependent on prize payout and jackpot size
- Greater emphasis on instant tickets is driving prize payouts higher, adversely affecting margins





Sales and Distribution Channels

- Distribution and availability has not evolved in step with changing consumer behavior



- Chain stores preferring newer technology and distribution channels that fits their structure (e.g. in-lane solutions)
- There is no transactional internet channel

Source: La Fleur's 2011 World Lottery Almanac, annual reports for US State Lotteries, US Census Bureau
1. Excludes sales over the internet; sales over the internet was over $100 billion for 2010
2. C-Store represents convenience store
3. Includes general merchandise store, large chain retailer stores, restaurants and non-store retailers

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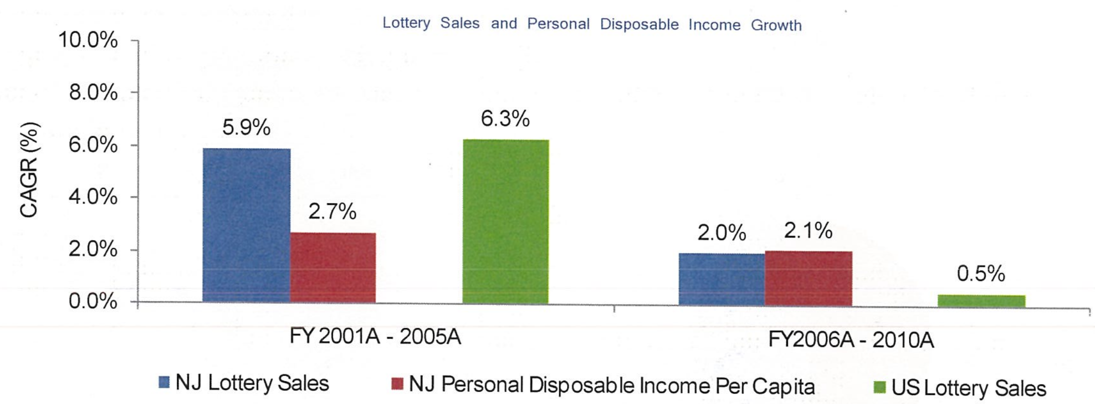
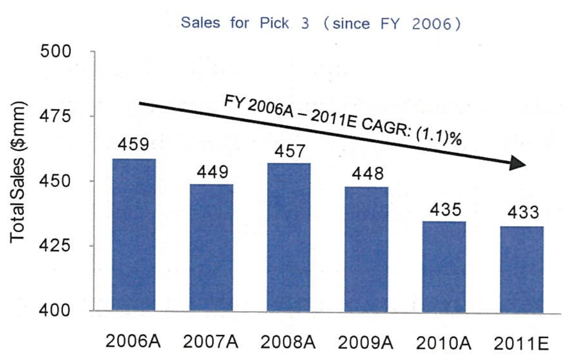
Observations on the Performance of the Lottery

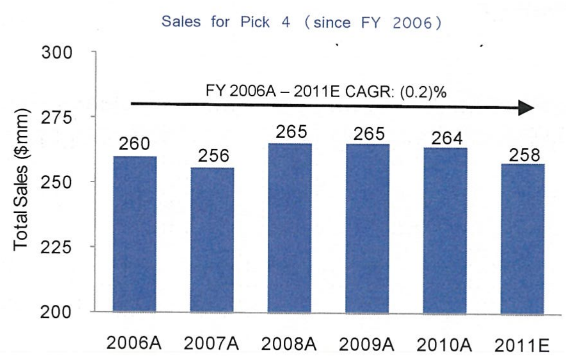
Many of the overall industry characteristics are evident in New Jersey

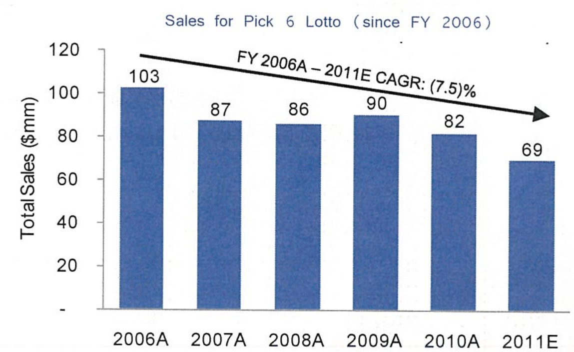
- Ticket sales growth has moderated in recent years



- Several core online games are delivering flat or declining performance







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Source: La Fleur's 2011 World Lottery Almanac, New Jersey Lottery Annual Reports, Bureau of Economic Analysis

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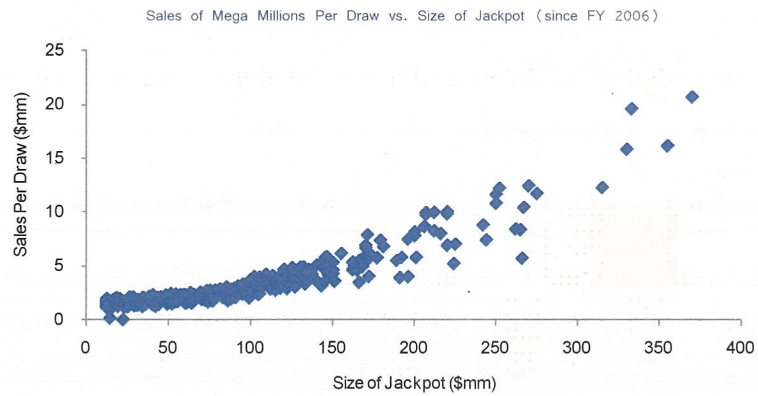
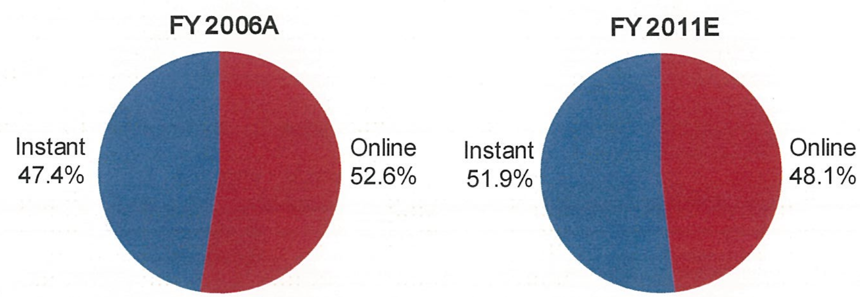
Observations on the Performance of the Lottery

Many of the overall industry characteristics are evident in New Jersey

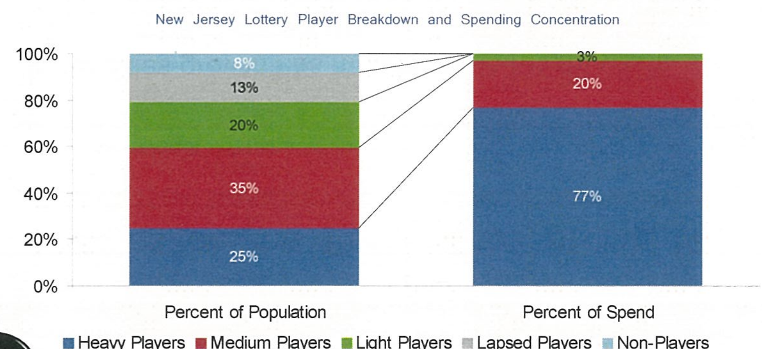
- As "purchase likelihood" increases as jackpots increase, online ticket sales are highly correlated to randomly occurring large jackpots



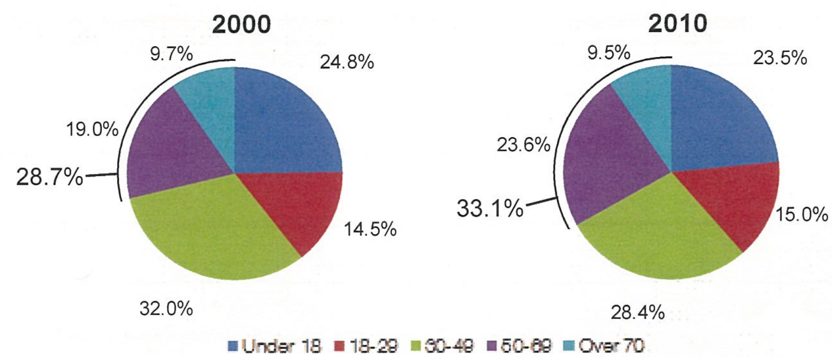
- Growth is primarily being driven by instant ticket sales, which will gradually reduce margins



- Lottery spending is concentrated, with the core player base accounting for the majority of the stated spending



- Population base in New Jersey is aging



Source: New Jersey Lottery, Crestwood Associates' Attitude and Usage Study dated March 23, 2011, US Census Bureau

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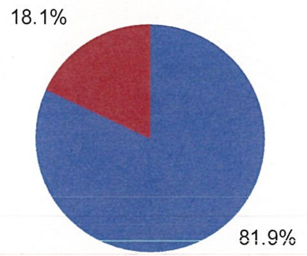
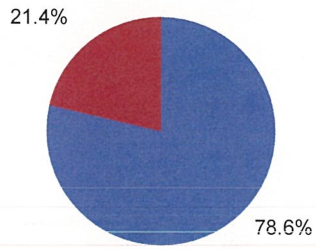
Observations on the Performance of the Lottery

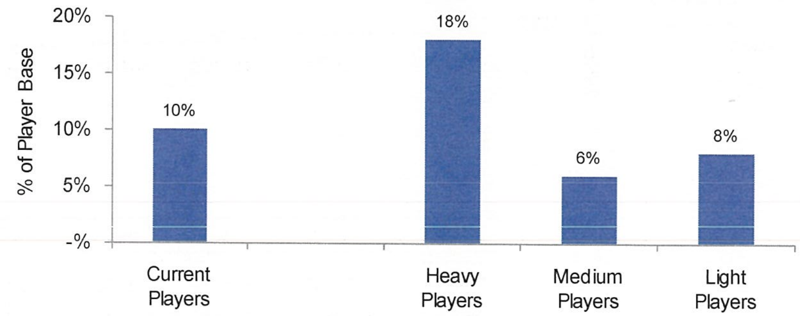
Many of the overall industry characteristics are evident in New Jersey

- Distribution of Lottery tickets is primarily conducted through independent convenience stores





- Current player awareness of the Lottery's Facebook page is low and the development of an online strategy is in early stages



- Pipeline of new product opportunities is limited

Fiscal Year Ended June 30,

	2008A	2009A	2010A	2011E
New Games	**$20 Instant Tickets**: Introduced in October 2007	None	**Powerball**: Introduced in February 2010	None
New Add-On Features	None	None	**Powerball**: Powerplay introduced in February 2010	**Mega Millions:** Megaplier introduced in January 2011; **Jersey Cash 5**: Instant Match introduced in April 2011

Source: New Jersey Lottery, Crestwood Associates' Attitude and Usage Study dated March 23, 2011

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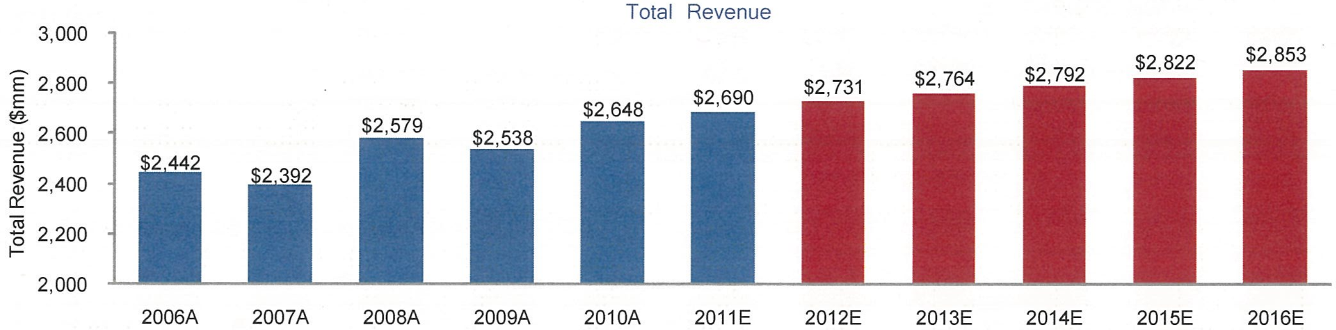
As-Is Scenario

Summary Historical and Projected Financial Information

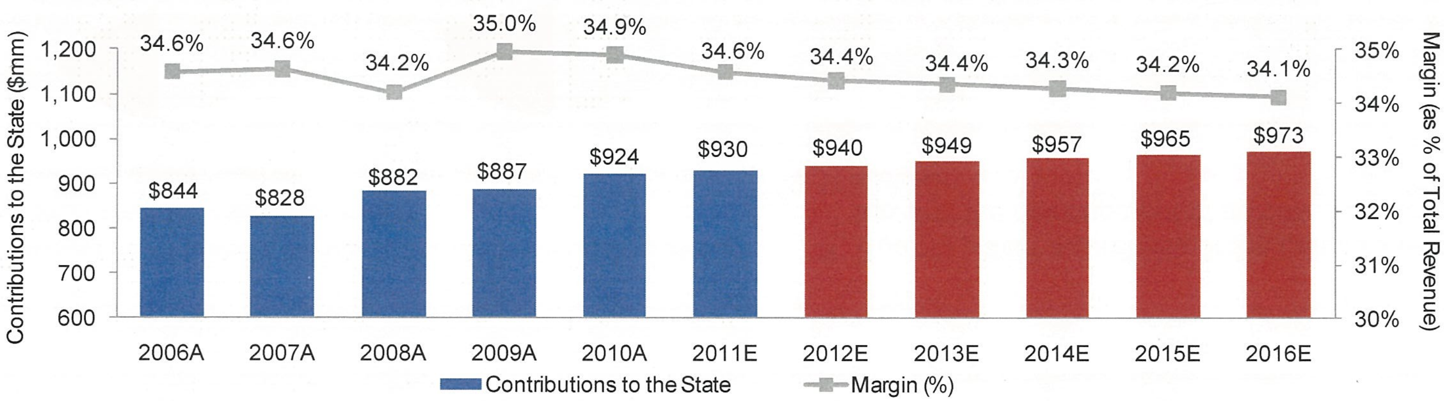
Total Revenue



	2006A	2007A	2008A	2009A	2010A	2011E	2012E	2013E	2014E	2015E	2016E
Annual Growth		(2.0)%	7.8%	(1.6)%	4.3%	1.6%	1.5%	1.2%	1.0%	1.1%	1.1%

CAGR[1]	
FY 2006A – 2011E	FY 2011E – 2016E
2.0%	1.2%

Contributions to the State[2]



	2006A	2007A	2008A	2009A	2010A	2011E	2012E	2013E	2014E	2015E	2016E
Annual Growth		(1.9)%	6.5%	0.6%	4.1%	0.6%	1.1%	0.9%	0.8%	0.8%	0.8%

CAGR[1]	
FY 2006A – 2011E	FY 2011E – 2016E
2.0%	0.9%

Source: New Jersey Lottery
Note: Graphs represent fiscal years ended June 30; 2006A to 2010A represents actual financial results; 2011E represents the Lottery's budget and is based on 10 months of actual financial results and 2 months of projections in-line with year-to-date performance; 2012E to 2016E represents Lottery management's As-Is Scenario financial projections
1. Represents the Compounded Annual Growth Rate
2. For FY 2012E to 2016E, Contributions to the State represents operating income + interest income + amortization expense

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New Jersey Lottery
Give Your Dreams A Chance

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Discussion Points (Cont'd)

Answer: In FY 2014, OMB reviewed 119 non-information technology (IT) requests above $36,000 (valued at a total of $28.9 million) and rejected three (valued at a total of approximately $570,000). In addition, OMB conducted a post-audit review of 94 FY 2014 non-IT procurements valued between $2,500 and $36,000 and selected a sample of 13 to obtain agency justifications for the exemption. The audit period was all of FY 2014 (July 1, 2013 – June 30, 2014). These audit reviews indicate that State agencies and departments are complying with the requirements of Circular Letter 11-12-OMB/DPP, as no purchases were found to be in violation of the circular letter. Based on these findings, no State agency or department will be subject to OMB pre-approval for non-IT procurement requests exceeding $2,500.

NEW JERSEY LOTTERY

8. Northstar New Jersey Lottery Group, LLC took full control of the New Jersey State Lottery's sales and marketing operations on October 1, 2013 and has since performed these functions under the supervision of the Division of Lottery in accordance with the 15-year State Contract No. T-2884 for "Lottery Growth Management Services." Northstar is a tripartite consortium consisting of GTECH Corp., Scientific Games International Inc., and a subsidiary of the Ontario Municipal Employees Retirement System. **State Lottery revenues have not met expectations in FY 2014 and FY 2015.**

The FY 2014 transfer of State Lottery income into the State General Fund equaled $965.0 million, some $55.0 million less than the $1.02 billion the FY 2014 Appropriations Act had anticipated. In all, the Lottery generated $2.94 billion in FY 2014 operating revenues, some $73.5 million less than the $3.02 billion originally anticipated, according to the State Lottery's FY 2014 "Financial Statements and Supplementary Information."

The outsourcing contract's pay-for-performance compensation model meant that Northstar needed to make a year-end payment to the State. The contractor's original prorated FY 2014 net income target for the period from October 1, 2013 through June 30, 2014 was $776.3 million. On January 17, 2014, the State lowered the target to $760.9 million "as the result of Superstorm Sandy," which had made landfall on October 29, 2012. The actual FY 2014 net income was $705.5 million, according to the Lottery's FY 2014 "Financial Statements and Supplementary Information." This $55.4 million shortfall required Northstar to make a $14.1 million so-called "contribution shortfall payment" to the State. The contractor opted to apply the $14.1 million against a preexisting $20 million credit.

The FY 2015 Appropriations Act anticipated a $1.04 billion transfer of State Lottery income into the State General Fund. As part of the Governor's FY 2016 Budget, the Administration lowered its FY 2015 projection to $955.0 million, some $10.0 million less than the FY 2014 total and $81.9 million, or 7.9 percent, less than originally anticipated. Northstar's FY 2015

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Discussion Points (Cont'd)

net income target equals $1.05 billion, some $32.5 million, or 3.2 percent, more than the $1.01 billion FY 2014 net income target absent the proration.

According to the August 2012 Request for Proposal 13-X-22694 for "Lottery Growth Management Services," the outsourcing initiative was to maximize Lottery proceeds for the support of State institutions and State aid for education. The compensation model reflects the pay-for-performance principle, shifts a portion of the Lottery performance risk to the vendor, and has three elements.

A) Accelerated Guarantee Payment: Northstar made a one-time $120 million Accelerated Guarantee Payment to the State in FY 2013. The vendor may use up to $20 million of the payment to offset any future Contribution Shortfall Payments. Northstar applied $14.1 million against the $20 million credit in FY 2014.

B) Contribution Shortfall Payments: Northstar must make Contribution Shortfall Payments for any contract year in which it fails to meet the Lottery net income target, but not more than 2.0 percent of a contract year's Lottery net income. The payments thus represent a partial shift to the contractor of the risk of Lottery net income shortfalls. The payment equals 50 percent of the difference between the net income target and the base net income level if the actual net income falls between the two markers. If the actual net income is less than the base amount, the payment is 50 percent of the difference between the net income target and the base amount plus 100 percent of the amount by which the actual net income falls below the base amount. The contract specifies gradually increasing base amounts and net income targets.

C) Incentive Compensation: Capped at 5.0 percent of the year's lottery net income, Incentive Compensation payments by the State to Northstar occur in any year in which the Lottery net income exceeds the contractual base net income level. The base net income level in contract year 1 is $959 million, which rises to $1,096 million in contract year 16, implying a 0.89 percent annualized growth rate. A payment is calculated as a percentage of the year's net income in excess of the base amount with the percentage ranging from 5 percent to 30 percent depending on the size of the excess over the base, middle, and upper net income levels, as defined in the contract. Net income targets are immaterial to the computation. Therefore, should a year's actual net income fall between the base net income level and the net income target, Incentive Compensation payments and Contribution Shortfall Payments will both come due and will offset one another to varying degrees. The table below shows Northstar's net income targets and base net income levels for FY 2014 through FY 2018.

Fiscal Year	Base Net Income Level	Net Income Target
2014 (Nine-Month Period)	$717,279,452	$760,897,061
2015	$967,000,000	$1,047,000,000
2016	$976,000,000	$1,060,000,000
2017	$985,000,000	$1,070,000,000
2018	$994,000,000	$1,080,000,000

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Discussion Points (Cont'd)

- *Questions:* **Please assess Northstar's performance as the manager of the State Lottery's sales and marketing operations. What factor(s) accounted for FY 2014 State Lottery operating revenues falling $73.5 million below the level originally anticipated? What factor(s) drive the year-to-date underperformance in FY 2015 Lottery operating revenues relative to original expectations? Has the Lottery identified any structural changes in consumer behavior that shift the demand curve for lottery products downwards? Since Superstorm Sandy motivated a January 2014 reduction in Northstar's FY 2014 net income target, do the superstorm's lingering effects also contribute to sluggish FY 2015 lottery ticket sales? In general, have Lottery ticket sales underperformed at a disproportionate rate relative to the rest of the State in the areas that were most impacted by the superstorm? For FY 2012, FY 2013, and FY 2014, please provide Lottery ticket sales totals for Monmouth and Ocean counties. Has the State Lottery reduced, or does it intend to reduce, Northstar's net income targets and base net income levels for FY 2015 and beyond?**

Answer: Prior to the Northstar contract, the growth of lottery revenues required significant economic, technological and human resource investment. Upgrading the agency's technological infrastructure was subject to budgetary constraints and procurement processing requirements. Staffing levels in the areas of advertising and marketing limited the agency's ability to promote new games and large jackpots. Despite limitations on these resources in the past, the Lottery had been able to grow revenues with the implementation of improved instant game distribution, portfolio management and the growth of large jackpot games. These methods had reached their maximum potential. Therefore, future growth required an infusion of economic, technological and human capital.

As Northstar completes its first full year under the Services Agreement, the overall impact on operations, the public and retailers has been positive. The Lottery believes that Northstar has fulfilled all of the operational requirements of the Services Agreement. The specific impact on each part of the operation is listed below along with a summary of technological and other advances that were achieved that would not have been possible without the agreement:

- Lottery operations – The Lottery works very closely with Northstar to achieve the common goal of increasing revenue for its beneficiaries. The Lottery's Executive Director and Deputy Executive Director meet weekly with the Northstar Vice President/General Manager and the Vice President/General Counsel to discuss performance and any emergent issues. Joint senior staff meetings are held bi-weekly. Constant communication between both organizations is the key to the success of this contract. While the Lottery manages the Northstar contract, both organizations must work together

Discussion Points (Cont'd)

seamlessly to achieve success. The cooperation of all parties has been extremely good; issues are raised, discussed and resolved.

- Year-to-date for Fiscal 2015 (through March) overall sales are more than 2.3% ahead of the same time last year, despite a 30% decline in sales for the multi-state games Powerball and Mega Millions. Because these games are jackpot driven by sales in all the states where these games are sold, Northstar's activities can only minimally influence those sales. This sharp drop in multi-state game sales has been partially offset by the introduction of the new multi-state game, CASH4LIFE sold by both the NY and NJ Lotteries.
- The full effect of the increased marketing, increased promotions, and increased sales staff by Northstar is evidenced by the 10% growth for instant ticket sales and in-state draw games. In these areas, the support from Northstar has had a direct and positive impact.
- Retailers have participated in several advisory meetings held by Northstar to elicit feedback on their performance, planned promotions and retailer incentive plans, player satisfaction, Point of Sale (POS) materials including instant ticket facings and service they receive from their Sales Representatives. Retailers expressed overall satisfaction with Northstar's performance and programs, especially with the increased visits by the Northstar sales team. There are now more than 7,100 licensed Lottery retailers in New Jersey, an increase of close to 800 (+11%) due to Northstar's retailer recruitment efforts. Through Northstar's efforts, this expansion incorporates growth at all levels of retail from small independent stores to regional and national chains.
- Northstar and Lottery officials regularly attend meetings with various retailer associations. In addition to fostering a solid relationship between the Lottery and the retailer community, these meetings help the Lottery work with the retailers to promote products in such a way that helps grow the retailers' lottery and non-lottery sales. These retailer associations include the Asian American Retail Association, the New Jersey Food Council, the New Jersey Restaurant Association and the Gasoline and Convenience Store Retailer Association.
- Northstar employs 130 people, of these 115 are devoted to sales and the marketing of lottery products. This staff provides added service to the growing network of lottery retailers throughout the State. By comparison, the Lottery only had 64 staff devoted to sales and marketing. Northstar's commitment to retailer optimization has already yielded much higher sales. Northstar is able to provide the personnel needed to properly service the retailers by the addition of these new, private-sector positions that it created.
- Prior to the Northstar contract, the Lottery had a payroll of 157 employees. The Northstar agreement has enabled the Lottery's payroll to be reduced to 101 employees and Northstar has established 130 private sector jobs.

