Committee Meeting

of

SENATE LEGISLATIVE OVERSIGHT COMMITTEE

"The Committee will take testimony on the State contract awarded to Northstar New Jersey Lottery Group, LLC, to manage the sales and marketing operations for growth of the State Lottery, on the shortfall in projected Lottery revenues and net income targets, and on the contractor's performance in New Jersey and other states.

The hearing also will focus on the broader issues of how the State oversees and monitors major private vendor contracts"

LOCATION: Committee Room 4
State House Annex
Trenton, New Jersey

DATE: November 24, 2015
10:00 a.m.

<u>MEMBERS OF COMMITTEE PRESENT:</u>

Senator Robert M. Gordon, Chair
Senator M. Teresa Ruiz
Senator Paul A. Sarlo
Senator Thomas H. Kean Jr.

<u>ALSO PRESENT:</u>

Michael R. Molimock
Office of Legislative Services
Committee Aide

Mark Magyar
Senate Majority
Committee Aide

Bill Murray
Senate Republican
Committee Aide

Meeting Recorded and Transcribed by
The Office of Legislative Services, Public Information Office,
Hearing Unit, State House Annex, PO 068, Trenton, New Jersey

MICHAEL R. MOLIMOCK
Office of Legislative Services
Committee Aide
(609) 847-3855
(609) 292-0561 fax

New Jersey State Legislature

SENATE LEGISLATIVE OVERSIGHT COMMITTEE

STATE HOUSE ANNEX
PO BOX 068
TRENTON NJ 08625-0068

COMMITTEE NOTICE

TO: MEMBERS OF THE SENATE LEGISLATIVE OVERSIGHT COMMITTEE

FROM: SENATOR ROBERT M. GORDON, CHAIRMAN

SUBJECT: **COMMITTEE MEETING - NOVEMBER 24, 2015**

The public may address comments and questions to Michael R. Molimock, Committee Aide, or make bill status and scheduling inquiries to Shirley Link, Secretary, at (609)847-3855, fax (609)292-0561, or e-mail: OLSAideSLO@njleg.org. Written and electronic comments, questions and testimony submitted to the committee by the public, as well as recordings and transcripts, if any, of oral testimony, are government records and will be available to the public upon request.

The Senate Legislative Oversight Committee will meet on Tuesday, November 24, 2015, at 10:00 AM in Committee Room 4, 1st Floor, State House Annex, Trenton, New Jersey.

The committee will take testimony on the State contract awarded to Northstar New Jersey Lottery Group, LLC to manage the sales and marketing operations for growth of the State Lottery, on the shortfall in projected Lottery revenues and net income targets, and on the contractor's performance in New Jersey and other states. The hearing also will focus on the broader issues of how the State oversees and monitors major private vendor contracts.

Issued 11/17/15

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TABLE OF CONTENTS

TABLE OF CONTENTS (continued)

APPENDIX (continued)

TABLE OF CONTENTS (continued)

APPENDIX (continued)

TABLE OF CONTENTS (continued)

APPENDIX (continued)

pnf: 1-100

SENATOR ROBERT M. GORDON (Chair): This meeting of the Senate Legislative Oversight Committee will come to order.

Would you all please rise and join me in the Pledge of Allegiance? (all recite pledge)

May I have the roll call, please?

MR. MOLIMOCK (Committee Aide): Senator Kean.

SENATOR KEAN: Here.

MR. MOLIMOCK: Senator Ruiz.

SENATOR RUIZ: Here.

MR. MOLIMOCK: Chairman Gordon.

SENATOR GORDON: Here.

Good morning, everyone, and welcome to today's Senate Legislative Oversight Committee hearing on the privatization of the New Jersey State Lottery management, and on contract administration issues.

The initial focus of today's hearing is to examine the New Jersey Lottery's contract with Northstar and the reasons for projected shortfalls in promised Lottery revenues. We are grateful to Carole Hedinger, Executive Director of the Lottery, for joining us today -- along with officials from Northstar and International Game Technology -- to discuss these complex issues.

The privatization of management in the State Lottery was supposed to pay off big for Treasury and for the taxpayers of New Jersey. So far, unfortunately, that has not been the case. The $120 million upfront payment that Northstar paid to the State in 2013 for its 15-year Lottery contract has already been cut by $14 million, under a contract provision that let Northstar write off its first year loss; another $6 million presumably has been or will be written off for Fiscal Year 2015.

The Treasury Department also reduced its expectations of Fiscal Year 2016 Lottery revenues, and we are not sure that those are on track. In fact, there is real question as to whether Lottery privatization is paying off anywhere. Two months ago, the state of Illinois fired Northstar after three years of sub-par performance. It took Illinois a year to get out of its contract.

We would like to hear what went wrong in Illinois, and how Lottery operations are going in Indiana, the third state to privatize its state Lottery operations with Northstar.

The Lottery case is important because the State depends on these revenues, and it privatized what was regarded as a highly efficient government agency with a hope of generating greater revenues. The Lottery privatization is also important because, in my view, it is an example of the all-too prevalent flaws in the State's contract management process. The Lottery contract raises fundamental questions about how we ensure that the State's interests are protected in complex privatization initiatives, and in the award of mega contracts -- such as the $670 million HGI contract for the processing of Superstorm Sandy claims that the Department of Community Affairs quietly canceled without informing anyone for almost six weeks.

Today we are going to raise a number of important questions: When does it make sense to keep an operation within State government, rather than to outsource? How hard is it to undo bad privatization decisions of mega contract awards? How can we improve the monitoring of contractor performance? What sort of public notice should there be of modifications or cancelations of major contracts -- those in the tens or hundreds of millions of dollars?

In that regard, our hearing this morning will start with the specifics of the Lottery contract and Northstar's performance, and move onto more general contracting issues; concluding with a presentation by Rutger's Professor Janice Fine, and the team that worked on her 2014 study which reviewed the State contract management practices.

We are, as always, going to get into the weeds today, as is our reputation.

At this point, I'd like to ask any of my Senate colleagues for opening remarks.

Senator Kean, would you like to make any comments?

SENATOR KEAN: No.

SENATOR GORDON: Senator Ruiz.

SENATOR RUIZ: No.

SENATOR GORDON: Okay.

As our first panel, I'd like to call up Carole Hedinger, Executive Director of the New Jersey State Lottery Commission; and Russ Knapp, representing Northstar Lottery Group, LLC.

Ms. Hedinger, would you like to begin?

CAROLE HEDINGER: Yes, good morning.

Good morning, Mr. Chairman and members of the Committee. I am pleased to be here today to provide the Committee with an update of 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 the Lottery produced in 2015 was $960 million, just a half a percent less than the previous year's total of $965 million. Much lower amounts for FY 2015 were reported in the press; however, those were unaudited figures and did not account for final adjustments.

While we would all 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 multi-state jackpot games, Mega Millions and Powerball. This change in consumer purchasing behavior is a function of market forces beyond any state's control, 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 others states' comparable lotteries. There is one crucial reason for our success in combating 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.

And 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 21 to October 1 of 2013, the Lottery and Northstar engaged in a transition period. At the time of the agreement, approximately half of Lottery's employees were involved with the sales and marketing departments; that's 64 out of 130. 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 record growth in instant ticket sales which are now, through October, more than 10 percent higher than the prior year. In addition, our in-state daily games are more than 9 percent 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 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 percent 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's 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.

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 marketplace for a share of the discretionary dollars people spend on games and entertainment. In spite of increasing gaming competition and a 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 FY 2015, a growth of more than 3 percent over FY 2014. 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 percent, and sales for instant ticket games are up 10.2 percent. 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 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 very 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 retail or points-of-sale, maintain and train sales force sufficient to support the retailers, secure adequate advertising resources, gather meaningful research, and procure the necessary technology to support a multi-billion business while having the agility to respond to market demands. I know, because I've been engaged in that struggled 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 *non-bid contract* more than once. There was a public Request for Proposals 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 New Jersey 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, a joint venture between GTECH Corporation, Scientific 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 had 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 attributed 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 need 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 multi-state games.

Thank you.

SENATOR GORDON: Thank you, Ms. Hedinger.

Mr. Knapp.

R U S S E L L K N A P P: Good morning, Chairman, Committee members.

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

Let me begin my remarks today by echoing an observation 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 atten 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 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. And 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 that Lottery funds. And I hope my remarks today 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.

Northstar’s duties under the service 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, an increase of 3 percent. In our second year of operations, Fiscal Year 2015, Lottery sales increased another $98 million, despite a $112 million decline in the Powerball and Mega Million games. That represents more thana 3 percent 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 was approximately $1.8 billion, and total retailer commissions and bonuses were more than $171 million -- which represent a 5.4 percent and 4.5 percent 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, sales are up 5.1 percent, and transfers to the General Fund are 4.3 percent higher than the same period last year.

To demonstrate the impact these games have 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 2015. The range of government transfer declines for those states runs from minus 0.5 percent down for New Jersey -- which was the lowest of the group -- up to minus 14 percent 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 games; however, Northstar was able to adapt to the changing market condition and execute a robust innovation plan that resulted in significant growth for New Jersey in-state games.

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 State government. Of the 133 employees, 94 -- or 70 percent -- 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.

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, nine 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 of $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 has 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 million 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 percent increase. This expansion included the key deployments with Wawa convenience stores and Rite Aid pharmacies. As 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 Cash 5, which is achieving 30 percent higher jackpot levels in Fiscal Year 2015.

Northstar launched the successful Cash4Life draw game for the New Jersey Lottery in collaboration with the New York lottery. Membership in this game was expanded to the Pennsylvania, Virginia, and Tennessee lotteries earlier this year, and two more states are contemplating joining 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 they select numbers that are one digit off the numbers that are drawn by the New Jersey Lottery.

Under the Service Agreement with the Lottery, Northstar provides an expanded marketing and advertising program, and an in-house staff of 21 employees who develop all retailer collateral advertisements -- including point-of-sale materials, as well as all 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 have also developed a dedicated promotion team that highlights the New Jersey Lottery by engaging the public through a wide array of external events at parades, concerts, and at retail locations around the state. Internally, our insights team designs and facilitates research programs to understand consumer feedback, assists 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 one 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 launched our sixth After School Advantage computer lab at the Hackensack Boys and Girls Clubs on November 16, 2015. Northstar contributes $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, freshly painted walls, and room decor. Northstar and Lottery employees volunteered 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. 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.

SENATOR GORDON: Thank you, Mr. Knapp.

I, in fact, do have a few questions -- one of a very general nature. This may be best directed to the Director. The idea of privatizing a lottery was never mentioned in the Governor's 2010 privatization report. In fact, even before that I can remember asking Governor Corzine whether he ever considered privatizing the Lottery, and he said, "Well, it's a pretty well run organization; we don't expect there to be the kind of incremental gain from doing that -- or as much as we would get by doing other things." Where did the idea for privatizing the Lottery management come from? I mean, the press is suggesting that it was the high-powered lobbyists who were friends of the Governors. But can you shed any light on this? Was it Illinois, for example, or Indiana?

MS. HEDINGER: Well, I don't know what the -- I can't speak to how that decision was made. I would like to say, however, that I've never considered the Lottery *privatized.* And in the entire process of constructing the RFP to award a contract, privatizing was not what we were intending to do. We haven't privatized the Lottery in any way. We've outsourced marketing and sales services, something that we had done very much of prior to this contract. We had always outsourced our marketing services. We only had a one-person marketing staff, so all of our marketing was outsourced through an agency. The idea of outsourcing the sales unit as well would bring us professional sales -- trained sales staff, and experienced, something that we were not able to achieve. So privatizing was never the way I looked at it, and it was never the intention of the contract. It was always intended to just secure and procure better professional services.

SENATOR GORDON: Okay. You describe the RFP process, and having the interest, initially, of something like 30 organizations; but in the end, just one bidder. Did you ever consider starting the process over and reletting the bid with the hope of trying to engender more competition and, perhaps, a better deal for the State?

MS. HEDINGER: Well, since the process had been done legally and properly, according to procurement rules, the fact that we had received only one bid did not negate the process that took place. A decision-- I don't know that a decision was considered; it would not have been my decision, so if anything like that happened it was outside my purview.

SENATOR GORDON: Okay. We heard you both speak about the national trends, the decline particularly in the multi-state games. This didn't just happen. I have a report that I believe was completed in 2012 in response to the Lottery's request for information. I think it was a December request for information on ideas for increasing revenues and performance of the Lottery. And this was a report that I believe was prepared at that same time by Macquarie and Deloitte. It highlights the troubling national trends; the demographic issues that are all proving to be challenges for lotteries. With that knowledge, I'm wondering whether it was unrealistic to establish the targets that you did for Northstar, or that Northstar set for itself. Because, certainly, if given those challenges, if you don't make those targets you're going to get a bunch of legislators all exercised and holding hearings about the subject.

What went into the establishing of those targets for both revenues and income?

MS. HEDINGER: Are you addressing Mr. Knapp?

SENATOR GORDON: Whoever can best answer it.

MS. HEDINGER: Mr. Knapp can address what went into setting the targets, as they were part of their proposal. As far as the national trends were concerned, at that time, right up through FY 2012 and into FY 2013, the jackpot games were extremely -- were doing extremely well. The sales had been growing; each year we had been seeing larger jackpots. And there was no reason to expect the terrific drop-off in sales that we started to experience in January of 2014. That was really when the trend in jackpot games changed. Up to that point there hadn't been any reason to suspect that there would be that kind of a drop-off. Jackpot games, you must understand, always have peaks and valleys. If you look at a history of jackpot games, you will see periods of time when they have high sales and valleys where they have low sales -- because they are all jackpot-driven. And as a function of consumer interest, there will be times when people tire of the level of jackpots and want even larger ones. And as larger jackpots occur, they come back into the marketplace. So there are always those peaks and valleys to contend with.

We're in a severe valley right now, as far as those games are concerned, and that began around January of 2014. So there's always an interest in revitalizing games to keep consumer interest so they don't get bored. But there was nothing that would have led us to believe that we wouldn't have continued to see growth in jackpot games.

