

PENNSYLVANIA LOTTERY PRIVATE MANAGEMENT AGREEMENT SUMMARY OF TERMS AND CONDITIONS

Objective: Governor Corbett is exploring a Private Management Agreement (PMA) for the Pennsylvania Lottery to provide more reliable and predictable revenue to ensure the continued strength and viability of programs supporting older Pennsylvanians.

PMA Description: First and foremost, if a PMA is executed, the Commonwealth would retain ownership of and actual control over the Lottery and all significant business decisions.

The PMA is a contract between the Commonwealth and a yet-to-be-determined private industry expert structured to assure reliable and predictable future funding to support Lottery-funded senior programs.

The PMA establishes the management relationship between the Commonwealth and private manager, governs day-to-day operations of the Pennsylvania Lottery, defines the scope and duties of services to be provided by the private manager, establishes expectations on Lottery growth opportunities, employs industry best practices for marketing and management of the Lottery and provides metrics by which the contractor will be measured to ensure the Commonwealth is getting expected results.

Annual Profit Commitment: In order to grow future funding for senior programs, the PMA would contractually bind a manager to 20 years of annual profit commitments. These are profit thresholds that must be achieved by the manager in order for the manager to earn any incentive compensation. If a private manager fails to meet these annual profit commitments, the Commonwealth will draw shortfall payments down from the \$150 million cash collateral provided by the manager to secure its performance, in order to preserve funding for programs benefitting older Pennsylvanians. Such funding protections are not available today.

Prior to executing a PMA, the Commonwealth will verify that the private manager’s annual profit commitments are significantly higher than the profit levels the Pennsylvania Lottery could achieve on its own, in order to justify the agreement and incentive payments to the manager.

PMA Project Timeline	
2011	Governor Corbett’s Advisory Council on Privatization and Innovation considers Lottery privatization among other public-private partnership ideas.
December 2011	Corbett Administration secures financial counsel regarding exploration of a PMA for the PA Lottery.
February 2012	Multi-agency committee established to explore the feasibility of a Lottery PMA.
March 2012	Legal counsel contracted to advise the Commonwealth as a PMA is explored.
April 2, 2012	Request for Qualifications issued to gauge industry interest in a PA Lottery PMA.
June – October 2012	Commonwealth takes next steps in exploring initiative to maximize PA Lottery funding for senior programs, kicking off a due diligence phase as the first of two steps in an Invitation for Bid procurement process. PMA is developed through due diligence phase as the Commonwealth interacts with potential bidders to inform them of PA Lottery operations and learn from them industry ideas for improving operations. Pennsylvania engages probity firm to ensure bidder integrity.
November – December 2012	Commonwealth and bidders finalize a PMA so that bidders can develop and submit business plans based on the contract. AFSCME engaged in contractually mandated process for providing notice of the proposed contract, meeting with union officials to discuss the reasons the contract is being considered and affording the union opportunity to propose alternate methods for achieving the results the contract is proposed to achieve. Decisions expected: 1. Business plan acceptability 2. Whether or not to seek and evaluate priced bids (IFB Step 2)
January 2013	PMA could be executed between Commonwealth and private manager.