Discussion Points (Cont'd)

- Northstar's recently launched automated "claims and payment" system (CAP) has helped streamline and modernize all aspects of claims payment including the maximizing of the collection of debt from claimants that is owed to government agencies. Similar automated equipment for use on instant games returns has helped to facilitate the efficient closeout of these games while enabling retailers to better manage their inventory. Both of these systems were provided by Northstar, allowing the State to avoid making large capital investments.
- The largest investment NorthstarNJ has made in technology is that of expanding the Lottery's instant ticket vending machine (ITVM) network and introducing full-service vending machines (Geminis). The Geminis enable customers to purchase tickets for lottery draw and instant games without the assistance of a sales clerk. Northstar has added nearly 300 Geminis at a value of more than $5 million. These machines, located at retailers throughout the State, are a huge convenience to both retailers and customers. Introduction of the Geminis allowed for the addition of retail chains such as Rite Aid and WaWa to the retailer network.

In Fiscal 2014, the primary factors in operating revenues falling below the originally anticipated amount was the overall economy, the harsh winter of 2013-2014 and the onset of jackpot fatigue for the multi-state Powerball and Mega Millions games.

Starting in the winter of 2013-2014 and continuing through the end of the year, the effects of jackpot fatigue on Powerball and Mega Millions began to intensify. Powerball sales were $42 million lower in the second half of the year. Mega Millions sales were $31 million lower in the second half of the year. Jackpot fatigue is a result of the casual lottery player waiting longer for larger jackpot rolls before playing. Whereas in the past, a $100 million jackpot would be ample enough to attract such players, it now takes a $300 million jackpot to attract the casual player. The effects of jackpot fatigue intensified in Fiscal 2015.

Through March, Fiscal 2015 gross sales for the multi-state games Powerball and Mega Millions have declined in New Jersey by $108.6 million or 30% compared to the same period in Fiscal 2014. The trend in New Jersey mirrors a trend that is taking place nationwide. The subject was discussed at length in a recent article published by La Fleur's, a Lottery industry periodical. The La Fleur's article indicated the cause of this trend to be the dearth of large jackpots and jackpot fatigue. The recent $565 million Powerball jackpot this past February was the first of its size in nearly two years.

These factors have resulted in lower sales and an increased number of rolls to generate large jackpots. More and more often, the rolls are at minimal amounts. For

Discussion Points (Cont'd)

instance, the February 2015 $565 million Jackpot which began on December 3, 2014 increased by the minimum $10 million for the first nine rolls. A similar size jackpot started on August 10, 2013, but only increased the minimum amount for the first four rolls. After ten rolls, that jackpot reached $245 million, whereas the recent jackpot only reached $131 million for the same number of rolls. The inability to reach jackpots high enough to attract casual players has an extremely detrimental impact on overall sales.

This trend is having an adverse impact on the Lottery's contribution to education and state institutions. Both Powerball and Mega Millions have a prize payout of 50%, resulting in a contribution amount of approximately 40%. When these games are successful they are highly profitable. Both the Lottery and NorthstarNJ have been aware of this trend and have been working aggressively to attract players to our in-state draw games and instant games and at the same time heighten player awareness of rising jackpots for Powerball and Mega Millions.

Aside from the decline in Powerball and Mega Millions, there has been no discernable change in behavior for the Lottery's other draw games. However, there has been a surge in instant ticket sales. Through March, instant ticket sales are 10.2% higher than in Fiscal 2014. Instant games do have a higher prize payout than draw games, thus they generate less contribution per dollar of sales revenue.

Regarding FY 2012, FY 2013, and FY 2014 Lottery ticket sales total for Monmouth and Ocean counties, the table below shows those sales. While there has been an increase in sales in these shore counties, it has not been as strong an increase as was hoped for prior to Sandy.

Lottery Sales Totals

County	FY 2012	FY 2013	FY 2014
Monmouth	$199.9 million	$212.1 Million	$211.4 million
Ocean	$182.2 million	$194.3 million	$198.1 million

While coastal areas may have taken the most dramatic impacts of the storm, other areas were just as severely impacted by Superstorm Sandy. Damaging floods and winds pummeled interior areas of the State, particularly in the area in-and-around Newark Bay and its primary tributaries, the Hackensack and Passaic Rivers. These areas are among the most densely populated in the State and traversed daily by large numbers of commuters going to and from work. Many Lottery retailers were slow to re-open as a result of flooding, the initial lack of electrical power, and stalled or slow moving flood remediation projects.

Discussion Points (Cont'd)

The State Lottery has not reduced Northstar's net income targets and base net income levels for FY 2015 and onward.

9. Northstar New Jersey Lottery Group, LLC took over the sales and marketing operations of the New Jersey State Lottery on October 1, 2013. According to the State Lottery's FY 2014 "Financial Statements and Supplementary Information," the contractor charged the State Lottery $29.3 million in **administrative expenses** in FY 2014: a) $16.3 million in advertising and marketing expenses, b) $9.4 million in manager expenses, and c) a $3.6 million management fee. As the table below shows, combining the administrative expenses of the Division of Lottery and Northstar, FY 2014 experienced the highest administrative expenses since at least FY 2008 at $45.0 million. From FY 2008 through FY 2011, annual administrative expenses fluctuated between $18.0 million and $22.0 million. Driven by increased advertising purchases, FY 2012 and FY 2013 administrative expenses rose to $37.0 million and $35.0 million respectively. Similarly, administrative expenses as a share of total operating revenues stood at 1.53 percent in FY 2014, exceeding the 0.68 percent to 0.89 percent range between FY 2008 and FY 2011, the 1.32 percent in FY 2012, and the 1.22 percent in FY 2013.

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Division of Lottery Administrative Expenses	$23,000,000	$22,000,000	$18,000,000	$22,000,000	$37,000,000	$35,000,000	$16,000,000
Northstar Fees and Expenses	$0	$0	$0	$0	$0	$0	$29,000,000
Total Administrative Expenses	$23,000,000	$22,000,000	$18,000,000	$22,000,000	$37,000,000	$35,000,000	$45,000,000
Total Operating Revenues	$2,579,000,000	$2,538,000,000	$2,648,000,000	$2,677,000,000	$2,798,000,000	$2,861,000,000	$2,942,000,000
Total Administrative Expenses As Share of Total Operating Revenues	0.89%	0.87%	0.68%	0.82%	1.32%	1.22%	1.53%

In part, the higher FY 2014 administrative expenses reflect an increased position count. The division replied to OLS Discussion Point #7 in the FY 2014-2015 Department of the Treasury Budget Analysis: "Northstar has 100 staff devoted to sales and marketing of lottery products, plus 15 staff in executive and administrative positions; all are newly created private sector jobs. This staff provides welcome added service and support to the growing network of lottery retailers throughout the State. By comparison, the State Lottery only had 64 staff devoted to sales and marketing. Looking ahead, Northstar is now recruiting multilingual sales staff."

- *Questions:* **What are the projected FY 2015 administrative expenses of the Division of Lottery and Northstar? Does the division expect future administrative expenses to stabilize at the FY 2015 level? Is the division concerned that the ratio of division and Northstar administrative expenses over total operating revenues reached 1.53 percent in FY 2014, the highest level since at least FY 2008? Does the division have a target range for the ratio?**

Discussion Points (Cont'd)

Does the division exercise any control over Northstar's administrative expenses and staffing level? What is Northstar's current position count?

Answer: The FY 2015 projected administrative expenses for NorthstarNJ are:

- $19.9 million – management and administrative expenses
- $4.8 million - management fee
- $23.3 - marketing/advertising expenses

The Lottery's projected expenses are $11 million.

The Lottery does expect administrative expenses to stabilize at or about FY 2015 levels. FY 2015 represents Northstar's first full year of operation.

It should be noted that the chart provided in this discussion point for administrative expenses does not include centrally funded employee fringe benefits. This artificially reduces some Lottery internal administrative costs when compared to NorthStar administrative expenses.

Current administrative expenses are appropriate in light of the Lottery's business objectives to grow revenue and contributions to the State.

The Division does not have a target range for this ratio. The New Jersey Lottery remains one of the most effective state lotteries with administrative expense ratios and per capita spending at levels equal to or below most of our neighboring states and other large state lotteries. All expenses are carefully considered by Northstar and the State Lottery before being incurred.

The Agreement contains caps on the increases to both the manager's expenses and the management fee. These costs, as well as all of Northstar's major expenses (primarily for marketing and sales), have a direct impact on the net proceeds to the State. If these costs are not properly controlled by Northstar (and the State Lottery), and the net proceeds are adversely impacted, any Northstar incentive payment will be reduced commensurately. Conversely, the revenue shortfall payment remitted by Northstar to the State will be increased. Thus, it is truly in Northstar's best interest to control costs. In FY 2014, Northstar spent $5 million less than the amount permitted by the contract. Northstar is projected to underspend by $8 million in FY 2015.

NorthstarNJ currently employs 130 full time employees. Of these, 115 employees are devoted to sales and marketing.

Discussion Points (Cont'd)

- **Given Northstar's failure to meet performance targets and the higher administrative costs associated with privatizing the State Lottery's sales and marketing operations, has the Treasury considered ending the business relationship with Northstar, just as the State of Illinois publicly announced its intention in December 2014 to terminate its contract with Northstar for similar underperformance issues?**

  Answer: The State is not considering terminating the contract.

  The comparison of administrative costs presented by OLS is misleading. The full cost of fringe benefits is not included for 2013 costs, thereby understating them. Additionally, the comparison represents apples to oranges because the administrative costs in 2015 included substantially new services, including essential additional sales and marketing services, above and beyond those provided in earlier years. Had the expanded services been paid for by the State though the hiring of State employees, the relative costs of health benefits and pensions would have made administrative expenses even more expensive than under the Northstar contract.

  Additionally, the Illinois reasons for terminating the contract are not analogous.

10. In its February 2015 audit report on the Division of the State Lottery, the Office of the State Auditor **recommended operational changes related to debt collection, the verification of prize winner identities, and the division's backup facility as well as disaster recovery plan.**

First, the State Auditor criticized that the Division of Lottery only checked whether winners of $250,000 or more had debt outstanding to the State or federal government and, if so, applied the claimants' winnings against the claimants' liabilities before paying out any remaining balance. N.J.S.A.5:9-13.17, however, requires the debt collection process for all prize claims of $600 or more. Had the division done so, the State Auditor reckoned, it could have recovered an additional up to $890,000 in prize winnings from July 1, 2013 through July 28, 2014 to offset debts owed to the State and the federal government. Consequently, the State Auditor recommended that the division perform State debt collection matches for all claimants of lottery prizes of $600 or more, just as it was already doing for outstanding child support, overpaid public assistance, and defaulted student loan debt. In its audit reply, the division explained that federal law precluded it from using winners' social security numbers to perform automated matches for all State agencies participating in the Set-Off of Individual Liability (SOIL) system, a centralized debt collection program operated by the Division of Revenue and Enterprise Services. The State Lottery therefore crosschecked the SOIL database manually for winnings greater than $250,000 based on claimants' names and addresses. The division, however, was collaborating with the Office of the Attorney General and SOIL-participating State agencies to ensure that regulations were in place by the end of

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Discussion Points (Cont'd)

FY 2015 that would allow for the use of social security numbers in identifying opportunities for offsetting amounts owed to the State against lottery winnings.

Second, the State Auditor noted that if a prize claimant provided a Social Security or taxpayer identification number the Division of Lottery withheld federal personal income taxes on winnings of at least $5,000 and State gross income taxes on winnings of at least $10,000. If the claimant did not provide the information, federal tax was withheld on winnings of at least $600. The division, however, only verified the accuracy of the identification numbers provided if a winner claimed a top tier or jackpot. When crosschecking prize claimants' provided identification numbers with the Veris Social Security database, the State Auditor found 680 individuals whose numbers were listed as either "invalid" or "maybe." Of those individuals, 46 used identification numbers of deceased persons with different names. The State Auditor remarked that prize winners who provided invalid identification numbers created a risk of reduced tax withholdings, overpayment of public assistance, and lost collections on outstanding child support, defaulted student loans, and other debt owed to the State. For those reasons, the State Auditor recommended that the division lower its threshold for claim validation to $600 and use the Veris database to verify social security numbers. In its audit response, the division demurred that the State Auditor could not substantiate that the 680 questionable social security numbers were indeed fraudulent. Nevertheless, the division would study the adoption of fraud-reduction methods, including the Veris database.

Third, the State Auditor admonished that the division's backup Business Continuity Site in Cranbury was not fully operational and that its disaster recovery plan had not been updated since July 2007. Both were vital in keeping State Lottery operations running in case of an unplanned interruption. Accordingly, the State Auditor recommended making the backup facility fully operational and updating and testing the disaster recovery plan annually. In its audit reply, the State Lottery projected that the Business Continuity Site would be operational by the summer of 2015 pending the connection of the site to Treasury's information technology network by the Office of Treasury Technology. Moreover, once the connection would be established, the division would review and update its disaster recovery plan and run quarterly drills to test the plan's effectiveness.

- **Questions: Does the Division of Lottery intend to perform a Set-Off of Individual Liability (SOIL) system match of prize claimants for State debt collection purposes for all prize claims of $600 or more, as recommended by the Office of the State Auditor and required by N.J.S.A.5:9-13.17? If so, please specify the date by which the division plans to begin doing so; if not, please provide the reason(s) for not lowering the current $250,000 threshold. Does the State Lottery remain optimistic that all the necessary regulations will be promulgated by the end of FY 2015 so as to allow for a social security number-based SOIL system match of prize claimants for State debt collection purposes?**

Discussion Points (Cont'd)

Answer: Lottery performs a match of prize claimants for State debt collection purposes for all prize claims of $600 or more for the following programs; NJKIDS (child support); TANF, FS, General Assistance, Medicaid, Child Care; USF/HEA (home energy); and the Higher Education Student Assistance Authority (student loans). If a match exists, payments of claims are held pending agency determination as to debt collection or release. Match with these agencies has been ongoing and is integrated with the Lottery claims payment processing system.

A key component to expanding SOIL matches to other state programs is dependent upon obtaining the necessary legal authority. The use of Social Security numbers is critical to doing the match or "look-up". The Lottery can perform a look-up by Social Security number but is not authorized to do so in every instance. The Division is presently working with the Office of the Attorney General to obtain the necessary authority.

- **Please indicate whether the division intends to lower the threshold for validating the social security numbers provided by claimants to prizes of $600 or more, as recommended by the Office of the State Auditor. If so, please specify the date by which the division plans to begin doing so; if not, please provide the reason(s) for not lowering the threshold. Has the division concluded its investigation into methods of verifying social security numbers provided by prize claimants? If so, what methods will the division employ? If the division is still studying the issue, by what date does it intend to conclude the examination period?**

Answer: The Lottery has not concluded its investigation into the methods of verifying Social Security numbers provided by prize claimants.

- **Please update whether the division still projects to have its backup Business Continuity Site fully operational by the summer of 2015. If the facility is already fully operational, please share whether the division has already updated its disaster recovery plan and run drills to test the plan's effectiveness.**

Answer: The Lottery is working with the Division of Revenue and Enterprise Services (DORES) to complete the necessary connections by the summer of 2015. The site already has connectivity to conduct the critical functions of ongoing lottery business.

The disaster recovery plan itself is being developed. The Lottery will conduct tests and drills. Facility, security and information management system inspections are being performed monthly to ensure functionality in the event of an emergency.

11. N.J.S.A.5:9-7 dedicates at least 30 percent of the gross receipts from the sale of lottery tickets to the support of State institutions and State aid for education. In FY 2014,

Discussion Points (Cont'd)

some 33.3 percent of gross lottery sales were used for that purpose and the Administration anticipates that some 31.4 percent of gross lottery sales would be used in that manner in FY 2015 and some 31.5 percent in FY 2016, as displayed in the evaluation data in the Governor's FY 2016 Budget (page D-385).

The State Lottery has recently introduced the first drawing game with fixed top prizes. Notably, the Cash4Life multi-state game features two weekly drawings with a top prize per drawing of $1,000 a day for life and a second prize of $1,000 per week for life. **Fixed-prize payout games, however, make it more difficult to manage for the attainment of prize payout to sales ratio goals.** This is so because fixed top prizes weaken the link between ticket sales and prize payouts that makes for fairly stable and predictable prize payout to sales ratios irrespective of fluctuations in sales under traditional lottery games. Under a fixed-prize game, variable ticket sales have a more significant, less controllable effect on the ratio. For example, according to the February 2015 audit report on the Division of Lottery, the Office of the State Auditor related that the division projected the new Cash4Life game to have prize payouts equal to 55 percent of sales. Through August 31, 2014, however, prize payouts allocated to New Jersey ($22.8 million) represented 98 percent of total New Jersey sales ($23.3 million). In its audit reply, the division noted that it was closely watching the game's prize payout to sales ratio. Moreover, it expected the ratio to perform as designed over a peak and trough smoothing time period of at least one year.

- ***Questions:*** **Is the new Cash4Life multi-state game meeting the Division of Lottery's original performance expectations? Has the prize payout to sales ratio hit or fallen below its 55 percent target? If the ratio exceeds 55 percent, please detail any modifications the division may already have brought, or may intend to bring, to bear on the game's design. Please indicate total New Jersey sales and prize payouts to date for the Cash4Life game.**

  Answer: The sales for CASH4LIFE have exceeded the Lottery's expectations. The prize expense has been higher than anticipated due to a higher than expected number of top tier prize winners within weeks of the game's launch. In recent months, the number of top tier prize winners has been in line with expectations. The Lottery expects that CASH4LIFE will perform as designed when measured over a period of at least one year, which will tend to level the peaks and valleys of sales and prizes.

  Over time, the Lottery expects CASH4LIFE to perform as designed with a prize expense of 55%.

  On April 7, 2015, Pennsylvania joined New Jersey and New York in selling the CASH4LIFE tickets. In May, the State of Virginia will begin selling CASH4LIFE tickets. The addition of sales from both Virginia and Pennsylvania will help to fund the top prizes at a faster pace, thereby mitigating potential prize pool shortfalls. The impact of the additional States on the game will be closely monitored and evaluated.

Discussion Points (Cont'd)

CASH4LIFE was launched late in FY 2014 with the first draw taking place on June 16, 2014. During FY 2014 sales were $4.7 million and the prize expenses were $5.3 million. For FY 2015 through March 31, sales were $57.4 million and prize expenses were $37.5 million.

- **How many fixed-prize payout games does the State Lottery currently operate? Does the State Lottery intend to increase their number? What strategies does the division employ to ensure that fixed-prize payout games attain the projected prize payout to sales ratio and contribute to meeting the State Lottery's overall statutory mandate that at least 30 percent of gross receipts from the sale of lottery tickets support State institutions and State aid for education?**

Answer: The Lottery's other major draw games; Jersey Cash 5, Pick 6, Mega-Millions and Powerball all have some level of fixed prize payouts particularly at the lower prize tiers. All but Jersey Cash 5 have a minimum jackpot amount, however as the jackpot rolls, the jackpot prize is predicated on sales. Mega Millions and Powerball do have significant 2nd tier fixed prize payouts of $1 million each. CASH4LIFE is the only draw game the Lottery operates where both the top two prize tiers are always fixed prize payouts. All of the Lottery's instant games have fixed prizes. With Instant Games there are a fixed number of tickets that are sold. These games are designed in such a manner that there is a correlation between the fixed number of tickets, the price of the tickets and the fixed prize payout for each prize tier including top-tiers.

The Lottery is always reviewing its portfolio of games to ensure that there is a proper mix of games that appeal to all segments of the lottery playing public.

To ensure that it is achieving the statutory mandate of 30%, the Lottery closely watches the performance of all games, particularly those with higher tier fixed prize payouts. The Lottery expects that its games will perform as designed when measured over a period of time which will tend to level the peaks and valleys of sales and prizes. When sales for a game start to remain flat or become stale, the game is often refreshed with a revised prize structure and add-on components that give the player the chance to multiply winnings for an additional wager.

12. The Division of Lottery clarified in its response to OLS Discussion Point 8 in the FY 2014-2015 Department of the Treasury Budget Analysis that it did not sell any lottery games online. State Contract No. T-2884 for "Lottery Growth Management Services" also does not require Northstar New Jersey Lottery Group, LLC to offer online lottery games. In fact, the division noted in answering OLS Discussion Point #6. a. in the FY 2013-2014 Department of the Treasury Budget Analysis that the variables that determined the contractor's annual compensation did not include assumptions on any revenue from the introduction of

Discussion Points (Cont'd)

internet lottery ticket sales or internet-based lottery games. The contract, however, allows for such internet-based offerings and the contractor would be ready to integrate them into its activities. Notably, Section 4.5 of the "Services Agreement" sets forth the procedure that must be followed if the Division of Lottery decided to create new online lottery game offerings during the contract period. The vendor, though, cannot make a decision to that effect. If online lottery games were to be allowed, the variables determining the contractor's annual compensation may be revised accordingly. Schedule 10.2 of the contract authorizes the Division of Lottery to recommend to Northstar upward adjustments to the variables if there was a material change in the gaming environment, such as "a change in law that would make available or expand Lottery sales channels or authorize game types or platforms currently unavailable to the Lottery." If Northstar disagreed with the recommendation, the issue would become subject to the contract's dispute resolution procedure.

Even so Section 21.1 of the "Services Agreement" also authorizes Northstar to recommend to the Division of Lottery downward adjustments to the variables determining its compensation in the event of an "Adverse Action." The contract defines an "Adverse Action" as any affirmative State action whose effect can reasonably be expected to have a material adverse effect on the Lottery's net income and, by extension, Northstar's compensation. However, several State actions do not qualify as an "Adverse Action," among them actions that permit **internet gaming** activities. P.L.2013, c.27 did just that by authorizing Atlantic City casinos to offer internet gambling to persons physically located in New Jersey for a ten-year trial period. Responding to OLS Discussion Point #6. b. in the FY 2013-2014 Department of the Treasury Budget Analysis, the Division of Lottery noted that the law's enactment had not affected contract negotiations with Northstar. Notwithstanding the contract's treatment of internet gambling, concerns over competition to the Lottery from internet gambling persist.

- *Questions:* **Does the State Lottery plan to sell lottery tickets over the internet or expand its internet-based lottery game offering in the next five years? If so, what are the plans and has the State Lottery already begun discussions with Northstar regarding the implementation of the changes to the business plan and possible upward adjustments to Northstar's compensation variables? Does the State Lottery intend to desist from offering internet-based lottery games, so as to not compete for players' attention with online games of chance operated by Atlantic City casinos, thereby potentially jeopardizing the viability of online casino gambling? Conversely, is the nascent online casino gambling putting downward pressure on Lottery instant ticket sales?**

  Answer: The Division and Northstar continue to consider expanding the game portfolio through internet sales and with internet-based lottery games, but have not reached a decision or established a timetable. Just as with any new game or

Discussion Points (Cont'd)

variation of an existing game, rules and regulations would have to be promulgated and approved by the State Lottery Commission. If and when the sale of lottery tickets over the internet is approved by the State, an extended ramp-up period can be expected to establish this new program.

As previously noted, Northstar's initial proposal was not predicated on internet sales to meet its income targets.

There are many variables involved in ticket sales, and Lottery cannot discern a relationship between instant ticket sales and online casino gambling.

DIVISION OF TAXATION

13. According to its response to OLS Discussion Point #10 in the FY 2014-2015 Department of the Treasury Budget Analysis, the Division of Taxation received eight submissions to its March 2014 **Request for Information (RFI) for the State of New Jersey Tax Systems Modernization Project**. The division intended for the submissions to inform the terms and conditions included in any future Request for Proposal (RFP). Specifically, the RFI solicited possible solutions for the replacement of the division's current separate tax administration and collection systems with a more versatile, integrated system. The division envisioned a benefit-based procurement model, whereby the vendor would get paid a percentage of the incremental savings and revenues the vendor's solution generates. The State would thus not face any significant up-front costs for the capital project and limit its financial liability in case of cost overruns and nonperformance of the vendor's solution. The Office of Information Technology subsequently stated in its FY 2014 Annual Report that the project team had readied an RFP whose release was expected at some point in FY 2015.

The State's current tax administration systems, collectively known as TAXNET, date from the mid-1980s. They are: 1) the Taxpayer Registration System (TAXREG); 2) the Generic Tax System (GENTS), which is used for taxpayer account maintenance; 3) the Taxation Unremitted Liability Inventory Plotting System (TULIPS), which is used for collections case management; 4) the Cash Receipts Account System (CRAS); and 5) the Set-Off of Individual Liability (SOIL) system. In addition, the division would like to replace its audit case management system (ESKORT), which dates from 2005. According to the March 2014 RFI, the division hopes that a new integrated tax administration system that delivers a single view of the taxpayer and audit process will: a) improve customer service, in part through the centralized capture and tracking of all taxpayer communications; b) increase online public access and services to taxpayers; c) comply with industry security standards; d) enhance the efficiency of the division's taxpayer accounting, tax compliance, and auditing processes through the use of up-to-date database technology and big data analytics strategies; and e)

Lottery Revenue Transferred to General Fund
Estimated and Actual
$$ in Millions

	FY 16	FY 15		FY 14	FY 13*	FY 12	FY 11	FY 10	FY 09
Estimated GBM	$ 1,020.00	$ 1,036.85		$ 1,020.00	$ 975.00	$ 1,040.00	$ 953.00	$ 928.80	$ 853.00
May Estimate	1,000.00	$ 1,036.85		1,020.00	975.00	1,030.00	953.00	928.00	863.00
AA Certified	1,000.00	1,036.85		1,020.00	975.00	1,030.00	953.00	893.80	888.00
Revised GBM		955.00		993.00	975.00	967.00	930.00	913.80	888.00
May Estimate		930.00		965.00	975.00	967.00	930.00	923.80	888.00
Actual		960.00	*	965.01	965.01	950.08	930.00	924.01	887.21

FY 13 excludes $120 million up-front vendor payment
Northstar began operting the Lottery in October 2013 (FY 2014)
FY 15 Actual is preliminary, subject to change.

