

**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 3, 2020

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.

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. Both divisions have major projects underway or in the request for proposal (RFP) phase. 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 shortly after the consolidation became law. The Liquor division was also undertaking a major signage project for the retail stores and was also working on a request for information (RFI) for an online licensing system. The Lottery division was working on the creation of an RFP for a gaming system vendor. The contract with the existing vendor is set to expire after ten years in July 2020. The RFP is for a ten-year contract with two five-year extensions for a possible twenty-year contract worth an estimated \$80-120 million to the winning vendor or more if additional gaming options for the Lottery are approved by the legislature during the contract time frame. While all this mission critical work was taking place in the two divisions the regular day-to-day business operations had to also continue uninterrupted.

I am happy to report that despite all these challenges both divisions continue to function very well. 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 the last three and a half years, as this experience allowed them to communicate and coordinate their efforts effectively despite now operating two businesses out of separate offices.

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

- In FY 19 Lottery sales were a record \$139,267,937 up \$6,848,000 (5.17%) over FY 18.
- In FY 19 Liquor revenues were a record \$90,655,320¹ up \$3,694,523 (4.25%) over FY 18.
- In FY 19 the Lottery division transferred a record \$29,179,325 to the Education Fund which was up \$2,025,482 (7.45%) over FY 18.
- In FY 19 the Liquor division transferred a record \$25,392,200 to the General Fund which was up \$1,057,841 (4.35%) over FY 18.
- The Liquor division \$9,000,000 point-of-sale project was complete ahead of schedule and under budget which is highly unusual for such a large and complex IT project.

In conclusion, we believe that the new combined Department has been highly successful in carrying out its required functions.

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 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.

¹ This figure represent total gross income of which liquor sales were \$87,464,770. Other major income sources included licensing fees of \$2,434,565, FDA contract of \$313,965, Tobacco Master Settlement payment of \$213,841 and educational fees of \$201,222.

- 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 Liquor IT Director. This has allowed the work of both divisions to be better allocated amongst the five existing IT staff members. More importantly, this has created bench strength at Lottery where there is a single IT staff person with very specialized knowledge and skills with no back-up in place. This change is helping to mitigate the possibility of a single point of failure that threatens Lottery operations.
- 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, and this effort is continuing. 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 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 has been prepared and it is expected to be issued in early 2020.²
- Previously, Lottery had an Administrative Services Manager that oversaw financial operations and customer service and Liquor 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 and will supervise a five-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 customer service representatives. This was an internal promotion and has resulted in a higher level of focus on customer service than had been the case previously. While this is a recent change, we are already 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 an additional staff member 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 allowed us to efficiently fill this opening.
- The Lottery has a staff member who works on social media. This staff member will be spending a portion of her time working to assist Liquor in improving its social media presence and engagement.

² The licensing RFP is completed. The issuance of the RFP is being delayed as a report is being issued related to a possible statewide licensing solution.

- 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-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 outfitted for the Lottery in 2004 and includes 5,000 square feet of warehouse space and 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 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. The space is also very inefficient to operate as over 2,100 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).

Recognizing that we could not have a repeat of last year's warehouse issues we began 8-10 months ago to make 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 de minimis level. Despite this risk we felt that we had little choice but to make the changes. Our Liquor Warehouse Director said the change to just-in-time delivery of product to the warehouse along with modifications in our agent delivery schedule and automation of agent ordering via a new point-of-sale system resulted in the least stressful December in his 26-year career, and also had the benefit of drastically reducing warehouse staff overtime hours all while shipping a record 47,833 cases in December, a 10.2% increase over cases shipped in 2018.

Since the consolidation we have been looking at how we could efficiently create a single office and warehouse space for the Department. We are considering a large array of options in our efforts to accomplish this goal. We have worked closely with BGS staff and have had numerous meetings and planning discussions with them. Presently, BGS staff, in consultation with Department management, have completed and posted an RFP for consulting services to help us narrow the many possible options and find a solution that is both efficient and cost effective. We expect RFP submittals to be received in the next 45-days with evaluation of the proposals in the following weeks.

Here are some of the options that are under consideration:

- Build an office and warehouse space specifically to suit the Department's needs.
 - The building could be owned by the State.
 - The building could be developed and owned by a third party and leased to the Department.
 - The building could be developed and owned by a third party with a lease to own agreement.
- Identify existing available office/warehouse space and purchase or lease this space (we have looked at several facilities).
- Find existing office space and purchase or lease it to allow office consolidation. This would *not* include the Liquor warehouse.
- Build office space to allow office consolidation. This would *not* include the Liquor warehouse.
 - The building could be owned by the State.
 - The building could be developed and owned by a third party and leased to the Department.
 - The building could be developed and owned by a third party with a lease to own agreement.
- Contract with a private company either in-state or out-of-state to operate a liquor warehouse and deliver product directly to our agents.
- Contract with a private company either in-state or out-of-state, to operate a liquor warehouse which would pick store orders and ship wrapped and palatized to our existing warehouse. Our existing warehouse would function as a cross-dock with Department staff continuing to provide deliveries to our agents.

As you can see there are a wide range of options to consider. Our goal in evaluating each option is to generate the greatest amount of revenue for the Education Fund and the General Fund in the long term. We also want to reap the benefits of the consolidation as quickly as possible, keeping in mind that some of these benefits will only be fully realized once the Department's office staff is housed in a single building.

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 part of the licensing process and required by statute. 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 improvement is allowing liquor licensing to be done on a rolling basis throughout the year. Presently, all liquor licenses expire on April 1st each year. This may have worked acceptably when there were a few hundred licensees but now it is over 7000. This single expiration date hurts economic development, results in a less than ideal level of customer service and creates a huge demand on staff to renew all these licenses on the same day. The Department would like to work with legislative council and our committees of jurisdiction to get both issues resolved this session.

Respectfully Submitted,



Gary Kessler, Deputy Commissioner
Department of Liquor & Lottery