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May 11, 2017

Gregory L. Acquaviva
Chief Counsel
Office of the Governor
125 West State Street
Trenton, New Jersey 08625

Formal Opinion No. 1-2017

Re: Contribution of the State Lottery Enterprise to
Certain State Retirement Systems

Dear Chief Counsel Acquaviva:

You have requested a legal opinion on whether the proposed contribution of the State Lottery to certain State retirement systems ("Proposed Transaction") would violate the State Constitution. Based on our current understanding of the Proposed Transaction, you are advised that it comports with the State Constitution and other applicable state laws.

Our understanding of the Proposed Transaction and the draft legislation to effectuate the Proposed Transaction ("Proposed Act") is as follows:

The Administration proposes to contribute the State Lottery enterprise to certain retirement systems and deposit it into a newly created common pension fund ("Fund L") for a term of thirty years. The Proposed Act will define which retirement systems are eligible to receive a portion of the contribution by virtue of their members' past or present employment in the State's schools and State institutions, in keeping with the constitutional dedication of net lottery proceeds discussed below. The Proposed Act will direct the State Treasurer to make



the lottery contribution. The Lottery Contribution and all proceeds of the Lottery Enterprise shall be allocated among the Retirement Systems in the Allocable Percentages (as such term is defined in the Proposed Act), which were determined based on (a) the relative percentages of the total actuarial accrued liabilities of the eligible Retirement Systems (as such term is defined in the Proposed Act); (b) the relative percentages of the total actuarial accrued liabilities of the Eligible Member (as such term is defined in the Proposed Act) portions of such Retirement Systems; (c) the relative percentages of the total unfunded actuarially accrued liabilities of the eligible Retirement Systems; (d) the relative percentages of the total unfunded actuarially accrued liabilities of the Eligible Member portions of such Retirement Systems; (e) the relative percentages of the total number of members in each eligible Retirement System; and (f) the relative percentages of Eligible Members participating in each such Retirement System.

Although the entirety of the Lottery enterprise will be contributed to Fund L, there will be no material change in its operation and management. The Proposed Act will direct that operation of the State Lottery remain with the Division of the State Lottery, which will continue in its existing form as a division within the Department of the Treasury. The State Lottery Commission will continue to have seven members, but the Proposed Act will add the Director of the Division of Investment as a member of the Commission. The State Lottery Commission will continue to exercise regulatory oversight over the State Lottery by adopting lottery rules and approving all games.

With the exception of a few retained assets and liabilities (such as annuities purchased to pay previous prize winners), all of the assets and liabilities of the State Lottery, including all State Lottery intellectual property, will be conveyed as part of the Proposed Transaction for the term of the lottery contribution. The intellectual property will continue to be used by the Division of the State Lottery under a no-fee license provision in the Proposed Act.

During the term of the lottery contribution, the gross proceeds of the State Lottery will be paid into an operating account within Fund L for payment of operational and administrative costs. The operating account will be managed by the Division of the State Lottery. The Division of the State Lottery will, on a periodic basis, transfer into a second account -- the investment account -- State Lottery proceeds net of operating and administrative expenses, including prize payments. Consistent with existing State law, annual lottery

net proceeds must be at least 30% of gross proceeds. These net proceeds may be used by each retirement system for payment of benefits to eligible members, or may be invested on behalf of the retirement systems by the Director of the Division of Investment consistent with the Director's existing fiduciary obligations. In all other respects, neither the Director of the Division of Investment nor the State Investment Council will have any responsibility or authority over operation of the State Lottery, and neither will have any supervision over or use of the operating account.

The lottery contribution will take effect when the Treasurer delivers a "Memorandum of Lottery Contribution" ("Memorandum") to the Director of the Division of Investment. The Memorandum will include detailed schedules of all the State Lottery assets and liabilities conveyed to Fund L. The Director will acknowledge the lottery contribution to Fund L, but will have no discretion to reject or condition receipt of the lottery contribution.