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Comparison of Lottery FY 2008 - FY 2014 Actual Ticket Sales and Operating Expenses

	2008	2009	2010	2011	2012	2013	NorthStar 2014	Annualized Change 2010 to 2013	Annualized Change 2010 to 2014	Change 2012 to 2013	Change 2013 to 2014
Operating Revenues:											
Total Ticket Sales:	$2,538,476,656	$2,503,266,384	$2,605,104,142	$2,636,447,566	$2,758,899,785	$2,821,400,159	$2,901,645,562	2.69%	2.73%	2.27%	2.84%
Instant Games	$1,283,985,517	$1,270,533,859	$1,301,493,067	$1,364,543,070	$1,417,664,313	$1,474,285,065	$1,531,771,568	4.24%	4.16%	3.99%	3.90%
Multi-State Drawing	$299,215,366	$282,504,403	$378,312,441	$363,416,413	$422,087,644	$437,214,147	$444,242,142	4.94%	4.10%	3.58%	1.61%
NJ Drawing Games	$941,008,401	$942,771,062	$925,298,634	$908,488,083	$919,622,769	$909,900,947	$930,895,556	-0.56%	0.15%	-1.06%	2.31%
Other	$14,267,372	$7,457,060	$0	$0	-$474,941	$0	-$5,263,704	NA	NA	-100.00%	NA
Operating Expenses:	$1,690,550,485	$1,667,240,260	$1,723,218,645	$1,746,614,803	$1,845,655,927	$1,899,233,149	$1,985,610,464	3.29%	3.61%	2.90%	4.55%
Prize Expenses	$1,471,117,973	$1,455,242,612	$1,511,914,428	$1,543,672,565	$1,617,771,751	$1,670,394,764	$1,731,959,514	3.38%	3.46%	3.25%	3.69%
Retailer Commissions	$141,385,821	$139,486,773	$144,890,988	$146,973,605	$153,657,527	$157,880,945	$162,107,574	2.90%	2.85%	2.75%	2.68%
Treasury Admin.	$32,397,394	$29,195,191	$22,506,760	$21,518,435	$37,149,047	$35,276,475	$15,877,577	16.16%	-8.35%	-5.04%	-54.99%
Northstar NJ Admin.	$0	$0	$0	$0	$0	$0	$29,268,004	NA	NA	NA	NA
Management Fee	$0	$0	$0	$0	$0	$0	$3,552,740	NA	NA	NA	NA
Management Expenses	$0	$0	$0	$0	$0	$0	$9,383,269	NA	NA	NA	NA
Advertising and Marketing	$0	$0	$0	$0	$0	$0	$16,331,995	NA	NA	NA	NA
Instant Ticket Vendor Printing Fees	$17,379,142	$16,430,631	$17,362,734	$14,793,052	$16,739,981	$18,140,608	$18,706,070	1.47%	1.88%	8.37%	3.12%
Gaming System Vendor Fees	$26,502,830	$25,119,355	$25,447,918	$17,901,509	$20,273,146	$17,398,700	$27,220,623	-11.90%	1.70%	-14.18%	56.45%
Other	$1,767,325	$1,765,698	$1,095,817	$1,755,637	$64,475	$141,657	$471,102	-49.44%	-19.03%	119.71%	232.57%
Operating Expenses / Operating Revenues	66.60%	66.60%	66.15%	66.25%	66.90%	67.32%	68.43%			0.42%	1.53%

Comparison of Lottery FY 2013 Actual and Budgeted Performance

	FY 2011 Actual	FY 2012 Actual	FY 2013 Budgeted	FY 2013 Actual	Variance FY 2013 Actual v Budgeted	Variance FY 2013 Actual v Budgeted	FY 2013 Budgeted - FY 2012 Actual	FY 2013 Budgeted / FY 2012 Actual	FY 2013 Actual - FY 2012 Actual	FY 2013 Actual / FY 2012 Actual
Operating Revenues:	$2,676,881,894	$2,797,638,855	$2,896,619,808	$2,860,958,793	-$35,661,015	-1.23%	$98,980,953	3.54%	$63,319,938	2.26%
Total Ticket Sales:	$2,636,447,566	$2,758,899,785	$2,858,950,181	$2,821,400,159	-$37,550,022	-1.31%	$100,050,396	3.63%	$62,500,374	2.27%
Instant Games	$1,364,543,070	$1,417,664,313	$1,502,688,748	$1,474,285,065	-$28,403,683	-1.89%	$85,024,435	6.00%	$56,620,752	3.99%
Multi-State Drawing	$363,416,413	$422,087,644	$440,003,917	$437,214,147	-$2,789,770	-0.63%	$17,916,273	4.24%	$15,126,503	3.58%
NJ Drawing Games	$908,488,083	$919,622,769	$916,732,516	$909,900,947	-$6,831,569	-0.75%	-$2,890,253	-0.31%	-$9,721,822	-1.06%
Other	$0	-$474,941	-$475,000	$0	$475,000	-100.00%	-$59	NA	$474,941	NA
Other Revenues:	$40,434,328	$38,739,070	$37,669,627	$39,558,634	$1,889,007	5.01%	-$1,069,443	-2.76%	$819,564	2.12%
Forfeited Prizes	$38,453,261	$37,781,380	$36,869,627	$38,677,399	$1,807,772	4.90%	-$911,753	-2.41%	$896,019	2.37%
Miscellaneous	$1,981,067	$957,690	$800,000	$881,235	$81,235	10.15%	-$157,690	-16.47%	-$76,455	-7.98%
Operating Expenses:	-$1,746,614,803	-$1,845,655,927	-$1,921,616,247	-$1,899,233,149	$22,383,098	-1.16%	-$75,960,320	4.12%	-$53,577,222	2.90%
Prize Expenses	-$1,543,672,565	-$1,617,771,751	-$1,688,790,708	-$1,670,394,764	$18,395,944	-1.09%	-$71,018,957	4.39%	-$52,623,013	3.25%
Retailer Commissions	-$146,973,605	-$153,657,527	-$159,243,525	-$157,880,945	$1,362,580	-0.86%	-$5,585,998	3.64%	-$4,223,418	2.75%
Treasury Admin.	-$21,518,435	-$37,149,047	-$36,532,000	-$35,276,475	$1,255,525	-3.44%	$617,047	-1.66%	$1,872,572	-5.04%
Northstar NJ Admin.	$0	$0	$0	$0	$0	$0	$0	NA	$0	NA
Management Fee	$0	$0	$0	$0	$0	$0	$0	NA	$0	NA
Management Expenses	$0	$0	$0	$0	$0	$0	$0	NA	$0	NA
Advertising and Marketing	$0	$0	$0	$0	$0	$0	$0	NA	$0	NA
Instant Ticket Vendor Printing Fees	-$14,793,052	-$16,739,981	-$18,032,265	-$18,140,608	-$108,343	0.60%	-$1,292,284	7.72%	-$1,400,627	8.37%
Gaming System Vendor Fees	-$17,901,509	-$20,273,146	-$18,367,749	-$17,398,700	$969,049	-5.28%	$1,905,397	-9.40%	$2,874,446	-14.18%
Other	-$1,755,637	-$64,475	-$650,000	-$141,657	$508,343	-78.21%	-$585,525	908.14%	-$77,182	119.71%
Operating Expenses / Operating Revenues	65.25%	65.97%	66.34%	66.38%	0.04%		0.37%		0.41%	
Non-Operating Revenue: Interest	$365,309	$204,726	$200,000	$213,544	$13,544	6.77%	-$4,726	-2.31%	$8,818	4.31%
Northstar NJ Accelerated Guarantee Payment	$0	$0	$120,000,000	$120,000,000	$0	0.00%	$120,000,000	NA	$120,000,000	NA
Northstar NJ Incentive/Shortfall Payment	$0	$0	$0	$0	$0	NA	$0	NA	$0	NA
Loss on Sale of Publicly Traded Stock	$0	-$885,793	$0	$0	$0	NA	$885,793	NA	$885,793	NA
Income Available for Transfer (w/o opening ba	$930,632,400	$951,301,861	$1,095,203,561	$1,081,939,188	-$13,264,373	-1.21%	$143,901,700	15.13%	$130,637,327	13.73%
Transfer to State General Fund	$930,000,111	$950,082,268	$1,095,000,000	$1,085,009,581	-$9,990,419	-0.91%	$144,917,732	15.25%	$134,927,313	14.20%

Comparison of Lottery FY 2014 Actual and Budgeted Performance

	FY 2012 Actual	FY 2013 Actual	FY 2014 Budgeted	FY 2014 Actual	Variance FY 2014 Actual v Budgeted	Variance FY 2014 Actual v Budgeted	FY 2014 Budgeted - FY 2013 Actual	FY 2014 Budgeted - FY 2013 Actual	FY 2014 Actual - FY 2013 Actual	FY 2014 Actual - FY 2013 Actual
Operating Revenues:	$2,797,638,855	$2,860,958,793	$3,015,688,054	$2,942,217,410	-$73,470,644	-2.44%	$154,729,261	5.41%	$81,258,617	2.84%
Total Ticket Sales:	$2,758,899,785	$2,821,400,159	$2,976,388,054	$2,901,645,562	-$74,742,492	-2.51%	$154,987,895	5.49%	$80,245,403	2.84%
Instant Games	$1,417,664,313	$1,474,285,065	$1,562,847,468	$1,531,771,568	-$31,075,900	-1.99%	$88,562,403	6.01%	$57,486,503	3.90%
Multi-State Drawing	$422,087,644	$437,214,147	$482,173,278	$444,242,142	-$37,931,136	-7.87%	$44,959,131	10.28%	$7,027,995	1.61%
NJ Drawing Games	$919,622,769	$909,900,947	$935,967,308	$930,895,556	-$5,071,752	-0.54%	$26,066,361	2.86%	$20,994,609	2.31%
Other	-$474,941	$0	-$4,600,000	-$5,263,704	-$663,704	14.43%	-$4,600,000	NA	-$5,263,704	NA
Other Revenues:	$38,739,070	$39,558,634	$39,300,000	$40,571,848	$1,271,848	3.24%	-$258,634	-0.65%	$1,013,214	2.56%
Forfeited Prizes	$37,781,380	$38,677,399	$38,500,000	$38,866,559	$366,559	0.95%	-$177,399	-0.46%	$189,160	0.49%
Miscellaneous	$957,690	$881,235	$800,000	$1,705,289	$905,289	113.16%	-$81,235	-9.22%	$824,054	93.51%
Operating Expenses:	-$1,845,655,927	-$1,899,233,149	-$2,042,168,424	-$1,985,610,464	$56,557,960	-2.77%	-$142,935,275	7.53%	-$86,377,315	4.55%
Prize Expenses	-$1,617,771,751	-$1,670,394,764	-$1,766,079,116	-$1,731,959,514	$34,119,602	-1.93%	-$95,684,352	5.73%	-$61,564,750	3.69%
Retailer Commissions	-$153,657,527	-$157,880,945	-$166,450,733	-$162,107,574	$4,343,159	-2.61%	-$8,569,788	5.43%	-$4,226,629	2.68%
Treasury Admin.	-$37,149,047	-$35,276,475	-$17,000,000	-$15,877,577	$1,122,423	-6.60%	$18,276,475	-51.81%	$19,398,898	-54.99%
Northstar NJ Admin.	$0	$0	-$43,157,126	-$29,268,004	$13,889,122	-32.18%	-$43,157,126	NA	-$29,268,004	NA
Management Fee	$0	$0	-$3,552,740	-$3,552,740	$0	0.00%	-$3,552,740	NA	-$3,552,740	NA
Management Expenses	$0	$0	-$17,604,386	-$9,383,269	$8,221,117	-46.70%	-$17,604,386	NA	-$9,383,269	NA
Advertising and Marketing	$0	$0	-$22,000,000	-$16,331,995	$5,668,005	-25.76%	-$22,000,000	NA	-$16,331,995	NA
Instant Ticket Vendor Printing Fees	-$16,739,981	-$18,140,608	-$19,074,580	-$18,706,070	$368,510	-1.93%	-$933,972	5.15%	-$565,462	3.12%
Gaming System Vendor Fees	-$20,273,146	-$17,398,700	-$29,756,869	-$27,220,623	$2,536,246	-8.52%	-$12,358,169	71.03%	-$9,821,923	56.45%
Other	-$64,475	-$141,657	-$650,000	-$471,102	$178,898	-27.52%	-$508,343	358.85%	-$329,445	232.57%
Operating Expenses / Operating Revenues	65.97%	66.38%	67.72%	67.49%	-0.23%		1.33%		1.10%	
Non-Operating Revenue: Interest	$204,726	$213,544	$200,000	$209,438	$9,438	4.72%	-$13,544	-6.34%	-$4,106	-1.92%
Northstar NJ Accelerated Guarantee Payment	$0	$120,000,000	$0	$0	$0		-$120,000,000	-100.00%	-$120,000,000	-100.00%
Northstar NJ Incentive/Shortfall Payment	$0	$0	-$6,591,878	$0	$6,591,878	-100.00%	-$6,591,878	NA	$0	NA
Loss on Sale of Publicly Traded Stock	-$885,793	$0	$0	$0	$0		$0	NA	$0	NA
Income Available for Transfer (w/o opening ba	$951,301,861	$1,081,939,188	$967,127,752	$956,816,384	-$10,311,368	-1.07%	-$114,811,436	-10.61%	-$125,122,804	-11.56%
Transfer to State General Fund	$950,082,268	$1,085,009,581	$967,000,000	$965,010,000	-$1,990,000	-0.21%	-$118,009,581	-10.88%	-$119,999,581	-11.06%

Comparison of Lottery FY 2008 - FY 2014 Actual Ticket Sales and Operating Expenses

	2008	2009	2010	2011	2012	2013	NorthStar 2014	Annualized Change 2010 to 2013	Annualized Change 2010 to 2014	Change 2012 to 2013	Change 2013 to 2014
Operating Revenues:											
Total Ticket Sales:	$2,538,476,656	$2,503,266,384	$2,605,104,142	$2,636,447,566	$2,758,899,785	$2,821,400,159	$2,901,645,562	2.69%	2.73%	2.27%	2.84%
Instant Games	$1,283,985,517	$1,270,533,859	$1,301,493,067	$1,364,543,070	$1,417,664,313	$1,474,285,065	$1,531,771,568	4.24%	4.16%	3.99%	3.90%
Multi-State Drawing	$299,215,366	$282,504,403	$378,312,441	$363,416,413	$422,087,644	$437,214,147	$444,242,142	4.94%	4.10%	3.58%	1.61%
NJ Drawing Games	$941,008,401	$942,771,062	$925,298,634	$908,488,083	$919,622,769	$909,900,947	$930,895,556	-0.56%	0.15%	-1.06%	2.31%
Other	$14,267,372	$7,457,060	$0	$0	-$474,941	$0	-$5,263,704	NA	NA	-100.00%	NA
Operating Expenses:	$1,690,550,485	$1,667,240,260	$1,723,218,645	$1,746,614,803	$1,845,655,927	$1,899,233,149	$1,985,610,464	3.29%	3.61%	2.90%	4.55%
Prize Expenses	$1,471,117,973	$1,455,242,612	$1,511,914,428	$1,543,672,565	$1,617,771,751	$1,670,394,764	$1,731,959,514	3.38%	3.46%	3.25%	3.69%
Retailer Commissions	$141,385,821	$139,486,773	$144,890,988	$146,973,605	$153,657,527	$157,880,945	$162,107,574	2.90%	2.85%	2.75%	2.68%
Treasury Admin.	$32,397,394	$29,195,191	$22,506,760	$21,518,435	$37,149,047	$35,276,475	$15,877,577	16.16%	-8.35%	-5.04%	-54.99%
Northstar NJ Admin.	$0	$0	$0	$0	$0	$0	$29,268,004	NA	NA	NA	NA
Management Fee	$0	$0	$0	$0	$0	$0	$3,552,740	NA	NA	NA	NA
Management Expenses	$0	$0	$0	$0	$0	$0	$9,383,269	NA	NA	NA	NA
Advertising and Marketing	$0	$0	$0	$0	$0	$0	$16,331,995	NA	NA	NA	NA
Instant Ticket Vendor Printing Fees	$17,379,142	$16,430,631	$17,362,734	$14,793,052	$16,739,981	$18,140,608	$18,706,070	1.47%	1.88%	8.37%	3.12%
Gaming System Vendor Fees	$26,502,830	$25,119,355	$25,447,918	$17,901,509	$20,273,146	$17,398,700	$27,220,623	-11.90%	1.70%	-14.18%	56.45%
Other	$1,767,325	$1,765,698	$1,095,817	$1,755,637	$64,475	$141,657	$471,102	-49.44%	-19.03%	119.71%	232.57%
Operating Expenses / Operating Revenues	66.60%	66.60%	66.15%	66.25%	66.90%	67.32%	68.43%			0.42%	1.53%

Comparison of Lottery FY 2013 Actual and Budgeted Performance

	FY 2011 Actual	FY 2012 Actual	FY 2013 Budgeted	FY 2013 Actual	Variance FY 2013 Actual v Budgeted	Variance FY 2013 Actual v Budgeted	FY 2013 Budgeted FY 2012 Actual	FY 2013 Budgeted FY 2012 Actual	FY 2013 Actual FY 2012 Actual	FY 2013 Actual FY 2012 Actual
Operating Revenues:	$2,676,881,894	$2,797,638,855	$2,896,619,808	$2,860,958,793	-$35,661,015	-1.23%	$98,980,953	3.54%	$63,319,938	2.26%
Total Ticket Sales:	$2,636,447,566	$2,758,899,785	$2,858,950,181	$2,821,400,159	-$37,550,022	-1.31%	$100,050,396	3.63%	$62,500,374	2.27%
Instant Games	$1,364,543,070	$1,417,664,313	$1,502,688,748	$1,474,285,065	-$28,403,683	-1.89%	$85,024,435	6.00%	$56,620,752	3.99%
Multi-State Drawing	$363,416,413	$422,087,644	$440,003,917	$437,214,147	-$2,789,770	-0.63%	$17,916,273	4.24%	$15,126,503	3.58%
NJ Drawing Games	$908,488,083	$919,622,769	$916,732,516	$909,900,947	-$6,831,569	-0.75%	-$2,890,253	-0.31%	-$9,721,822	-1.06%
Other	$0	-$474,941	-$475,000	$0	$475,000	-100.00%	-$59	NA	$474,941	NA
Other Revenues:	$40,434,328	$38,739,070	$37,669,627	$39,558,634	$1,889,007	5.01%	-$1,069,443	-2.76%	$819,564	2.12%
Forfeited Prizes	$38,453,261	$37,781,380	$36,869,627	$38,677,399	$1,807,772	4.90%	-$911,753	-2.41%	$896,019	2.37%
Miscellaneous	$1,981,067	$957,690	$800,000	$881,235	$81,235	10.15%	-$157,690	-16.47%	-$76,455	-7.98%
Operating Expenses:	-$1,746,614,803	-$1,845,655,927	-$1,921,616,247	-$1,899,233,149	$22,383,098	-1.16%	-$75,960,320	4.12%	-$53,577,222	2.90%
Prize Expenses	-$1,543,672,565	-$1,617,771,751	-$1,688,790,708	-$1,670,394,764	$18,395,944	-1.09%	-$71,018,957	4.39%	-$52,623,013	3.25%
Retailer Commissions	-$146,973,605	-$153,657,527	-$159,243,525	-$157,880,945	$1,362,580	-0.86%	-$5,585,998	3.64%	-$4,223,418	2.75%
Treasury Admin.	-$21,518,435	-$37,149,047	-$36,532,000	-$35,276,475	$1,255,525	-3.44%	$617,047	-1.66%	$1,872,572	-5.04%
Northstar NJ Admin.	$0	$0	$0	$0	$0	$0	$0	NA	$0	NA
Management Fee	$0	$0	$0	$0	$0	$0	$0	NA	$0	NA
Management Expenses	$0	$0	$0	$0	$0	$0	$0	NA	$0	NA
Advertising and Marketing	$0	$0	$0	$0	$0	$0	$0	NA	$0	NA
Instant Ticket Vendor Printing Fees	-$14,793,052	-$16,739,981	-$18,032,265	-$18,140,608	-$108,343	0.60%	-$1,292,284	7.72%	-$1,400,627	8.37%
Gaming System Vendor Fees	-$17,901,509	-$20,273,146	-$18,367,749	-$17,398,700	$969,049	-5.28%	$1,905,397	-9.40%	$2,874,446	-14.18%
Other	-$1,755,637	-$64,475	-$650,000	-$141,657	$508,343	-78.21%	-$585,525	908.14%	-$77,182	119.71%
Operating Expenses / Operating Revenues	65.25%	65.97%	66.34%	66.38%	0.04%		0.37%		0.41%	
Non-Operating Revenue: Interest	$365,309	$204,726	$200,000	$213,544	$13,544	6.77%	-$4,726	-2.31%	$8,818	4.31%
Northstar NJ Accelerated Guarantee Payment	$0	$0	$120,000,000	$120,000,000	$0	0.00%	$120,000,000	NA	$120,000,000	NA
Northstar NJ Incentive/Shortfall Payment	$0	$0	$0	$0	$0	NA	$0	NA	$0	NA
Loss on Sale of Publicly Traded Stock	$0	-$885,793	$0	$0	$0	NA	$885,793	NA	$885,793	NA
Income Available for Transfer (w/o opening ba	$930,632,400	$951,301,861	$1,095,203,561	$1,081,939,188	-$13,264,373	-1.21%	$143,901,700	15.13%	$130,637,327	13.73%
Transfer to State General Fund	$930,000,111	$950,082,268	$1,095,000,000	$1,085,009,581	-$9,990,419	-0.91%	$144,917,732	15.25%	$134,927,313	14.20%

Comparison of Lottery FY 2014 Actual and Budgeted Performance

	FY 2012 Actual	FY 2013 Actual	FY 2014 Budgeted	FY 2014 Actual	Variance FY 2014 Actual v Budgeted	Variance FY 2014 Actual v Budgeted	FY 2014 Budgeted - FY 2013 Actual	FY 2014 Budgeted - FY 2013 Actual	FY 2014 Actual - FY 2013 Actual	FY 2014 Actual - FY 2013 Actual
Operating Revenues:	**$2,797,638,855**	**$2,860,958,793**	**$3,015,688,054**	**$2,942,217,410**	-$73,470,644	-2.44%	$154,729,261	5.41%	$81,258,617	2.84%
Total Ticket Sales:	**$2,758,899,785**	**$2,821,400,159**	**$2,976,388,054**	**$2,901,645,562**	-$74,742,492	-2.51%	$154,987,895	5.49%	$80,245,403	2.84%
Instant Games	$1,417,664,313	$1,474,285,065	$1,562,847,468	$1,531,771,568	-$31,075,900	-1.99%	$88,562,403	6.01%	$57,486,503	3.90%
Multi-State Drawing	$422,087,644	$437,214,147	$482,173,278	$444,242,142	-$37,931,136	-7.87%	$44,959,131	10.28%	$7,027,995	1.61%
NJ Drawing Games	$919,622,769	$909,900,947	$935,967,308	$930,895,556	-$5,071,752	-0.54%	$26,066,361	2.86%	$20,994,609	2.31%
Other	-$474,941	$0	-$4,600,000	-$5,263,704	-$663,704	14.43%	-$4,600,000	NA	-$5,263,704	NA
Other Revenues:	**$38,739,070**	**$39,558,634**	**$39,300,000**	**$40,571,848**	$1,271,848	3.24%	-$258,634	-0.65%	$1,013,214	2.56%
Forfeited Prizes	$37,781,380	$38,677,399	$38,500,000	$38,866,559	$366,559	0.95%	-$177,399	-0.46%	$189,160	0.49%
Miscellaneous	$957,690	$881,235	$800,000	$1,705,289	$905,289	113.16%	-$81,235	-9.22%	$824,054	93.51%
Operating Expenses:	**-$1,845,655,927**	**-$1,899,233,149**	**-$2,042,168,424**	**-$1,985,610,464**	$56,557,960	-2.77%	-$142,935,275	7.53%	-$86,377,315	4.55%
Prize Expenses	**-$1,617,771,751**	**-$1,670,394,764**	**-$1,766,079,116**	**-$1,731,959,514**	$34,119,602	-1.93%	-$95,684,352	5.73%	-$61,564,750	3.69%
Retailer Commissions	**-$153,657,527**	**-$157,880,945**	**-$166,450,733**	**-$162,107,574**	$4,343,159	-2.61%	-$8,569,788	5.43%	-$4,226,629	2.68%
Treasury Admin.	**-$37,149,047**	**-$35,276,475**	**-$17,000,000**	**-$15,877,577**	$1,122,423	-6.60%	$18,276,475	-51.81%	$19,398,898	-54.99%
Northstar NJ Admin.	**$0**	**$0**	**-$43,157,126**	**-$29,268,004**	$13,889,122	-32.18%	-$43,157,126	NA	-$29,268,004	NA
Management Fee	$0	$0	-$3,552,740	-$3,552,740	$0	0.00%	-$3,552,740	NA	-$3,552,740	NA
Management Expenses	$0	$0	-$17,604,386	-$9,383,269	$8,221,117	-46.70%	-$17,604,386	NA	-$9,383,269	NA
Advertising and Marketing	$0	$0	-$22,000,000	-$16,331,995	$5,668,005	-25.76%	-$22,000,000	NA	-$16,331,995	NA
Instant Ticket Vendor Printing Fees	**-$16,739,981**	**-$18,140,608**	**-$19,074,580**	**-$18,706,070**	$368,510	-1.93%	-$933,972	5.15%	-$565,462	3.12%
Gaming System Vendor Fees	**-$20,273,146**	**-$17,398,700**	**-$29,756,869**	**-$27,220,623**	$2,536,246	-8.52%	-$12,358,169	71.03%	-$9,821,923	56.45%
Other	**-$64,475**	**-$141,657**	**-$650,000**	**-$471,102**	$178,898	-27.52%	-$508,343	358.85%	-$329,445	232.57%
Operating Expenses / Operating Revenues	65.97%	66.38%	67.72%	67.49%	-0.23%		1.33%		1.10%	
Non-Operating Revenue: Interest	$204,726	$213,544	$200,000	$209,438	$9,438	4.72%	-$13,544	-6.34%	-$4,106	-1.92%
Northstar NJ Accelerated Guarantee Payment	$0	$120,000,000	$0	$0	$0		-$120,000,000	-100.00%	-$120,000,000	-100.00%
Northstar NJ Incentive/Shortfall Payment	$0	$0	-$6,591,878	$0	$6,591,878	-100.00%	-$6,591,878	NA	$0	NA
Loss on Sale of Publicly Traded Stock	-$885,793	$0	$0	$0	$0		$0	NA	$0	NA
Income Available for Transfer (w/o opening ba	$951,301,861	$1,081,939,188	$967,127,752	$956,816,384	-$10,311,368	-1.07%	-$114,811,436	-10.61%	-$125,122,804	-11.56%
Transfer to State General Fund	$950,082,268	$1,085,009,581	$967,000,000	$965,010,000	-$1,990,000	-0.21%	-$118,009,581	-10.88%	-$119,999,581	-11.06%

NORTHSTAR
NEW JERSEY

EMBARGOED FOR RELEASE WHEN MR. KNAPP BEGINS SPEAKING ON 11.24.2015

Contact: **Angela Wiczek**
1-401-392-7452

NORTHSTAR NEW JERSEY: A VALUED NEW JERSEY PARTNER

Revitalized and Modernized the New Jersey Lottery
Delivering Solid Financial Returns to Taxpayers and Residents

Statement of Russell Knapp, General Manager, Northstar New Jersey Lottery Group, LLC, at a Hearing held by the New Jersey Senate Committee on Legislative Oversight, November 24, 2015

My name is Russell Knapp. I am the General Manager of the Northstar New Jersey Lottery Group, which is a company that was formed in 2013 by the world's leading suppliers of lottery systems and services, GTECH Corporation (GTECH) and Scientific Games (SGI), together with an investment unit of the Ontario Municipal Employees Retirement System (OMERS), one of the largest pension funds in North America.