SENATOR GORDON: Just a follow-up: What if the decline in jackpot games continues? What if this is a longer term trend, as we've seen in horseracing, for example? What's the plan to counter that?

MS. HEDINGER: Well, MUSL, the Multi-State Lottery Association which runs the Powerball games, studied the performance of the Powerball game and came up with changes to that game which were just put into effect on October 4. Periodically, that's what states and lotteries do with their games. In the case of Powerball, which is run by a different multi-state organization -- we are not a member of that, we're just licensed to sell that game -- they examined it, researched player behavior, and decided to make certain changes to the prize structure in the matrix, which we expect will lead to those jackpots that bring people back to that game. Jackpots are only one part of a portfolio, but they appeal to players because of their high jackpots. And I believe that as long as we can produce those jackpots through tweaks to the games, players will play them and they won't go away.

SENATOR GORDON: Okay. There was-- There has been a lot of publicity about the problems in Illinois. Mr. Knapp, can you tell us what happened in Illinois that led to the termination of the contract?

MR. KNAPP: So as I reported in my testimony, as you can see -- my focus really is on New Jersey. I come to work each day with my team, and we focus on driving new sales for the New Jersey Lottery, and it's a full-time job. I cannot, today-- I don't have testimony to provide on what happened in Illinois; I could certainly secure it for you and get back to you, or share that result back with you. But I don't have insight into the Illinois operation.

SENATOR GORDON: Okay. Ms. Hedinger, there was press on the Illinois -- there was correspondence back and forth between Northstar and the Illinois officials prior to the letting of the Northstar contract in New Jersey. Do you know whether the Illinois issues were considered or addressed by the Lottery Commission?

MS. HEDINGER: Well, when we were constructing the RFP -- and that was a team effort by various parts of the Treasury Department to construct that RFP -- we looked at Illinois' contract. In fact, we thought we had improved on aspects of that contract to make our RFP stronger and better. What was happening in Illinois when we were constructing the RFP was very early. What I know about the Illinois contract is that Illinois made more money in the first couple of years than they had ever done before. And that's really all I know about it. What went on inside Illinois, internally, I can't speak to that.

SENATOR GORDON: What kind of improvements have we made over the Illinois contract?

MS. HEDINGER: One area was regarding employees. It's been several years since I read that Illinois contract, so my memory would be hazy as to the specifics. But in general, the way employees would be handled under the Illinois contract and the way we contemplated it in New Jersey was a change that we thought greatly improved our contract.

SENATOR GORDON: Okay. At this point, I want to give my colleagues an opportunity to ask any questions.

Senator Kean; Senator Sarlo.

SENATOR SARLO: Thank you, Senator Gordon. I apologize for running a little late this morning.

I just want to spend a little time focusing in on the contract, from a revenue perspective; and as the Budget Chairman, how it impacts the State of New Jersey and revenue projections.

I just want to lay out a timeframe here and, if I'm incorrect, please correct me. Sandy hits -- Superstorm Sandy hits New Jersey in October of 2012. Northstar takes over the Lottery operations about a year later. Is that correct, sir?

MR. KNAPP: That's correct.

SENATOR SARLO: About a year after Sandy hits New Jersey?

MR. KNAPP: That is correct.

SENATOR SARLO: Okay. So in January 2014, the Administration grants Northstar's request to lower the income targets as a result of Superstorm Sandy. The question I have is, did Sandy continue to affect Lottery sales throughout New Jersey? I mean, outside of Monmouth, Ocean, pockets of Newark, pockets of Bergen County-- This downward trend -- they took it all the way out to 2015 and 2016, when we granted Northstar's request to lower the income targets. We took it all the way to FY 2015 and FY 2016. Was that all due to Sandy -- I mean the impact of Sandy, or was it based upon the economy, based upon the national trend? Were we blaming it on Sandy when, in fact, it was the national trend as everybody has been testifying? The demographics are changing out there across the country when it comes to these types of games.

MR. KNAPP: So Director Hedinger can confirm -- I believe it was a one-year adjustment for Sandy. And I believe it had -- it was driven by the fact that the handoff from Lottery to Northstar -- their revenue totals were impacted, I believe. And as a result, ours were brought down.

MS. HEDINGER: The background on that, if I may--

SENATOR SARLO: Sure, please. Thank you.

MS. HEDINGER: --is that our RFP was out in public at the time that Sandy hit.

SENATOR SARLO: Correct.

MS. HEDINGER: The bids were due in December of 2012. All of our information that we were posting for bidders to consider indicated that the Lottery would make a $995 million revenue. So that caused bidders to consider proposing their income targets jumping off from that $995 million level. Sandy impacted us greatly for many months -- and I think even for the next couple of years. We didn't have a way to--

SENATOR SARLO: I just want to correct you -- impacted us, impacted the Lottery?

MS. HEDINGER: Yes.

SENATOR SARLO: Okay. And why, after-- Why did it impact the Lottery well after a year after the storm had hit?

MS. HEDINGER: I think it's the same reason it is still impacting families two years after the storm. There were many people displaced, there were many communities that suffered. I live at the shore; I saw for myself the tremendous economic impact in Ocean and Monmouth counties. And I believe that that impact rippled through the state for a long time after Sandy, and people who suffered from it would, I think, support that.

In ay event, the adjustment was made because of the impact it had on Lottery revenue, which was being represented differently to the bidders. So in fairness, an adjustment was made for that one year.

SENATOR SARLO: Is there a higher-- You may not have this data available by county, but is there a higher participation rate in these types of games in the Ocean and Monmouth county area?

MS. HEDINGER: I don't have that kind of data.

SENATOR SARLO: You don't have that kind of data.

MR. KNAPP: I don't either.

SENATOR SARLO: And that would be -- that would also really justify that -- a lot of folks trying to get back on their feet and didn't have the disposal income.

Okay, so the downward trend carried out almost into the FY 2015. And in your opinion, a lot of that had to do with Sandy.

MS. HEDINGER: I do believe it had a great economic impact to the State of New Jersey, yes.

SENATOR SARLO: And that's kind of -- when you look at, then, actual ticket sales from 2012, to 2013 to 2014, there's really not a big-- There's actually an uptick in actual ticket sales: $2.75 billion in 2012; $2.8 billion in 2013; and then it jumped to $2.9 billion in sales -- actual ticket sales, total ticket sales during that same time period. So how does that correlate? The total ticket sales going up, correlating to revenues coming down.

MS. HEDINGER: I think either one of us could answer that question. It has to do with a mix of games that sell. Some games are more profitable than others. We make the highest profit from draw games; we make a lesser profit from instant games. And it's that mix of games that determines the bottom line. So ticket sales can go up, while revenues will also go up, but maybe not at the same levels depending on that mix of games.

SENATOR SARLO: So there's a potential that during -- as the state is recovering from the Superstorm, ticket sales may be going up, but it's to the-- The tickets that are going up are not as profitable as some of the other tickets, where there was a drop-off? Is that--

MS. HEDINGER: Yes.

MR. KNAPP: That's right.

SENATOR SARLO: --correct?

MR. KNAPP: Correct.

MS. HEDINGER: Yes.

SENATOR SARLO: Okay. In FY 2015-- Well, let me just back up for a moment. Northstar's contract -- let me just focus on Northstar's payments -- for those who are here in this room and trying to learn a little bit more about this, Northstar is reimbursed or-- Are you reimbursed or are you actually paid for your administrative costs? How is Northstar compensated? Let's back up.

MR. KNAPP: So we are reimbursed for our administrative costs.

SENATOR SARLO: And what does that run a year?

MR. KNAPP: That is $19 million.

SENATOR SARLO: It's $19 million?

MR. KNAPP: Yes

SENATOR SARLO: Okay. On a yearly basis.

MR. KNAPP: On a yearly basis.

SENATOR SARLO: Roughly, on average.

MR. KNAPP: Yes.

SENATOR SARLO: Okay. And then what other compensation would Northstar receive from the State?

MR. KNAPP: So as we've been talking about targets--

SENATOR SARLO: Correct.

MR. KNAPP: --that is a trigger. So if we exceed a target, there's a process that takes place that's played out in the contract. So depending on where we meet a target that was established, we either get some incremental upside -- some revenue -- that's separate from our reimbursed expenses; or we go into a situation where we're paying a shortfall payment. So the two components we have are our expenses are reimbursed, and then, based on our actual sales performance -- which is the motivator for Northstar to work a little harder and do a little more, introduce more innovation -- that puts us in the place where we have the ability to make an incentive payment.

SENATOR SARLO: Okay. Maybe this is -- this came from our Office of Legislative Services, but it says, "Northstar New Jersey administration fee was $29 million in 2014." Now that included a $3.5 million management fee, a $9.3 million management expense fee, and a $16.3 million advertising marketing fee. So that $29 million -- you said $19 million -- that $29 million is reimbursable expenses?

MR. KNAPP: So they're separate-- What I didn't include with my number I gave you was there's a marketing and advertising budget that was established; it has a small escalate in it annually. But this year, for 2015, that was in the range of $23 million, $24 million.

SENATOR SARLO: Okay. And that's where you're trying to keep up with the national trends, and--

MR. KNAPP: Exactly; the on-air--

SENATOR SARLO: --curtail your games to the demographic changes, the Millennials--

MR. KNAPP: On-air advertising that you would see about the New Jersey Lottery; promotions that you would see at the store level -- that funds those programs.

SENATOR SARLO: Okay. And that's a reimbursable expense.

MR. KNAPP: That is.

SENATOR SARLO: Okay, thank you; good.

So due to the-- I know we had some weak numbers in 2014 and 2015; we talked a little bit about Sandy, the demographic change. What are your expectations now for meeting revenue projections in 2016 --

which were lower than the FY budget projections. Are you concerned-- As the Budget Chairman, should I be concerned that we're not going to hit FY 2016 revenue projections? Or are you-- We're closing in on six months.

MR. KNAPP: Yes. So as I reported in my testimony, in 2016, year-to-date, we are seeing very positive results of growth.

SENATOR SARLO: Good.

MR. KNAPP: We are up -- I believe it was 4 percent; is that-- Let me see if I can find that quickly for you. So we have good trends for the year that a lot of the innovation, a lot of the investments that we made earlier in our contract are now settling in, and retailers are finding the advantages and the time that we're spending with them -- they're having paybacks. So I'm confident that we are on the right track. The national games -- we've highlighted that quite a bit today -- the health of those national games play a big part in Northstar's success of meeting those targets that were set early on. And they were changed; the game -- the Powerball game was changed earlier last month, and we anticipate that will have a positive result and get us back on track.

SENATOR SARLO: Are you taking into consideration-- In your projection, do you take into consideration all the other forms of types of gaming that are available out there now -- the Internet gaming-- I for one am always talking about expanding gaming outside of Atlantic City to the northern part of the state. (laughter)

SENATOR KEAN: Really? I hadn't heard that. (laughter)

SENATOR SARLO: You haven't heard that?

Do you factor all of that into your projections -- what's happening in the surrounding states from gaming? Is that factored into your games' projections -- your revenue projections from your games?

MR. KNAPP: As much as we can, we do. It's a changing world; it changes very quickly. When you look on the Pennsylvania side of the border, they've expanded their gaming operations on that side for casino operations -- which don't appear to have an enormous effect on us, but it is another way for someone to spend that discretionary dollar. Rather than Lottery, they could be spending time at a casino. So it is in our plan, it's in our equation. But the market changes so quickly it's very hard to have a finite impact analysis done on it.

SENATOR SARLO: Yes. So we just talk about that. The budget calls for -- the FY 2016 calls for about $1.02 billion. I think the actual numbers that Treasury had put out for FY 2015 was about $960 million. Am I correct on that -- FY 2015 numbers were about $960 million?

MS. HEDINGER: Yes. The FY 2015 number is $960 million.

SENATOR SARLO: And the FY 2016 is $1.02 billion?

MS. HEDINGER: Yes.

SENATOR SARLO: Okay. So we have about an increase there of $60 million or so. At this point in time, it would be about 6 percent; a 6 percent increase. You're comfortable with that number heading into the last six months here?

MR. KNAPP: It would be very difficult for me to make a prediction of whether that number is achievable.

SENATOR SARLO: Understood.

MR. KNAPP: It does -- as I mentioned, the national game performance does play into that. If we have several jackpot rollups where we get up into the $400 million, $500 million jackpot level, the Lottery sales respond accordingly and bring in new revenue. It helps on a number of factors: number one, it drives new sales; but it also balances what you highlighted earlier -- at the bottom line, it also balances that 30 percent or that profit back to the State. It puts that back in balance because the national games are at a more blended rate of 50 percent prizes.

SENATOR SARLO: Maybe you don't know this -- the revenues that-- Are we doing this on a-- Are your folks from Northstar looking at-- You have a 15-year contract.

MR. KNAPP: Yes.

SENATOR SARLO: Are you projecting out-- Of course it's changing; we talk about this all the time, but changing revenues -- there's no exact science. But are you looking two, three years out at the revenue projections here, or are we doing this on a snapshot year-to-year basis? Wrap up one year, we finish $960 million; throw a minimal increase -- 6 percent increase; go to $1.02 billion-- Or are you projecting out five, years, six years--

MR. KNAPP: So I'll answer the question to say that we do an annual business plan and submit it to the New Jersey Lottery for their review, consideration, and comment, That plan drives what we do for the next 12 months. In the background, we internally at Northstar are looking beyond that one-year window; we have to, because we have innovation, as Carole had mentioned, that we deploy, that many times has a great lead time for manufacturing, or supplying and procuring. So we do have internal practices where we're looking out beyond the three years. But we take the approach of building almost like a bottoms-up forecast where we look at where we are; we look at what innovations we plan to add over the next 12 months; and then we build and layer on top of that how that would affect sales and revenue. So yes, we do.

MS. HEDINGER: May I add something to that, please?

SENATOR SARLO: Sure, please.

MS. HEDINGER: Looking at one year at a time, wrapping it up, and then moving onto the next year -- that was our world before this contract. The point of this contract was to establish strategic planning for longer than one budget year at a time.