The Proposed Act will account for valuation of the lottery contribution, and for re-calculation of the funded ratio of the eligible retirement systems to reflect the lottery contribution. The Proposed Act will also provide for an adjustment of the State's annual required contribution based on the amortized value of the lottery contribution in each year of the term of the lottery contribution.

I. The Lottery Clause of the New Jersey Constitution

New Jersey's constitutional restrictions on gambling go back to the Constitution of 1844, which provided that "[n]o lottery shall be authorized by this state; and no ticket in any lottery not authorized by a law of this state shall be bought or sold within the state." N.J. Const. (1844), art. IV, § VII, ¶ 2. The 1844 Constitution was amended in 1897 to prohibit all gambling, and then again in 1939 to make an exception for pari-mutuel wagering on horse racing. See Atl. City Racing Ass'n v. Attorney Gen., 98 N.J. 535, 540-41 (1985).

In the 1947 Constitutional Convention, gambling was the most debated issue, with the delegates ultimately deciding to more or less maintain the status quo. Id. at 542-44. As adopted in 1947, the Gambling Clause of the Constitution provided that:

No gambling of any kind shall be authorized
by the Legislature unless the specific kind,

restrictions and control thereof have been heretofore submitted to, and authorized by a majority of the votes cast by, the people at a special election or shall hereafter be submitted to, and authorized by a majority of the votes cast thereon by, the legally qualified voters of the State voting at a general election.

[N.J. Const. art. IV, § 7, ¶ 2.]

This provision was amended in 1953 to provide an exception to the general prohibition on gambling to allow for bingo games and raffles held by veterans, charitable, religious, civic, fraternal, and other non-profit organizations. See id. at ¶¶ 2(A), 2(B). Beginning in 1959, the Legislature considered proposing a further amendment to the gambling provisions of the Constitution to authorize a State lottery. In 1969, the question was put to the voters, who approved the amendment by a vote of 81.4%. In re Challenge of Contract Award Solicitation No. 13-X-22694 Lottery Growth Mgmt. Servs., 436 N.J. Super. 350, 361 (App. Div. 2014).

As adopted in 1969, the Lottery Clause provided that:

It shall be lawful for the Legislature to authorize the conduct of State lotteries restricted to the selling of rights to participate therein and the awarding of prizes by drawings when the entire net proceeds of any such lottery shall be for State institutions and State aid for education.

[N.J. Const. art. IV, § 7, ¶ 2(C).]

The Lottery Clause has only been amended once since, in 1999, to provide that lottery net proceeds may not be used in any way for the support of institutions, facilities, or programs for adult criminal offenders or juveniles adjudged delinquent. Ibid.

The Lottery Clause permits the Legislature to authorize "State lotteries." Ibid. (emphasis added). While the Constitution does not explain what "State lotteries" means, sources contemporaneous to the adoption of the Lottery Clause make clear that the phrase means State operation and control of the State Lottery. See L. 1970, c. 13, § 2 (codified at N.J.S.A. 5:9-2) (noting Legislature sought "to carry out the

mandate" of Lottery Clause "by establishing a lottery to be operated by the State" (emphasis added)). Courts have long given "virtually contemporaneous[]" statements of intent such as these great weight when construing the gambling provisions of the State Constitution. See Atl. City Racing, *supra*, 98 N.J. at 548. A recent Appellate Division case, although it arose in a slightly different context, also provides some guidance on what "State lotteries" means. See Challenge of Contract Award, *supra*, 436 N.J. Super. 350. There, the court held that "the power" of the State Lottery Commission and the Director of the Division of the State Lottery "to determine policy and make major business decisions" concerning the Lottery satisfied the State-operation requirement of the Lottery Amendment. Id. at 369.