Let me begin my remarks today by echoing an observation Executive Director Hedinger made during her opening statement. We recognize that delivering relatively flat government transfers since the start of the Northstar contract would raise concerns with the public and elected leaders and I am pleased to attend this hearing today to share insights into the State Lottery's performance. We believe that our actions in the face of the unprecedented sales declines of the national games which Executive Director Hedinger highlighted ultimately minimized the impact on the State of New Jersey. I would like to share the details of our actions with you today. Let me assure you that the entire Northstar team approaches each day with one purpose and that is how to increase lottery sales and revenue for the important programs they fund. I hope that my remarks today will reinforce that point.

Since 2013, the New Jersey Lottery has achieved record sales through the partnership with Northstar, allowing for the continued funding of the important human services programs it supports. Since its inception, Northstar has made significant investments in the New Jersey Lottery through the expansion of the Lottery Retailer Network, investing millions of dollars in technology and personnel and making a one-time upfront payment of $120 million to the State in 2013.

New Jersey Lottery Sales Are At Record High Level

Northstar's duties under the Services Agreement began on October 1, 2013, three months into the State's 2014 fiscal year. By the end of that fiscal year, Lottery sales had increased by more than $80 million, a nearly 3% increase. In our second year of operations, Fiscal Year 2015, Lottery sales increased another $98 million, despite a $112 million sales decline in the Powerball and Mega Millions games. That represented more than a 3% increase from the previous year and a new sales record of over $3 billion for the New Jersey Lottery. In Fiscal Year 2015, total prizes paid to players were approximately $1.823 billion and total retailer commissions and bonuses were more than $171 million which represent a 5.4% and 4.5% increase from Fiscal Year 2014 respectively.

The decline in national game sales has continued into Fiscal Year 2016; however, due to the investments made in improved products, equipment and services, Northstar was able to soften the effects on Lottery sales and revenues. By focusing our staff on the games that we can control we are pleased to report that after the first four months of Fiscal Year 2016, total sales are up 5.1% and transfers to the General Fund are 4.3% higher than the same period last year.

To demonstrate the impact these games had on the industry at a national level, let me report that there are 45 lotteries in the United States and 39 of them have reported their preliminary sales and revenue figures for Fiscal Year 2015. The range of government transfer declines for those states runs from -.5% for New Jersey, which was the lowest, up to -14% for the State of North Dakota.

On a more regional level, the New Jersey Lottery also fared much better in Fiscal Year 2015 than a few key neighboring state lotteries due to the efforts of Northstar to shield the New Jersey Lottery from the national trend. The table I'm submitting with my written statement compares New Jersey Lottery's sales performance for *traditional* games with the New York, Pennsylvania and Massachusetts lotteries.

As you can see from the table, each of these lotteries saw double digit declines in national game sales performance; however, Northstar was able to adapt to the changing market conditions and execute a robust innovation plan that resulted in significant growth for New Jersey's in-state games.

	IN-STATE GAMES						NATIONAL GAMES		
	Instants			All Other Draw Games			Multi-State Lotto (PB/MM)		
	FY2015	FY2014	% Growth	FY2015	FY2014	% Growth	FY2015	FY2014	% Growth
New Jersey	1,695.1	1,531.8	10.7%	990.6	936.9	5.7%	327.9	439.5	-25.4%
Pennsylvania	2,591.6	2,444.9	6.0%	863.2	907.4	-4.9%	364.7	447.3	-18.5%
New York	3,760.1	3,677.1	2.3%	2,176.8	2,119.4	2.7%	592.3	863.5	-31.4%
Massachusetts	3,523.3	3,382.8	4.2%	447.1	460.7	-3.0%	170.1	195.9	-13.2%

in thousands Source: La Fleur World Lottery Almanac

Northstar Employees

Northstar's strength and long list of accomplishments can be attributed to its skilled and professional workforce. Northstar has created 133 private sector jobs, including 38 employees who transitioned from the State government. Of the 133 employees, 94, or 70%, are in the Sales Department, which enables us to serve the retail network throughout the State. In addition to increasing ticket sales, the properly sized sales force is improving retailer satisfaction by delivering tailored, store specific programs and support.

Technology Modernization and Game Innovation

In response to the significant and ongoing declines associated with the national games, Northstar accelerated the introduction of new innovation early in our contract term which allowed us to make headway in narrowing the sales gap caused by these games.

During Northstar's contract term, the New Jersey Lottery's Instant Game category has achieved its top 10 selling weeks in New Jersey history, 9 of which occurred during Fiscal Year 2015. The week ending April 4, 2015 set the highest level of Instant Game sales for a single week at $38.1 million.

Much of the instant ticket sales growth can be attributed to the complete re-engineering of the instant ticket supply chain and product management practices that Northstar put in place. The majority of these changes were introduced early in the Northstar contract and were designed to simplify the tasks of managing, selling and accounting for the instant ticket product by the retail network. These investments are having paybacks as witnessed by the increased sales levels.

Separate from these operational improvements, Northstar also launched the first new price point for the New Jersey Lottery since 2007. The $5,000,000 Cash Extravaganza Instant Game went on sale in January 2015 and has generated over $103 million in sales during the second half of Fiscal Year 2015.

With the technology investment, since October 2013, Northstar has expanded the number of New Jersey Lottery retail outlets from 6,378 to 7,201, a 13.2% increase. This expansion included the key deployments with Wawa convenience stores and Rite Aid pharmacies. As Executive Director Hedinger reported, Wawa's 239 stores have generated over $100 million in lottery sales since joining the network. Rite Aid's 180 locations, which were added during calendar year 2015, have generated over $26 million in sales since they joined. The overall retail network expansion managed by Northstar has generated an estimated $280 million in sales revenue while earning lottery retailers $15.5 million in commissions.

Many aspects of the Lottery's in-state draw-based game category have also undergone significant changes with positive results:

- A few recent examples of the product upgrades include the refreshment of New Jersey's daily jackpot game, Jersey Cash5, achieving 30% higher jackpots in Fiscal Year 2015.
- Northstar launched the successful Cash4Life draw-based game for the New Jersey Lottery in collaboration with the New York Lottery. Membership in the game was expanded to the Pennsylvania, Virginia and Tennessee Lotteries earlier this year, and two more States are contemplating joining the game in 2016.
- In August 2015, Northstar Launched a very successful line of multi-priced, quick-play games to the draw game category. After 16 weeks, these games are significantly exceeding projected sales levels.
- Since Northstar began operations, we have introduced the use of consumer and retailer facing promotions on a more regular basis. These programs drive trial play by occasional and lapsed players and encourage the retail network to remain engaged in selling lottery products.
- Finally, just this week we began selling a new wager type for the Pick 3 and Pick 4 games named Close Enough. This creative feature allows players to win a prize even if their selected numbers are one digit off the numbers that are drawn by the lottery.

Marketing and Advertising

Under the Services Agreement with the Lottery, Northstar provides an expanded marketing and advertising program with an in-house staff of 21 employees who develop all retailer collateral advertisements, including point-of-sale materials as well as retailer and player-facing promotional campaign programs. These materials are used by the retail network to increase consumer interest in buying New Jersey Lottery tickets.

We also have developed a dedicated promotions team that highlights the New Jersey Lottery by engaging the public through a wide array of external events at parades, concerts and retailer locations around the state. Internally, our insight team designs and facilitates research programs to understand consumer feedback, assist with new product development, and track brand health.

Our in-house staff also produces and manages digital messaging that uses Facebook, Twitter, YouTube, and other social media to keep consumers informed about the latest New Jersey Lottery games and prizes. Northstar created a new website and mobile app for the Lottery and we administer both on the Lottery's behalf to deliver updated information to the public. The redesigned website continues to be among the most popular of all State agency websites, at the rate of more than 1 million visitors a month.

In Fiscal Year 2015, we awarded subcontracts to two New Jersey advertising agencies, Ferrara and Company of Princeton, and Brushfire, Inc., of Cedar Knolls. With their help, we've created new advertising campaigns highlighting the Lottery's popularity for providing entertaining games enjoyed regularly by the majority of adult consumers in the State.

Northstar is a Strong Corporate Citizen

Northstar launched our sixth After School Advantage computer lab at the Hackensack Boys and Girls Clubs on November 16, 2015. Northstar contributes from $15,000 to $30,000 in computer technology and equipment to each After School Advantage lab in New Jersey, including 8 to 16 flat-panel computers, headsets, educational software, chairs, workstations, and printers as well as a complete room renovation with freshly painted walls and room décor. Northstar and Lottery employees volunteer their time to complete these renovations by assembling desks and chairs, painting, light construction and installing the computers and software.

We make sure that all our efforts to grow the New Jersey Lottery's business are conducted in a responsible manner. Northstar has built on the Lottery's longstanding cooperative relationship with the Council on Compulsive Gambling of New Jersey.

Since the start of Northstar operations in 2013, we have succeeded in helping the Lottery to win certification from the World Lottery Association for an effective Responsible Gaming Program, advancing from Level 1 to Level 2 in 2014, and then to Level 3 this year, and we are on track to help the Lottery achieve the highest Level 4 in 2016. Only the California Lottery has achieved a level 4 accreditation.

In conclusion, we are pleased that in our first two years of operation we've been able to build an effective and successful partnership between Northstar and the State of New Jersey.

I thank you for your attention, and I hope my testimony provided improved insights into the performance of the New Jersey Lottery since Northstar began operations.

I would be happy to respond to any questions you may have.

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CHARLES WOWKANECH
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LAUREL BRENNAN
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CHARLES H. MARCIANTE
PRESIDENT EMERITUS

November 24, 2015

Dear Members of the Senate Legislative Oversight Committee:

Re: Legislative Action on Best Practices in the Privatization of Contracts

We would like to focus our testimony at legislative efforts here in New Jersey and throughout the nation that have addressed contracting and privatization reform.

Regardless of philosophical positions on privatization, whether in support or in opposition to the concept, we can all agree that the interest of taxpayers and residents must be front and center when considering the merits of privatization. After all, these are the people who depend on efficient and cost-effective delivery of these services and pay for them.

We think common ground can be achieved, if we focus on the most basic of best practices – such as transparency in the contracting process and a cost-benefit analysis to protect taxpayers.

Today's hearing brings attention to privatization "gone wrong" specific to the lottery, but we all recognize this is not the first instance, and it certainly won't be the last unless we come together, both parties, to work towards a solution. Let's be frank - these types of privatization practices, where tax dollars are squandered, political interference is rife and workers lose their jobs and then a portion of them are then hired back at half their salaries with little to no benefits - keeps happening, time and time again. This is not good government, and it's certainly not being a good steward of taxpayer dollars. Something must be done.

To illustrate this is not a Democrat or Republican issue, you can look to recent legislative actions taken on this issue in deep red states such as Texas and Louisiana as well as deep blue states such as Massachusetts, California and Washington.

In 2014, Texas passed legislation increasing transparency, limiting no-bid contracts, strengthening conflicts of interest's laws and created an accountability system to measure contractor performance.

California is advancing legislation focusing on wage and benefit protections for employees contracted by the State's Public Colleges and Universities.

- Over -

Massachusetts has been perhaps the strongest leader on this subject passing in 1993 what is referred to as the "Pancheco Law." This law had seven separate provisions that focused on many of the best practices we are discussing here today. In 2004, a report assessing the law after 10 years was published by academics at Columbia University. A summary of that report is attached to this testimony. The conclusion stated that law prevented $73 million in questionable privatization decisions and has "effectively delivered good management practices" to private contracts and now allows Massachusetts government agencies to accurately judge the cost impact on taxpayers of contracting.

The Pancheco Law is what S-770 of 2014, which was vetoed by the Governor, was modeled after. Unfortunately, the New Jersey bill was not bi-partisan and was viewed by some as purely a product to protect unionized workers when government functions where privatized, rather than the comprehensive set of best practices that it truly was. And although the NJ State AFL-CIO believes that wage and benefit protections should be front and center when talking about reforming the contracting practice, after the Governor's veto, we recognize that we must move past that in order to advance a bill that focuses on taxpayer protections.

And so, we urge the legislature to revisit this bill, to have representatives of the Governor review what they feel can be achieved. Perhaps a bill simply embracing the cost-benefit analysis and post contract audit are more palatable at this time. These concepts were strongly embraced by Dick Zimmer, Chairman of the Governor's Privatization Task Force, in their report issued in May 2010. Specifically, the Zimmer report advocated for government entities to "apply a rigorous cost-benefit analysis to determine if a privatization should go forward." The bill then requires an annual post audit if the contract was privatized to assure actual net reduction in costs and therefore realized anticipated savings to taxpayers.

This simple recommendation would go a long way ensuring that our elected officials are being the best stewards of taxpayer dollars as possible. If this logical requirement was in place, we would have avoided many of the pitfalls this hearing is outlined today.

Thank you for your attention to this matter and the New Jersey State AFL-CIO stands ready to work with those that are willing to make an effort to protect taxpayer dollars in the contracting process.

Sincerely,

Charlie

Charles Wowkanech
President

Laurel

Laurel Brennan
Secretary-Treasurer

CW:LB:jmn
Attachment
OPEIU:153

Democracy, Shared Prosperity, and the Common Good

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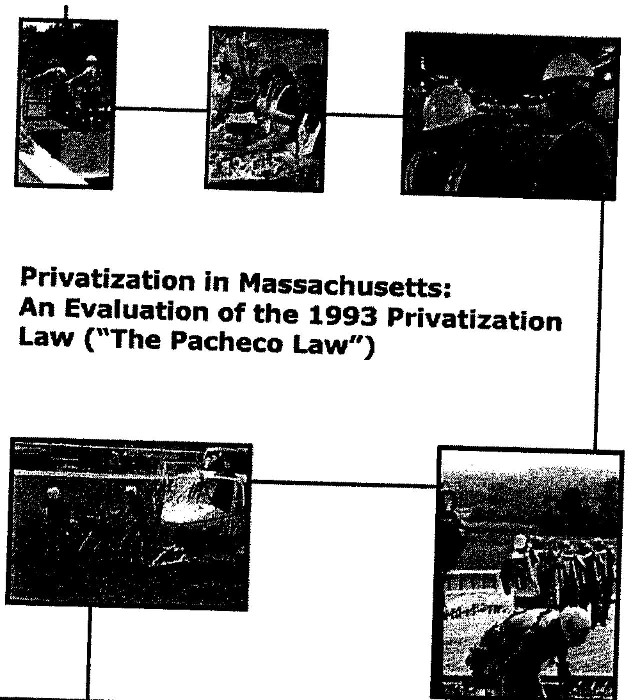

All Research Responsible Contracting/Best Practices

SHARE

Privatization in Massachusetts: An

Democracy, Shared Prosperity, and the Common Good

5/18/2004 **Authors: Elliott Sclar**
Columbia University

Click here for full report.

In 1993 Massachusetts passed a law requiring state agencies (excepting some specifically exempted organizations) to concretely establish a cost savings to taxpayers prior to contracting out

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Public-Private Contracting and Political Reciprocity any service previously provided through in-house labor. This law, the first of its kind, essentially mandated that good management practices had to accompany privatization. The law required subject agencies to submit contracting plans to an independent audit, conducted by the Office of the State Auditor (OSA). Furthermore, the Privatization Law (Chapter 296 of the Acts of 1993, sometimes also called the Pacheco Law or the Pacheco-Menard Law) required that a cost comparison, that would accurately establish the savings taxpayers could expect to derive from any such contracting out action, accompany any proposal to outsource work currently done by state employees. The privatization solution to which this law was responding was born of a time when state budgets were being squeezed by simultaneous economic downturn and Federal reductions in fund transfers. A similar economic climate today may account for the renewed focus on privatization and points to the need for the Privatization Law to continue to bring rational order to privatization efforts.

Top

Privatization, as it emerged in the early 1980s, held out the promise that taxpayers could have their cake and eat it. That is to say that by substituting private service providers for public employees, it would be possible to have high quality public services and lower costs and presumably lower taxes. This view, rooted in a libertarian ideology that distrusts government in general and views public employees in particular as inefficient, turns to a simplified model of a competitive market to justify the approach. But government is neither simply "good" nor "bad" and public employees do not go to work everyday to do a bad job. The vast majority of them are hardworking citizens dedicated to promoting the

Managing Public Service Contracts: Aligning Values, Institutions, and Markets

Evaluation of Outsourcing in the Public Sector

The Mythology of Privatization in Contracting for Social Services

common good through their public service. Moreover the contracting out that would substitute for public service is itself not free from inefficiency and corruption. However in the 1980s and early 1990s the attraction of this simple solution was very powerful. Since then as difficult and costly experiences with privatization have accumulated both domestically and internationally a more balanced view has emerged. It holds that privatization is sometimes a good thing and sometimes not. But regardless of which way a service is delivered its effectiveness depends upon good public management. Even the World Bank, an early and ardent proponent of privatization has begun to change its stance. It now argues that more important than the way the service is delivered is the managerial quality of the public agency responsible for its delivery. The Massachusetts Privatization Law was an early exemplar of how to achieve this balance in public contracting. In an era when public managers are looking with a more critical eye at privatization, the Massachusetts Privatization Law stands as a first-in-the-nation attempt to legislate sensible contract decision making for public agencies. The law has effectively helped the state save over $1.2 million per year and, more importantly, to avoid at least $73 million in bad contracts. The process set up by the law effectively provides state agencies with assistance in measuring the likely impact of contracting decisions and helps them to ground privatization in reality.

Since 1993, various subject agencies and organizations have attempted to contract out 8 separate services.3 Of these, the OSA approved six applications and two were rejected based on either a failing to adequately comply with the Privatization Law, or a failure to adequately establish true cost savings to the taxpayers. A review of the cases demonstrates that winning approval for contracting out a service is not a matter of institutional size, ability to hire consultants, or contracting experience. Rather the Privatization Law process simply rewards good management and good management processes. Operations as large as the Massachusetts Highway Department and as small as Holyoke Community College have successfully negotiated the required process and have contracted out services with a subsequent financial benefit to state taxpayers. A review of the various proposals submitted to the OSA demonstrates that the process works; it creates an atmosphere that encourages good management. The process does not discourage good contracting decisions, but avoids bad ones. It compels public managers to enter into a dialogue with an independent and competent public auditor to justify change in the name of either cost savings and/or improved services.

This report reviews the Privatization Law and its consequences. Four of the cases reviewed by the OSA are examined in-depth (two approved and two denied cases). These case studies and the general review of the impacts of the law are used to determine the efficacy of the law as it stands, and to derive recommendations for improvements to the current review system.

This report clearly demonstrates that the Massachusetts Privatization Law is effective. The Law enables agencies that have a compelling, cost-saving way to effectively contract out a public service without sacrificing quality to do so. The Law avoids being too cumbersome for smaller agencies to handle. Agencies can successfully complete the review process without outside legal or accounting assistance. The Privatization Law is effective because it forces state agencies to carefully consider the fiscal and service impacts of contracting decisions, just as any private firm would do. Taxpayers are spared the cost and service burden of privatization experiments, and agencies that have not carefully examined the impacts of a potential contracting solution are discouraged from doing so without first examining the finer detail.

It is easy to understand why managers in the public and private sectors can become excited over new ideas. Often the fight to implement change then pushes managers to oversell the value or cost savings associated with these ideas. The Privatization Law provides a needed counter balance. It gives subject agencies a workable process through which to ground their concepts and ideas in fact, and to ensure that a simple basic, "back of the envelope" calculation is not substituted for a careful managerial and financial analysis. The privatization law has created an atmosphere where state agencies are forced to think like private firms as opposed to assuming that a private provider working under contract will automatically solve any problem at a lower cost. It compels state agencies to think through the pitfalls that lie ahead and prods them to be sure they are making the highest and best use of scarce resources in difficult fiscal times. It avoids the squandering of public funds on untested ideas that has plagued privatization efforts in so many other places. Massachusetts voters and legislators should be proud of their ground-breaking law.

JANICE FINE, PATRICE MARESCHAL, DAVID HERSH, AND KIRK LEACH
RUTGERS UNIVERSITY

OVERLOOKING OVERSIGHT:

A Lack of Oversight in the Garden State is Placing New Jersey Residents and Assets at Risk

RUTGERS
UNIVERSITY

Department of Labor Studies and Employment Relations, New Brunswick
Department of Public Policy and Administration, Camden

MARCH 2014

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CONTENTS

Financial support for this study was provided by the Rutgers School of Management and Labor Relations, Rutgers Department of Public Policy and Administration, the New Jersey AFL-CIO, and In the Public Interest.

EXECUTIVE SUMMARY

Governments and to some extent scholars have long treated contract oversight as a trivial or at best mundane sideline to broader issues of privatization. This is a critical mistake. In the context of human services, contractor oversight can prove to be a life or death question. In all contexts, it is crucial to protecting taxpayers' investment in their government. From services provided to the most vulnerable among us, like child protection and the treatment of the disabled, to prisons that protect us from harm, to more prosaic tasks like maintaining infrastructure, states provide a broad array of services that dramatically affect our lives. The fact that states contract with private companies to provide ever more of these services therefore takes on a heightened sense of urgency. As a corollary, the means by which states oversee these contractors goes from a mundane matter of public administration to a vital matter of public interest. Bucking the trend against detailed examinations of administrative capacity, we conducted an in-depth analysis of how New Jersey oversees its contractors. Our findings were eye-opening.

Recent events highlight the urgency of this issue. Failure to properly oversee the contractors responsible for the Department of Corrections' Residential Community Release program resulted in the death of innocent people. More recently, the failure to properly manage the administration of recovery funds following Hurricane Sandy delayed needed aid to Sandy victims for many months and led to millions of dollars in unexplained costs.

