

**REPORT TO THE LEGISLATURE
REGARDING ACT 1, SECTION 112 (SPECIAL SESSION 2018)
ON THE CONSOLIDATION OF THE DEPARTMENT OF LIQUOR
CONTROL AND THE VERMONT STATE LOTTERY**

**Submitted to the
Senate Government Operations Committee
House General, Housing & Military Affairs Committee
House Corrections & Institutions Committee
House Government Operations Committee
Senate Economic Development, Housing & General Affairs Committee
Senate Institutions Committee**

Department of Liquor and Lottery

January 12, 2021

Introduction

During the 2018 Legislative Special Session Act 1, relating to the consolidation of the Department of Liquor Control and the Vermont State Lottery into a single department was passed and signed into law. Section 112 of Act 1 directs the Department to prepare a written report on or before January 15, 2019, 2020, and 2021 regarding the Department's

“success in carrying out the functions of the former Department of Liquor Control and the Vermont State Lottery. Specifically, identify any improvements in efficiency and customer service levels, as well as any savings or additional costs, that have resulted from the merger of the two entities. The report shall also provide detailed information regarding the Department's progress with respect to securing a facility that will meet its office and warehouse needs. In addition, the report shall include any recommendations for legislative action that may be necessary to effect the intent of this act.”

1. Success in Carrying Out the Functions of the Former Department of Liquor Control and Vermont State Lottery

Pursuant to Act 1, The Department of Liquor Control (hereinafter Liquor) and the Vermont State Lottery (hereinafter Lottery) officially became one entity on July 1, 2018. At the time of the consolidation the top-level management team consisted of a Commissioner and a Deputy Commissioner at Liquor, and the Executive Director of the Lottery. The Lottery Executive Director position transitioned to become a Deputy Commissioner position on July 1. In early August the Deputy Commissioner responsible for the operation of the Lottery resigned. Shortly after his resignation, the decision was made to assign the remaining Deputy Commissioner to be responsible for the day-to-day operation of the Lottery on an interim basis.

This loss of a top-level manager created several challenges but also allowed Deputy Commissioner Kessler, who had two and a half years of experience at Liquor at that time, to identify opportunities for improvement in the consolidated Department (further discussed in the section that identifies improvements below). One of the challenges was that the existing work of three top-level managers was now being done by two. This challenge was further exacerbated by the fact that the two divisions operate out of separate offices five miles apart.

Additional challenges included a number of major projects underway in each division. At the time of consolidation, the Liquor division was starting the implementation phase of replacing the existing antiquated point-of-sale system. The first phase of the rollout of the new system had just commenced in August. The Liquor division was also undertaking a major signage project for all seventy-eight of the retail stores.

In the last calendar year, the Department has completed the RFP evaluation process for a combined licensing system. The Lottery division has working on an RFP for a gaming system vendor (the backbone of the lottery operations). The contract with the existing vendor was set to expire after ten years in July 2020. An RFP for a ten-year gaming system contract with two optional five-year extensions for a possible twenty-year contract worth an estimated \$80-120 million to the winning vendor was issued in April of 2019. A lawsuit filed by the existing vendor resulted in an extension of the existing contract by sixteen months until November 2021. A revised RFP was issued in June

of 2020. The time-consuming evaluation of proposals has now been completed and a winning vendor selected. Unfortunately, the existing vendor has once again filed a lawsuit in an effort to prohibit the Lottery from entering into a contract with the selected vendor. As of December 2020, all evidence has been presented and memorandums filed. In late December the court issued a ruling in favor of the state rejecting a temporary injunction request made by the present vendor. A motion to dismiss the lawsuit is still pending. In addition, while all this mission critical work was taking place in the two divisions the regular day-to-day business operations have continue uninterrupted.

Of course, 2020 presented a new and unexpected challenge with the arrival of the COVID-19 pandemic. Early on the Governor issued a “stay home – stay safe” order that shuttered bars and restaurants and kept most Vermonters at home. Nearly all state employees began working remotely in an effort to prevent the spread of the virus. This was certainly unknown territory for everyone, and we were very concerned with protecting the health of Department staff. The initial question for the Department were either of these businesses “essential.” It was soon determined that both businesses should try to continue to operate.

I am happy to report that despite all these challenges both divisions continue to function at a very high level. A great deal of this success is attributable to the dedicated and hardworking staff in the Department. The staff recognized the challenges that were presented and rose to the occasion. It was also crucially important that Commissioner Delaney and Deputy Commissioner Kessler have worked closely together over nearly five years, as this experience allowed them to communicate and coordinate their efforts effectively despite now operating these two businesses remotely.

Of course, it is easy to claim that all is going well. Below is information that supports our assertion:

- In FY 20 Lottery sales were \$137,387,256 the second highest year in the history of the lottery¹.
- In FY 20 Liquor revenues were a record \$91,116,741 up \$3,694,523 (4.25%) over FY 19.
- In FY 20 the Lottery division transferred a \$27,375,528 to the Education Fund which was the second highest amount transferred in the history of the Lottery.
- In FY 20 the Liquor division transferred a record \$26,061,889 to the General Fund.