SENATOR SARLO: And I'm going to just expand upon that -- and you talked a little bit about it in your testimony. The folks who were pushing for the privatization of the Lottery operations contended that in order to position our Lottery, to make it stronger in the future, it would require some of these innovative investments, significant investments in technology, and human resources; and that the State was not in a positon to budget. But if we're reimbursing Northstar for that, isn't it the same-- I get it; in the private sector that sometimes they do it better than how we do it here in government; and I appreciate that. But if we were going to do it ourselves, it's still costing us the same amount of money, because you're getting reimbursed for all of your research, investments, and technology, correct? You get reimbursed for all of that at Northstar?

MR. KNAPP: We are not. So for instance, the machines that we installed at Wawa, as an example, we're not reimbursed like-- We don't send the Lottery an invoice and they pay us back for that investment.

That's done on our IGT, which is a partner of Northstar. They make that investment.

SENATOR SARLO: Okay. So they're making the investment, and they're not being reimbursed for that.

MR. KNAPP: Exactly.

SENATOR SARLO: Okay. So as you constantly are researching and exploring ways to become more creative, all of that type of work is not reimbursed by the State of New Jersey, correct?

MR. KNAPP: So research takes many forms. We have Northstar staff whose salaries are reimbursed -- that their job is to do research. They feel the market, see what opportunities are out there that we might want to implement. So those types of investments are reimbursed by the New Jersey Lottery to our administrative expense.

SENATOR SARLO: My final question for now: When Northstar took this contract -- it's a 15-year contract -- did you assume that this form of gaming-- And as the demographics continue to change -- right? -- people run out to the convenience store and are buying the ticket, that demographic has changed. I know my dad did it all the time- -- faithfully did it.

MR. KNAPP: Yes.

SENATOR RUIZ: Mine, too.

SENATOR SARLO: And your dad too, right? And unfortunately my dad is no longer with us, but he was a faithful -- go to the local convenience store, get his--

SENATOR RUIZ: Was it boxed or straight?

SENATOR SARLO: I'm not sure what he did. (laughter) We weren't successful, I'll tell you that. He made his contribution to the State. When they went out and did that-- When you took this contract, did you build into those assumptions that this type of form of gaming -- that there was going to be a downward trend, nationally?

MR. KNAPP: So the national games are very difficult to predict, as Carole had mentioned, because they are -- they are jackpot-driven. And there's a point where the players had chosen -- the games were not rolling up often enough to a level that was appealing. It's almost as if each time a jackpot is hit, that's the new threshold and players don't get re-engaged as quickly as they would until you exceed that new threshold. So one of the challenges you see at the national level is driven by that change in the market.

We do recognize that our player base is not only aging, but it's changing considerably. And we are adapting and, as I mentioned in my testimony, as an example we just put these Fast Play games out in the market. They are instant-win games; you walk in, you buy a ticket, and you know instantly whether you win or not. They're exceeding even our expectations on sales. And I think what's driving that is, it's a new player who is coming into the market who is looking for that instant gratification. So we're trying to broaden the portfolio of products Lottery has in place, to appeal to a new market that we know is changing all the time.

SENATOR SARLO: I mean, clearly, yes. The new generation -- the younger generation is all about instant gratification, getting your immediate results immediately.

MR. KNAPP: You got it.

SENATOR SARLO: Not waiting two or three days for the rub off, or for the results -- to read them in the newspaper.

Just a final question: Right now, this is -- whether it's $960 million, or $1.02 billion, it's a billion dollar industry -- or billion dollar revenue to the State of New Jersey from Lottery. Do you envision that this industry will continue to reap those benefits for the State; will we continue to be a $900 million to a $1 billion industry 10 years from now? Or is this an industry-- I'm not going to hold you to this; I'm not going to hold this to you. I mean, I know this is a very difficult question. But across the country, should all states be saying, "Hey, 10 years from now this is no longer going to be netting us a billion dollars' worth of revenue. This may only net us $500 million worth of revenue." I mean, I think it's a fair question.

MR. KNAPP: Yes.

SENATOR SARLO: We all criticize each other here; everybody's worried about their next election, everybody's worried about the next budget. But it would be important to everybody to think a little bit outside the box. So 10 years from now, is this still a billion dollar revenue hit for the State, or is it a $500 million revenue hit?

MS. HEDINGER: Well, I don't have a crystal ball--

SENATOR SARLO: I knew you were going to say, but-- (laughter)

MS. HEDINGER: Although I actually do, at home, have a little crystal ball that I use to refer to.

SENATOR SARLO: I wish you did; I wish you did. We'd give you a performance bonus -- incentive bonus. (laughter)

MS. HEDINGER: If past is any indication of the future, for 45 years the Lottery has not only been very healthy, very vibrant, but it has grown. It has grown to an extremely vital source of revenue for the State. And that's for 45 years. And I would imagine that 45 years ago, people wondered if now, in 2015, we'd be wondering if it's still going to be healthy.

Lotteries are centuries older than our 45 years, and they have always been popular. I tend to be optimistic and think people have always loved a lottery -- they've always loved that ability to take a chance, and that they will continue to want to do that. Our challenge and our task is to be nimble, agile, and innovative to respond to the way they want to play those games. I think there will always be a place for a lottery. And one of the reasons -- I'd say a key reason -- why we entered into this contract: so we could have that kind of innovation and agility to be able to quickly respond to very fast market changes. When your father was playing the Lottery -- and I appreciate very much that he did; and I hope you'll all join him -- when he was playing the Lottery, games changed very infrequently, and that satisfied people. But it's not like that today. Even Candy Crush is losing popularity. And who plays Angry Birds anymore? No one. I only just learned how to play it, and it's already passé. (laughter)

So the makeup of game players changes much more quickly than it used to. I think that with technology and with the kind of resources that we have, we can respond to that.

SENATOR SARLO: Are you comfortable with the contract with Northstar, as the Director of the Lottery? Are you comfortable, no regrets? You feel it is in the best interest of the taxpayers?

MS. HEDINGER: You know, I have, altogether, about 15 years' experience with the New Jersey Lottery. And I'm extremely comfortable with the services that we are getting right now -- more comfortable than I have ever been before.

SENATOR SARLO: Thank you.

SENATOR GORDON: Thank you, Senator.

Senator Kean, you have a question?

SENATOR KEAN: Sure, thank you. Thank you, Mr. Chairman. It's always tough to follow Old Man Sarlo complaining about kids these days. (laughter)

SENATOR SARLO: We're the same age, there, Senator Kean.

SENATOR KEAN: That's what I'm saying, that's what I'm saying. You're two days older than me, or something like that -- or younger; I don't remember which.

SENATOR SARLO: I feel older, but I'm--

SENATOR KEAN: Okay. Be that as it may, we have three of the youngest Senators here in the room.

But the question I have, first and foremost, through you, Mr. Chair, is Rite Aid and Walgreens and that transaction that's going on -- does that have an impact on Lottery sales, as you see it?

MR. KNAPP: We're working with both firms to figure out if there would be an impact to -- whether they'll transition into the family, or whether they will continue to operate as Lottery retailers. We believe they're going to continue to engage in selling Lottery products.

SENATOR KEAN: Okay, so that would not have an impact.

MR. KNAPP: That's correct, as long as it's within -- if they stay within the network, it will not have an impact, yes.

SENATOR KEAN: And when do you anticipate that a determination will be made?

MR. KNAPP: It's a moving-- It's into next year; it's into 2016.

SENATOR KEAN: Okay. Now, the question I have for you is, if you're looking at the report that was referenced earlier by the Chairman, by Macquarie -- done by Deloitte, I guess -- and getting to the -- to put some numbers behind it, the core user of the Lottery product is -- here it says for 18 to 24 year olds, it's 1 percent. And the *core* meaning a weekly user; versus 25 to 34, it's 15 percent; 9 percent for 35 to 44; 45 to 54 is 9 percent; 11 percent; and then 6 percent. Your strategy is to try to increase that 1 percent from 18 to 24 year olds, for example, and as that age bracket grows, to expand it to closer, obviously, to 9 percent or 15 percent. Those games you're rolling out are part of that strategy?

MR. KNAPP: They are. Our most recent set of introductions have been geared towards that younger demographic, trying to make up for and bring them into the Lottery product family.

SENATOR KEAN: Okay. Now, if I may, through the Director, is it your sense that type of nimbleness is key to the successful growth as a revenue source for the taxpayers and people who rely on this? I mean, that type of ability to look at national trends, look at State trends, look at demographic trends -- it's helpful to the long-term health of the New Jersey budget and those who rely on the services that are provided by the Lottery, right?

MS. HEDINGER: Yes. I mean, we've always tried to be innovative at New Jersey; as a matter of fact, I'm very proud of the innovations that we've made over the years, as limited as they may have become because technology is necessary today to really remain vital in the marketplace.

SENATOR KEAN: So this partnership is -- and again, it's an extraordinary division; I think they've done extraordinary work over the years -- but this partnership for sales, marketing, and what have you allows for that nimbleness; that much more rapid response with the appropriate oversight by the State on those efforts.

MS. HEDINGER: Absolutely. I mean, in the last year alone, the number of games that we were able to introduce -- the new games we were able to put out into the marketplace-- And you know, creating a new game and starting to sell it is one thing; but educating the retail sales force on what that game is, producing the necessary kind of points of sale that need to be placed in the marketplace, backing that up with marketing and advertising support to educate the players to that game -- that's all part and parcel of it. With limited resources that we had before with a very small staff, it was practically impossible for us to launch, quickly, more than one game a year. In the last year, we introduced the Fast Play games, along with many new instant games, with new -- how shall I say it -- marketing support with retailers, and expanding the retailer base at the same time, all to reach these players who we're trying to reach. I think the Wawa stores are key in that effort to reach new players, especially the demographics that we're looking for. And we couldn't have done that without Northstar.

SENATOR KEAN: Okay. So getting back to Senator Sarlo's question regarding the long-term health of this segment of revenue, first and foremost, but also expense because the benefits that this revenue does for certain residents of the State of New Jersey. That health, as you said earlier, is-- You feel even more optimistic now because of the ability to manage appropriately.

MS. HEDINGER: Yes, I'm more confident that we can manage the Lottery into the future with a secure and steady stream of revenue.

SENATOR KEAN: Okay.

Thank you, Mr. Chairman.

Thank you.

SENATOR GORDON: Thank you.

Any other-- Senator Ruiz, do you have a question?

SENATOR RUIZ: Thank you, Chairman.

Good morning, everyone. A couple of questions -- I think it was just piggy-backing on the questions that Senator Sarlo was trending towards.

I recall my dad used to play -- avid player -- and then, even in years past, the Lottery was trying to reinvent itself with the 12 o'clock Pick 3. Remember, that's something that's fairly new that he engaged in quite frequently. So his walks to the store started before noon, and then before the call times for the evening.

It appears that you all are internally, continuously looking to see how you can engage the next customer for gaming. Do you think that online or Internet ticket sales is going to be the next frontier and something that will generate great revenue? Are you leaning towards that in a very direct way, hanging your hat on that, possibly, for generating more revenue?

MR. KNAPP: So as I had mentioned earlier, we do always have a -- we try to maintain a five-year view of where we're going to go over the term of the contract. Because, as we've talked about, it's a long-term contract. Selling Lottery products over the Internet is a logical next step for the Lottery when it's right for the market. That doesn't mean we rush to it; a lot of lotteries had rushed to it; but we have, in our longer-term plan, trying to figure out where it fits into the market.

So yes, to your question. We do look at other ways of innovating and broadening the Lottery's portfolio or the way they reach players. As I mentioned in my testimony, we did quite -- we reengineered the Lottery's website and put a new one on the market. And that enabled us to really get into the social media side of engagement with players. So we have a whole group in our marketing group in-house staff that uses Facebook, uses Twitter, YouTube; we really try to engage the player at another level than the previous Lottery wasn't able to, because they didn't have that technology.

So we're continuously looking for ways to expand the Lottery -- not only in just general sales of its current games, but also how can we broaden the portfolio and make it more attractive to a wider audience.

SENATOR RUIZ: Thank you. And I believe in one of the opening statements there was some nod to creating over 100 private jobs in the timeframe when Northstar came on. I guess my question overall is, do you think that the Lottery would have had this same outcome? I mean, there's some uptick; I think it was close to 5.1 percent increase in sales in someone's testimony opening, bringing on this workforce. Do you think there would have been that same kind of outcome had you not outsourced this component to Northstar, and just hired, maybe, a portion of those individuals and brought them onboard with a different mission and focus?

MS. HEDINGER: Very simply -- no. Even if I had been able to acquire more human resources in the sales department, they would have required training that we could not have given them; training that they get from the industry experience of Northstar. We would not have had the ability to make the investments in the equipment that Northstar has made; so even with an additional sales force, we wouldn't have been able to supply the kind of equipment necessary to bring on the Wawa and the Rite Aid chains, for instance. So just hiring more people was not the answer; we needed human resources, we needed technological resources, and we needed economic resources. Those are the resources that Northstar provides.

SENATOR RUIZ: Thank you.

SENATOR GORDON: Thank you.

Just a couple more questions.

For Fiscal 2015, you've reported that you now expect $960 million to be going over to the General Fund. Does any of that include performance penalties for the failure to meet the target in 2015?

MS. HEDINGER: Yes, it does.

SENATOR GORDON: Can you estimate how much that is?

MS. HEDINGER: It is $12.9 million

SENATOR GORDON: Okay.

MS. HEDINGER: In addition -- $12.9 million, in addition to the $5.89 million credit that was remaining from the initial $20 million credit that they were allowed to use.

SENATOR GORDON: Okay.

A question for Mr. Knapp. How does the trend in your cost compare with the trend in revenues? I mean, are you expecting a growth in revenues to outstrip your increase in costs that you project for the next few years?

MR. KNAPP: Could you qualify *cost,* so I understand your question properly?

SENATOR GORDON: Well, I guess the costs that are required for operations: personnel, marketing, and so on.