Contracting for services is not inherently bad. Contracting can be an important tool for government if it is done for the right reasons and if it is done well. Government can legitimately contract in order to tap into special expertise, to carry out activities that would be better delivered in a community setting or to augment state capacity in a specific area. Research tells us that to be effective however, contracts must be carefully managed. Management at its core is about the construction and maintenance of collaborative communities[1] who share large amounts of information in real time and among whom cooperation is incentivized and rewarded and led by skilled individuals given the time to do the job. Contracting units must educate contractors about performance measurement and monitoring requirements.[2] Moreover, contracting units must develop standards and communicate clear and explicit guidance on what is expected from contractors.[3] Research also tells us that government must engage in thorough contract costing before a contract is

1 Adler, Paul S., and Charles Heckscher. "Towards collaborative community. The firm as a collaborative community: Reconstructing trust in the knowledge economy (2006): 11-105, http://www-bcf.usc.edu/~padler/research/01-Heckscher-chap01%20copy-1.pdf. (accessed Feb. 2014)

2 Amirkhanyan, Anna. "Privatizing public nursing homes: Examining the effects on quality and access." *Public Administration Review* 68, no. 4 (2008): 665-680.

3 Weil, David, *The Fissured Workplace* (Harvard University Press, 2014).

let, ensure transparency from the bidding stage through contract execution, put in place a system of monitoring and auditing to ensure that standards are being followed, set outcomes-based benchmarks with clear performance measures, conduct regular, qualitative multi-stakeholder evaluations of services provided, impose significant penalties in the face of failure to meet goals and rebid all contracts at most, every 3 years. This list highlights two key points. First, overseeing contracts is difficult to do well. Second, it requires experienced, well-trained government employees given the time to manage with care.

Our review of contractor oversight in New Jersey shows that the state is failing in its duty of protecting vulnerable citizens from poor service and taxpayers from wasted funds. At the core of the problem is a complete lack of priority given to oversight despite a preference for contracted service provision. This is best exemplified by the massive shortage in qualified staff to manage contracts. Our recommendations are designed to drastically improve the quality of the state's oversight of its contractors and thus make it a better steward of the public interest. We base our recommendations on the simple principle that quality oversight should be seen not as a luxury to be dispensed with in the face of austerity but as an inseparable element of the contracting process.

Finally, it is important to note that the current state of affairs evolved over a long period of time, under both Democratic and Republican administrations.

KEY FINDINGS

Significant Neglect of On-the-Ground Oversight

Effective oversight of contractors involves:

1. adequate staffing and training of contract managers
2. thorough contract costing and design
3. strong ongoing communication and cooperation between contract managers and contractors
4. strategic contract monitoring with clear performance requirements and standards

Capacity in all four elements of contractor oversight is severely lacking.

Attrition is a predominant problem, depriving every contracting unit we studied of practical expertise while simultaneously increasing the burdens on those workers that remain. This is not surprising, given the structural lack of priority given to oversight. It occurred in all four of the departments for which we were able to obtain such information. Here are a few examples:

- Office of Information Service's workforce, critical to providing the data necessary for oversight, has dropped from 82 in 2003 to 54 in 2012
- The Office of Auditing within the Department of Health Services has been reduced from 60 staff to 30
- The Department of Transportation has lost approximately 50% of its staff in the past ten years, putting tremendous stress on remaining staff particularly with respect to Contract Managers

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No contract costing and minimal specification of contract terms prior to the issuance of RFP's. Every official we asked confirmed that, to their knowledge, costing was not done in any systematic way.

Contract Managers are not always qualified or properly trained to fulfill their roles effectively. According to officials from every department studied, there are not enough human resources being assigned to oversight and effective oversight is not being fulfilled by many of the individuals who are being designated as Contract Managers.

Contracts had weak performance requirements and standards. Only a minority of contracts had outcome-based performance measures and there was little evidence of performance targets being integrated into a comprehensive oversight system. Only the Department of Mental Health Services (DMHS) had clear, outcome-based performance measures in contracts combined with a comprehensive system of oversight.

Very few contracts required specific data collection and reporting, outcomes-based benchmarks with clear performance measures and milestones tied to payment despite these being widely accepted best practices. Similarly, very few contracts had automatic sunset provisions and requirements that contractors would have to reapply in a competitive bidding process.

There are substantial impediments to transparency. The biggest of these is that contract data for human service contracts is not kept in any systematic way. As a result, it is nearly impossible to gather information on these contracts.

Structural Deficiencies in State Oversight

Many of the most significant oversight decisions and processes are subject to few if any formal rules. The Division of Purchase and Property (DPP), which has primary responsibility for procurement in NJ, regulates and enforces only one part of the process: bidding. Moreover, contracts that go through DPP are estimated to account for only 50% of the total number of contracts in which the state is engaged. Strikingly, services provided directly to NJ's citizens through third party contracts are exempt entirely from DPP oversight, including bidding requirements.[4] In 1976, the Attorney General issued an opinion indicating that DPP is not required to exercise oversight of the procurement process where the end user of a purchase is a third-party, rather than the state itself. Notably, this includes most of the services with which the public is concerned, for example, the provision of the overwhelming majority of human services, such as those provided to the developmentally disabled, to abused children or to struggling families, not to mention the detention and rehabilitation of a large number of criminals. As a result of this exemption, regulations governing the contracting process for these critical services are left to the individual departments. While some departments have created their own regulations, others have not. In all cases, the regulations fail to ensure sufficient protections for the vulnerable clients who received the services and the taxpayers who pay for them.

The Independent Office of the State Comptroller (OSC) and the legislative Office of the State Auditor (OSA) both have authority to review decisions and audit processes.

4 This opinion continues to define the parameters of DPP oversight today so that oversight of contracts for which the end-user is a party other than the state ("Third-Party Contracts") is entirely decentralized, handled by each department as it sees fit.

However, both agencies' roles are limited by resources and regulations to after the fact, retroactive analyses of only a small group of contractors. The State Commission of Investigation (SCI) also conducts investigations relevant to oversight, but is similarly limited. They investigate only when there is reason to think there is something that needs investigation and are, as currently constituted, not in a position to evaluate systemic issues and recommend changes before disaster strikes or money is wasted.

There are no institutionalized mechanisms within state government to ensure that sufficient resources exist so that individuals responsible for the majority of oversight are able to do the job well. Simply put, the budgetary process does not build in the cost of oversight of contractors at individual state agencies.

There does not appear to be any agency within the state with the capacity or competence to monitor the overall efficiency or effectiveness of resources allocated to contractors. OSC and the Office of Management and Budget (OMB) are prime candidates, with relevant competencies, but neither currently has a mandate or the resources to do so.

Lack of Oversight has had significant consequences for vulnerable people and for New Jersey taxpayers and is continuing to place assets at risk

- A lack of contract monitoring at DCF's Division of Child Protection and Permanency (DCPP) leaves children vulnerable to being served by inadequate providers
- Lack of oversight at DHS's Department of Developmental Disabilities led to substantial waste of taxpayer money with little assurance that services for which the state has contracted are being provided
- Lack of oversight at DOC's Residential Community Release Program (RCRP) led to assaults and deaths in the facilities as well as in communities
- Lack of oversight of the state's Hurricane Sandy relief and rebuilding programs led to the inappropriate denial of aid to thousands of families and businesses

RECOMMENDATIONS

In drafting recommendations, our biggest priority is to ensure the institutionalization of oversight as an unseverable element of the contracting process. We do this primarily through statutory and regulatory changes or additions that do the following:

- Eliminate the budgetary disincentive to fund administration, ensuring sufficient resources for other recommendations
- Eliminate the blind spot for third party contracts
- Fill gaps in oversight for both the RFP generation and contract management stages of the process, and
- Create capacity and a mandate for systemic oversight.

Statutory Changes and Additions

Eliminate the Gaping Hole Caused by the Exemption for Third-Party Contracts Every statutory change listed below should make explicit that its provisions apply to third-party contracts.

Sufficient Resources Requirements The legislature should enact legislation that conditions the issuance of service contracts on sufficient resources to oversee those contracts and provides a floor on the level of resources that may be deemed sufficient.

New State Contract Manager Requirements The sufficient resources requirements should explicitly include managers to rebuild the corps of State Contract Managers. Every State Contract Manager should also have expertise in both contract management and the substantive area of the agency.

A Ban on Outsourcing Oversight The State should eliminate any ambiguity around whether oversight can itself be managed by a contractor with a clear statute precluding the outsourcing of oversight activities.

Compulsory Contract Costing Before a contract is let, the state should require a three-step cost comparison including ABC accounting, an avoidable cost analysis and a comparison of avoidable cost with the contract price.

Make Certain State Commission on Investigation's Recommendations Binding The legislature should enact legislation making recommendations from SCI investigations binding under certain conditions.

Require all human service contracts to establish mechanisms for client, family and line worker voice. The legislature should enact legislation that requires DHS to establish an ombudsperson to represent clients, their families and line workers and community oversight committees that have formal and ongoing roles in enforcement.

Include all state contract managers, state employees, contractors and contractors' employees who raise questions about the quality of service being delivered under the New Jersey Conscientious Protection Act (CEPA). At present, only nurses are covered for whistleblowing related to quality of service issues. We propose to extend this protection to all state and contract workers and managers.

Rebidding Requirements The State should require that all human service contracts be rebid after, at most, 3 years.

Transparency from bids through contract execution All information relevant to determining the effectiveness and efficiency of every contract should be made publicly available in a centralized and standardized format.

Authority and Appropriations for Data Systems Legislation mandating and enabling the development of appropriate data systems will facilitate the other recommendations included here.

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Regulatory Changes

Exemplary service providers should be involved in the drafting (as opposed to just the comment period) of the regulatory requirements derived from the authority granted in the above statutory requirements. In addition, the following regulatory changes should be made under existing authority, again with exemplary service provider input in the drafting stage. These changes should apply to third-party contracts.

Additional Requirements for all RFP's and Contracts DPP should provide additional standard language to be included in all RFP's to ensure contract terms that provide additional protections to the state and taxpayers

Detailed requirements for Data Systems To be effective, systems and the data contained in them must be standardized. Regulations should be created to effectuate this.

Improve Data System to Facilitate Better Oversight and Meta-Oversight

A data system should be created that is ubiquitous, centralized, accessible and includes data that can be used to hold contractors and contracting units accountable.

FULL REPORT

Introduction

States provide a broad array of services that directly affect residents' lives. Foremost among these are critical human services provided to the most vulnerable among us, from child protection to the treatment of the disabled. Equally critical are those services involved in the protection of the rest of the population from others, such as the handling of convicted criminals. Add to these the construction and management of infrastructure, the protection of the environment and the administration of social programs like Medicaid and welfare and the picture of just how much we are all affected by what government does becomes clear. Because of this, we all have a great interest in how well these things are done. At the same time, because these services are taxpayer funded, we also have an interest in the cost of their provision. As such, the fact that the state contracts with private companies to provide ever more of these services takes on a heightened sense of urgency. As a corollary, the means by which states oversee these contractors goes from an archaic matter of public administration to a vital matter of public interest. While there is much debate surrounding the merits of privatizing public services, to the extent that it is being done, all sides should agree that states have a duty to ensure that clients are receiving quality services and taxpayers are receiving a good value.

Issues in the wake of Hurricane Sandy bring the issue into focus. Documents released by the Fair Share Housing Center paint a disturbing portrait of what can happen when oversight is neglected. Contractors awarded multi-million dollar contracts and charged with administering millions in Sandy Recovery funds were supposed to be overseen by the Department of Community Affairs (DCA). But last December, the Christie Administration terminated the largest Sandy contractor, HGI (Hammerman & Gainer) which had a 3 year, $67.5 million contract to manage the RREM program[5], and more recently, the URS Corporation, which had a $20 million contract to supervise the rebuilding of homes destroyed in the hurricane[6]. Their failures had far-reaching consequences for Sandy victims. Official guidelines for the Renovation, Reconstruction, Elevation and Mitigation (RREM) program that DCA was in charge of overseeing were not adopted until five months after the program started and were not made available to the public. Recovery centers frequently lost applications or provided misleading advice on what documentation was needed, ultimately thousands of homeowners were wrongly found to be ineligible and the appeals process was poorly publicized.[7]

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5 Colleen O'Dea, "Botched Process Denied NJ Residents Millions in Sandy Relief," *NJ Spotlight*, Feb. 7, 2014.
6 Matt Katz, "NJ Quietly Fires Second Contractor Hired to Help Sandy Victims," *NJ Spotlight*, Feb. 14, 2014.
7 Fair Share Housing Center, et al., "The State of Sandy Recovery: Fixing What Went Wrong with New Jersey's Sandy Programs to Build a Fair and Transparent Recovery for Everyone," Housing and Community Development Network of New Jersey, January 2014, http://www.hcdnnj.org/assets/documents/report%20state%20of%20sandy.pdf (accessed Feb. 2014)

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This is not merely a matter of poor governance of emergency funding, however. While state governments are actively engaging in government contracting, research strongly suggests that government capacity to provide adequate and effective oversight has dwindled.[8] The two keys to contract oversight are (1) well-written contracts adequately defining the responsibilities of the contractor and the protections of the state and (2) strong, experienced, well trained managers with a deep knowledge of the activities they are monitoring and time to do the job well. Unfortunately, between 2004 and 2011, the size of the state workforce in New Jersey shrank by 36,319 while the total value of contracts held steady and in some years increased quite significantly[9]. Management professionals in both public administration and private sector supply chain management agree that strong, relational contract oversight is critically important to ensuring that contractors are fulfilling their obligations and that taxpayers are receiving quality public services.

When employment is shifted to another party that is paid to provide services, the lead employer is simply "less able to monitor performance, since those doing the work are now potentially hidden within another organization."[10] Best practices in the business literature[11] suggest that lead firms maintain quality in services delivered by their subcontractors, by providing for 3 things:

- Clear and explicit guidance on what is expected
- A system of monitoring and auditing to ensure that those standards are followed
- Significant penalties in the face of failure to meet goals

Given the drastic decline in the state workforce, and the number of Garden State citizens dependent upon the services of contractors, it is crucial that we understand the state's capacity to manage and oversee them. What we have uncovered is a stunning lack of effective oversight in the state due to the stripping out of experienced state contract managers and the overloading of those who remain. As a consequence, largely what we have is oversight by audit and expose, which only catches problems after they arise and in many cases only once they have become quite severe.

The contracting process proceeds in three stages:

1. RFP generation
2. Bidding
3. Contract management

The RFP generation stage is critical because it is here that the terms of the contract are created. Prospective contractors bid on the RFP and the terms of that RFP ultimately become the vast majority of the terms of the contract between the state and the winning bidder. Thus, over the course of the process the RFP essentially becomes the contract, meaning that the RFP also effectively defines what the state can demand of the contractor and what remedies are available if the contractor fails to live up to its duties. We focused

[8] Van Slyke, David M. "The mythology of privatization in contracting for social services," *Public Administration Review* 63, no. 3 (2003): 296-315.

[9] Despite our best efforts to arrive at comprehensive numbers, we have only been able to obtain figures regarding Department of Purchasing and Property contracts. The state Office of Management and Budget generally estimates that these contracts account for approximately 50% of all state contracts. We have no data about the other 50%, which includes all human service contracts.

[10] Weil, *The Fissured Workplace*, 59.

[11] Ibid., 63-73.

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far less on the bidding process, as this process is the most heavily regulated by far and has been studied by others. Contract management covers the process by which the state ensures that contracts are being properly executed by contractors. It involves both people who maintain relationships with contractors and clients, and systems that facilitate the work of those people. In analyzing these three stages, we also learned about the overarching institutions — laws, regulations and policies — governing the entire process. We found significant issues in both of the stages that we studied in depth as well as in the overarching institutions. Where legal and administrative structures exist, they are not being effectively implemented. Where they do not exist, people and systems are not sufficient to compensate.

Our recommendations, based both on our findings and our review of the literature, are designed to drastically improve the quality of New Jersey's oversight of its contractors and thus make it a better steward of the public interest. We argue that quality oversight should be seen not as a luxury to be dispensed with in the face of austerity but as an inseparable element of the contracting process. Where our recommendations would lessen the cost savings sought from privatization, the conclusion should not be that oversight is too expensive, but that that the particular service may not be a good candidate for privatization. We are not taking a side in the debate about the merits of contracting with third parties to provide services to state government — beyond stating that there are instances where it makes sense and instances where it does not. We aim instead to inform that debate by demonstrating that to reap the benefits of hiring contractors, New Jersey cannot continue to overlook oversight.

Methodology

In conducting our review of the New Jersey state government's capacity to oversee its contractors, we analyzed a rich source of relevant documents, including applicable New Jersey statutes, administrative code provisions, executive orders, government circulars, organization charts, service contracts/RFP's, select reports from the Office of the State Comptroller and news articles. We also interviewed current and former state employees from as many departments as possible, as well as outside experts. In addition, we reviewed two OSC audits of contractor oversight — Department of Human Services' (DHS) Department of Developmental Disabilities (DDD) and the Department of Correction's (DOC) Residential Community Release Program (RCRP) — to support a more in-depth look at particular instances where oversight issues we had identified in our research had significant consequences in practice. Finally, we reviewed reports and data available on the yourmoney.nj.gov website.

We had a difficult time getting at what we needed: data about state contracts not held by the Department of Purchasing and Property was not available and much data on employment in oversight-related positions was not kept in any way that made it easy to request. One overarching issue with OPRA requests is that they are for specific documents, rather than answers to research questions. This often made us feel as though we were playing a game of twenty questions with NJ state agency officials. Additionally, responses to our OPRA requests were often considerably delayed, redacted and in some instances, never provided. DCF refused to cooperate with our requests to speak with staff. Although Executive Order 8[12] was an attempt to add some level of transparency, in truth it provides overly general and vague performance data.

This report is divided into four sections. Part 1 discusses why oversight is such a critical component of the contracting process. Part 2 describes problems commonly associated with government oversight and highlights their specific impacts in New Jersey. Part 3 includes several case studies that illustrate how oversight failures manifest themselves in practice and what the consequences are for taxpayers and the impact on critical public services. The case studies feature examples from four New Jersey agencies: the Department of Children and Families' Division of Child Protection and Permanency (DCPP), the Department of Human Services' Department of Developmental Disabilities (DDD), the Department of Corrections' Residential Community Release Program (RCRP), and the Department of Community Affairs-Administration of Hurricane Sandy recovery efforts. Lastly, Part 4 provides detailed recommendations designed to specifically for New Jersey but which we hope will serve as best practices that can be applied to other states.

PART I: Why is Oversight Important?

Oversight is a critical component of the contracting process for several reasons:

Protecting the public's investment

The state has a fiduciary responsibility to manage tax dollars and protect precious public assets such as forests, parks, beaches, rivers, roads, and bridges for future generations. Short-term thinking focused on income maximization can lead to disinvestment and neglect. When the state contracts out a service, it is still taxpayer money that is going to pay private contractors and the duty to protect the public's investment remains with the state. It is the responsibility of government to ensure that those who are most knowledgeable about the service being performed are involved in oversight so as to do the best job of stewarding our resources.

Ensuring a high quality of service

The state has a responsibility to ensure the quality of service provided. Whether government provides services directly or does so through a contractor, citizens expect their government to ensure the highest quality services for our communities.

Protecting vulnerable members of our society

The state has a duty to protect vulnerable members of society. We as a society have made a decision to utilize government to collectively care for our developmentally disabled, our elderly, and our children in crisis, our indigent ill, those in the criminal justice system when they are deprived of their freedom, and those struggling with addiction. These people cannot protect themselves. When private entities are entrusted with caring for

[12] Executive Order 8 was issued by the Christie Administration to improve transparency and increase the use of performance measures in government contracts. It is discussed in more detail below.

vulnerable populations, government is expected to ensure that they are carefully looking after those in its care.

Ensuring public health and safety

The state is obligated to ensure public health and safety. Everyone in society depends on government to ensure that we drink clean water, breathe clean air, and safely travel over roads and bridges. When we entrust private entities with these activities we are literally putting our lives in their hands. Careful oversight of government contractors is critical to community wellbeing.

Catching mistakes in real time

Finally, a central challenge is ensuring that the state fulfill these obligations in a timely way. State and local governments often identify and expose abuses after they happen and the damage has been done. Mechanisms that ensure effective ongoing monitoring are necessary so that problems can be identified and dealt with before people are harmed or state assets are destroyed, depleted or misspent.

In the supply chain literature, there is growing understanding about the danger of shifting too much responsibility to outside actors: "Businesses face significant risks if outsourced functions interact with decisions central to core competency or require nuanced understandings of customers, markets, or other external factors," David Weil cautions. He goes on: "For example, companies have found that shifting major human resource and IT functions can backfire if it impinges upon the development of key staff positions in the case of personnel...The problem is intensified if business functions are hard to bring back in-house once outsourced."[13] Like supply chain management in the private sector, oversight is only as strong as the government's capacity to undertake it — in other words, there have to be adequate numbers of people in government charged with doing it and the people who carry it out on the ground day in and day out must possess significant skill, experience and area-specific expertise. Also, once allowed to atrophy through attrition and lay-offs of skilled and experienced managers, this capacity is difficult to regain.

PART II: Findings from a Review of Contractor Oversight in New Jersey

Our interviews with state workers and analysis of the New Jersey documents described above reveal several common problems related to government oversight of private contractors. In particular, we found problems in contracts and the process by which the state creates the contracts, a critical issue given that the contract defines both the contractor's obligations and the remedies available to the state in the event of a violation. We also found problems in contract management, the process by which the state ensures contractors are doing what the contract requires of them. At the heart of both of these problems is an overarching problem: a lack of institutional prioritization of oversight as evidenced by a severe lack of systemic oversight capacity. While these findings are based on state-specific evidence, many of these problems are endemic to poor government oversight and it is probable that New Jersey's experience is not unique to our state.

[13] Weil, *The Fissured Workplace*, 58.

Problems with Contracts and the Process by Which They are Created

Oversight costs are not incorporated into contracts or the decision to contract

Oversight requires that adequate funding be provided for government personnel to monitor performance. Yet, states' experiences have shown that contracting managers typically do not allocate sufficient levels of financial support to perform administrative and oversight duties.[14] Establishing a process to estimate costs, including the costs of oversight and performing a cost-benefit or cost-effectiveness analysis, improves government decision-making regarding contracting out. However, government agencies tend to underestimate or exclude indirect and overhead costs associated with additional internal capacity to monitor, manage and oversee contracts.[15] Researchers suggest that these hidden monitoring and transaction costs are approximately 20% of the total contract cost.[16] The additional administrative costs associated with contracting out, in particular the cost of oversight, routinely fail to be incorporated into the contracting-out decision.[17] Contract administration costs tend to be difficult to calculate since they include costs associated with contract negotiations, contract amendments and contract oversight.[18] It is critical for states to fully understand how these additional costs offset or completely reduce any projected savings or efficiency gains promised by contracting out.[19]

In New Jersey, we found that the state failed to perform routine contract costing and/or included minimal specification of contract terms prior to the issuance of RFP's. This leaves the foundation upon which oversight might be built extremely weak. In most cases the bidding process locks in place the costs and requirements associated with contracting for a service. Thus, any RFP that is based on a poor (or non-existent) estimate of the costs and lacks thorough, clearly defined contract terms will make it extremely difficult to ensure that services are being delivered well and cost-effectively.

The decision of when to contract and when not to do so is fundamental and must be made with great care and deliberation. Yet, every official we interviewed confirmed that to their knowledge costing was not done in any systematic way. We found two concrete example of an agency comparing the costs of keeping a service in-house with the costs of contracting for it for the purpose of making a decision. The first was the Department of Corrections (DOC) in assessing how to best provide education services to inmates. The second was the Department of Transportation (DOT), which compared the cost of replacing highway lighting in-house against the cost of contracting for it. In both cases, however, costing was not done as thoroughly as best practices might suggest, in particular ignoring the cost of oversight in the calculation of the cost of contracting.

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[14] Hodge, Graeme. "Contracting Public Sector Services: A Meta-Analytic Perspective of the International Evidence." *Australian Journal of Public Administration* 57, no. 4 (1998): 98-110.

[15] Young, Richard D. *On Cost Analysis Comparisons: Government In-house Provision vs. Contracting Out.* USC, Institute for Public Service and Policy Research, 2005.

[16] See Sclar, Elliott D. *You don't always get what you pay for: The economics of privatization.* Cornell University Press, 2001; Marvel, Mary K., and Howard P. Marvel. "Outsourcing Oversight: A Comparison of Monitoring for In-House and Contracted Services." *Public Administration Review* 67, no. 3 (2007): 521-530; Pack, Janet Rothenberg. "Privatization and cost reduction." *Policy Sciences* 22, no. 1 (1989): 1-25.

[17] Durant, Robert F., Amanda M. Girth, and Jocelyn M. Johnston. "American exceptionalism, human resource management, and the contract state." *Review of Public Personnel Administration* 29, no. 3 (2009): 207-229.

[18] Young, *On Cost Analysis Comparisons*, 2005.

[19] Carr, Jered B., Kelly LeRoux, and Manoj Shrestha. "Institutional ties, transaction costs, and external service production." *Urban Affairs Review* 44, no. 3 (2009): 403-427.

Very few officials were aware of the possibility of internalizing oversight costs into contracts. It did not appear to be a consideration for many contracting units. Not a single contract we reviewed included oversight cost recovery terms. The only explicit indication of a cost of oversight being built into an RFP was in the Department of Human Services (DHS) and it was fairly limited. DHS vendors are required to include the $30,000-$80,000 costs of CPA audits as line items in their budgets. However, CPA audits cover only the financial integrity of the vendors, not the specific contracts, nor the vendors' performance under them. This audit cost is only one small element of the overall cost of oversight.