In conclusion, we believe that the new combined Department has been highly successful in carrying out its required functions generating revenue for the General and Education Funds.

2. Opportunities for Operational Improvements as a Result of the Consolidation

An objective of this report is to “identify any improvements in efficiency and customer service levels, as well as any savings or additional costs, that have resulted from the merger of the two entities.”

- Both Liquor and Lottery had an HR/Executive Staff Assistant position. We did not believe that we needed two people in this role. While we were not allowed to RIF staff as part of the

¹ Prior to the arrival of Covid-19 and the issuance of the emergency “Stay Home – Stay Safe Order” lottery sales were on-track for a record sales year in FY 20. After the issuance of the emergency order sales were severally impacted which prevented the Lottery from achieving a new sales record.

consolidation, we did have staff departures and as a result we were able to consolidate these duties into a single position. This change resulted in both increased efficiencies and cost savings.

- The Lottery has a single person responsible for security. This includes internal security matters as well as compliance checks at the 630+ lottery agents. The security staff member is also responsible for supervising lottery warehouse staff and helping in that area when there is high demand, or when a staff member is out. As a result of the consolidation, we have paired the Lottery Security Director with the Liquor Director of the Office of Compliance and Enforcement. They have worked together to develop a tracking application for lottery compliance in FastField, which is a low-cost/low programming application, that has been used very successfully by Liquor for the last eighteen months. There are plans to further use Liquor staff, including investigators and minors, to assist with Lottery security.
- We recruited and hired a new Director of Education for the Department who will be adding a lottery component related to responsible gaming awareness to our required liquor training for convenience store staff.
- We have consolidated Agency of Digital Services (ADS) staff management under the former Liquor IT Director. This has allowed the work of both divisions to be better allocated amongst the four existing IT staff members. The Lottery IT person retired near the start of the pandemic and the existing four person IT team is successfully addressing all day to day needs in both divisions.
- We are working to create a single licensing unit for the Department. Commonly, convenience stores sell beer, wine, tobacco and lottery products. Presently, a store owner applies for a tobacco and liquor license from Liquor and applies separately to Lottery to sell lottery products. Prior to the consolidation Liquor was working to create a more efficient online licensing system. Our goal is to create a single licensing unit for all licenses issued by the Department. We will have a single licensing application and applicants will specify which licenses they would like to obtain on this single online form. The result of this change will be improved customer service for the applicant and increased efficiency for the Department as duplicative work will be eliminated. In furtherance of this goal, an RFI was issued to gather information about online licensing systems. An RFP was issued in 2019 and a vendor chosen in 2020. We expect the new consolidated licensing system to be operational in late 2021 or early 2022.
- Previously, Lottery had an Administrative Services Manager that oversaw financial operations and customer service and Liquor had a Financial Manager I position overseeing financial operations. With the departure of the Lottery Administrative Services Manager the decision was made to hire a Financial Director III to oversee and streamline all Departmental financial operations. This person was recruited and hired in November 2019 and supervises a six-person financial staff. This provides several benefits including allowing the creation of a fully integrated budget for the Department and increased bench strength across the enterprise by combining staff from both divisions into a single financial unit.
- A Director of Customer Service and Licensing was created at the Lottery. This position oversees a staff of two full time customer service representatives and one temporary staff member. This was an internal promotion and has resulted in a higher level of focus on

customer service than had been the case previously. This change took place in 2019 and we are reaping the benefits of having a strong supervisor in this role.

- The Lottery is required to have staffing six nights a week to operate the internal control system (ICS). There are very specific requirements that must be met to work on the ICS team. As a result of Lottery staff changes there was a need to add additional staff members to the ICS team to spread the workload in this area. A benefit of the consolidation is the ability to recruit from Liquor division staff which has allowed us to efficiently fill this opening.
- The Lottery has a staff member who works on social media. This staff member is spending a portion of her time working to assist Liquor in improving its social media presence and engagement.
- One of the challenges in the operation of a small Department is the lack of staff bench strength which, as noted above, creates potential single points of failure. While both Liquor and Lottery divisions maintain very lean staffing levels, the twenty-one-person lottery staff is particularly threatened by this lack of bench strength. The consolidation is resulting in staff being cross trained in several areas which is helping to minimize this as an issue.

3. Facility Update

Act 1 requires that detailed information be included in this report on the Department's progress in securing a facility that will meet the present and future office and warehouse needs of the combined entity.