MR. KNAPP: So I believe we are -- the current staffing is the proper staffing to run this enterprise. I don't see it expanding; I think reducing it would have an impact on our ability to service retailers. Again, 70 percent of our workforce is in the field, working with the retailers; engaging them, making sure that they have a reason to sell Lottery products. So our workforce is really geared to go out in the marketplace. So I think we're in good balance as far as--

SENATOR GORDON: So you're now at the level of investment of personnel, and--

MR. KNAPP: That's right.

SENATOR GORDON: --and other operating expenses that will -- you see that as stabilized.

MR. KNAPP: I can carry forward with that investment.

SENATOR GORDON: Okay.

A question for the Director. I think in response to the Sandy situation -- so-called *adverse event* in the contract -- you made a decision to reduce the -- you made contractual changes. And I don't think those were made public -- that decision was made public before the decision was made.

Would you be able to provide advance notice on any future contractual changes so that the Legislature and others have a chance to react to that?

MS. HEDINGER: I think the area of contract is complex, in terms of the involvement of Treasury officials and the Attorney General's staff. It's not my decision; it's a group effort whenever anything that has to do with a contract is brought up. I don't know that I can really answer your question.

I would say this: It would not be the Lottery's intention to, in any way, keep secret something like that. But to the extent that notice is given -- I don't know that I'm in control of that.

SENATOR GORDON: I think this may be just one of those areas in contract management that may require some legislative changes on our part, such as a requirement that any substantial change in contractual terms be made public so that there could be some discussion and evaluation of that.

Worst case scenario: If, for some reason, the Lottery Commission had to terminate the Northstar contract, what's Plan B? What would be required to get back up to speed? We're following what's going on in Illinois, and they seem to be struggling to get their operation back together. I mean, is there any kind of contingency plan for such things?

MS. HEDINGER: The contract contemplates disentanglement for various reasons. Depending on the reason -- a termination, for instance, for cause, which would be New Jersey terminating the contract -- there are provisions, depending on when in the life of the contract that occurs, for retaining needed and necessary services until transitions could take place.

I would say it would almost be like reversing the process we did to implement the contract. We would have to do it in reverse. To get it down to some simple terms, we would have to hire up the necessary staff to support a retail network at whatever level that is at that time. I mean, right now it's 820-some higher than it was when Northstar assumed responsibility for the retailers. We would have to hire that staff; they would have to be trained; we would have to transition over a marketing staff or acquire a marketing staff, something that we really didn't have before. It would take substantial planning, I think, very careful planning. I think it would be extremely difficult, but it could be done if it were necessary. I don't know what's going on in Illinois with their attempt to-- I mean, right now they don't have a budget, and they're not even paying their prizewinners. So I think they have some serious problems that have nothing to do with the contract.

But there are provisions in the contract for how we would disentangle.

SENATOR GORDON: Okay. In, I believe, February of 2015 there was an audit report done by the Office of the State Auditor, who is a legislative -- it's a legislative office focused on those prizewinners who owe the State money. I gather this has been, kind of, a long-standing issue; there are people who owe the State, owe child support, or outstanding -- or have been overpaid public assistance, or they have defaulted on student loan debt -- and the State Auditor, looking back at, I believe, one year of data, said that if there had been a process in place that would be able to match prizewinners with those who are in debt to the State, the State might have recovered as much as $890,000. And I know the Lottery Commission has been working with the Attorney General in dealing with issues about the use of Social Security numbers to track down these people. Can you give us an update on where things are in trying to deal with that problem?

MS. HEDINGER: Yes. We responded to the OLS audit by looking into what could we do to better match our prizewinners against the various agencies in the State to whom debts are owed. We are working with our Deputy Attorney General to revise regulations that will allow us to go beyond what we're currently allowed to do. Those regulations are in review; there will be a public comment period in the future. I don't have a date for that. But we expect, I would say, in early 2016 that we'll have everything in place.

We did ramp up whatever kind of matching we could do and that we're allowed to do to improve the process. But as always, we try in every way -- not only with our prizewinners, but even with our retailers -- to make sure that all their debts are paid.

SENATOR GORDON: Okay, thank you.

And finally, not a question, but just an observation and, really, a comment I'd like to make to my colleagues about a need for legislative change.

Today's *New York Times* editorial, and I think the lead story in the *Record* today, focuses on the problem of inversion -- corporate inversion, whereby a major corporation will, through merger, change its tax domicile. The story today is about Pfizer and Allergan essentially changing their tax home to the U.K. to reduce their tax obligation. This is pretty much what happened with GTECH and IGT -- at an earlier time, admittedly -- but the merger that was announced in 2015, but reported in 2014, showed that the merger of -- the acquisition of IGT Italy of GTECH, and the immediate acquisition of IGT U.S., resulted, after this convoluted process, in the moving of that entity to the U.K. for the purpose of reducing tax liability.

Now, I understand that the leadership of these organizations is trying to do what's best for their shareholders. But in the case of organizations that are serving public sector entities as their customers and that are subsidized by the taxpayers, I personally have some concerns about contracting with those organizations. At the very least, I think it should be a factor considered in making decisions about contracting. And I may well be developing some legislation to require that factor to be considered as we go forward with the contracting process.

Are there are any other questions for these witnesses?

Senator Kean.

SENATOR KEAN: Yes, I think there have been many conversations regarding the Federal government's inability to get their house in order--

SENATOR GORDON: Yes.

SENATOR KEAN: --regarding making sure you make the entire country more affordable for every citizen and everybody else. So I think that's an issue that can be discussed at a future time and place.

SENATOR GORDON: Okay.

If there are no other questions, let me thank you both for appearing here and for your responses.

At this point, we will hear from Seth Hahn, the Communications Workers of America.

MS. HEDINGER: I want to thank you for the opportunity to answer your questions and present our testimony.

MR. KNAPP: Also, here. Thank you.

SENATOR GORDON: Thank you.

Mr. Hahn, welcome.

S E T H H A H N: Thanks, Senators -- or Mr. Chairman.

SENATOR GORDON: Do you have an opening comment?

MR. HAHN: I do; thank you.

My name is Seth Hahn; I'm the Legislative and Political Director for the Communications Workers of America. We represent 70,000 working families in New Jersey, including-- Well, we used to represent 64 workers in the sales and marketing division at the Lottery before those functions were privatized in 2013.

We do, still, represent some workers at Lottery; we represent those involved in functions such as processing paperwork for vendors, data entry, managing electronic fund transfers, and testing some games.

Thank you for holding this hearing, Senator; and I would just like to start out by saying that this process is everything that people hate about politics in New Jersey. You know, we had, by any measure --- New Jersey had one of the most efficiently run lotteries in the country, if not *the* most efficiently run Lottery in the country. And the idea that we would take that -- that thing that has a $3 billion asset, and as soon as private companies come around and start throwing money at politically connected operatives and lobbyists, we start talking about privatization. And then you have the same companies start throwing around money to political counts (*sic*) that are not covered under State pay-to-play laws. Then you have, almost immediately, sweetheart -- well, what looks like sweetheart deals being cut so that performance isn't really something that is necessary. Then you have revenues being lost, taxpayers being on the hook, and really no oversight and nothing done to really stand up and protect the taxpayers of New Jersey. This is everything that people think is wrong with the political process in New Jersey, and it's hard to fault them for thinking that.

Before I start, I would just like to say that we need to not lose sight of one overarching fact here, and that is that under the public worker Lottery, if we had just maintained sales growth that the public workers sales force and marketing force had maintained between 2007 and 2012 -- right? -- so if we had just maintained the annual growth that the public workers had maintained during the middle of a recession, this year we would be on track for $987 million coming back to the State, and next year we would be on track for more than $1 billion. So that's actual real money, and that's money that goes to do things like helping to provide housing for homeless veterans; it goes to community colleges; it goes to tuition aid for students; it goes to a range of things that are absolutely critical for people who are underserved and who need services in New Jersey.

And this was really a process that was very problematic from the start, and shows the need for systemic reforms in the way we go about privatizing things in New Jersey. In December 2011, the Christie Administration released a Request for Information, soliciting options for increasing net revenues received from the Lottery -- including possible privatization. The study was conducted by Macquarie Capital, and this was really the first part of the problem. Macquarie is one of the world's leading proponents of privatization and corporate takeover of public wealth, and its conclusions were never in doubt.

Despite producing a study that showed New Jersey's Lottery was growing at a rate that far exceeded national and regional averages; despite the study noting more than a decade of consecutive record sales -- and it also made note that New Jersey was an award-winning Lottery that was among the most efficiently run in the country -- Macquarie recommended sales and marketing functions should be privatized. As I mentioned, average net growth, between 2007 and 2012, was 1.9 percent a year; and Macquarie, very arbitrarily, just decided that, moving forward, every year for the next 15 years we could only anticipate a 0.9 percent revenue growth -- less than half of what we'd had during the recession. And that 0.9 percent becomes very important, moving forward, because Treasury just accepted that without really questioning what that should be, and that 0.9 percent is now the base net increase. And if Northstar does any better than that whatsoever, they start getting a good-sized chunk of the net sales.

The Request for Proposal was released in August of 2012 -- and it was substantially similar to the proposal in Illinois; it entered into an agreement with Northstar's equivalent in Illinois in January of 2011. Following a single-bid received, the contract was awarded to Northstar on June 20, 2013.

I do want to take a second to talk about the single-bid received. The State has argued that it doesn't matter that only one bid was received; that Northstar didn't know it would be the sole bidder, so it was forced to put forth what it deemed to be a competitive bid and, therefore, taxpayers were protected. This is nonsense. First of all, the fact that the New Jersey RFP was nearly identical to that of Illinois, in which Northstar won the contract, should indicate that, at the very least, Northstar was the preferred vendor to receive the contract. Secondly, there were three non-public entities in the world that can manage a lottery this size -- and they were really the only three who were seriously considering putting a bid in in New Jersey: they were GTECH, Scientific Games, and Camelot. GTECH and Scientific Games knew that they were going to put in one bid together; and it was well-known early in the process. I mean, I actually knew in March that-- I actually knew well in advance that Camelot was no longer seriously considering putting in a proposal. And so you have two of the three companies deciding they're going to put in one bid; and you have the Governor's budget that is dependent upon $120 million in upfront payments -- and that means that Northstar really had a lot of leverage. They knew they were going to be the one bidder, and that they had $120 million that the State was going to be dependent upon in its budget. And under those circumstances, it's incredibly difficult to make a credible argument that taxpayers really got the best deal that they could get here, and that Treasury really sought to go back and forth and get the best sales projections that they possibly could.

So that $120 million upfront payment is very problematic; and I think that certainly we can all agree that companies coming in and giving the State big chunks of money upfront to win a privatization contract is very problematic.

The contract stipulated that Northstar receives between 5 and 30 percent of revenue growth if it exceeds 0.9 percent a year, capped at 5 percent of net income. And I will say that this comes as -- that some of these revenue -- the lagging revenue comes as the new company has had certain advantages that the public -- that the Lottery didn't have under public workers, right? So selling to companies like CVS and Wawa was not something that the public workers were allowed to do under the old Lottery. There have also been the odds of some of the national games -- your odds of winning have been decreased, right? So you actually get to keep more of the revenue coming back from the tickets, because less has to go out in the form of awards, right? And so actually, under these circumstances, one would expect that Northstar would be doing even better than the baseline would suggest.

I do want to touch-- People talked about some of the differences between Illinois and some of the similarities. I want to touch quickly on two very important ways in which the Illinois contract was different from New Jersey. First, in Illinois, Northstar simply managed the state lottery workers. It was a contract for management, not to actually run those services; whereas in New Jersey, those workers are now Northstar employees. That means many of the State workers were rehired by Northstar when the contract was awarded, and many of those were close to retirement age or eligible for retirement, but were not ready to retire. So there are many workers now receiving a salary to work for Northstar, as well as their public New Jersey pension. What this means is that the Administration was so ideologically committed to privatization that it was willing to accept higher employee costs to obtain the same work.

The second way in which it was different is the arbitration process for disagreements; and again, this is very problematic in how this came about. In November of 2012, Northstar was falling hundreds of millions of dollars short of revenue projections in Illinois. When Illinois tried to protect taxpayers and recoup some of those losses, Northstar took Illinois in front of an arbitrator seeking more than $230 million in concessions from the state. The arbitrator denied Northstar's request, allowing Illinois to obtain penalties.

In response, the RFP in New Jersey was altered to make clear that a New Jersey arbitrator would not have the ability to make a similar decision in New Jersey. So to be clear about that: A contract was awarded to a company in Illinois; after the company came in more than $100 million short of its revenue projections, it sought nearly a quarter billion dollars' worth of concessions from taxpayers. And seeing that, here in New Jersey, what we did is we not only hired the very same company, we increased the leverage that company has to sue taxpayers.

Almost immediately, revenue projections were lowered by the Administration. In January 2014, the State and Northstar agreed to lower base revenue projections using the adverse action process of the contract. The adverse action, in this case, was Hurricane Sandy, which made landfall in October of 2012. Between Sandy making landfall in October 2012, and the contract being awarded in June of 2013, and Northstar assuming control of sales and marketing functions in October of 2013, there were exactly zero references by the Administration and Northstar officials that sales would be down 15 months after Sandy, due to Sandy.

By the way, this adverse action section of the contract specifically states that another adverse action may be the expansion of gambling outside of Atlantic City. So if there are actions in which gambling is expanded, you can expect Northstar to come back to the State and say, "We need to lower revenue projections even further."

Once the ridiculous claim that Sandy caused sales losses could no longer be asserted, we heard a new ridiculous excuse -- jackpot fatigue. Again, what we heard in October of 2013 from the Administration and Northstar was that revenues would grow; that they would likely grow explosively -- more than 5.9 percent. And at no point in the two years of this process did anyone associated with it utter the words *jackpot* and *fatigue* together, nor does this explain why revenues to states are increasing in four of the nation's eight-largest lotteries.