Our analysis of RFP's shows similar findings. Most RFP's only require the bidder to provide program related costs such as the number of staff required or the number of beds, which leads us to conclude that the contracting out decision-making process lacks a robust cost comparison methodology. Few if any of the RFP's analyzed required bidders to include the proportion of overhead and administrative costs associated with providing the service. Therefore, contracting units are comparing their internal costs with an underspecified cost from a contractor. In the context of our RFP analysis this also means that costs such as management information systems and data collection systems associated with delivering the services are not routinely itemized or proportioned per contract, thereby limiting the effectiveness of making a cost comparison. Moreover, requests for the cost of tasks associated with monitoring and oversight of a specific contract were notably absent from the RFP's we reviewed. The proportion of administrative and overhead costs is necessary to ensure an accurate cost comparison between in house service delivery and contracting out. Additionally, once the contract is let, the RFP becomes one of the documents governing the contractual relationship, and therefore makes the RFP a critical document that should require and contain enough detail to be useful as a contract. The bottom-line is that contracting units are making the decision to contract out without having a complete picture of all the costs associated with contracting out the service.

Contracts do not contain adequate performance requirements and standards

Another challenge to performing oversight involves how contractor performance is measured. Research finds that states are struggling to develop strategies for gauging service outcomes or program effects. Developing sound and reliable performance indicators is an extremely difficult task because in truth, many of the most important outcomes cannot be quantitatively measured—instead what is required is the presence of knowledgeable, experienced individuals who remain close to the action, regularly in touch with all parties and can use all of their capacities to evaluate performance.
While it may be appropriate to consult contractors in determining which performance indicators will be used, ultimate responsibility and authority must reside with the state. Once government separates itself from its oversight and monitoring functions, state capacity continues to erode, and it becomes increasingly difficult to ensure transparency and accountability to the state.

Several best practice measurement and monitoring tools are available for contracting units to ensure quality service outcomes. For example, contracting units can employ onsite spot checks, unannounced site visits, and regular progress reports as routine built-in contract monitoring and oversight tools.[20] Specific measurement criteria, understood by the contracting unit and communicated to the contractor are key for effective contract oversight. As a best practice, contracting units should clearly detail performance measures and specifications as early as the RFP process.[21] By defining precise contract monitoring requirements in advance, contracting units communicate their goals, needs and requirements to potential vendors.[22] This requires contracting units, especially contracting units delivering complex human services, to invest in developing and communicating explicit standards to bidders.[23] The specificities of the contract and effective contract oversight are closely linked; therefore as a best practice, contracting units must pay careful attention to articulating the outcome they want to achieve during the contract specification process.[24]

Best practices research urges contracting units to specify as early on as the RFP what is being monitored and how this will be done. The New Jersey contracts we reviewed lacked detailed and meaningful performance requirements and standards. Only a minority of contracts had outcome-based performance measures and there was little evidence of performance targets being integrated into a comprehensive oversight system. Only the Department of Mental Health Services (DMHS) had clear, outcome-based performance measures in contracts combined with a comprehensive system of oversight. Additionally, very few contracts required specific data collection and reporting, outcomes-based benchmarks with clear performance measures and milestones tied to payment despite these being widely accepted best practices. Similarly, very few contracts had automatic sunset provisions and requirements that contractors would have to reapply in a competitive bidding process or specific evaluation procedures in cases when, given the specialized nature of the service or facilities being provided, they were not going to be competing against others for a contract.

Best practices suggest that contractors failing to deliver on performance standards should be subject to escalating sanctions and penalties. Sanctions and penalties typically entail a combination of fees or costs borne by the contractor or in severe cases cancellation of the contract.[25] A review of RFP's found that termination of the contract for cause was the typical sanctioning tool. This may be due to the complex nature of social service provision and the difficulty of evaluating outcomes and monetizing potential losses. The criteria for these sanctioning efforts should be based on the information gathered from monitoring and oversight of service inputs, outputs and outcomes, consistent with specific standards and measures previously developed and communicated to the contractor.[26] In general, we found neither the capacity to identify whether any outcome targets were being met nor the appetite to take action when they weren't.

20 Amirkhanyan, Anna A. "Collaborative performance measurement: Examining and explaining the prevalence of collaboration in state and local government contracts." *Journal of Public Administration Research and Theory* 19, no. 3 (2009): 523-554.

21 Chen, Yu-Che, and James Perry. "Outsourcing for e-government: Managing for success." *Public Performance & Management Review* (2003): 404-421.

22 Lamothe, Scott, Meeyoung Lamothe, and Richard C. Feiock. "Examining local government service delivery arrangements over time." *Urban Affairs Review* 44, no. 1 (2008): 27-56.

23 Weil, *The Fissured Workplace*

24 Warner, Mildred E., Mike Ballard, and Amir Hefetz. "Contracting back in: when privatization fails." *The Municipal Year Book* (2003): 30-6.

25 Weil, *The Fissured Workplace*

26 Lambright, Kristina Trent. "Getting What You Ask For: Barriers to Proper Use of Service Monitoring Tools." *The American Review of Public Administration* 38, no. 3 (2008): 362-379.

In our analysis of RFP's, only four cases (*see Table 1, p. 37*) identified that the contracting unit would monitor and oversee service provision, via a formal monitoring system that was specified to some degree in the RFP. This is problematic for contractors because the majority of contracts we reviewed did not convey the information necessary for contractors to effectively perform their duties and how those duties would be evaluated / monitored.

Additionally, every RFP reviewed called for a pre-award or bidders' conference to discuss the particulars of the service being required. Yet, analysis of the RFP's presents little evidence to suggest that contracting units and vendors engage in any robust collaborative processes to jointly develop contract performance measurement and monitoring systems. For example, 14 out of 17 RFP's analyzed did not require or identify whether the contracting unit worked with or collaboratively developed service procedures and protocols, even though case study research suggests a collaborative approach to contract monitoring and oversight is more likely to yield successful outcomes.[27] This is the case because it allows for flexibility in determining contract specifications and may reveal specific performance standards and service delivery requirements that may be beyond the scope of the contractor.

New Jersey has attempted to fill this gap in a couple of ways. Executive Order 8 is an attempt to create systems that can improve oversight across the board. It requires the Treasury to implement performance-based budgeting, which should require contracting units to obtain performance data and incentivizing the inclusion of performance benchmarks in all contracts. Meanwhile, the publication of data on a free website should increase accountability. However, while performance-budgeting reports are available for 22 Departments, they collect and provide only aggregate information on the quantity of services provided, and no information on the outcomes for those served or the performance under individual contracts.

Problems in Contract Management

Decline in the number of experienced contract managers and inadequate training and qualification of remaining contract managers

A crucial step in ensuring effective contract monitoring and oversight is developing and maintaining the fiscal and human resource capacity necessary to implement and execute oversight. The contracting process requires implementation and interpretation of costing methods, contract management, management of third parties and effective communication practices. Effective supervision of these core elements requires that contracting units maintain strong management capacity.[28]

In New Jersey, we found that there has been attrition at the level of experienced state workers who could function as contract managers and those who are acting as contract managers are not always qualified or properly trained to fulfill their roles effectively.

27 Brown, Trevor L., and Matthew Potoski. "Transaction costs and contracting: The practitioner perspective." *Public Performance & Management Review* 28, no. 3 (2005): 326-351.

28 Brown, Trevor, and Matt Potoski. "Contracting for management: Assessing management capacity under alternative service delivery arrangements." *Journal of Policy Analysis and Management* 25, no. 2 (2006): 323-346.

According to officials from every department studied, individuals who are designated contract managers often cannot provide effective oversight. An ideal contract manager must have an extremely high level of skill, experience and sophistication in dealing with private contractors. Unfortunately, many current contract managers are assigned this role by default and do not possess the necessary skills and training. Officials from every contracting unit studied echoed the sentiment from a DHS official that agencies "work with what [they] have." With the exception of DOT, which has created its own internal training program, the only training most of these default contract managers receive is a three hour online tutorial. Other contract managers told us that they had repeatedly requested contract management training and never been provided it.

In addition, the skill set needed to manage and oversee in-house service provision can be quite different from the skills required to oversee contractor performance.[29] The shift in service delivery from the state, to a private contracting organization, is a transition that state personnel may not be prepared for[30] as it requires that they now manage outside vendors and contractors rather than follow procedure. This shift requires that contract monitoring personnel be [re]trained to address their new responsibilities. Budgeting officials must recognize this need, and as a best practice, allocate sufficient resources to [re] train procurement personnel to effectively monitor service outcomes regardless of the type of delivery. In short, contracting units require an infusion of budgetary resources to train employees and develop oversight capacity rather than reductions.

Most of the RFP's we reviewed only include a cursory mention of overall staff training and they are mute on the specifics of contract monitoring staff. This silence hinders the contracting unit's ability to assess whether or not bidders can effectively oversee and monitor the services provided.

Insufficient On-the-Ground Oversight Capacity

In addition to having well-trained contract management personnel, a state must also have enough staff to adequately oversee contractors. Unfortunately, our examination of staffing levels in New Jersey agencies shows that capacity of contractor oversight has been significantly reduced. Attrition is a predominant problem, depriving every contracting unit we studied of practical expertise while simultaneously increasing the burdens on those workers that remain.

The most prevalent theme that came through in the interviews we conducted is that attrition of contract management staff has significantly hampered the capacity of contractor oversight. This information was corroborated by our broader analysis. Examples from the Office of Information Services (OIS) and the Office of Auditing (OOA) within DHS and DDD are illustrative. OIS is responsible for many of the largest and most critical contracting projects in the state. There are two current large and vital projects currently underway. The first is the Consolidated Alliance Support System (CASS), a data management system used to consolidate data from welfare, Medicaid, child care, and food

[29] Lamothe, "Examining local government service delivery," 29

[30] Romzek, Barbara S., and Jocelyn M. Johnston. "Effective contract implementation and management: A preliminary model." Journal of Public Administration Research and Theory 12, no. 3 (2002): 423-453.

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stamps and integrate these across agencies. The second is a digital imaging system designed to digitize paper documents and ultimately integrate them with CASS. Such projects are relatively new, as federal data management requirements rise and technology advances to make more sophisticated systems possible. They require enormous manpower and are conducted on top of the ordinary, ongoing responsibilities of OIS. Nevertheless, OIS's workforce has dropped from 82 in 2003 to 54 in 2012. A 2011 request by administrators for an increase of 28 workers to handle the additional work of CASS was denied. OOA is suffering from a similar problem. The Office of Auditing is responsible for ensuring adherence to contract requirements of the over 400 vendors hired by DHS, most of which provide services to DHS clients (e.g., the disabled, mental health patients, family development and welfare recipients). More specifically, OOA conducts full contract audits, desk reviews (i.e., review of financial audit) of all 400+ vendors' contractually required CPA audits (obtained and paid for by the vendor); and risk reports. All this work is being done by 30 staff. 12 years ago, there were 60.

The result of the decline in staffing in OOA is a concurrent decline in the number of audits conducted. There used to be roughly 150 full contract audits annually. Now only about 125 audits are conducted a year, split 50/50 between full contract audits and consulting reviews. This is problematic because full contract audits are thorough rather than perfunctory, and the only ones that cover any programmatic checks (e.g. number of clients served, number of beds provided etc.). Consulting reviews are lower-level audits looking at particular issues agreed between OOA and the agency. In other words, the most thorough audits have been reduced by almost 60%. Furthermore, the more than 400 annual desk reviews are conducted by only 1.5 DHS staff members.

The Department of Developmental Disabilities' (DDD) contract managers have suffered a similar fate. The contract managers for the fiscal side of the DDD play an essential role in oversight because, unlike the program side of DDD, these managers know how much each residential facility receives to operate and they have the ability to stop payments. Knowledge of a facility's budget means that their site visits can be especially important because their inspections can be particularly thorough--for example, they can tell when they walk into a house and inspect refrigerators and pantries whether funding is being appropriately channeled. But these site visits are taking place less frequently. Managers spoke candidly: "They don't get out nearly as often because we are buried in paper." While a decade ago they had 12-15 contract managers, they are now down to eight people with one supervisor responsible for overseeing all contracts at DDD.

An Oversight of Oversight: Systematic oversight is not a priority across agencies

Our analysis of New Jersey oversight policies and practices suggest that there are significant structural deficiencies in the state's overall approach to oversight. First, many of the most significant oversight decisions and processes are subject to few if any formal rules. The burden falls to the individuals within contracting units to ensure that contractors are performing honestly and delivering services well and cost-effectively.

There are two structural issues in particular that contribute to this dynamic. Even though the Division of Purchase and Property (DPP) has primary responsibility for procurement in New Jersey, it only regulates and enforces one part of the contracting process: bidding. Despite a few regulations designed to protect the state from poor performance, development of RFP terms and the actual oversight responsibility is left almost entirely to the contracting units themselves. Furthermore, for services provided directly to New Jersey's citizens, contracts are entirely exempt from DPP oversight, including bidding requirements. This leaves the governance of the contracting process for these critical services to the discretion of understaffed Departments. Individual Departments like DHS, DCF and DEP can issue their own regulations to govern the contracting process. Some do. Some do not. But in all cases, the regulations fail to provide the necessary requisites to ensure that RFP terms protect the state, taxpayers and clients receiving the services. They also fail to ensure sufficient resources for performance management. It is worth mentioning that the independent Office of the State Comptroller (OSC) and the legislative Office of the State Auditor (OSA) both have authority to review decisions and audit processes. Their role, however, is limited by resources and regulations to post-hoc retroactive analyses of only a small group of contractors.

Second, there are no institutionalized mechanisms to ensure that sufficient resources exist for the individuals responsible for the majority of oversight to do the job well. In fact, departmental decision-makers may be facing strong incentives to cut oversight while maintaining or increasing contracted services, leading to the lack of qualified contract managers and quality systems. Much of this derives from a budget process that prioritizes service delivery over administration, which includes oversight resources. Not only is it more difficult to get funding for oversight at the outset; oversight also belongs to a class of expenditures most likely to be cut when cuts are necessary.

Finally, there does not appear to be any agency within the state with the capacity or competence to conduct analyses across agencies, looking at the overall efficiency or effectiveness of resources allocated to contractors. The OSC and the OMB are prime candidates, with relevant competencies, but neither currently has a mandate or the resources to do so.

Together, these deficiencies reflect the lack of priority given to oversight, which is all the more troubling given the significant amount of contracting going on. This lack of priority has predictable results for oversight in practice, as seen in the case studies in the next section.

PART III: Case Studies: Examples of Failed Oversight and Their Consequences

Four cases highlight how oversight failures manifest themselves in practice and what the consequences are for taxpayers and the services the respective agencies are meant to deliver. The first case is DCF's Division of Child Protection and Permanency (DCPP), where a lack of contract monitoring systems makes it difficult to hold service providers who provide poor quality services accountable. The case remains somewhat general, as DCF would not cooperate with our requests for information, but the broad point remains. The second is the DHS's Department of Developmental Disabilities, where poor oversight has led to substantial waste of taxpayer money with little assurance that services for which the state has contracted are being provided, let alone provided well. The third case is DOC's Residential Community Release Program (RCRP) which has recently been the subject of a great deal of publicity for oversight failures that have had tragic consequences. The fourth and most recent case is DCA's Reconstruction, Rehabilitation, Elevation and Mitigation RREM program, which was implemented to assist in Hurricane Sandy recovery efforts. In all four cases, contractors are used to provide services to particularly vulnerable or high-risk clients. In all four cases, at least one of the key phases of the contract oversight process has failed to ensure that clients are well provided for, that taxpayer's are getting good value for their investments, and that citizens are protected from danger.

CASE STUDY 1 — *Department of Children and Families: Division of Child Protection and Permanency*

The Department of Child Protection and Permanency (DCPP), formerly the Division of Youth and Family Services, provides a good example of the challenges posed by a lack of a designated point person responsible for monitoring contracts and for contract monitoring systems. DCPP is charged primarily with protecting children from abuse and neglect. DCPP provides services to families designed to reduce the risks of abuse and neglect, services to children to help them cope with the consequences of abuse, and services to both children and their parents designed to rehabilitate families that have been disrupted by abuse and/or neglect. In most cases, these services involve therapy and/or education programs provided directly to family members. In some cases, residential treatment programs are required. The vast majority of these services are provided by for-profit and not-for-profit contractors, at a cost of hundreds of millions of dollars a year. DCF intervenes in the lives of an estimated 100,000 children each year.

Most contractors operate on fee for service (FFS) contracts that render them eligible to provide services to DCPP clients provided they meet and continue to meet certain conditions. For example, therapy providers and psychological evaluators must maintain minimum licensing requirements within their fields.

This creates a pool of providers who should all be qualified to provide necessary services to DCPP's clients. While the pool is generated by a contracting unit within DCF, contractors are matched with clients by state-employed social workers that serve as case managers for a given number of clients. When a family or family member on a caseworker's caseload needs a service, the caseworker chooses a contractor from a list of those in the pool that are contractually eligible to provide that particular service. The list generally contains the names of groups, such as psychologists' practices, rather than the names of all individuals employed by the group. Once the service is provided, the contractor submits an invoice to the caseworker, who, along with his or her supervisor, signs off on the invoice, before submitting it for payment.

Under this system, the caseworker is the primary state employee in a position to assess the quality of the services being provided to the client. Unfortunately, caseworkers are not informed of the terms of provider's contracts or any individuals who might be precluded from providing services under contract for a particular reason. Because of this lack of communication, it is possible that work could be subcontracted to someone who has a record of endangering children or has even lost their license because the state does not follow up with its subcontractors adequately. For example, if John Smith Medical Group employed Bob Johnson, who for licensing or other reasons is not permitted to provide therapy to children for DCPP, a caseworker who needed child therapy for a client and chose John Smith Medical Group would be the only individual in a position to know if Bob Johnson was providing the service in violation of the contract but would not know that the use of Bob Johnson was a violation. Nor is there any institutionalized mechanism for caseworkers to communicate to the contracting unit any quality issues they see with particular providers. Because there are dozens of caseworkers in each local office and contractors generally serve multiple local offices, a contractor can provide poor services to dozens of clients with no repercussions. Thus, psychologists who routinely provide poor reports and therapists whose services are routinely ineffectual continue getting paid taxpayer money to provide services even though many caseworkers are aware of the poor quality of their work.

This issue is compounded by time pressures of litigation, which is common in child protective services and often compels caseworkers to choose the available provider rather than the best provider. As long as they remain on the list, contractors continue to be used. Because there is no institutionalized means for the state to hold poorly performing contractors accountable, they are likely to remain on the list, providing services that impact children, families and taxpayers. The solution to this may be fairly simple: a database in which caseworkers can see a "no-fly-list" and can enter complaints about providers which can then be referenced by the contracting units and a point person who will keep track of such reports and function as the agency's institutional memory with regard to contractors.

Please note, DCF refused requests to interview people for this study.

CASE STUDY 2 -
Department of Human Services: Department of Developmental Disabilities

The Department of Developmental Disabilities (DDD) provides a more dramatic picture of oversight problems that have resulted in substantial waste of taxpayer dollars and little information about the quality of services provided. DDD provides services to individuals with legally defined "developmental disabilities." These include, among other disabilities, mental retardation, autism, cerebral palsy, epilepsy and spinal bifida. DDD serves over 35,000 of New Jersey's most vulnerable citizens with residential treatment programs, training, medical services, therapy and more. These services are funded by DDD at a cost of nearly a billion dollars and generally provided by for-profit and not-for-profit contractors. Like those in DCPP, DDD employs case managers to coordinate services for its thousands of clients while the contracts themselves are supposed to be monitored by contract administrators.

In 2009, OSC audited DDD's oversight of these third-party contracts.[31] The Comptroller found that "DDD does not adequately oversee the third-party contracts it awards. As a result, taxpayer dollars are not being spent efficiently and providers may not be delivering all services as required by the operative contract."[32] OSC found the following general weakness in DDD's oversight:

- Contracts were renewed without a competitive process and with little review of past performance
- Contract modifications were granted with little review of the merits of the request
- Most contracts were either fee-for-service (FFS) or general service (GS) contracts which, when combined with other oversight failures, led to payment for services that were not being provided.
- DDD's system of contract monitoring was not designed to uncover inappropriate or unreasonable expenditures.
- DDD's system of contract monitoring was also not designed to ensure that services were being delivered as prescribed.[33]

These specific failures have resulted in both inefficient expenditures and poor information about the quality of services being provided. The contracting process is hampered by limited review of renewals and modifications and by the lack of performance-based payment structures. In 2008 alone, 95 contracts worth over $2 million each, including 23 worth over $10 million each, were renewed without competitive bidding and with limited review of past performance due to the absence of procedures and systems to collect, compile and maintain data on past performance. According to OSC, "if a provider is not identified as having had any significant problems in its delivery of services within the fiscal year, the contract is routinely renewed without DDD undertaking *any* deliberative process that considers fiscal and program performance."[34]

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[31] State of New Jersey Office of the State Comptroller, Department of Human Services, Division of Developmental Disabilities. A Performance Audit of Oversight of Third-Party Contracts, 2009, PA-05, Trenton, New Jersey.

[32] Ibid., p.6

[33] Ibid.

[34] Ibid., p. 19, emphasis added

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Similarly, contract modifications are approved throughout the year with limited review. OSC reviewed a sample of 10 contractors and found that modifications increasing payments by over $21 million were approved with little review of the merits of the modification. DDD did not obtain documentation from its contractors, so it had no way of knowing if a request for new equipment, such as vehicles, was appropriate or necessary. While DDD did implement an electronic modification tracking system, OSC suggested that the system would not provide assurance that requests were appropriate.[35]

The lack of performance-based payment structures compounds the problem, leading the state to pay for more individuals than actually received services. In 2008, DDD had 174 GS contracts and 106 FFS contracts. OSC found that the GS contracts did "not appear to be in the best interests of the state" because contractors were paid for the contracted amount of individuals serviced even though they did not actually service that many.[36] As a result, in 2008 taxpayers paid for service provision for 405 individuals even though only 323 were served, for an excess cost of $1.4 million. Furthermore, some contractors did not even have the capacity to serve the number of individuals required by their contract. DDD indicated to OSC during the audit that it intended to switch contracts for all future providers to FFS. OSC expressed concern. While FFS contracting does ensure that contractors are paid only for the number of individuals served — subject to a monitoring system that can verify the accuracy of invoices — FFS continues paying regardless of outcomes. In effect, ineffectual or poor quality services are reimbursed at the same rate as effective services. OSC recommended the use of a Milestone Payment System (MPS) that would pay contractors for the results of their efforts.[37]

Fiscal performance in existing contracts was also poorly monitored. For example, in 2008, DDD did not review contractors' expenditure reports thoroughly enough to identify $160,000 of inappropriate expenditures by one provider that included Mediterranean and Caribbean cruises and trips to Nashville and Florida. DDD simply did not analyze specific expenditures for any providers. While the DHS Contract Policy and Information Manual (CPIM) doesn't require such specific analysis, it does require on site reviews to be performed by contract administrators. This was not done. Instead, case managers were the de facto on site reviewers and, as in DCPP, communication between these social workers and the people with contract expertise was minimal. The result was very little scrutiny of expenditures. Just as problematic, DDD was up to three years behind in closing out contracts, a process designed to identify recoverable funds by the end of each fiscal year. As a result, up to $15 million in over-payments to contractors had not been recovered. Finally, DDD also failed to follow up on legally required independent audits, with a significant number of contractors sampled having failed to provide any audit reports. DDD also experienced low oversight staffing capacity during this period. In 2008 fourteen contract administrators were responsible for nearly 280 contracts worth well over $800 million.[38]

35 Ibid., p. 20
36 Ibid., 21.
37 Ibid., 22.
38 Ibid., 3.

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Monitoring of program performance was equally poor. DDD case managers monitor the individuals who are receiving services through the agency. They are required to conduct either monthly or quarterly in-person visits with clients, depending on the clients' circumstances, and to generate specific reports for each visit. Given the role of case managers as the primary advocates for highly vulnerable people, these reports contain critical information. However, OSC found that a sample of case managers regularly did not fully complete required reports or did not sign off on supplementary forms such as medical records. OSC reviewed over 1200 reports and identified well over one-third as incomplete or copied verbatim from prior reports. As with fiscal oversight, lack of capacity may be a significant factor: case managers had caseloads as high as 500 individuals whereas national standards are 50 or fewer.[39] The OSC has made several recommendations to DDD aimed at improving contract oversight and monitoring. The recommendations include establishing procedures to ensure that provider expenditures and reports are complete and supported by relevant documentation, and implementing systems to ensure competitive procurement of third party contracts.[40] A follow up OSC report suggested that even though DDD was moving in the right direction, significant work remains to be done regarding developing procedures to ensure provider compliance with contract requirements,[41] in particular, ensuring that case managers complete accurate site visit reports.[42]

CASE STUDY 3 — *Department of Corrections (DOC): Residential Community Release Program*

DOC Office of Community Program's halfway houses, formally called Residential Community Release Programs (RCRPs), present perhaps the most egregious example of the dire consequences that can result from a lack of oversight of contractors: poor oversight contributed not merely to substantial waste of money, but also to several violent deaths. In 2010, David Goodell, escaped from an RCRP in Newark and killed a young woman in Newark who had spurned him. The same year, Rafael Miranda escaped from another RCRP and shot a man in Newark on the sidewalk after 4 months at large. He was three miles from the RCRP. The year before, Valerie Parziale escaped from an RCRP in Trenton and slashed a man's ear in a liquor store. Prosecutors had no idea she was a fugitive.[43] And in 2009, Derek West Harris was killed at an RCRP by gang members looking for $20 when he only had three. Mr. Harris was in the RCRP awaiting a hearing after his arrest for driving an unregistered vehicle.[44]

OCP is the office within DOC charged with preparing criminal offenders to re-enter society productively and reduce their risk of recidivism. Towards that end, OCP contracts with not-for-profit companies to provide RCRP services to inmates who meet certain criteria.