The characteristics of a state-conducted lottery are also described in federal law, notably in contemporaneous federal legislative history. Federal criminal law forbids interstate mailing and transport of lottery tickets and paraphernalia except by lotteries "conducted by" a state acting under the authority of state law. 18 U.S.C. § 1307(b). This exemption was passed by Congress in 1975, close in time to the passage of New Jersey's Lottery Clause. The history and interpretation of the federal law distinguishes lotteries run by state entities for the public benefit from private, for-profit lotteries long associated with corruption and fraud. The general model for the operating structure of a state lottery was understood to consist of

an appointed commission with advisory responsibilities, and an executive director with a free hand in running the day-to-day operation. Tickets are distributed on consignment to authorized banks and sales agents, who are licensed by the state after careful scrutiny. The tickets are sent through the banks to the sales agents, and unsold tickets and revenues are returned to the state, less a 5 or 6 percent commission for the agents and 1/2 or 1 percent commission for the banks, which also benefit from the use of the funds. Prize payments generally equal 45 percent of gross revenue receipts. The remainder is returned as net revenue to the state after operating expenses are subtracted.

[Report of the House Judiciary Committee on
H.R. 6668, H. Rep. No. 93-1517 at 15
(December 4, 1974).]

State-conducted lotteries are notable for their reliability and absence of fraud: "[A]ll tickets are fully accounted for at all times by a central computer, and a dual auditing system accounts for the flow of revenues at each step of the operation." Ibid. State-operated lotteries that dedicate net revenues to "the public good," ibid., are distinguished from those operated for private profit "with no guarantee . . . that undesirable elements would not profit as licensees, [which] . . . could lead to criminal involvement in gambling," id. at 21. These federal guideposts on what is a state-conducted lottery are generally consistent with the legislative history and interpretation of New Jersey's Lottery Clause described above.

The Proposed Transaction addresses the requirement of State conduct and operation of the State Lottery in several ways. First, the Proposed Act provides that the Division of the State Lottery and the State Lottery Commission will continue to operate the State Lottery as they are presently doing. The State Lottery Commission will have exclusive authority to adopt rules and approve all games, and the eligible retirement systems will have no direct regulatory control over the State Lottery. The Director of the Division of the State Lottery will still be appointed by the Governor with the advice and consent of the Senate. The Governor will also continue to appoint all of the other State Lottery Commissioners. Therefore, despite the transfer of the State Lottery to Fund L, the State through the Division of the State Lottery and the State Lottery Commission will retain responsibility for "policy and major business decisions." See Challenge of Contract Award, supra, 436 N.J. Super. at 369.

The Lottery Clause also provides that "the entire net proceeds" of the Lottery must be used "for State institutions and State aid for education" (but may not support juvenile or adult correctional facilities or programs). N.J. Const. art. IV, § 7, ¶ 2(C). With respect to "aid for education," it is notable that no distinction between primary, secondary, and higher education is made, and that this broad term was chosen rather than a more limited term such as "State educational programs" or "State educational institutions." This suggests that Lottery net proceeds may be used to fund any State initiatives and programs that support education at any level.

This is consistent with the allocation of Lottery net proceeds by the Legislature in recent years, with monies appropriated for education as follows: (1) to the Department of Agriculture for school nutrition programs; (2) to the Department of Education for the benefit of the Governor's School, the Marie Katzenbach School for the Deaf, non-public school aid, school construction and renovations, and the Statewide assessment program; and (3) for higher education programs including operating aid, various program and tuition aid grants, scholarship programs, capital improvement, aid to county colleges, debt service on Higher Education Capital Improvement Fund Contract Bonds ("CIF Bonds") and Higher Education Facilities Trust Fund State Contract Bonds ("HEFT Bonds"), and services for students with special needs. See, e.g., Fiscal Year 2017 Appropriation Act, L. 2016, c. 10.

With respect to "State institutions," at the time the Lottery Clause was approved, that term was understood to mean those institutions under the Department of Institutions and Agencies (later reorganized as the Department of Human Services), defined as "long-term care facilities, institutions, and psychiatric facilities." See N.J.S.A. 30:1-7 (providing specific list of psychiatric hospitals and developmental centers); see also N.J.S.A. 18A:60-1.1 (discussing "State institutions within the Department of Corrections, the Department of Children and Families, and the Department of Human Services"); N.J.S.A. 30:4-136 to -177.42 (discussing various State correctional, mental health, and treatment facilities under the category of "Specific Institutions"). Based on these statutory definitions and contemporaneous usage, it is clear that, under the State institutions prong of the Lottery Clause, lottery net proceeds may be used to support State-run residential facilities that provide psychiatric, developmental, and public health services. This interpretation is also consistent with the Legislature's history of appropriating lottery net proceeds to aid (1) the State psychiatric hospitals, (2) centers for the developmentally disabled, and (3) homes for disabled veterans. See, e.g., L. 2016, c. 10.