It is a little bit more difficult for us to talk to some of the workers there now, but I do want to highlight some issues that they have brought up in preparing for this. First, the number of employees has nearly doubled to achieve a slight increase in sales. There were 64 CWA members involved in sales and marketing, and workers now estimate that that number is a lot closer to 120 workers involved in sales and marketing.

Before privatization, the marketing department was three people; now it's closer to a dozen. Legislators should ask why it takes a doubling of staff to raise roughly the same amount of money from the Lottery.

It brings us to a second issue: Workers are reporting that the work of servicing vendors is being diced up so much that it's getting in the way of productivity. When workers were State employees, there was one worker assigned to handle all aspects of sales to each individual vendor; now there are three. Under the Northstar system, there is one worker who handles the application -- this includes filling out the application, obtaining banking and personal information, a background check, and other initial duties. Another worker is assigned to deliver game materials and provide maintenance; and another worker, still, delivers promotional materials and helps educate about the type of games available. Legislators should ask if management structures at Northstar are causing inefficiencies that did not exist when sales and marketing was run by the State.

Another issue is the licensing renewal process. Licenses to sell Lottery products are required to be renewed each year. Under State management, the sales representative would help vendors with this process. Now, the forms are simply mailed out, filled out, and mailed back in. Not only can this be complicated for vendors, it carries increased security risks of the State's assets. Instead of a sales representative knowing the store owner and being able to detect for fraud or monitor if a business has changed hands, now there's a diminished link between the State and vendors, increasing the risks to the State and the integrity of the games.

I think there was a question about some of the money being owed back to the State. Well, when you have a worker who is in a store on a monthly or quarterly basis, and helps filling out forms and doing things like that, they can often detect for fraud very quickly to see if something is going on to get around the State garnishing a winning. Whereas, if all you're doing is mailing out forms, front and back, you can't really do that.

So legislators should ask whether measures designed to cut corners and lower costs by Northstar are leading to increased risk of fraud or losing money.

Next, while recent reports that numbers of vendors are increasing, legislators should ask specific questions about what types of vendors are increasing. Workers report that mom-and-pop stores, particularly those in poorer areas, are leaving in droves. This is because Lottery used to tailor packs of games to specific vendors, a procedure that has now stopped under private management. If you're in a poor area, and you'll never sell a $30 ticket, but you will sell lots of $1, $2, or $5 tickets to a specific game, then why include the $30 tickets in a pack to a vendor who doesn't want it? Now, if you're a vendor, you could be on the hook for rolls of very expensive tickets you'll never be able to sell and, therefore, drop out if you can't afford those tickets.

There is an issue in the sharp increase in the number of tickets being returned, and whether this is changing the reported odds of the games. Here's how this system works: Vendors buy a pack of tickets for games; and once 90 percent of the low-tier winning tickets in that pack are cashed in, the vendor has to pay for all of the tickets in that pack. But now that vendors are being stuck with the more expensive packs and the more expensive tickets, workers report that the number of tickets being returned has gone through the roof. It used to be that the only time a ticket would be returned would be if a game had ended, or the big prizes were done and the State was moving on to a different game. Now you have lots of tickets being returned because vendors don't want to take the risk of accepting the liability for all those high-end tickets.

Here's why that's a problem. On the State's Lottery website, it lists the odds of all the games and how many winning tickets are available. For example, let's say there's a game and there are five \$1 million prizes. The game starts, and two of those tickets are sold. Now a player knows there are three \$1 million prizes left. Many players will go online and check these numbers to determine if there are any winning large pots left when making decisions about what games to play next. But if vendors are sending packets of tickets back to avoid being on the hook for a bunch of those \$30 tickets they know they'll never sell, they could be sending those \$1 million winners back. This means you could be telling players there are three \$1 million awards left in a game, when all the \$1 million tickets are sitting in a warehouse somewhere waiting to be destroyed.

Not only that, now you've changed the reported odds of winning. So legislators should ask how many tickets are being returned, and whether there are concerns about the odds being altered.

Finally, workers believe that Northstar is setting up computer systems to take control of the electronic fund transfers from the State. This would mean that the State wouldn't even have the ability to control its own money. This would obviously raise some very serious issues, given the performance so far. Legislators should be asking if Northstar has any intention of trying to take functions currently being run by State workers and bring them under private management.

I'd like to close by making two points. First, when a State worker is hired, that worker has a four-month working test period. If anything goes wrong, the worker has another two-month period. During those six months, a worker can be terminated for failing to meet any and all performance goals. Why is it that an entry-level worker can be discarded so easily, but a vendor put in charge of a $3 billion asset that raises $1 billion a year of revenue for the State can fail this spectacularly and still receive nothing but the highest praise from high-ranking State officials?

By any objective measure, this experiment with privatization is failing. Revenue and efficiency are down, even though the Lottery now has advantages that weren't there when it was State-run. Taxpayers are not being protected. This doesn't have to be a partisan issue the way it has been in New Jersey. Legislators in both parties should demand that Governor Christie do what the Republican Governor of Illinois recently did, and fire Northstar and bring the work back in-house.

Second, looking at the issue of privatization with Lottery -- the problem is that this is the norm in New Jersey; it's not the exception. Whether you look at the Department of Motor Vehicles -- which was privatized after an aggressive push from a politically connected firm that threw around campaign contributions, and then completely abandoned commitment to upholding proper levels of service -- the result with that was such a disaster, the agency was brought back in-house six years later.

NJN, New Jersey's public broadcasting network, was privatized in 2010, the rationale being that private ownership of television production and programming would lead the network to abandon its out-of-date technologies and upgrade its facilities. Flash forward to this year, when taxpayers are now on the hook for almost half-a-million dollars so that the private company can purchase the new technology that was the reason for privatizing NJN in the first place.

Whether you look at Corrections, contracting with a firm to deliver in-prison health care; whether you look at the *New York Times* revealing the hell-on-earth system of privately run prisons and halfway houses in New Jersey; whether you look at the private company trying to do social services computer software, where we're now $100 million in the hole, and it's so broken that we have to start over and contract with a new firm -- the problem is that the system of privatizing government work in New Jersey is completely broken; and we need much stronger protections in place to ensure that that won't happen.

We already know how the next big privatization contract will be won. We already know what the results will be. And if we can't agree on reforming the way that process is done, with real oversight with teeth from independent managers, then we need a bipartisan effort to put a freeze on privatization until taxpayers and consumers can count on at least a small degree of protection.

Thank you, Mr. Chairman; that's all I have. I'm happy to answer any questions you may have.

SENATOR GORDON: Thank you very much, Mr. Hahn.

You raise a number of important questions that I think this Committee should redirect to the Lottery Commission. I wish we had heard some of these issues before.

As you may know, I introduced some legislation in response to my work with Professor Fine -- and we're going to hear from her very shortly -- that will attempt to improve the contract management process.

Can you offer your own suggestions on what kinds of systemic reforms are necessary to better manage our contracting process?

MR. HAHN: My understanding of that legislation is that there are protections in place that provide regular review of some of these contracts. I think that's a very good idea. I think there are provisions of that legislation that require that you can't just go in and achieve savings on the backs of workers. I think that's a good idea. You know, we're actually going to be talking about a private company coming in and being more efficient. That should mean more than just workers get paid half, and a CEO gets paid more.

I think there are provisions of that legislation that may extend some of the pay-to-play prohibitions in New Jersey -- maybe to Federal or other political entities. I think that's a very good idea. You know -- I mean, I think another big thing here is that the $120 million upfront payment was -- the cynic could very easily call that something that could really persuade an Administration through means that are less than savory. So I really think that maybe a piece of that legislation could be that we don't allow those big upfront payments to come in and try to persuade legislators -- or, at the very least, that money should have been placed in escrow to protect the taxpayers against future losses instead of going to plug a one-time budget hole.

But I think the legislation you've talked about is generally on track, Senator.

SENATOR GORDON: Okay. Thank you very much.

It seems as if I've been abandoned here.

MR. HAHN: Nobody wanted to hear what I had to say, huh? (laughter)

SENATOR GORDON: I'm sure that's not the case.

Let me thank you for your presentation. I certainly have focused on this issue of contract management and what I perceive to be failures in our ability to manage contracts. We're going to hear from Professor Fine shortly about some of this, but I thank you for your assessment of the Lottery situation.

MR. HAHN: Thank you, Senator.

SENATOR GORDON: Our next witness will be Eric Richard of the AFL-CIO.

Mr. Richard.

E R I C R I C H A R D: Good afternoon, Senator Gordon. Thank you very much for the opportunity to speak before you today.

Again, my name is Eric Richard, representing New Jersey State AFL-CIO. And I just, first and foremost, want to thank you for continuing your pursuit; as you said when you opened this hearing, getting into the weeds. There are few committees that I feel get into the weeds as deep as you do on this Oversight Committee.

SENATOR GORDON: Some people call me W*eedman*. (laughter)

MR. RICHARD: But we appreciate you taking the time to move forward; and sincerely, Senator, from the-- You're one of the few who I think goes to the depths required to try to find solutions to these types of problems. And we thank you for that.

Some of the previous folks on the Committee have spoken specific to the Lottery. I was going to present to you some of the bigger picture issues that are legislative-specific to privatization; and also talk a little bit about hat's happening in other states on this issue; and hoping that here in New Jersey we can finally, hopefully, find a bipartisan solution or consensus to begin to move forward.

I think we all recognize, at this point, that regardless of our positions on privatization -- and privatization is called a lot of different things. I heard someone say it references *outsourcing*. We deal with privatization from a context of subcontracting. No matter what you call it, it all results in typically the same type of result. And I think, again, regardless of our philosophical or political leanings, in support or opposition to privatization, we can all come together and agree that the interests of taxpayers, that the interests of residents has to be front and center when considering the merits of these types of contracts. After all, these are the folks who depend on these services, and these are the folks who, frankly, pay for those services.

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 of contracts prior to them moving forward.

Today's hearing brings attention to what we consider to be yet another example of privatization gone wrong, specific to the Lottery. But we all recognize that surely this is not the first time and, unfortunately, I think this perhaps won't be the last time that this type of egregious failure of privatization and contracting out happens here in the State of New Jersey.

Let's all be frank with each other. The types of privatization practices, where taxpayer dollars are squandered, where political interference is rife, where workers lose their jobs and then a portion of them are hired back at a significantly lower salary with few, if any, benefits -- this keeps happening. It keeps happening time and time again. That's certainly not good government, and it's certainly not being a good steward of taxpayer dollars. Something must be done now.

The alarm bell has been going off on this. The previous -- Seth Hahn, who had testified previously, mentioned some of the other privatization practices. The alarm bells on this issue have now been going off for over two decades, since the debacle that occurred on DMV back in 1995. When are our elected officials going to begin to hear those alarm bells? I know government moves slowly, Chairman, but I'm hoping that it doesn't move as slowly as it has been on this issue over the past two decades.

To illustrate that this is not a Democrat or Republican issue, you can look to recent legislative action taken on the issue in deep red states, such as Texas and Louisiana; as well as deep blue states, such as Massachusetts and California. In 2014, Texas passed legislation increasing transparency, limiting no-bid contracts, increasing and strengthening conflict of interest laws, and creating an accountability system to measure contractor performance. California is advancing legislation focusing on wage and benefit protections for employees contracted by the state Public University System. And Massachusetts, of course, as some of us may know here on the Committee, has been perhaps the strongest leader on this issue. Back in 1993, they passed what is referenced as the *Pacheco Law.* The Law had several 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 my testimony and has been provided to the Committee. The conclusion stated that the law prevented -- again, this is back in 2004 -- stated that the law prevented $73 million in questionable privatization decisions and has "effectively delivered good management practices" to private contracts, which now allows the government of Massachusetts and the agencies of Massachusetts to accurately judge the cost impacts on taxpayers of contracting.

The Pacheco Law is basically what the model was for S-770 of 2014, sponsored by Senator Weinberg, here in New Jersey. That bill, unfortunately, was vetoed by the Governor, but it was modeled after many of the best practices involved in the Pacheco Law. The New Jersey bill, unfortunately, was not bipartisan; my understanding is that it was viewed by some as purely a product to protect unionized workers from privatization, rather than what we hoped -- that it would take a look at, in regard to a compilation of best practices. And though the New Jersey State AFL-CIO believes that wage and benefit protections should be front and center when talking about reforming the contract practice, after the Governor's veto we recognized that we must move past that in order to advance a bill that helps taxpayers.

And so we urge the Legislature to revisit this bill; to have representatives of the Governor's Office, representatives of both parties review, jointly, what they feel can be achieved. Perhaps a bill simply embracing the cost-benefit analysis and a post-contract audit are more palatable at this time. These concepts were strongly embraced by Dick Zimmer, the 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 contract should go forward." The bill then requires an annual post-audit if the contract was privatized, to assure actual net reductions in costs and therefore realized savings to taxpayers.

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

We appreciate your attention to this matter, Chairman, and the AFL-CIO stands ready to work with those who are willing to make an effort to protect taxpayer dollars in contracting and outsourcing.

Thank you.

SENATOR GORDON: Thank you very much, Mr. Richard.

As you know, I've been working on this subject for over a year. I have a bill that addresses a number of the recommendations that you made. And it's, hopefully, a bill that will see some action soon. (laughter)

Do any of my colleagues have questions?

SENATOR KEAN: I'll follow your lead, sir, if you have--

SENATOR GORDON: Senator Sarlo?

SENATOR SARLO: Yes, I have a question.

And I apologize; perhaps I was on a call in the back. Maybe I should have directed this to Seth, but on the Northstar privatization, do you have the approximate number of employees who actually were State employees who now work for Northstar? Do we have a number on that, or--

MR. RICHARD: I believe Seth did mention that in his testimony.

SENATOR SARLO: I know, and I apologize.

MR. RICHARD: Yes.

SENATOR SARLO: I was in the back.

MR. RICHARD: I don't know the -- I don't know if Seth is still here.

MR. MAGYAR (Committee Aide): It's 37.

SENATOR GORDON: Thirty-seven.

SENATOR SARLO: Thirty-seven? Okay.

