Senate Finance Committee Testimony
Dan Meuser, Secretary of Revenue
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Chairman Brubaker, Chairman Blake and members of the committee, my name is Dan Meuser, and I am the Secretary of Revenue. Thank you for the opportunity to testify today before the committee to talk about the Pennsylvania Lottery and the private management agreement ("PMA") designed to be in the best interest of growing and securing Lottery funding, and to ensure the continued strength and viability of programs supporting older Pennsylvanians.

House Resolution 106 of 2011 which passed 202-0, directed the Legislative Budget and Finance Committee to conduct a study on the health of the Lottery Fund. The conclusion of that study, as made evident by the report released by the committee in February 2012 (11 months ago), was that Pennsylvania will see a substantial growth in senior population in coming years and Lottery funding could fall short of demand by as early as 2015. Therefore, according to the Legislative Budget and Finance Committee report, the Lottery must consider and analyze approaches being used in other states to stimulate sales and net revenue growth. Six weeks later, in response to the legislative report, the administration, faced with the demands of a dramatically growing senior population and Lottery revenue projections falling short of demands, decided to explore the benefits of contracting with a private manager to manage growth initiatives of the Pennsylvania Lottery. As we are nearing the end of a lengthy procurement process, I would like to take this opportunity to highlight the critical details of the PMA.

In order to grow future funding for senior programs, the PMA would contractually bind a manager to 20 years of annual profit commitments, known as APCs. These are the profit thresholds that must be achieved by the manager in order for the manager to earn <u>any</u> incentive compensation. Incentive compensation is based on performance, with the manager receiving an established percentage of incremental gain above the APC in each contract year. Incentive compensation is limited by federal law to no more than 5 percent of the total annual Lottery profit per year. Should revenues fall below APCs, the commonwealth is protected. If the private manager fails to meet the APCs, the commonwealth can draw shortfall payments from the $150 million cash collateral and $50 million springing line of credit provided by the manager, in order to preserve and keep funding consistent and predictable for programs benefitting older Pennsylvanians. Such predictable funding protections are not available today. Moving forward, the downside is removed, and the upside offers millions of dollars of potential incremental revenues annually.

In addition to the financial protections afforded to the commonwealth if APCs are not met, the PMA outlines several instances in which the contract with the private manager can be terminated. Under Article 13 of the PMA, the commonwealth can terminate for the following reasons:

- if the manager consistently fails to meet annual profit commitments;
- if there is a change of control of the manager without the commonwealth's consent;

- if the manager commits any number of events of default identified within the contract; and
- at the commonwealth's convenience after the third year of the contract.

Under the private management agreement, the commonwealth will maintain ownership of and control over all aspects of Lottery operations at all times (and is required by federal law to do so). The private manager would be responsible for assisting with the day-to-day operations of the Lottery during the term of the PMA, but the commonwealth will retain full rights to conduct, control, inspect and audit the Lottery.

The private manager would be responsible for managing equipment, services and functions necessary to operate the Lottery, including system technology, data reporting, sales channels, Lottery game development, instant game logistics, retailer recruiting, training, marketing, website and consumer research; customer service; and maintaining a responsible Lottery program. The commonwealth will continue to retain oversight functions including ticket validation, payment of prizes, data validation, drawings, Lottery retailer licensing, retailer accounting and collections, tax reporting, security investigations, auditing and public reporting.

In terms of commonwealth employees, we would expect to maintain a complement of about 70 Lottery employees to perform the commonwealth-retained responsibilities. We anticipate real employment with the private manager for the roughly 160 other Lottery employees over a one year contractually mandated employment transition period, and well into the future.

The private manager is required to submit a business plan each year to be approved by the commonwealth. Each plan must include details regarding organizational structure, operational and administrative expenses, strategies for growing the customer base, measures of operational transparency, projected income statements, innovative ideas for growing profit as planned, plans addressing social responsibility and information regarding subcontract/vendor contracts.

From a financial perspective, the PMA offers assurances that funding will grow for Lottery-funded senior programs. Camelot's bid on the Lottery PMA will generate $50 million in newly available funds in the coming fiscal year; guarantees over $460 - $530 million in incremental value over state budget projections over the next 5 years, and $3.0 - $4.5 billion of incremental value over the next 20 years. In comparison, over the past 20 years, the longest stretch of consecutive positive Lottery profit growth the commonwealth achieved was five years. Lastly, with the downside protections afforded by the PMA, these profit commitments provide numbers the commonwealth can reliably budget for without concern about performance volatility.

In closing, the Pennsylvania Lottery performs well, but a private management agreement brings world class expertise to our lottery operation. It has the potential to increase sales and profits through new ideas and industry best practices, to protect the programs that benefit older Pennsylvanians and create a more reliable, secure and predictable Lottery funding stream. We believe that by combining forces – partnering the Pennsylvania Lottery, which is one of the best in the nation, with Camelot, an international industry leader – we will establish one of the best lotteries in the world, oversee its responsible growth, and meet the funding needs of programs and services for older Pennsylvanians for decades to come.