PMA Details

Performance Security	Upon execution of the PMA, the manager would provide to the Commonwealth \$150 million in cash collateral. It is against this cash collateral that any shortfall payments would be drawn, if the manager fails to meet its annual profit commitment in any year. If the cash collateral is depleted to less than \$50 million at any point in the contract term, then the manager would obtain letters of credit of \$50 million to ensure the financial and performance-based obligations of the agreement.								
Manager Scope of Services	The manager would provide all equipment and services and perform all functions necessary to operate the Lottery, including gaming system technology; data reporting; sales channels; Lottery game development; instant game logistics; retailer recruiting, training, supervising and managing; marketing, website and consumer research; customer service; responsible gaming program; and appropriate and related staffing, procurement, compliance and legal services.								
Commonwealth-Retained Responsibilities	The Commonwealth would provide oversight functions in addition to performing specific functions including ticket validation, payment of prizes, data validation, drawings, lottery retailer licensing, retailer accounting and collections, tax reporting, security investigations, auditing and public reporting.								
Operating Standards	As part of the PMA, the Commonwealth developed a manual describing the policies and procedures that will govern the operational provisions for the performance of the manager's scope of services.								
Compensation	<p>Incentive Compensation: The manager would only be paid incentive compensation when it exceeds its annual profit commitment. Incentive compensation is based on performance above the APC, with the manager receiving 25 to 50 percent of the incremental gain above the APC. The manager earns 25 percent of the incremental gain up to 1 percent over the APC, plus 50 percent of the incremental gain over 101 percent of the APC. Incentive compensation is limited by federal law to no more than 5 percent of Lottery profit.</p> <p><i>Example (for illustrative purposes only):</i> Private manager sets an APC of \$1.2 billion, then achieves profit of \$1.3 billion that contract year. Incremental profit above the APC is \$100 million. Five percent cap is \$65 million.</p> <table style="margin-left: auto; margin-right: auto; border-collapse: collapse;"> <thead> <tr> <th style="text-align: center; padding: 0 10px;">Tier 1</th> <th style="text-align: center; padding: 0 10px;">Tier 2</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">$[0.01 \times 1.2B \times 0.25]$</td> <td style="text-align: center;">$[(1.3B - 1.01 \times 1.2B) \times 0.50]$</td> </tr> <tr> <td style="text-align: center;">\$3 million</td> <td style="text-align: center;">\$44 million</td> </tr> <tr> <td colspan="2" style="text-align: center;">= \$47 million</td> </tr> </tbody> </table> <p>Operating Expenses: Invoiced costs of managing the Pennsylvania Lottery, including payments to contractors, personnel expenses, administrative expenses, etc.</p> <p>Manager Expenses: 0.75 percent of profit, to cover manager's indirect, non-invoiced expenses.</p> <p>In any year the private manager fails to meet its annual profit commitment, a Shortfall Payment will be deducted from the manager's \$150 million cash collateral, equal to the difference between the APC and the actual profit achieved, up to 5 percent of profit.</p>	Tier 1	Tier 2	$[0.01 \times 1.2B \times 0.25]$	$[(1.3B - 1.01 \times 1.2B) \times 0.50]$	\$3 million	\$44 million	= \$47 million	
Tier 1	Tier 2								
$[0.01 \times 1.2B \times 0.25]$	$[(1.3B - 1.01 \times 1.2B) \times 0.50]$								
\$3 million	\$44 million								
= \$47 million									
Personnel	<p>The Commonwealth would expect to maintain a complement of about 70 Lottery employees to perform the Commonwealth-retained responsibilities. These employees will occupy a combination of management and union-covered positions. Which employees would be retained would be determined by applying provisions of the collective bargaining agreement (union-covered employees) and Civil Service rules (Civil Service management employees).</p> <p>Bidders recognize the tremendous asset the Lottery's workforce is to its success, and they have expressed interest in incorporating current employees into private management operations. Current Lottery employees beyond the approximately 70 retained by the Commonwealth would be invited to apply for job opportunities and interview with the private manager during an employment transition period that may take up to a year.</p> <p>The Commonwealth would provide advance notice to and pursue alternate placement for any current Lottery employee not selected for employment by the private manager and not retained by the Commonwealth.</p>								
Subcontractors, Vendors and Managed Contracts	The manager could use subcontractors and vendors to provide products or services for the management of the Lottery. The manager would be responsible for enforcing the existing Scientific Games contracts, extended to August 2017 (gaming systems) and December 2018 (instant games) upon execution of a PMA.								
Implementing Industry Best Practices for Responsible Growth: Internet Products and Monitor-Based Games	<p>In exploring the viability of a PMA, it became evident that incorporating Internet products and monitor-based games into Lottery's portfolio is one of the most effective ways to responsibly grow revenues to benefit older Pennsylvanians.</p> <p>Bidders' plans for implementing a secure Lottery subscription service, Internet-based games and Keno-like monitor-based games will be evaluated against the Commonwealth's own implementation plans for such ideas to ensure bidders' plans are socially responsible, conform with Commonwealth policies and meet Commonwealth expectations for profitability. Monitor-based games could be implemented in 2013, Internet-based games in 2015.</p>								
Annual Business Plan	The manager would submit a business plan each year. Each plan must include details regarding organizational structure, tactics for growing the customer base, measures of operational transparency, projected income statements, innovative ideas for growing profit as planned, plans addressing social responsibility and information regarding subcontract/vendor contracts.								