MR. RICHARD: I can get you the details; he did mention it in his testimony. I just don't know off the top of my head.

SENATOR SARLO: But 37. And all of them came in-- So from your perspective, from the AFL-CIO's perspective, how many employees were laid off from the workforce on that deal, as part of the Northstar privatization?

MR. RICHARD: Frankly, Senator, I don't know off the top of my head. I kind of left the details of that to the union that represents those workers. I don't know off the top of my head.

SENATOR SARLO: Right.

What was that, Mark?

MR. MAGYAR: I think it was-- I think it was listed as 62, and not a--

SENATOR SARLO: Approximately 62?

MR. MAGYAR: I don't know if they were laid off or transferred. But it would have been -- 25 would have been cut.

SENATOR SARLO: You know, because we were pushing them a little bit on their administrative costs.

MR. RICHARD: Yes.

SENATOR SARLO: Because if their administrative costs keep creeping up year in and year out, what are we gaining, right? Because now we're paying for their administrative costs.

My concern with that contract is that we reimburse them for their administrative costs, dollar for dollar.

MR. RICHARD: Understood.

SENATOR SARLO: And how do we control and cap their costs, you know?

MR. RICHARD: I couldn't agree with you more, Senator. And frankly, we shouldn't be looking at those types of "cost savings" with blinders on, right? It doesn't take-- You know, a lot of these privatization firms are saying that there are innovative approaches to cost savings, and so on, and so forth. It doesn't take much to simply cut benefits, cut salaries from workers, and then pass that on as innovation. It's important to make sure-- And that's why we pushed for the cost-benefit analysis so strongly prior to that contract being awarded. Let's look at the details of where these savings are truly coming from. Are they coming from inniovation, or are they simply coming from laying off your existing workforce and then hiring a percentage of that workforce back at a significantly reduced salary and no health care, and no benefits?

SENATOR SARLO: Right. Being creative, and innovative, and all those things, and looking at big picture items, right? That's not savings, right? If you're going to tell me you're bringing in folks who have this national experience, and they're going to bring those ideas here to New Jersey, and they're going to invest some-- That's a different scenario. But if you're just telling me you're going to -- the way you're being innovative is laying off 40 employees--

MR. RICHARD: Efficiency, we're all for. Cost-savings for taxpayers, we're all for. At what price? Who's bearing the brunt of those "efficiencies," and are taxpayers actually seeing the return on those privatized contracts? That's why the cost-benefit analysis prior to awarding the contract is so important.

SENATOR SARLO: Thanks, Eric.

SENATOR GORDON: Mr. Richard, are there-- You mentioned Massachusetts. Where do we look for model legislation in the contract management area?

MR. RICHARD: Model legislation for contract management -- I mean, there are two examples; and I can bring you a host of resources, Chairman Gordon. But here in New Jersey we've had some pretty significant experience with this already. The Rutgers academics are bringing forth the bill we wholeheartedly endorse -- which is contract oversight, that's now pending in the Legislature, that contains a list of best practices. And of course, the bill I just mentioned, which has now been vetoed by the Governor twice, basically pulls together all of the various best practices from throughout the country, particularly the legislation that advanced in Massachusetts, to be implemented here in the State of New Jersey.

And listen; I get it. If folks feel as if this is a product to protect unionized private-sector workers, we respectfully disagree. We feel that that's an important component of this, moving forward; but if we can't agree on that, let's put that on the shelf for now. Let's come back to what we can agree on. And if we're simply agreeing that something needs to be done in order to protect taxpayers, let's stop talking about it and let's start doing it. These types of examples now have been going on, like I said, for well over 20 years. Every couple of years we hold more and more hearings. We sat here five years ago talking about NJN, and I think we all recognize internally we have our own thoughts about whether or not that's been a smart move or not. However, we keep having these hearings on specific examples -- on these types of egregious examples. Let's take a holistic view of this: How can we prevent these types of hearings for the next Lottery, for the next NJN? Let's bring these best practices together and do it in a bipartisan fashion. If we don't like the cost containment or the worker protections, again, we'll agree to disagree on that. But the things that we do agree on, let's advance them; let's prevent this from happening again.

SENATOR GORDON: Thank you very much.

Any questions from any members?

SENATOR KEAN: If I may?

SENATOR GORDON: Sure; Senator Kean.

SENATOR KEAN: Through the Chair, thank you for your testimony today.

What would you define as *common ground?*

MR. RICHARD: I think two things, Senator, that I think we're all in favor of are, obviously, transparency, right? We should have a better understanding of the contract process and the bidding process, right? That should be more transparent. Number two, a cost-benefit analysis prior to the contract being awarded is absolutely essential. They're almost one in the same -- transparency and cost-benefit. We want to lay out where the savings are being achieved so everyone has the opportunity to look at whether they feel this is attainable or not, or if it's being done simply through some of the things that I had mentioned to Senator Sarlo. You don't need to be an innovative corporation to just lay off workers and cut their salary by 50 percent. Anyone can do that; anyone can take away the cost of a pension, anyone can take away the cost of health care. The cost-benefit analysis is going to give us, our elected officials, the opportunity to look at this before the contract is awarded.

The second component to this that I think we could all respect -- we do it in our own households, small businesses do it -- after you sign a contract, you perform an audit. Did you actually realize the savings that were promised to you? None of that is being done. And when it is being done, no one is being held accountable. I think we had a couple of folks, prior to me, talk about how we keep moving the goalposts, so to speak, after the contract has been awarded. Common ground is cost-benefit analysis; common ground is transparency; common ground is auditing. I think those are three of the things that could very easily be achieved by this Committee and by this Legislature; and, I would hope, something that the Governor would be agreeable to.

And as I mentioned in my testimony, Senator, this isn't a *D* or an *R* issue; this is being done in red states, this is being done in blue states, this was one of the number one recommendations by former Congressman Dick Zimmer in his report in 2010.

SENATOR KEAN: Yes, I didn't bring up partisan affiliation, or geography in my question. I simply asked, as you see it, what a best practice is and what is common ground.

Thank you.

MR. RICHARD: You're welcome.

SENATOR GORDON: Any other questions? (no response)

Seeing none, thank you very much, Mr. Richard.

MR. RICHARD: Thank you.

SENATOR GORDON: We'll now hear from Professor Janice Fine of Rutgers; she may want to bring her team up as well. They have been working on a number of these issues for a couple of years now, and issued a report regarding the lack of oversight over our contracting process.

And I welcome them to the Committee

J A N I C E R. F I N E, Ph.D.: Good afternoon.

Senator Gordon, before I start, I have to read you a funny text from my son today. He said, "If Senator Bob Gordon is there, I just want to let you know he's a cool guy."

SENATOR GORDON: Could you forward that to my wife? (laughter)

SENATOR KEAN: And through the Chair, and the rest of the Committee?

SENATOR GORDON: Thank you very much.

PROFESSOR FINE: Duly noted, right?

SENATOR GORDON: Would he like to be a judge?

PROFESSOR FINE: He said -- I guess you had addressed the Junior Statesmen of America or something, and he was there. I don't know.

SENATOR GORDON: Okay

PROFESSOR FINE: So can we fire this up? (referring to PowerPoint presentation)

It may take a little while to warm up, so I'll just start by saying-- First of all, let me reintroduce the three of us who did this study together. This is Patrice Mareschal; she's a Professor of Public Administration at Rutgers-Camden. I'm a Professor of Labor Studies and Employment Relations, trained as a Political Scientist -- as is Patrice -- at Rutgers-New Brunswick; and this is our stellar Ph.D. student, who is also a former lawyer in the Department of Children and Families here in the State of New Jersey.

So we spent three years or more working on our study, which we're going to share with you. And our plan is that we're going to spend some time laying out what we learned from the study; go through the study; and then from there, we're going to walk through the draft bill that we've worked on with Senator Gordon and his staff, Jen Mancuso, and various people at OLS for the last year.

SENATOR GORDON: Thank you. Please proceed.

PROFESSOR FINE: So let me just say a little bit about what motivated this project. When Governor Christie was elected, and appointed the Zimmer Commission to identify targets of opportunity for privatization, my colleague, Jeff Keefe, and I were struck by how little evidence there actually was for the study recommendations. And this made us want to dive a little deeper and get more of a sense of, sort of, the state of play around contracting and what the scholarly literature had to say about it, and what New Jersey's capacity was to oversee contracts.

And what was interesting was that, at the municipal level, there had been actually a trend of insourcing among municipal governments, who weren't sure now, with a wave of State privatizations, whether it made sense to continue privatizing. In other words, what we learned was that the lessons of the municipal privatization and contracting experiences were not necessarily being communicated to states as they were contemplating a wave of contracting, all right? I'm happy to see this.

SENATOR KEAN: And through the Chair, if I may. Your reference points are municipalities across the country and, obviously, all 50 states? Or are your reference points in New Jersey?

PROFESSOR FINE: Yes, I mean, what the literature showed was that-- And I can send you follow-up information, but the literature showed that there was a period when there had been this sort of rise of municipal contracting. And then there was a trend toward insourcing. And that 72 percent of the time, the respondents to the ICMS survey basically were -- municipal officials surveyed were saying that they did it because of problems of quality, right? They did it because the quality of the service was really compromised, right?

And then they had other reasons too, and one of them was actually that the state had become the most efficient provider, and they were better off going for the services directly from the state.

SENATOR KEAN: If I may--

PROFESSOR FINE: Sure.

SENATOR KEAN: I'm sorry; through the Chair -- as a person who has not yet completed my Ph.D., but working on it -- let's just disaggregate this question, just for a quick second. (laughter)

PROFESSOR FINE: Yes, sure.

SENATOR KEAN: And if it's a follow-up, through the Chair, getting to us-- I guess the question is, as you look in your data sets, are you looking at breakdown by types of service? I mean, because municipal governments could outsource, or privatize, or what have you, many different aspects of what was done by government--

PROFESSOR FINE: Yes.

SENATOR KEAN: --than the State could deal with. But if you could have one experience in health care, you could have another in sewage treatment, you could have another in--

PROFESSOR FINE: Right.

SENATOR KEAN: --other assets. So the question is--

PROFESSOR FINE: So I'm talking about-- It was an ICMS of alternative service delivery with an *n* of 245 U.S. municipalities who answered the question, "Why did you bring services back in-house within the in last five years?" So the 72 percent said because service quality was not satisfactory; 51 percent said cost-savings were insufficient; and 35 percent said local government efficiency improved. So--

SENATOR KEAN: But did you breakdown-- If I may--

PROFESSOR FINE: I'm sorry--

SENATOR KEAN: --among the 245, did you break down what the types of services--

PROFESSOR FINE: It was 245 municipal--

SENATOR KEAN: Correct.

PROFESSOR FINE: Right? So it's municipal services. So it would be the--

SENATOR KEAN: So you do have a sense of what that is? I mean, municipal services are very broad.

PROFESSOR FINE: A whole range of-- Yes.

SENATOR KEAN: Okay; thank you.

PROFESSOR FINE: Okay? So anyway, that was just patter before I could get this up. (referring to PowerPoint presentation)

Now let's talk about the findings of our study. But I'm happy to share with you that earlier finding.

Anyway, so in our view, Government has been doing contracting since the Revolutionary War. So we think there are times when it makes absolute sense to do contracting, right? We're here to talk about under what circumstances does it make sense, and how do we manage it. Because even if we contract, that doesn't absolve the State of our responsibility, ultimately, to manage our precious resources.

So we were trying to understand really simple questions: how many contracts does New Jersey have, and does the State oversee them. These were very simple questions. This is our study that we -- I don't know; I guess it doesn't go backwards, it only goes forwards (referring to PowerPoint). Okay, here we go.

So we're going to talk with you this morning about the importance of oversight; we're going to talk about best practices; we're going to talk about how New Jersey is doing; and we're going to go through with you proposed legislation.

So first of all, let me just say, from our perspective -- as I was just saying, Senator -- contracting can be a tool to tap into special expertise;

it can tap into -- it can augment State capacity in a specific area; and it can carry out activities that would be better delivered in a community setting.

In a nutshell, what we found is that New Jersey contracts a lot; that we do it very poorly; and in some ways, that New Jersey has oversight by audit and exposé -- we're only catching the problems after they arise, and after they become very severe. And this has had huge consequences, especially for the most vulnerable citizens.

I know that contracting can be incredibly boring to talk about. And before your eyes glaze over, let's just say a little bit about why it's such an important issue to talk about.

First of all, government provides goods and services that we cannot provide for ourselves. Government may do this directly, or may contract with third parties to provide them. But since societies collective resources are at risk, we have to make sure that we're keeping a very, very close watch.

The duty to protect the public's investment always remains with the State. We have fiduciary responsibility to manage tax dollars and protect public assets; we have a duty to protect vulnerable members of society; and we have an obligation to ensure public health and safety.

Now, here's the rub. When we contract, because of the principal agent problem the difficulty is that when we contract with a third party to provide services, the work is always hidden within another organization. That's just how it works. And so that means that it makes it harder for us to do meaningful oversight. It means we have less access to information, fewer procedural safeguards, and limited ability to challenge decisions -- and that's why, when we contract, we really have to have a robust set of policies in place.

So the bottom line is, overseeing contracts is difficult to do well; and that effective oversight requires experienced, well-trained government employees with the time to manage with care.

So I don't know how well you all can see this slide about best practices, but I'll just -- I'll walk you through it very, very quickly; and then my colleagues will be talking about it a lot more.

So best practices in the literature start with comprehensive planning and contract costing; and also making sure that we build in the cost of oversight into our contracts. These are sweeping best practices, completely agreed upon in the literature. So, again, we need comprehensive planning, comprehensive contract costing, and contract comparators that compare the costs of providing the service in-house versus providing the service through a contractor.

The second best practice is that we want to make sure that we have sufficient staffing and professional contract managers. Again, we need contract managers who have the skills and the time to conduct thorough oversight. And that's not controversial at all in literature; that's what all the states are worried about, what everybody is trying to do -- is ensure that we have the person power, and also that we have the training for contract managers.