For background, the Lottery offices are located on Barre-Montpelier Road in Berlin in leased space. The lease expired in August of 2019 and was renewed with a 10% increase in the monthly rent. Presently, the lease is \$196,350 per year (\$16,362/month). The space was built out for the Lottery in 2004 and includes 5,000 square feet of warehouse space and a small entryway with a customer service window. The Liquor offices are located on Green Mountain Drive in Montpelier. The space was first occupied by Liquor in 1963 and included the present office space and 15,000 square feet of warehouse space. The warehouse was expanded in 1971 with the addition of a second attached building which doubled the warehouse square footage to 30,000. As you might imagine, Liquor staffing and warehouse needs have changed since 1963. Some staff in the Liquor building work in a windowless basement "office." Others work out of cubicles in former hallways and alcoves. The education training room is in the basement and is windowless, and the Board meeting room is cramped and often overflowing for larger Board hearings. We have been forced to move larger hearings to offsite locations often with an additional cost for doing so.

Our warehouse building has deteriorated with large cracks in the brick walls and the unreinforced concrete floors, which were not constructed to support the picking and forklift equipment now in use which are starting to break-up. The space is also very inefficient to operate as over 2,200 product SKUs are stored and must be picked from ground level to 30 feet up on storage shelving greatly reducing order picking speed and requiring a higher number of employees to pick orders.

In 2018 the warehouse was operating over capacity. During the month of December 2018, the warehouse shipped out 43,400 cases of product. Even with recent improvements to the layout and racking system this put the facility at approximately 115% of operational capacity. Picked orders were being stored in aisles throughout the warehouse making them even more narrow and requiring staff to operate picking and forklift equipment in very close proximity. This resulted in increased risk to staff and increased damage to product. The only upside of the existing Liquor facility is that it is fully depreciated and does not cost the Department very much money to rent from Buildings and General Services (BGS). In 2020 the warehouse shipped over 50,000 cases which was a record for a single month.

We have made significant changes to how we order and receive product to reduce the level of inventory in the warehouse at any one time. This “just in time” delivery modification has so far shown very positive improvements in warehouse utilization which is now closer to 90%, without meaningfully increasing product out of stocks. We will continue to refine our efforts in this area with the goal of further improving warehouse utilization and efficiencies until a new facility or other changes can be implemented. We are mindful that this change is not without risks as even minor supply chain issues could result in an increase in out of stock products, something we have worked very hard to reduce to a deminimised level. Despite this risk we felt that we had little choice but to make the changes. In 2020 we leased additional off-site “annex” warehouse space where we could store up to sixty pallets of product. While this overflow space came with additional cost it was absolutely essential to allow the warehouse to function and to minimize out of stocks during the busy holiday season.

Our Liquor Warehouse Director said the changes made along with modifications in our agent delivery schedule and automation of agent ordering via the new point-of-sale system resulted a smooth December despite the greatly undersized warehouse. The improvements made also had the benefit of drastically reducing warehouse staff overtime hours.

Since the consolidation we have been looking at how we could efficiently create a single office and warehouse space for the Department. An RFP was issued in 2020 with a consulting firm to examine our warehouse needs and evaluate a number of alternative models for creating the needed facility. As of December 2020, the report is nearly complete. The report concluded that the existing liquor warehouse is presently under sized by 50% based on the current volume of sales. This space shortage makes the business much more likely to experience product out of stocks because we do not have sufficient space to store products. Out of stock products hurt sales and profitability and negatively impact our relationships with Agents and customers. In addition, the lack of space creates inefficiencies in operations which costs money and deprives the Department of the opportunity to take advantage of special pricing of products which would increase profitability. This fall the space shortage was so severe that the Department worked with BGS to find additional warehouse annex space to store product. This was a heavy lift for both Departments. With our present 50% shortfall in needed space the warehouse is much less efficient than it could be, and the use of annex space is inefficient and adds additional costs to our operations. Once the report is completed, we are hopeful that action will be taken to finally move forward with creating a single office and warehouse location for the combined Department that will meet our expanding business needs over the coming 20-year time horizon. When this happens, we will finally be in a position to realize all of the potential benefits of the combined Department laid out by Governor Scott and the consolidation study committee.

4. Recommendations for Legislative Action

We have several areas where a legislative change would be helpful. One is related to criminal background checks. Criminal background checks are a statutorily required part of the licensing process. The Department has been told by the Department of Public Safety that a change or addition to statute is needed to allow DLL to conduct national criminal background checks. Our goal is to conduct these in an efficient manner that will improve the customer service we provide to applicants which is a goal noted in the licensing discussion in Section 2 above.

A second area for legislative action is the modernization of the Lottery by approving iLottery which will allow players to purchase draw game tickets and play e-instant games on-line. This will allow us to meet our players where they want to play which is a standard and reasonable customer expectation. The COVID-19 shutdowns which started in March negatively impacted fourth quarter lottery sales and further highlighted the need to move the Lottery into the 21st century by allowing iLottery.

We want to take this opportunity to thank the Legislature for addressing our yearly licensing tsunami during the 2020 session. This statutory change has arrived just in time for our licensing system vendor to build these changes into our new licensing system.

Respectfully Submitted,

A handwritten signature in black ink that reads "Gary Kessler". The signature is written in a cursive, flowing style.

Gary Kessler, Deputy Commissioner
Department of Liquor & Lottery