[39] Ibid., 15.
[40] State of New Jersey Office of the State Comptroller, *A Performance Audit of Oversight of Third-Party Contracts*
[41] State of New Jersey Office of the State Comptroller, Department of Human Services, Division of Developmental Disabilities. *Follow-up Report on Oversight of Third-Party Contracts*, 2011, F-05, Trenton, New Jersey.
[42] State of New Jersey Office of the State Comptroller, *Follow-up Report on Oversight of Third-Party Contracts*, 5
[43] Dolnick, Sam, "At a Halfway House, Bedlam Reigns," *New York Times*, June 17, 2012, US Edition, New York Region
[44] Dolnick, "At a Halfway House, Bedlam Reigns," 2012

RCRPs are basically lower security facilities that increase the freedom of inmates to allow them to gradually acclimate and build the skills and job prospects necessary to ease their transition back to society. They are staffed by counselors who make roughly $11 hourly, do not carry weapons and are not permitted to use force to restrain residents. RCRPs are a fast growing segment of the criminal justice system in New Jersey and were home to over 2,700 people by 2011.[45]

Given the goals of RCRPs, eligible inmates are essentially required to be relatively low risk to public safety and close to getting out of confinement.[46] Facilities are supposed to provide for different target populations so that, for example, violent offenders are not placed with non-violent offenders. Prospective residents are funneled through two not-for-profit assessment centers charged with identifying proper placements. OCP is primarily responsible for overseeing RCRP contracts which were worth over $64 million in Fiscal Year (FY) 2011. It had 18 employees charged with developing and overseeing RCRP contracts and tracking inmate movement as of FY 2010.[47]

In 2011, OSC conducted an audit "to determine the effectiveness of DOC's oversight of the contracts it awards to RCRPs."[48] In addition to review documentation and interviewing DOC personnel, OSC examined six RCRPs run by 5 contractors. OSC found (1) that DOC did not adequately monitor RCRP providers, (2) that it overpaid them by almost $600,000 over the nearly three-year span covered by the audit, (3) that it did not enforce provisions designed to ensure key practices, especially those for public and RCRP resident safety, (4) its process for disciplining RCRP residents was flawed, and contract decisions were made with limited information, making it difficult to know what the state was getting for its $60+ million.

On top of OSC's findings, the New York Times (NYT) investigated the facilities in 2012, and found that escapees were not properly reported to authorities and were not prioritized by authorities.[49] DOC also failed to ensure that eligibility requirements were met for RCRP residents: violent offenders and individuals with relatively low bail were being placed together in RCRPs.[50]

While all of the flaws in oversight created the environment that allowed the tragic deaths highlighted by the NYT to occur, three of these flaws directly contributed to the outcomes: 1) failure to enforce escapee provisions, report escapees and pursue them, 2) failure to ensure proper disciplinary procedures followed, and 3) failure to review the assessment centers and monitor compliance with eligibility requirements. Lackluster oversight of basic regulations within the prisons also contributed in at least one case. While these measures would not have absolutely assured that these tragic events would not have taken place, failure to honor the limited requirements of contract provisions may be blamed for creating an environment in which bad things were more likely to happen.

[45] See Dolnick, "At a Halfway House, Bedlam Reigns," 2012; State of New Jersey Office of the State Comptroller, Department of Corrections, Office of Community Programs. *Residential Community Release Program*, 2011, PA-13, Trenton, New Jersey.
[46] State of New Jersey Office of the State Comptroller, *Residential Community Release Program*, 1
[47] State of New Jersey Office of the State Comptroller, *Residential Community Release Program*, 2
[48] Ibid., p. 3
[49] Dolnick, "At a Halfway House, Bedlam Reigns," 2012
[50] Ibid

Escape prevention was a precondition of the law that allowed the creation of the RCRPs in the first place. New Jersey laws require that the DOC Commissioner must certify annually that each RCRP is secure and appropriately supervised, reflecting "concern for security when entrusting inmate rehabilitative programs to private nonprofit groups" and "because of frequent expressions of concern about escapes from work-release-type programs."[51] That poor enforcement of escapee provisions directly contributed to the two murders and the assault is all the more disturbing. All three crimes were committed by individuals who escaped and were not searched for by agency officials thoroughly or quickly. The murderers were more violent than was appropriate for RCRPs. David Goodell was in jail for assault. Rafael Miranda was in on weapons charges.[52]

Meanwhile, Derek Harris was a victim of DOC's failure to ensure that the facilities only accepted eligible inmates and properly oversaw that disciplinary procedures were followed. Mr. Harris was awaiting a hearing for traffic violations and was therefore not eligible to be in an RCRP in the first place. His killers were part of a higher risk population that did not belong in an RCRP, let alone the same RCRP as someone who failed to register his car.[53] Moreover, they planned the attack knowing that late at night, inmates were rarely punished for roaming outside their rooms. The overnight supervisor knew that inmates routinely left their rooms at night. The security camera overlooking Mr. Harris's room had not been functioning for a month, which should have been identified on the oversight checklist and fixed. The men who killed Mr. Harris had recently been disciplined, sent briefly to jail, and then returned to the RCRP. One was sent to county jail after a fight in his room two weeks before the murder and returned only two days later. The other had been previously transferred into county custody and returned to the RCRP after only a week.

Our review of the RCRP contracts suggests that the problem had less to do with inadequate contract terms and more to do with enforcement of them. The RFP included performance targets and required the contractors to include plans to meet these targets in their proposals. The targets were also fairly clear, although they were output based not outcome based. And all proposals requested Quality Control and Quality Assurance Plans to be submitted by the bidder. The RCRP plans included, for example, procedures for facilities inspection, communication protocols with the contracting unit, surveillance techniques (redacted in OPRA requests), and procedures for complaints. The plans were designed to ensure that the bidder meet all the requirements of the contracting units Statement of Work. Moreover, as OSC noted in its audit, there were penalties built in for failure to perform key functions, such as escape prevention. The poor on-the-ground oversight and lack of enforcement, however, rendered these provisions functionally irrelevant.

For good reason, the law conditioned RCRPs on fairly stringent oversight requirements. In the end, the violations that led to three killings and an assault could have been identified by even the most basic of oversight; an occasional walk through, documentation and the enforcement of automatically enforceable contract provisions. As such, recommendations

[51] State of New Jersey Office of the State Comptroller, *Residential Community Release Program*, 13
[52] Dolnick, "At a Halfway House, Bedlam Reigns," 2012
[53] See N.J.S.A. 30:4-91.2; N.J.A.C. 10A:20-4.4 – 4.7; Dolnick, "At a Halfway House, Bedlam Reigns," 2012

from OCS's audit included updating RCRP evaluation forms and ensuring that internal DOC monitoring staff adheres to the requirements of the forms.[54] Additionally, OSC recommended unannounced spot visits and random selection of files to be reviewed.[55] As one of the killers said, his RCRP was "run by [a gang]" that does what it wants". To counter this perception, OSC also recommended that DOC strictly enforce contract requirements that RCRPs have secure holding areas, document and investigate escapes, develop and implement procedures to deter escapes, including appropriate security training for RCRP staff.[56] Certainly it should not have taken much for the state to notice that it was not actually being run by the agency.

CASE STUDY 4 — *Department of Community Affairs: Sandy Recovery*

The State's response to the impact caused by Hurricane Sandy presents a stark example of shortcomings in contract oversight and monitoring. In October 2012, Hurricane Sandy made landfall as a Category 1 Hurricane along the New Jersey coastline. The Federal Emergency Management Agency (FEMA) estimated that 56,100 residences sustained severe or major damage.[57] Moreover, of those reporting severe or major damage to their residence, approximately 49% were low to moderate income households.[58] In the months immediately following the storm, FEMA estimated that businesses incurred commercial property losses of $382,000,000 and another $63,900,000 in business interruption losses.[59] The storm had significant and crippling effects on statewide infrastructure from roads, railways and other public transport systems that sustained heavy flooding and damage from debris. These physical losses pale in comparison to the loss of life, physical and psychological effects associated with a natural disaster of this magnitude.

In order to best facilitate a coordinated response and recovery effort by both state and local entities, New Jersey was put under a state of emergency. This state of emergency significantly impacted the contracting out process in New Jersey. Under the state of emergency, purchases of goods and services could be made without regard to public bidding pursuant to N.J.S.A. 40A:11-6 and N.J.A.C. 5:34-6.1.

Various agencies such as FEMA and the Small Business Administration, and initiatives such as the Reconstruction, Rehabilitation, Elevation and Mitigation (RREM) Program — funded at $710 million and Homeowner Resettlement Program (HRP) — funded at $215 million[60] were established to assist in the recovery efforts. Our analysis examines the RREM program under the auspices of the Department of Community Affairs — Sandy Recovery Division. Three other programs also fall under the auspices of DCA as it relates to Sandy Recovery efforts — The Resettlement Grant Program, the Landlord Rental Repair Program (LRRP), and the Housing Mitigation Grant Program (HMGP). All of these

[54] State of New Jersey Office of the State Comptroller, *Residential Community Release Program*, 15-16
[55] Ibid.
[56] Ibid.
[57] State of New Jersey, Department of Community Affairs, *Community Development Block Grant Disaster Recovery Action Plan*, 2013, Public Law 113-2, Trenton New Jersey.
[58] Ibid., i
[59] iIbid., ii
[60] State of New Jersey Governor's Office of Recovery and Rebuilding, *Recovery Initiatives*, http://www.state.nj.us/gorr/plan/index.html (accessed Feb. 2014).

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programs have different policies and procedures in place with regard to administration and monitoring of Sandy Recovery Efforts. These overlapping and complementary programs greatly increase the complexity of meta-oversight at the state level. Given the fact that technology plays a crucial role in aggregating data streams, to effectively monitor the three programs and their interactions, DCA would have needed to allocate resources to enhance already antiquated data collection and processing systems and train staff in their use.

One key component of the RREM program is the establishment of two categories of contractors — those who administer the program and those who monitor the program.[61] This further complicates the overall monitoring of the program as it relates to the compatibility and integration of systems, capacity of staff to evaluate contractor reports, and sharing of knowledge and information. Even though the RFQ for the management of the RREM Program states that the State Contract Manager is responsible for the overall management and administration of the contract[62], RREM contractors were required to "perform management, file review, reporting and document management for compliance with all program policies and procedures. File documentation, document management, quality control, reporting, program and federal compliance, and issue tracking are also embedded requirements for this functional area" (RFQ for the Management of the RREM Program, 2013, p. 25). This ultimately means that RREM contractors remained at the forefront of contract monitoring and compliance. To aid in monitoring and compliance, contractors were required, per the RFP, to have data collection and storage systems that were compatible with the State's MIS and the SSHIP HP-CMIS systems.[63] It remains unclear if this RFP requirement was met. The DCA did identify an internal monitoring agent[64], however it is unclear if the monitoring agent was provided with the requisite training, financial resources, and additional staff required to engage in effective contract oversight. Given the size and scope of the contract, and in light of our recommendation that oversight costs approximately 20% of contract value, this signals to us that the State quite likely lacked the internal capacity to effectively monitor and oversee the RREM program.

Contracting out under emergency circumstances presents tremendous challenges, but there must be protocols in place to ensure that those at risk are treated carefully and equitably. A 2014 analysis by the Fair Share Housing Center found that 79% of residents who appealed denials of funds for housing recovery were successful which raises questions about how well the firm hired to determine eligibility did its job. The report also found troubling racial and ethnic disparities. African Americans were rejected for RREM and resettlement grants at two and a half times the rate of whites. Latinos were also disproportionately rejected.[65] Moreover, numerous media reports suggest that those applying for, or those in the process of receiving, RREM funding lacked access to the

[61] State of New Jersey, Department of Community Affairs, *Reconstruction, Rehabilitation, Elevation and Mitigation Program and Procedures* (RREM), 2013, Number 2.10.36, p. 6

[62] State of New Jersey, Division of Purchase and Property, *Request for Quote for Management of the Reconstruction, Rehabilitation, Elevation and Mitigation Program* ("RREM") for the State of New Jersey Department of Community Affairs, 2013, RFQ775040S, p. 53

[63] Ibid., p. 27

[64] New Jersey Department of Community Affairs, "*RREM Program and Procedures*," 2013, p. 6

[65] Fair Share Housing Center, et al., "*The State of Sandy Recovery,*" 2014, p. 8

feedback mechanisms required to voice their concerns and issues.[66] [67] These deficits are in direct contradiction to the process stated in the DCA's Community Development Block Grant Action Plan.[68] Finally, documents analyzed by the Fair Share Housing Center suggest that even after contracts were let, program details and policies continued to be amended without going out for public comment.[69] Worse, in many cases, there were no policies in place until after the program started.

PART IV: Recommendations

The issues in the case studies above are not isolated problems but are widespread across state agencies and are rooted in inadequate institutions, systems and staffing. Based on the problems identified in our study of New Jersey contracting oversight policies and practices, we developed the following recommendations. While these recommendations are discussed in a New Jersey-specific context, the ideas behind them are applicable to any state or local government looking to improve their oversight of contracts.

In drafting recommendations, our biggest priority is to ensure the institutionalization of oversight as an unseverable element of the contracting process. We do this primarily through statutory and regulatory changes or additions that do the following:

- Eliminate the budgetary disincentive to fund administration, ensuring sufficient resources for other recommendations
- Eliminate the blind spot for third party contracts
- Fill gaps in oversight for both the RFP generation and contract management stages of the process, and
- Create capacity and a mandate for systemic oversight.

When operationalizing these goals, we were guided by several broad principles. *Underwriting all of the principles below is the bedrock notion that proper oversight is not negotiable. If the resources do not exist to properly oversee a contract, that contract should not be let. Oversight is a core governmental function and should not be outsourced.* The state must rebuild and preserve its oversight capacity. In such situations, it is the contract as a whole, including proper oversight, that is too expensive, not the oversight itself.

- *The quality of public services is as important as the cost.* A contract that lowers costs by sacrificing service quality is no great value. Good oversight is the only way to ensure that lower costs come from innovation and efficiency rather than a reduction in service quality.
- *Respect and Inclusion of providers and ground-level workers in formulating policy.* Many contractors do excellent work and have developed institutional knowledge and expertise that the state lacks. The current process does not serve providers either,

[66] ibid

[67] Katz Matt, New Jersey Quietly Fires Second Contractor Hired to Help Sandy Victims, *NJ Spotlight*, February 14, 2014, http://www.njspotlight.com/stories/14/02/13/amid-criticism-nj-quietly-fires-2nd-sandy-contractor (accessed Feb. 2014)

[68] State of New Jersey, Department of Community Affairs, *CBDG Disaster Recovery Action Plan*, 2014, p. 6-12.

[69] "Documents Obtained from Christie Administration Through Litigation Raise Questions of Mismanaged Sandy Relief Funds", *Fair Share Housing*, press release, November, 2013, on the Fair Share Housing Website, http://fairsharehousing.org/media/ (accessed Feb. 2014).

with surveys showing that they are frustrated and limited by the irregularity of the current system. Surveys of human service nonprofits found that current formal government feedback mechanisms do not generate the systematic change needed to improve the contracting out process[70] [71]. These reports indicated that human service nonprofit organizations do not have the opportunities or mechanisms to provide feedback directly to contracting unit officials or policy makers with the power to address structural deficiencies on the contracting out process.[72] In fact, the reports suggest that nonprofits were more likely to provide feedback in direct meetings. As such, providers should have opportunity for input when regulations and rules are promulgated. Likewise, no one in the state knows more about service quality then the workers who have direct contact with clients and providers. Their voices must also be included in the process of creating new policy. What we are recommending are broad requisites to institutionalize and rationalize oversight to benefit all parties and allow the public to reap more of the benefits of the devolution of providers.

- *Systemic oversight is critical.* Meta-oversight is necessary to ensure that institutional requirements are being properly executed by the respective contracting units (state agencies). It also allows for analysis that can be useful in making changes to the system.
- *Competition is a necessary condition for privatization to be beneficial.* Absent competition, a contract goes from an incentive to innovate to provide better service more efficiently to an opportunity for patronage.
- *Retaining the discretion of well-trained experts is better than strict bureaucratic controls.* This applies to both contract managers and human services agencies as a whole. The goal is not to supplant the judgment of those with the most direct knowledge but to create institutional priorities that empower them. The qualitative aspects of service delivery are critical, especially in human services, and should not be reduced to a handful of discrete metrics. Retaining judgment and discretion is crucial.
- *Rebuilding administrative capacity will help line workers focus on delivering quality services.* It is crucial to recognize that the change in governance to involve more private providers involves a fundamental shift in the state's primary role and functions. Analogous to corporations that devolve their supply chains, the state must closely manage its contractors to ensure quality control and staffing should reflect this. The reporting should not fall entirely on line workers. Although it will always be important for workers to document their work, resources devoted to contract management could free them from some of the administrative burdens they currently handle by shifting them onto contract management staff for whom this is their primary competence and duty. Moreover, if contracting involves cost saving efficiencies, the additional resources we request should at least in part be paid for by recapturing some of those efficiencies, not to mention savings from proper execution of cost-recovery provisions that are not currently being enforced.

70 Boris, de Leon, Roeger & Nikolova, "Human Service Nonprofits and Government Collaboration: Findings from the 2010 National Survey of Nonprofit Government Contracting and Grants," Urban Institute, Washington DC, 2010
71 Pettijohn, Boris, De Vita & Fyffe, "Nonprofit-Government Contracts and Grants: Findings from the 2013 National Survey," Urban Institute, Washington DC, 2013
72 Ibid., 34

In sum, our recommendation is that the decision to contract out must be contingent upon a fully resourced and fleshed out system of oversight that is in turn contingent upon the restoration, articulation and preservation of the contract development and management role in state government. In other words, to ensure proper oversight, there must be an experienced manager who has deep knowledge of the service that is being delivered and the tools to do it well. This manager must serve as the node of the network, taking in information about what is going on in real time, and exercising the discretion to manage in the best interests of all. At its core, the work entails ongoing, active, flexible, relational management of the contract that respects, supports and consults the direct service providers and does not put the entire burden of performance measurement on them.

Here is how we would achieve this:

Statutory Changes and Additions

Eliminate the Hole in Third-Party Oversight

Every statutory change listed below should make explicit that its provisions apply to third-party contracts. While these contracts can still be designed and managed within the contracting unit — the entity with the most substantive expertise and the most direct connection to the contractors — they should be subject to these broad requirements and systemic oversight.

Ensure that Emergency Contracts are Not Exempt from Oversight

While there is a legitimate argument for the relaxation of competitive bidding requirements in the case of the dispensation of contracts to provide emergency relief, the case of Sandy relief shows that this raises the importance of the contract management stage of oversight. Legislation should make clear that where bidding requirements are relaxed, contract management requirements must remain.

Sufficient Resource Requirements

The legislature should enact legislation that conditions the issuance of service contracts on sufficient resources to oversee those contracts and provides a floor on the level of resources that may be deemed sufficient. In New Jersey, the law should require the State Treasurer to promulgate regulations detailing what constitutes "sufficient resources." At a minimum, "sufficient resources" should be defined to ensure that every contract has enough qualified staff with sufficient capacity to properly oversee it. The U.S. Office of Management and Budget's staffing formula provides a guide to what ratio should be deemed sufficient.[73] Human services contracts should have more staff relative to the size of the contract. The law should also provide a mechanism for evaluating whether a contracting unit's resources, and in particular its staff ratios, are sufficient to maintain proper oversight. This will effectively cap the number and scale of contracts that can be let without an increase in management staff. While this may seem expensive, better oversight will offset some of the upfront costs through improvements in service delivery and better collection

[73] Michel, R. Gregory. *Cost Analysis and Activity-based Costing for Government.* Vol. 6. Gfoa, 2004. The ratio is roughly 1 contract manager to every 20-25 employees providing the service. The ratio declines slightly as the contract gets larger owing to economies of scale.

of penalties due to the state. Accounting for this true cost will also on occasion identify scenarios where services can be more efficiently provided in house. Insofar as the state OMB currently has the authority to evaluate contracting units' performance, it should be tasked with conducting assessments of "sufficient resources" in conjunction with its review of overall performance. The law should also appropriate funding to allow Treasury and the state OMB to increase their capacity accordingly. The State Comptroller and or the SCI should be granted the authority and resources to oversee the process and issue recommendations.

New State Contract Manager Requirements

In addition to ensuring sufficient numbers of contract managers, legislation must ensure that they have sufficient expertise. The State Contract Manager role should accomplish two things: (1) it should ensure that all contracts are managed by someone with the expertise and resources to protect the states' interests and (2) it should free up workers providing direct services from administrative burdens so they can focus on serving clients. To accomplish this, the State Contract Manager or Managers (depending on the demands of the contract) assigned to each contract should be individuals whose sole job is to oversee the contracting process, from RFP design through contractors' performance. State Contract Managers should both directly oversee contractors and aggregate information received from direct service workers, such as DCPP caseworkers. They should also serve as liaisons to OMB, Treasury, SCI and/or OSC, to facilitate systemic oversight. And they should be assigned to only one contracting unit. Treasury should be tasked with issuing regulations defining the minimum qualifications of this person. These qualifications must include both management capacity and substantive knowledge of their contracting unit's services. The hiring decision for State Contract Managers should therefore be made jointly between Treasury and the individual contracting unit. Comprehensive, ongoing training should be mandated for those not already qualified. This strengthened corps of contract managers would be paid out of the oversight and monitoring charge recommended above.

A Ban on Outsourcing Oversight

The State should eliminate any ambiguity around whether oversight can itself be managed by a contractor with a clear statute precluding the outsourcing of oversight activities. Outsourcing oversight does not absolve the state of its responsibility as steward of public resources. It merely adds another layer to be managed and remove final service provision further from the accountable state. The state is better served by developing internal expertise as the primary manager of its own contracts.

Compulsory Contract Costing

Before a contract is let, the state should require a three-step cost comparison:

1. There should be activity-based cost (ABC) accounting for the specific activity being proposed.
2. Once the ABC accounting has been done, an avoidable cost analysis in terms of actual dollars saved should be estimated.
3. The avoidable cost of the activity plus or minus the new costs of contract bidding and supervision should be compared to the contract price.

Make certain of the recommendations of any state investigation binding

The legislature should enact legislation making recommendations from state investigative units including the State Commission on Investigation, Office of the State Comptroller and Office of the State Auditor binding under certain conditions. Investigative units should be required to provide contracting units with overall ratings and those with the worst ratings should trigger binding recommendations. For example, on a three-point scale of Poor, Fair, Good, a contracting unit receiving a rating of Poor, would be required to follow through with the recommendations within a set timeframe set by SCI. It would be enforced through the same funding-denial mechanism instituted by Treasury, above.

Require all human service contracts to establish mechanisms for client, family and line worker voice

The legislature should enact legislation that requires DHS to establish an ombudsperson to represent clients, their families and line workers and a community oversight committee that has a formal and ongoing role in enforcement. These organizations would become partners in monitoring and enforcement of projects or facilities, which involves according them clearly delineated and publicly recognized responsibilities, providing access to the information a regulator has about non-compliance, standing to file complaints or sue under the regulatory statute and a seat at the table along with government investigators and contractors in negotiations regarding improvements, fines and penalties.

Include all state contract managers, state employees, contractors and contractors' employees who raise questions about the quality of service being delivered under the New Jersey Conscientious Protection Act (CEPA).

At present, only nurses are covered for whistleblowing about quality of service. We propose to extend this protection to all state and contract workers and managers.

All contracts should be rebid after, at most, 3 years.

Competition is an essential element of the argument in favor of privatization and cannot just be a matter of ensuring a minimum numbers of bidders. Contracts that do not require rebidding eliminate the key incentive for private companies to provide quality services. Instead they create a strong incentive for paying to play and leave legal, rather than market, mechanisms as the primary mode of contract enforcement. While any rebidding requirement opens the possibility for loss of the contract for poor performance that remains short of a full breach of contract, if the tenure is too long, the likelihood of any competitors being available when the contract is rebid goes down. Conversely, for many contracts, continuity is important. In such cases, too short a term is problematic. For most contracts, 3 years will achieve the appropriate balance. Where 3 years provides insufficient continuity, the state has a strong incentive to provide that service itself. Finally, to maximize the effectiveness of a rebidding requirement, data gathered using the mechanisms already listed here should be used to evaluate contractors' past performance (both on the particular contract and on any other contracts with the state). The contract should also be costed again in light of lessons learned from the prior contract. In this way, the state can benefit from its data gathering efforts and become a more informed consumer of contractors' services.