The third is that we have to have continuous relationship-driven contract management so that contract managers are well informed in the State, and contractors know what they're responsible for, and that there's on-going relational communication. Relational contracting is another best practice in the literature; in other words, we don't want to have a situation where our only way of communicating our displeasure with a contractor is dropping the contract, right? We want to make sure that we're in constant contact, and we're figuring out as we go along what to do to make things better.

Lastly, we want to make sure that we have comprehensive contractor database. We have been blown away by how difficult it is to get information in New Jersey, because we know that when we have a comprehensive database we would be able to facilitate oversight, improve transparency, and provide data for planning.

PATRICE M. MARESCHAL, Ph.D.: Good afternoon. I am Patrice Mareschal; I'm an Associate Professor, as my colleague Janice mentioned, in the Department of Public Policy and Administration at Rutgers-Camden. So I work with these types of issues every day in teaching students in our Master's of Public Administration program. I'm also the former Director of the Rutgers-Camden certified Public Manager Program. So we do a lot of work with practitioners.

So we wanted to take a look at this, and see how New Jersey is doing in terms of overseeing contracts. And in trying to answer our questions, we found it was a lot more difficult than we originally thought it would be. We tried to start out by getting quantitative measures so that we could compare the resources devoted to oversight to the value of contracts issued in the State, and draw some conclusions from that. The problem was that there is no centralized database for this information in New Jersey. So then we went about trying to OPRA -- make OPRA requests for the information that we needed. The problem with that is that the records aren't kept in aggregate form; we're limited to pre-existing documents. And so most of our questions led to denials from the agencies we were trying to get information from. And we often felt like we were playing a game of 20 questions, and that if we didn't phrase the question precisely enough, the agencies would tell us "no." So this creates some problems, in terms of transparency -- if we, as well-educated researchers, can't get this information, then the general public is going to lack access to it as well.

So what we found is that the planning -- the Requests for Proposal rarely involved an analysis of whether it's more cost-effective to keep the services in-house, versus contracting. Oversight costs are not taken into consideration, and the contracts -- the RFPs eventually become the contracts for the services. And so they don't contain clear performance standards and requirements.

The problem with this is that the bidding process locks into place the costs and requirements for contracting and, taken together, all of this makes the basis for contracting very weak, and makes it difficult to ensure that services are being delivered well and cost-effectively.

One of the big things that we found is that attrition is a predominant problem, and this deprives the contracting units of the practical expertise that they would need to manage these contracts. At the same time that the State was increasing its amount of contracting -- so we looked at that period between 2004 and 2011 -- the State workforce shrunk by a little bit over 36,000 employees.

So this reiterates some of this. The other important part here to note is that the contract managers are rarely trained experts. For the interviews that we conducted, we often heard that the agencies work with what they have. They're often designated by default, so whoever is left in the department is assigned to do contract management in addition to whatever else they're doing. The only required training is a three-hour online tutorial. And often requests for training were denied.

So this makes it hard to find contract violations, and when they are found, it's hard to actually enforce the provisions of the contract.

So as I mentioned already, the data on contracts--

SENATOR KEAN: I'm sorry; through the Chair-- I'm sorry. You've talked about employment practices since 2004. Is the span of your contract analysis -- what's the-- I'm trying to figure out what the span of your contract analysis was.

PROFESSOR MARESCHAL: The span of the--

SENATOR GORDON: The span of the study.

SENATOR KEAN: Yes, the analysis of the contracts you studied. Were they since 2003 and 2004, or is-- What's the reference point for the length of contracts studied?

PROFESSOR FINE: Like, 2004 to 2012.

PROFESSOR MARESCHAL: It's around 2004 to 2012-13. We include information, for example, from what happened with Hurricane Sandy and contracting for remediation, and the result of that.

SENATOR KEAN: Okay, but that's 2012 on. Before 2012, what contracts were you looking at? Before 2012, what contracts were included in the span?

PROFESSOR MARESCHAL: We started--

PROFESSOR FINE: That's what we just said -- 2004 to 2013.

SENATOR GORDON: The question is, what types of-- What contracts, what major contracts--

SENATOR KEAN: What types of contracts are you talking about from 2012 on? What were the types of contracts, and how many were analyzed between 2004 and 2013 -- or 2012?

PROFESSOR FINE: Right. Well, we looked at a whole range of contracts, and we looked at a whole bunch of different departments, so it's not what contracts did we look at. We were attempting to take a comprehensive dive. So we looked at many of the -- we tried to look at the departments that have the largest number of contracts in the State.

SENATOR KEAN: Right. And so your analysis goes all the way back, starting with 2004 contracts?

PROFESSOR FINE: That's right. That's what we were trying to do; but what we're explaining is how impossible it was to get access to this stuff. So we looked at as much data as we could get; and then we had to augment a lot of that with interviews. So we did interviews at several different departments. We tracked down people who were retired, we tracked down contract managers, we tracked down people and did interviews. And a lot of what we learned is from that, because it's so difficult to get the kind of comprehensive-- There's no comprehensive contractor database in the State of New Jersey.

SENATOR KEAN: How many contracts did you look at overall? Do you know?

PROFESSOR MARESCHAL: I think about 20.

SENATOR KEAN: Okay, thank you.

PROFESSOR MARESCHAL: I mean, one of the other problems is that a lot of the bidding information is redacted. So it's hard to get; it's hard for the public -- and that's the point we're trying to make here -- to get access to this. It's redacted if the company bidding on it believes it's proprietary; and there are some things that may be proprietary, but particularly for social services -- it's not clear that there is something, some secret proprietary formula for dealing with children with developmental disabilities or with working with inmates at halfway houses. So the information isn't there.

So we had problems. Despite there being an executive order for transparency and having to have a database created, they're not accessible. Complaints and violations aren't tracked, and no agency has the mandate or the capacity to oversee and identify some of these problems across agencies. So what we're seeing, then, is that the State isn't performing its role to patrol this and kind of act as the police in the situation; and the public doesn't have access to the information, so they can't sound the alarm either when something goes wrong.

We already touched a little bit on this. There's no requirement for contract costing to be done prior to the issuance of the contract. And there is a mandate for State contract managers, but there are no detailed descriptions; the training is inadequate. All that is required right now is a three-hour online tutorial. And there aren't sufficient numbers of them.

But one of the biggest problems we saw is a loophole that goes back to 1976 -- an Attorney General's opinion. So this is a-- Contracts that go through the Division of Purchasing and Property; most of those aren't subject to any formal rules at all, and a lot of that is limited to bidding. But this Attorney General's ruling contends that any contracts, for which the State is not the end-user, are exempt from this oversight. So if the State, for example, is buying pens, and is going to use those pens, then it's subject to oversight. If the State is contracting out for programs for the elderly and disabled, that's not covered. If it's for children and families at risk, that's not covered. If it's for Department of Corrections for the halfway houses, that's not subject to regulation either, because the end-user is a resident of the state; it's not the State itself. So that's a big problem.

Okay, so next -- what are the consequences for what we found, for this lack of oversight? Well, it's wasted money, it's poor service, it's harm to service recipients and the public. So the Department of Developmental Disabilities -- which is one of the agencies we looked at -- we found substantial waste of taxpayer money with little assurance that services were actually being provided to the individuals who need them. And a 2008 audit shows that a review of 95 contracts -- worth at least $2 million each, including 23 that were worth over $10 million -- were renewed without competitive bidding and with limited review of past performance. In addition, one contractor in particular had $160,000 worth of inappropriate expenditures that included Mediterranean and Caribbean cruises, and trips to Nashville and Florida.

So DDD serves over 35,000 of New Jersey's most vulnerable citizens, and these services are funded at a cost of nearly $1 billion. And they go to for-profit and not-for-profit contractors. So this is something we ought to be keeping an eye on.

Next, the Department of Corrections residential--

SENATOR KEAN: If I may, through the Chair.

SENATOR GORDON: Senator Kean.

SENATOR KEAN: Were those contractors penalized at that time?

PROFESSOR MARESCHAL: This is based on an audit, a State audit that was conducted.

SENATOR KEAN: Right. Then were they--

SENATOR GORDON: Were they penalized?

SENATOR KEAN: Were they penalized?

PROFESSOR MARESCHAL: Not that we can determine from the data.

PROFESSOR FINE: It's part of our recommendation, when we go through the bill, that when the Auditor or the Treasurer -- when these reports are done that come out with these findings, we think that the recommendations should be mandatory for critical recommendations. So in other words, the Auditor does these studies, finds these horribly egregious behaviors, and there is nothing requiring that the--

SENATOR KEAN: No, but practically speaking, when you're looking at $160,000 of inappropriate expenditures, was that money clawed back by the State at any juncture, or what was the remuneration component?

D A V I D H E R S H, Esq.: There's no evidence whatsoever that any action was taken after this report took place.

PROFESSOR MARESCHAL: Right.

MR. HERSH: So we tried to follow up on the report, and we were not able to find any evidence that DDD had taken any actions on any of these items.

SENATOR KEAN: All right.

SENATOR GORDON: And I think one of the things we would like to see come out of this process is a database of contractors, so that a contracting agency can just pull up who are the vendors who work in this particular area, what has their performance been -- oh, they worked for DDD in such-and-such a year, and these were the outcomes; including any record of inappropriate activity.

PROFESSOR FINE: That's right.

SENATOR GORDON: We would want that--

PROFESSOR FINE: Including contacts, right? There's no database of contracts or contractors.

PROFESSOR MARESCHAL: So that fits with all of what we're recommending. And the provisions for claw backs are very weak, and they don't appear to be enforced. And that's something that Dave will get into when he talks about the legislation.

So moving onto the next agency -- the Department of Corrections Residential Community Release Program. This is what was formerly known as *halfway houses.* So we found an egregious lack of oversight here that contributed not only to a waste of money, but to several violent assaults and deaths. And so the incidents are listed here; there was an escapee in Newark who killed a young woman in Newark who had spurned him. There was an escapee who shot a man on the sidewalk after being at large for four months, and the information wasn't shared with local police; and there was an inmate at the RCRP, who was in for a minor offense of an unregistered vehicle and fines associated with that, and he was killed by gang members who were trying to get $20 out of him when he only had $3 with him.

MR. HERSH: Just to kind of drive home where this comes into the contracting world, so that first example--

SENATOR KEAN: I'm sorry; can you be--

PROFESSOR FINE: Turn on your mike.

MR. HERSH: Oh, sorry.

SENATOR KEAN: I'm sorry.

MR. HERSH: I'm so accustomed to my voice being too loud that I'm not accustomed to actually having to turn these on.

PROFESSOR MARESCHAL: Just push it.

MR. HERSH: Okay. Sorry about that.

So that David Goodell example -- that was a case where the RCRP was being overseen by DOC; DOC had identified back doors being left open in the past and checked the boxes on the oversight seats, but nobody had actually followed up to enforce penalties that were required on the provider. And so his escape was entirely predictable. There was a pattern of it beforehand.

And so, to your point, Senator, even where the contract creates the possibility of enforcing a penalty to ensure that this stuff is done right, there lacks the kind of institutional motivation to follow up on these things to prevent these things from actually happening. So there was no penalty that took place, in advance, to prevent this from ever happening.

SENATOR KEAN: All right. I don't mean to interrupt your testimony; I apologize. But how would you-- I mean, obviously at the end of the day, with any contract, the State is ultimately responsible for contract oversight and everything else. Why would you say that there is no set of incentives for the State to actually utilize its oversight potential?

MR. HERSH: So I think -- if you guys don't mind -- I think-- I wouldn't say the State doesn't have the proper incentives. What I would say is that the individuals who are actually charged with taking action -- they either don't have the resources; or, themselves, the proper incentives. So, for example, I'm a contract worker who is overseeing an RCRP. I walk through and identify 10 violations, right? What do I do with those violations? Where do they go? It's not my responsibility to enforce that; somebody else does. I don't even know what the contract says, right? Technically, the State Contract Manager for that contract is probably the person who would be responsible for that. But that State Contract Manager actually is just another caseworker who is assigned that because they're legally required to have been assigned something. Somebody has to be a State Contract Manager. And then once-- Let's say the State Contract Manager is really diligent and knows what they're doing and identifies it. They're actually not the one who can claw back the money, right? Somebody in Treasury probably has to go through and execute the process -- go through executing the process. The whole chain is broken; it's a very difficult chain to work through. And so even though the State, as a whole -- this kind of amorphous aggregate thing we call *the State* -- has plenty of incentive to do this -- because we would never argue that anybody wants this stuff to happen -- it's that the systems-- The kind of detailed, nitty-gritty stuff that makes this stuff work properly isn't being done.

So I wouldn't say it's a statewide incentive problem. It's the incentive of all the individual kind of street-level bureaucrats who are charged with enforcement.

PROFESSOR FINE: Right. But it's also there's been enormous attrition. So it's also just that -- we showed you an empty carrel that was actually from our interviews, where we would think that we were going to meet a whole set of people who were responsible for overseeing State contracts in a particular agency, only to discover that it was like one person in a warren of empty carrels.

So I think the other issue is we just don't have the capacity. So the combination of the training is really problematic or nonexistent; people get sort of, "Tag, you're it; now you're the Contract Manager," whether you have training in it. And thirdly, there are just huge holes and problems with the size of what we have left, in terms of the ability of managers who can oversee these contracts.

SENATOR GORDON: Not to get ahead of your presentation, but I think some of the things we were looking at in this legislation is, one, to have -- to build in the cost of contract management and oversight into the actual cost of the contract.

PROFESSOR FINE: Right.

SENATOR GORDON: And use those funds to create a cadre of trained professional contract managers in the State to oversee contracts within a particular area; and give them the authority, that if they see something that's amiss, to act on it. And that's what I'm hoping we're moving towards.

PROFESSOR FINE: We're heading there; yes.

SENATOR GORDON: So I'll let you get back to your presentation.

PROFESSOR FINE: Yes.

SENATOR GORDON: But that's where I hope we're heading.

PROFESSOR FINE: That's where we're going.