The Proposed Transaction contemplates that the contribution of the State Lottery shall be allocated only to members of the retirement systems who are employees or retirees of public schools, State universities and colleges, or State institutions that meet the criteria described above. These State employees are a key part of providing education and running State institutions.

II. The New Jersey Lottery Statute

Contemporaneously with the Lottery Amendment, the Legislature through a joint resolution created the Lottery Planning Commission to prepare a report on the operation of state lotteries and draft legislation for the conduct of a New Jersey lottery. The adopted State Lottery Law, L. 1970, c. 13 (codified at N.J.S.A. 5:9-1 to -25), was the statute submitted to the Governor and Legislature by the Lottery Planning Commission in its February 1970 report. See Report of the State Lottery Planning Commission (Feb. 9, 1970). Because of its enactment contemporaneous with the constitutional amendment, the State Lottery Law is entitled to particular interpretative weight with respect to the intent of the Lottery Clause. Atl. City Racing, supra, 98 N.J. at 548. The Lottery Planning Commission's report, as a contemporaneous statement of the legislation's drafters, is entitled to similar weight. Two key concerns of the Lottery Planning Commission, as expressed in its report, were that the lottery be conducted in an ethical and responsible manner to "preserve the full trust and confidence" of the citizens of the State, and that its operational structure provide maximum flexibility to allow for the various adjustments that might be needed in order to maximize lottery net proceeds. See Report at 4-5, 8. Features of the State Lottery Law designed to protect public confidence include appointment of key State Lottery officials by the Governor, appointment of a bipartisan lottery commission, id. at 6, conduct of an annual audit, id. at 7, and a statutory requirement that, in the allocation of the lottery's gross proceeds between operating expenses, payment of prizes, and support for education and State institutions, a minimum of 30% of gross proceeds would go to education and institutions, id. at 12-13. Features of the State Lottery Law designed to promote flexibility and allow for maximization of net proceeds include giving the Director of the Division of the State Lottery and State Lottery Commission substantial discretion with respect to lottery operations, including prices of tickets, frequency of drawings, manner of determining winners, and structure of prizes. Id. at 4-5.

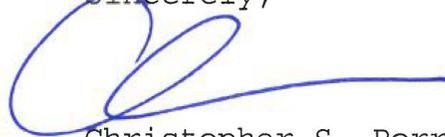
The Proposed Act makes several amendments to the existing State Lottery Law for the term of the lottery contribution, including the right of the Director of the Division of Investment to request an audit of the State Lottery on behalf of the retirement systems. In addition, in order to effectuate the contribution of the State Lottery, the Proposed Act provides that lottery operating funds, reserves, and net proceeds will be held in Fund L within the Division of Investment, rather than in

the State Lottery Fund within the Division of Treasury created by the State Lottery Law. These statutory amendments do not alter any of the principal operational features of the State Lottery that the Lottery Planning Commission saw as key to effectuating the goals of the Lottery Clause of the State Constitution.

III. Conclusion

Given that this is a novel transaction and in light of the uncertainties associated with litigation in general, we are unable to say with absolute certainty how a reviewing court would decide a legal challenge to the Proposed Transaction. However, based on our understanding of the Proposed Transaction and Proposed Act, we believe that they comport with the State Constitution and other applicable state laws. Please note that should any material terms of either the Proposed Transaction or the Proposed Act change, we advise you to request that we review such changes to determine whether they are prohibited.

Sincerely,

A handwritten signature in blue ink, consisting of a large, stylized 'C' followed by a horizontal line extending to the right.

Christopher S. Porrino
Attorney General of New Jersey