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Transparency from bids through contract execution

At present, it is too difficult and time-consuming to obtain access to actual RFP's, bids and contracts. All of this information, not just for contracts overseen by DPP, but all contracts let by individual agencies to third party vendors must be made available on a publicly accessible database.

Authority and Appropriations for Data Systems

Technology has advanced far beyond the systems in place in most state agencies. Improved data systems can drastically reduce the resources required to provide direct and meta-oversight. Funding for a statewide data-system should therefore be appropriated for that purpose. In New Jersey, the Office of Information Technology, within Treasury, should be charged with responsibility for the system, in coordination with OSC, OMB, and relevant personnel from the various contracting units. DPP should be granted authority to promulgate regulations requiring all contracting units to have oversight data systems and providing the specifications such data systems must meet.

Regulatory Changes

Service providers should be involved in the drafting (as opposed to just the comment period) of the regulatory requirements derived from the authority granted in the above statutory requirements. In addition, the following regulatory changes should be made under existing authority, again with service provider input in the drafting stage. These changes should apply to third-party contracts.

Additional Requirements for all RFP's and Contracts

DPP should provide additional standard language to be included in all RFP's to ensure contract terms that provide additional protections to the state and taxpayers. Among these requirements should be:

- Regular, qualitative, multi-stakeholder evaluations of services provided conducted by a skilled, experienced manager who looks to service providers, line workers, clients and their advocates as people on the ground who know and care about how their clients are doing as important sources of information
- Specific data collection and reporting requirements
- Pre-established monitoring points (specific times) as well as an understanding that some monitoring will be random
- Independent monitoring or auditing of the contractor by certified professionals or community oversight committees,
- Outcomes-based benchmarks developed in consultation with the contractor with clear performance measures against which the process and acceptability of the work will be evaluated and corrective measures taken,
- Milestones tied to payment performance evaluation would include: consulting clients, client families and employees about their experiences with the contractor, monitoring consumer complaints, sanctions for poor performance and rewards for strong performance,

97x

- End the practice of automatic contract renewals. All contracts would sunset after 3 years after which contractors would have to reapply in a competitive bidding process.
- Compliance with existing labor and employment laws including: the National Labor Relations Act, Fair Labor Standards Act, Occupational Safety and Health Act

Improve Data System to Facilitate Better Oversight and Meta-Oversight

Data systems serve several purposes, all of which make it easier to evaluate performance. A good system allows performance outcomes and expenditures to be tracked on a larger scale, it facilitates the work of "boots on the ground" by making it easier to orchestrate reviews and catalogue information, it bridges the gap between the "boots on the ground" and those that know what is in the contracts and it allows supervisors to track the work of the "boots on the ground." Unfortunately most departments systems in New Jersey are antiquated or non-existent and none are currently capable of being mapped onto others. A data system should be created that has the following features:

- ***Ubiquity:*** All contracting units that issue service contracts should have data systems.
- ***Centrality and Accessibility:*** If all data systems are not the same, all individual data systems should be made to map directly onto a centralized system viewable at different levels to different groups (Legislature, OMB, OSC, and the Public). State Contract Managers should have primary responsibility for data entry within contracting units. They should input data on overall contract performance (e.g. cost overruns, fidelity to contract terms) and caseworkers' complaints and assessments of client outcomes (e.g. client's condition has substantially improved or this psychologist's reports are frequently late and nearly identical to prior reports). Contractors should log objective, administrative data (number of beds, number of visits etc.) and performance data as set forth in their contracts, that can be cross-checked by the State Contract Manager and audited by higher-level reviewers (e.g. OMB, OSC, the Legislature, Researchers, the Public).
- ***Accountability:*** Systems should include data on contractor performance, including outcomes related to service quality as well as financial performance with respect to several measures (e.g. cost per client, cost per outcome, overall cost effectiveness, etc.) [74]

These recommendations are intended to catalyze a conversation about how to redesign state contracting systems with the fundamental principle that oversight is a necessity — not an optional luxury—embedded in their DNA. Contract oversight is an essential element of a responsible contracting system that protects the public interest.

[74] State of New Jersey, Department of Mental Health and Addiction Services, 360 dashboard reviews may provide a good model. This model aggregates data from numerous data fields and benchmarks it alongside of statewide and regional averages.

98x

TABLE 1: *Request for Proposal (RFP) Analysis*

Department	DHS	DHS	DHS	DHS	DHS	DHS	DHS	DOC	DOC	DOC	DCF	DCF	DHS	DHS	DHS	DHS	DHS
Division	DMHAS	DMHAS	DMHAS	DMHAS	DMHAS	DMHAS	DMHAS	OCP	OCP	County of Mercer	Central NJ	Hudson County	DDS - Camden	DDS - Hudson	Family Development	DFD	DFD
Case	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R
Comprehensive contract costing and design																	
Detailed program costs	H	H	H	H	H	H	H	H	H	M	M	M	M	M	M	H	M
Detailed personnel costs	H	H	NP	H	H	H	H	H	H	H	H	M	M	M	L	H	M
Specify monitoring / oversight personnel costs	L	M	L	M	M	M	M	L	L	L	L	L	NP	NP	NP	L	NP
Detail and define impact on clients or recipients	L	L	M	M	M	L	M	L	L	L	H	H	H	H	L	L	H
Outline how services delivered	H	H	H	H	H	H	H	H	H	H	H	M	H	H	H	NP	L
Require identification of who delivers the service	M	M	M	H	M	M	M	M	L	H	M	M	NP	NP	M	L	L
Compliance with laws and regulations	H	H	H	H	H	H	H	H	H	H	H	H	M	M	H	H	H
Specify the workload of service providers	H	H	M	H	H	H	H	H	H	H	H	H	L	L	L	L	M
Require contractor to carry insurance	H	H	H	H	H	H	H	H	H	H	H	H	NP	NP	NP	NP	L
Specify clear and detailed incentives	L	NP	NP	M	NP	NP	NP	M	M	NP	NP	NP	NP	NP	NP	NP	NP
Specify penalties and sanctions	L	M	NP	NP	L	L	L	L	L	L	NP	NP	NP	NP	L	L	NP
Contract oversight and monitoring																	
Require service statistics to be reported	L	NP	H	H	L	H	L	L	H	H	H	L	L	L	L	M	L
Performance -based acquisition and service contracting	L	L	NP	M	NP	NP	NP	L	M	L	NP	NP	M	M	L	NP	L
Contracting unit established a formal monitoring system				H				H	H		M	M	NP	NP	L	L	M
Is the monitoring system specified in the RFP	L	L	NP	M	L	L	M	L	L	M	M	NP	NP	NP	L	L	M
Collaborate to develop performance measurement and monitoring system	L	L	NP	NP	M	NP	NP	M	M	L	L	L	NP	NP	NP	L	NP
CU identified specific data to monitor performance	M	L	M	H	M	L	L	L	M	M	H	L	L	L	L	L	L
CU identified specific data for benchmarking purposes	L	L	M	L	L	L	L	H	M	M	L	L	NP	NP	NP	NP	NP
Identify who is responsible for monitoring contracts	L	L	NP	H	L	L	NP	M	M	L	H	NP	L	L	NP	L	L
Continuous monitoring	L	L	NP	M	L	M	L	M	M	L	L	NP	L	L	L	L	L
Mechanisms to evaluate contractor monitoring capacity	L	L	L	L	L	L	L	L	L	L	L	NP	NP	NP	L	NP	NP
Adequate staffing and training																	
Contractors provide training to contractor monitoring staff	L	L	L	H	H	M	M	L	L	L	M	L	NP	NP	NP	NP	NP
Contracting unit staff provided with service specific monitoring training	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP
Contractors identify and train contract monitoring staff	L	L	L	M	H	M	M	L	L	L	L	L	NP	NP	NP	NP	NP
Mechanisms to evaluate staffing, financial management capacity	M	M	M	H	M	M	M	H	H	M	H	M	M	M	M	L	L
Relational contracting and communication																	
CU to meet / discuss the operation of the contracted service or activity	L	L	NP	M	L	L	L	L	L	L	L	NP	NP	NP	NP	NP	NP
CU communicate with the contractors solve operational problems	NP	NP	NP	L	NP	M	NP	L	M	L	M	NP	NP	NP	NP	NP	NP
Communication protocols for monitors to access decision-makers	L	L	L	L	L	L	L	L	L	L	L	L	NP	NP	NP	NP	NP
Clients served communicate to contractor	M	M	L	M	M	M	L	L	L	L	H	M	H	H	L	NP	L
Clients served communicate to contracting unit	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP
CU and contractors develop standardized service procedures and protocols	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	NP	L	M	M	NP	NP	NP
Frequency monitor contractor performance	L	L	L	L	L	H	L	M	M	H	H	NP	L	L	L	L	L
Frequency monitor fiscal performance	L	L	L	L	L	H	L	H	H	M	NP	NP	NP	NP	L	L	L
Frequency monitor service performance	L	L	NP	L	L	H	L	M	M	M	L	NP	L	L	L	NP	L
	$1.68M	$8.41M	$3.00M	$5.337M	$1.75M	$0.570M	$1.00M	$64M			$1.005M	$.258M	$0.60M	$0.255M	$5.20M	$1.06M	$5.56M

99x

Reviewer Guidelines and Scoring Criteria[75]

The following describes the guidelines for evaluating contracting unit Request For Proposals (RFP's'). The overall goal is to have all reviewers have consistent evaluative criteria for screening the presence of an item in the RFP. The criteria will be used by the reviewers to evaluate RFP's in two major areas — Performance measures (i.e. does an RFP identify, detail and require systems to assess service outcomes) and Contract Oversight (i.e. how the contracting unit monitors contracted work). A third category, Signed Contract (i.e. RFP's that have been awarded) will also be evaluated based on availability of the documentation. Each major area is broken into particular items suggested by the literature to be best practices in contract development. Reviewers will judge each item based on the following non-numeric scale:

NP: Not present — refers to an item not mentioned in the RFP.

For example, item 35 — Has the contracting unit identified specific sets of data they are collecting to monitor performance — e.g. program products, caseloads ratios, donor client satisfaction? If the RFP makes no reference or contains no narrative relating if the contracting unit collects data to monitor contractor performance, this item would be coded as NP

L: Low — refers to an item mentioned in the RFP narrative but contains no further description.

For example, item 35 — Has the contracting unit identified specific sets of data they are collecting to monitor performance — e.g. program products, caseloads ratios, donor client satisfaction? If the RFP mentions that the contracting unit collects data for monitoring purposes, BUT does not say what type of data then this item would be rated as L

M: Medium — refers to an item that is both mentioned in the RFP narrative and contains a description of the item.

For example, item 35 — Has the contracting unit identified specific sets of data they are collecting to monitor performance — e.g. program products, caseloads ratios, donor client satisfaction? If the RFP mentions that the contracting unit collects data for monitoring purposes, and also identifies what type of data is being collected (e.g. caseloads) then this item would be rated as M

H: High — refers to an item that meets three criteria. The item must be mentioned in the RFP narrative, must contain a description of the item, AND must be quantified and measurable.

For example, item 35 — Has the contracting unit identified specific sets of data they are collecting to monitor performance — e.g. program products, caseloads ratios, donor client satisfaction? If the RFP mentions that the contracting unit collects data for monitoring purposes, and also identifies what type of data is being collected (e.g. caseloads), AND the data is quantified and measurable (e.g. case load as a ratio of number of clients to number of case managers) then this item would be rated as H

75 Savas, Emanuel S. "Competition and Choice in New York City. Social Services." *Public Administration Review* 62, no. 1 (2002): 82-91.

Document Analysis

Documentary evidence, in this case contracting unit Request for Proposals (RFP's), is used to corroborate and augment evidence from the interview data. Specifically, the RFP's were gathered from 6 contracting units within three state agencies. The RFP's analyzed were for the delivery of human services including supportive services for individuals with mental illness, supportive services for individuals with substance and drug abuse problems, and support services for reintegration of inmates into the community. The RFP's ranged in value from $500,000 to $64,000,000. The RFP service areas included both state wide and county specific focus.

The documents were analyzed and coded as indicated above.

11/3/2015

Mr. Robert A. Romano
Acting State Treasurer
State of New Jersey
Department of the Treasury
PO Box 002
Trenton, NJ 08625

Retailer # 316635

Re: Northstar Lottery

Dear Sir:

We are a lottery retailer and convenience store in Jersey City.

Our lottery customers depend on us to provide the service and we depend on Northstar to effectively enable us to do that. Northstar has been very responsive and attentive to every function of our lottery operation. I observe that Northstar provides the following:

1. **A dedicated Lottery Sales Representative (LSR)**
2. **Automatic supply tracking**
3. **A dedicated and friendly call center rep for orders and sales advice** *(Helen calls every week to ask us what we need)*
4. **Weekly visits from our dedicated LSR**
   a. *Anette visits quite often in a month*
   b. *She reviews our display*
   c. *She asks if we have any problems*
   d. *She decorates and places advertisements to attract more customers*
5. **On site show and introduction to new games for customers**

We really appreciate these contributions from Northstar. Our month to month sales volume and steady commission income are proven results from the work of Northstar. We know that lottery plays a big role for our customers and our community. We also know Northstar has applied all the ingredients to make it better for everyone.

Respectfully,

Levar Ambroise, President

TERRY ROSE CORPORATION DBA STREET CORNER
713 Highland Ave, Newark, NJ 07104 • Tel: 973-484-2414 • Fax: 973-774-1919 • Email: LAmbroise3@gmail.com

102x

Lottery

Robert A. Romano
Acting State Treasurer
State of New Jersey
Department of the Treasury
PO Box 002
Trenton, NJ 08625

Dear Acting State Treasurer Romano:

I am writing this letter to inform you that Wawa, Inc. is extremely satisfied with the Northstar NJ Lottery organization and wanted to thank you for the support that they provide. We work with many lotteries and Northstar is certainly one of our top lottery partners that provide us with strong service, dedicated sales force that understands our customer and business, and flexibility with their go to market strategy.

Wawa was searching for a new way to offer lottery to our customers in New Jersey. When Northstar began managing the Sales and Marketing of the NJ lottery, this became a reality. Northstar was able to provide a back-office reporting system to support the management of lottery sales data within Wawa's financial systems. This was instrumental with our decision to launch the lottery in our NJ stores with a solution that was an ongoing challenge in the past. In addition, Northstar NJ Lottery was able to meet our requirement to sell through self-service terminals and made the investment in Wawa to provide that solution for us. Furthermore we have Lottery Sales Representatives that visit our stores on a bi-weekly basis that help our locations with understanding our lottery customer, merchandising and selling solutions. The retail support of the LSR is an important and critical need for our business.

We have been working with Northstar NJ lottery for a little over two years and they have fully supported our business model and help drive the continuous sales growth. We are pleased that we have now exceeded over $100M in lottery sales with the state of NJ and believe that this is a testament of the Lotteries dedication to our business. We currently have 239 locations across the state that offer lottery and plan to expand to 245 stores by the end of this year and currently employ more than 9,100 individuals in NJ.

Thank you again for your continued support and we look forward to a prosperous business in the future.

Sincerely,

Anne L. Kerstetter

Anne L. Kerstetter
Manager of Store Ops Payments & Reconciliations
Wawa, Inc.
260 W. Baltimore Pike, Wawa PA 19063

Robert A. Romano
Acting State Treasurer
State of New Jersey
Department of the Treasury
PO Box 002
Trenton, NJ 08625

Dear Acting State Treasurer Romano:

I am the President of the New Jersey Liquor Store Alliance and wanted to reach out to you about the partnership we have with Northstar NJ Lottery organization and the value that they provide me and the members of our association. We represent 875 retailers in the NJ market that are retailers that are passionate about their business in the state.

Northstar NJ Lottery has managed to align with our members and provide them with sales and marketing opportunities to help grow their lottery business. They have demonstrated over the years that they have the best interest for our members by supporting them with service, sales solutions and business building opportunities.

I recently became a licensed agent approximately a year ago and I am extremely satisfied with the service that they provide my retail store Super Wine Warehouse. They continue to provide strong service and help me grow my lottery business. We are pleased with Northstar's support that they give us and our organization.

The New Jersey Liquor Store Alliance looks forward to our continued relationship with Northstar and their support of our association.

Juan Carlos Negrin
President & CEO
juan@superwinewarehouse.com

SUPER WINE WAREHOUSE
www.superwinewarehouse.com

42 East 30th Street (973) 684-2337
Paterson, NJ 07514 (973) 684 -2707 fax

NJ Liquor Store Alliance - President
juannegrin@njlsa.com

206 West State Street (609) 396-1980
Trenton, NJ 08608

Drink Responsibly, Drive Responsibly

NJ GCA
NEW JERSEY GASOLINE • C-STORE • AUTOMOTIVE ASSOCIATION

To: Carole Hedinger

4900 Rt. 33W • Suite 100
Wall Twp., NJ 07753
Phone: 732-256-9646
Fax: 732-256-9666
Web: www.njgca.org

Robert A. Romano
Acting Treasurer
State of New Jersey
Department of the Treasury
PO Box 002
Trenton, NJ 08625

November 4, 2015

Dear Acting Treasurer Romano:

I am writing this letter to inform you that the New Jersey Gasoline, C-Store, Automotive Association (NJGCA) is so far pleased with the partnership we have established with the Northstar NJ Lottery organization. So far I have received positive feedback from my members on how they have been operating the Lottery program.

NJGCA represents over 1,500 small business owners who serve the public in the gasoline service station, convenience store, and automotive repair industry. As you are no doubt aware, lottery sales are a cornerstone of their business, and these businesses are the cornerstone of the State Lottery.

Northstar supports our vision of servicing the small businesses that serve the motorists. They have been supportive of our members by providing service to each retail outlet by assigning one dedicated Lottery Sales Representatives that calls on each store. Northstar has been able to support the small businesses in our organization and align to their needs.

We are pleased with Northstar's support that they give us and their approach to our organization. Northstar is available to our association and our members and able to identify any opportunities to improve upon the services they provide our members. They have been proactive about reaching out to come in and discuss the issues facing the lottery with myself, my staff, and some of my top members who are lottery retailers.

NJGCA looks forward to our continued relationship with Northstar and their support of our association.

Sincerely,

Sal Risalvato
Executive Director

QuickChek

3 Old Highway 28 • P.O. Box 600 • Whitehouse Station, NJ 08889 • p (908) 534-2200 • f (908) 534-9216

November 11, 2015

Robert A. Romano
Acting State Treasurer
State of New Jersey
Department of the Treasury
PO Box 002
Trenton, NJ 08625

Dear Acting State Treasurer Romano:

In the past year there has been a tremendous amount of negative media coverage on the NJ lottery contract with Northstar NJ and I am writing this to contradict the bad press and negative comments. We have been a licensed agent since the inception of the lottery and have seen a tremendous amount of improvement during the past two years. At Quick Chek we have seen a 16% growth in our topline number and 17% increase in commissions this past year. We attribute this to the nimbleness of the Northstar organization, promotional support, LSR retail support, dedicated direct Corporate Account Rep, and alignment and understanding of our business.

We have been able to sit down with the Northstar organization and develop joint business plans to align on growing the lottery business. The plans have included integrated business planning, strong POS, reporting alignment and marketing co-op programs. The Northstar team has been aligned to our business needs and continues to work with us to grow our business.

We currently have 130 stores that sell the lottery in NJ and 3,400 employees work in these stores. We plan to expand an additional 6 stores in NJ over the next year and look forward to partnering with Northstar.

I believe that Northstar deserves the recognition of a strong business partner and a team that understands how to market and sell products at Quick Chek.

Sincerely,

Michael Murphy
Senior Vice President

Mitesh Patel
V7 Stores – 313023
389 ½ Broadway
Bayonne, NJ 07002
201-339-1823

November 5, 2015

Dear Sir/Madam:

Some of the improvements over the past two years as a result of the LSR retailer support with Northstar that I have noticed is that customers have been a lot happier with the new games and they want to play more. Northstar has also done a lot more marketing and POS. They have been effective in doing this with the help of my LSR, Angelo Negron. He is great at what he does and he is always there for me when I need him.

Because of the great partnership with Northstar since they have taken over I am able to communicate any concerns I have to the LSR and during retailer advisory meetings. Because of this sales have grown significantly over the past two years. Northstar deserves the respect of a strong business partner. They understand what is needed for advertising, inventing new products, promotions, and retailer and customer experience.

I am pleased to write this letter for such a great business partner. Northstar is doing an incredible job and I hope that the partnership with them continues.

Thank you.

Sincerely,

Mitesh Patel
V7 Stores

107X

Deenbandhu Ramani
Union Food Stores – 130893
357 Union Blvd.
Totowa, NJ 07512
978-289-0937

Deenbandhu Ramani
Union Food Store – 314206
90 Union Blvd.
Totowa, NJ 07512
978-289-0937

November 5, 2015

Dear Sir/Madam:

Some of the major improvements over the past two years attributed directly to LSR retailer support with Northstar that I have noticed is that there have been a lot of new games that keep customers interested. Northstar has also put a lot of effort behind POS and marketing. They have been successful in doing this with the help of the LSR that they put in my store, Josean Colina. He is great at what he does and whatever time we need anything from him he is there for us. Between both of my stores I average more than $110,000.00 on a weekly basis in gross sales. With that amount of traffic, we are thankful to receive the attention we do from Josean Colina.

Because we have such a better partnership now that Northstar has taken over we are able to communicate back some of our concerns back to the LSR and during retailer advisory meetings. I myself had the honor of attending one and addressed the issues I had on hand. Because of this sales have grown substantially over the past two years. Northstar deserves the recognition of a strong business partner. They understand what is needed for marketing, innovating new products, promotions, and high quality retailer and customer experience.

I hope the partnership with Northstar continues. I am honored to write this letter for such a great business partner. Northstar is doing a tremendous job.

Thank you.

Sincerely,

Deenbandhu Navalbhai Ramani

Deenbandhu Ramani
Union Food Stores

108X

10/29/2015

182 Ridgedale Ave
Florham Park, NJ 07932
973-966-8833

SPEEDY MART
Quality & Convenience

To:
Mr. Robert A. Romano
Acting State Treasurer
State of New Jersey
Department of the Treasury
PO Box 002
Trenton NJ 08648

Dear Mr. Romano,

I am writing you this letter of appreciation for all the positive changes in NJ Lottery that have occurred within the last 2 years, since my North Star Rep began calling on me. I am the owner of the Speedy Mart Convenience Store in Florham Park NJ. My lottery agent # is 312002. I have been at this location for about 12 years now and a long time Lottery agent.

The service is now consistent as I see my rep Tom several times a month. There is always something new going on as far as promotions and signage for my store. The implementation of the Inventory Management Program has worked very well and made managing my Instant Ticket inventory must less stressful. It also allows me to quickly get out new games by creating the space in my dispensers which were recently replaced and look great. My instant ticket sales are up about 16% with this upgrade.

I have also received several visits in the past year from North Star management including a senior member of the North Star team. This kind of attention to detail really speaks to how well North Star is running the NJ Lottery.

That said, my heartfelt thanks for all the positive changes you have help implement for the NJ lottery.

Sincerely,

M Shah

Milind Shah

109X

TO WHOM IT MAY CONCERN:

WE HAVE BEEN IN THIS BUSINESS SINCE 1977 WHICH EQUALS TO 38 YEARS AND AMONGST OTHER

FEATURES OF OUR GENERAL BUSINESS PLAN WE HAVE ALWAYS HAD THE NEW JERSEY LOTTERY AS A TOP

PRIORITY IN OUR OPERATIONS. WE HAVE ALWAYS RELIED ON THE NEW JERSEY LOTTERY AS A DEPENDABLE

REVENUE STREAM. ALTHOUGH, WE HAVE ALWAYS WORKED HARD AT MAKING OUR LOCATION A NEW JERSEY

LOTTERY PLAYERS PREFERRED STOP, IT REALLY WASN'T UNTIL THE NORTHSTAR OPERATORS STARTED

MANAGING THE LOTTERY OPERATIONS THAT WE HAD A TRUE PARTNER IN OUR LOTTERY BUSINESS.

A CONSTANT FLOW OF NEW SYSTEMS AND IDEAS - THAT ACTUALLY WORKED AND BENEFITTED OUR

OPERATIONS. WE SEE THE HONEST VIGILANCE AND DEVOTION TO THE DEVELOPMENT OF OUR LOTTERY

BUSINESS - ON A DAILY BASIS. BEST OF ALL IT IS REALLY GRATIFYING TO WORK WITH A PARTNER

THAT "KNOWS"- I WANT TO EMPHASIZE - THAT REALLY KNOWS THE LOTTERY BUSINESS - ESPECIALLY FROM

OUR END OF THE BUSINESS - AFTER ALL - AT OUR LEVEL, ISN'T THAT " WHERE THE TIRE MEETS THE ROAD"!

I LOOK FORWARD TO CONTINUING TO WORK WITH - OUR HARD WORKING PARTNERS - AT NORTHSTAR -

AND CONTINUE OUR CONSTANT IMPROVEMENT AND RISING REVENUE FOR US - AND YES - FOR

THE STATE OF NEW JERSEY.

THANK YOU NORTHSTAR AND NEW JERSEY LOTTERY

Sal Cassar

SAL CASSAR OPERATOR OF TOWNE MARKET, PHILLIPSBURG,NJ

110X