PROFESSOR MARESCHAL: Okay; so the next big program we looked at was the Hurricane Sandy relief. And here we found inappropriate denial of aid to thousands of families and businesses. So there were lost applications, misleading advice on how to file claims, racial and ethnic disparities in the denial of claims, and the process to appeal the decisions was very cumbersome.

We also found reporting failures in this case. HGI, the company that got that contract to oversee all of this, promised to submit weekly and monthly reports. They were supposed to provide an accounting of progress towards their major milestones, and over the course of eight months they didn't provide reports. We found a lack of transparency. Even though Public Law 2013 authorized the deployment of oversight monitors for this program, New Jersey spent 10 months training them and we could find no reports on what the Integrity Monitors did.

And finally, there was a failure to communicate. In less than eight months, HGI billed the State for over $51 million. And yet, HGI had proposed a three-year contract for a total of $67 million. So there's this ongoing dispute between HGI and the State; HGI says the State still owes it $18 million. It claims the State demanded more work than was originally written into the contract and that the State guaranteed payment. But we can't find any documentation of that. So there are no written amendments to the contract to account for the additional costs. And this again makes it -- and how this dispute arose.

SENATOR GORDON: And as I recall, if I have the right company, there was some history in Louisiana--

PROFESSOR MARESCHAL: Yes.

SENATOR GORDON: --with Katrina.

MR. HERSH: That's right.

PROFESSOR MARESCHAL: Right.

SENATOR GORDON: And somehow the State didn't take that into consideration when it was letting the contract.

PROFESSOR MARESCHAL: Right. So ideally, we would want the State to vet proposed contractors -- those bidding. And it appears, in this case, that the State didn't do its due diligence.

SENATOR KEAN: I'm sorry. We're just trying to figure out--

PROFESSOR FINE: Sure.

SENATOR KEAN: This issue, on the State level, has been resolved, hasn't it? Has that impasse between the company and the State been resolved?

PROFESSOR FINE: So we're giving an example-- We're giving you case studies that just show you what the problem is with contracting. So when you say *resolved*, Senator -- there's *resolved* and then there's *resolved*, right?

SENATOR KEAN: And there's ameliorated, and--

PROFESSOR FINE: There's dealing with the individual case, or there's dealing with the underlying problem with contracting. And our contention is, no, the systemic problems-- The reasons why we're going to have one issue after another is because we're doing auditing and monitoring by exposé; only *ex post facto*. What we need to do is change the system so that we are monitoring as we go, and learning as we go, and shifting as we go.

SENATOR KEAN: I understand. But isn't auditing, by definition, something that's done on a retroactive basis?

PROFESSOR FINE: No; that's the point, right? Is that-- No, when you do contracts--

SENATOR KEAN: There are maintenance contracts, and maintenance, and then the audit is when you have a set period of time and you look back to figure out--

PROFESSOR FINE: The argument is that we're not overseeing our contracts. We're only discovering the problems after it's too late. So it's the idea that we're monitoring by exposé and audit, *ex post facto*.

Yes, go ahead.

PROFESSOR MARESCHAL: So we want to make the case for getting involved earlier on, and strengthening that planning process, and the relationships between the agencies and the outside contractors.

So what we concluded then is that there's no man behind the curtain overseeing State contracts. There seems to be a lack of priority given to oversight, despite this preference for contracting over in-house delivery. We don't see that contracting is institutionalized as a core element, that oversight is institutionalized as a core element of the contracting process. We see little capacity for meta-oversight of contracts; and again, that goes back to the Attorney General's decision which carves out the third-party contracts. And then, again, as we mentioned, the lack of qualified well-trained staff.

And at this point, I'll turn it over to my colleague, Dave.

MR. HERSH: Thanks, Patrice.

Just, kind of, as a segue into the bill -- one point to think about with something like Sandy is that we've identified a serious problem in having insufficient amounts of people to oversee the contracts we already have. Sandy, in a very short time period, dramatically increased the amount of contracts we had to oversee; and we don't have any extra people to do that. We don't have enough people to do what we're already doing. So the fact that Sandy contracts ended up getting mismanaged is obviously, in and of itself, wildly predictable. It's not something that we would have been surprised by, at all.

Towards that end, audit is a highly, highly limited feature. It only works after the fact; but it also only works for really, really big things that people care enough about to audit. You're not going to audit a $500,000 contract with a psychologist who works only with a handful of abused children through DCF, right? Those things don't get audited and, even if they do, they don't make press. So audits are extremely limited.

The bigger issue is that we need institutionalized requirements that prevent us from doing the contracting in the first place if we can't do it right. And so the whole purpose of our bill is to set up a system so that, as a precondition for contracting, you know you can actually do contracting well.

So just continuing with the way we went through best practices, and we went through our findings, I'll go through the draft bill for each piece, in each stage.

So the first stage is the planning of the contract. What we do before the contract-- Forgive the slightly inappropriate language, but I couldn't resist, in the upper left corner: Planning and preparation prevent piss-poor performance. The alliteration was just too good to avoid.

We don't plan well for our contracts and so, of course, our contracts don't do a very good job of protecting us. How do we recommend fixing this? So we're requiring that the cost of oversight be factored in when contracts are planned and bid. As part of a plan that's a prerequisite for determining whether we can issue a contract in the first place, we have to figure out how much it's going to cost to oversee it, not just the cost of the contract itself.

It requires public-sector cost comparison. I think that's similar to what Eric was talking about earlier regarding cost-benefit analysis; but basically, identifying if, when you factor in all the additional costs of contracting, it still makes sense to issue the contract in the first place.

And then finally, to avoid these very long-term contracts that are never rebid and, therefore, eliminate the incentive of the contract provider to do anything better than bare minimum under the contract, we're recommending a mandatory three-year maximum, after which time everything has to be rebid. There will be no unlimited term contracts, no automatic rebidding.

SENATOR GORDON: Just a question on that one.

MR. HERSH: Yes.

SENATOR GORDON: I mean, I can envision certain types of contracts that would require a vendor to make a huge capital investment. And if they're looking at the possibility of not having a contract after three years they would be reluctant to bid.

MR. HERSH: Sure.

SENATOR GORDON: They would probably want some kind of flexibility built in--

MR. HERSH: So we do, actually. There's a carve-out in the bill for exactly that scenario. So if the term of performance is longer than that three-year span, then the three-year span doesn't apply, right? There is a small carve-out.

Just for reference, going forward, I'm going through, like, the big elements of the bill. I think--

SENATOR GORDON: Okay.

MR. HERSH: I mean, this would be painful -- really painful if I went through every detail of the bill and all the carve-outs. But there is exactly that carve-out, Senator.

So here's the real meat of the thing. The biggest problem is, you can have every rule, every law, every requirement in the world -- if there is nobody to actually execute on these things, there's nobody to actually do the work, and with the time and resources to do the work well, it doesn't matter, right? We actually have some decent things on the book; the problem is we don't have people to enforce them.

So the meat of the bill, the biggest, most important thing is getting enough people in place to do this. And the mechanism we came up with is the requirement that there be certain numbers of contract managers on every possible contract, and that availability of contract manager is a prerequisite to the letting of the contract in the first place.

Again, in keeping in line with not making this way too painful, there's a four-tiered -- four types of contracts; there are different requirements for each type of contract to make sure it's not unnecessarily onerous on contracts that don't need a lot of oversight; making sure you have plenty of people for the ones that do need a lot oversight. It's in an appendix; I can go through it, if you guys have questions. But for the sake of making this manageable, we'll just say that it requires enough contract managers to do the job well.

It mandates that those contract managers actually be competent to do the job well through certification and training requirements -- again, detailed requirements in the bill on certification and training. Those are in an appendix; Patrice can talk about those in detail, since she runs programs like that already.

We provide for lead contract managers. So every contract needs some focal point to be the primary person on it, right? You could have 100 people; if nobody is the main focal point, you just have chaos. So we create a different position called the *lead contract manager* who is supposed to do a lot of what current State contract managers are legally supposed to be doing, but are neither trained nor have the resources to do. Those lead contract managers then become the primary, and then they have a support of other contract manager, who aren't the lead, who are just helping with the day-to-day work.

And then finally, again dealing with this Sandy problem, is we came up with a mechanism to ensure that we retain oversight in emergencies without limiting our ability to actually respond to an emergency. So on the one hand, we have a serious problem with something like Sandy -- which is we can't manage the contracts we already have, and now we have twice as many contracts in a very short period of time. What we don't want to do is say, "We can't let contracts to do Sandy stuff, because there's no way the State itself can handle all of Sandy." You have to contract in that scenario.

So the way we handled that is we created a 45-day window where you can actually let the contract before certifying that you have enough people to oversee it; but you have 45 days to develop a plan and start the process of actually then staffing so that you can oversee those contracts. So instead of it being a requisite to letting the contract, you let the contract but you are required to then staff up after-the-fact.

So to kind of summarize how we handled the -- or, overarching, how we're handling this problem, is the one way to do it is to make an enormous amount of bureaucratic red tape, right? We could make this all paperwork; you have to document everything you do; you file -- both the private provider, and the State contract manager, and everybody else has to file paperwork, over paperwork, over paperwork. We were desperately trying to avoid that, because we're pretty sure that wouldn't work, no matter how many people you had to do it. Instead, what we're talking about is something that's much more relationship-based, right? Intimate relationships between contractors and contract managers so that as problems arise, and often before they arise, they can be headed off, they can be taken care of. So that's our goal: the rare case of a large comprehensive bill that is not designed to increase paperwork.

And finally, facilitating all of this has to be access to information. You could have a million people available to do stuff; if they don't have access to information, they can't do anything about it. So the bill mandates the creation of a database that applies to every contract in the State; contains the type of information you would need to plan for future contracts, to identify systematic problems with certain contractors -- things that the Treasurer could act on, to say, "You have minor violations that I wouldn't worry about in one case; but in 100 cases, I actually care that you've made that violation everywhere." Systematic things that could be identified through this database.

The actual data entry would be the lead State contract manager, so the mechanism is a very simple thing. Even though the idea of a giant database seems huge, the mechanism for populating that database is actually really simple and fairly straightforward. That contract manager has an enormous amount of information; all they have to do, for the few contracts they're handling, is populate what is basically a simple spreadsheet.

The data is made publicly available by default. Again, we can get into all kinds of different exceptions, but the idea is the default is public availability; the exception is things aren't publicly available. And there will always be exceptions, but the default should always be transparency.

So the final piece is that somebody has to make sure this is all taking place. It's not good enough to have contract managers; it's not good enough to have rules. You have to have systems and people in place to ensure that these things are actually being done. And most importantly, you have to have systems in place to ensure that we have the money to be able to do this. So one of the biggest things that we create is a funding mechanism. And the funding mechanism is designed to internalize -- Senator, you mentioned this already -- internalize the cost of the contract into the contract itself. The way we do that is by imposing a fee on the winning bidder. The fee-- Again, we can go into details; it's really, really hard to figure out what these fees need to be, and so we leave that, in detail, to the Treasurer. But I can give you back (indiscernible) numbers; the fees actually aren't terrifying at all. They are totally manageable relative to the size of the contract. And those fees would cover the vast majority of the cost of overseeing the contract, including the hiring of all the additional staff, the additional contract managers.

The remainder would come from cost savings and clawing back things that we're not clawing back now. When there's a violation, we leave money on the table. I think somebody mentioned already that under Pacheco, Massachusetts clawed back an additional $73 million. That is what pays for the rest of oversight, right? That's how we've envisioned this happening. But the idea is we're going to internalize the cost of oversight into the contract itself.

Very straightforward -- we close the third-party contract loophole. That's an Attorney General's opinion that sat around forever. As far as we can tell from everybody we've spoken to, there's really no reason for it to remain, so we just basically get rid of it.

Preclude contracts from being signed if key conditions aren't met -- I've already mentioned this. And then there are a handful of other things that are important institutional mechanisms; they are a little bit detailed at this point, but they're important institutional mechanisms.

Whistleblower protection, right? If I work for a private contractor, and I know they're doing something they're not supposed to be doing, I don't want to get fired; I need protections. Right now, protections apply to the State; we're enhancing whistleblower protections so that anybody who calls on a violation to a contract or any other inappropriate thing is protected under whistleblower laws.

PROFESSOR FINE: Particularly around quality of service issues.

MR. HERSH: True; thank you.

We're working on oversight -- establishing an ombudsman, oversight ombudsman on the Oversight Committees. This is kind of presenting -- creating exactly what Senator Kean was talking about. It would be somebody who actually is the backstop, the person with the primary incentive to make sure that systematically things are going as they're supposed to go.

And we also create a mechanism to make certain recommendations of oversight agencies binding. So for example, when the State Comptroller does an audit of the Division of Developmental Disabilities and finds a million systematic things that are going wrong, some of those things can be made -- through a process that we won't go into the details of -- binding on DDD so that they're not just ignored -- which is what they seem to be now. We see a problem, we identify it as a problem, there's a little bit of political woe behind it for very short period of time, and then we do nothing about it.

And the rest is just the appendices. So I am going to pause there -- pause there.

SENATOR GORDON: Okay.

I want to thank you very much for summarizing this. I know you've done years of work on this. This is one of those issues that no one would ever get excited about; you'd never find it on a piece of campaign literature if you did legislation on this. But it's so important to the quality of government, I think -- and the quality of the services that we provide, and the cost at which we provide them -- that I think it's essential that we pass legislation that implements a number of your recommendations.

I've got my bill; it's not the last word, but I'm hopeful that we'll pass something in this session, in a bipartisan way, to implement a number of these things. Because we just can't -- we really can't go on with these multi-million dollar losses that we've seen in cases like Sandy, and people getting hurt or killed because of lack of oversight. And we have an obligation to our residents to do something about this.

So I thank you for your presentation, and look forward to working with you as we finalize the legislation. I hope a number of my colleagues will get involved in that as well.

I have no one to ask if there are any other questions, so unless you have a final statement to make-- And if not, I will adjourn the meeting.

Thank you very much.

MR. HERSH: Thank you.

PROFESSOR FINE: Thank you.

(MEETING CONCLUDED)