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Opinion No. 10-73

Tennessee Education Lottery Corporation: Contract Amendments

QUESTIONS

1. What obligation does the Tennessee Education Lottery Corporation ("TEL") have to follow state procurement rules?

2. In 2003, TEL went through a procurement process for its lottery gaming systems and services agreement and its instant ticket printing and associated services agreement. Effective January 20, 2004, TEL entered into a Lottery Gaming Systems and Services Agreement with Gtech Corporation (the "Gtech Agreement") and an Instant Ticket Printing and Associated Services Agreement with Scientific Games International, Inc. (the "Scientific Games Agreement"). Each of these contracts was to terminate on April 9, 2011. Effective March 3, 2009, TEL and Gtech Corporation amended the Gtech Agreement by changing the expiration date to April 9, 2015, thereby extending the term for four additional years. Effective February 26, 2009, TEL and Scientific Games International, Inc., amended the Scientific Games Agreement by changing the expiration date to April 9, 2015, extending the term for four additional years.

a. Is the TEL authorized to extend major contracts without receiving the approval of state agencies, officers, or legislative committees?

b. What are the guidelines, regulations, and/or rules governing major contract extensions?

c. Is there a limit to how many years a contract may be extended?

d. Does the contract between TEL and Scientific Games International, Inc., include an option to extend?

e. Does the contract between TEL and Gtech Corporation provide for an option to extend?

3. Are any TEL procurement decisions subject to the legislative Fiscal Review Committee or the legislative Lottery Oversight Committee?

4. In addition to the two contract extensions described in Question 2, the TEL originally awarded its Instant Ticket Vending Machine ("ITVM") business to Scientific Games International, Inc. But, as a part of the extensions described in Question 2, this portion of the Scientific Games Agreement was canceled and awarded to Gtech Corporation without going through the request for proposal ("RFP") process. Should the award of ITVM business to Gtech have been made after a new RFP process?

OPINIONS

1. Generally, service contracts of state agencies in the executive branch must comply with Tenn. Code Ann. § 12-4-109 and rules promulgated by the Department of Finance and Administration. Contracts for the purchase of supplies and commodities for state agencies must generally be purchased through the Department of General Services. Tenn. Code Ann. §§ 12-3-101, *et seq.* But TEL contracts are not subject to these statutes or rules. Instead, Tenn. Code Ann. § 4-51-126 sets forth a separate procurement procedure for TEL contracts. The board of directors of TEL is authorized to adopt policies and procedures governing major procurement contracts. These policies are subject to the approval of the State Board of Standards. TEL must submit procurement documents to a Lottery Procurement Panel made up of the Treasurer, Secretary of State, and the Commissioner of Finance and Administration. The panel is authorized to comment on the documents but is not required to approve them.

2. a. and b. Under its Major Procurement Policy, TEL may amend a "major procurement contract" if the chief executive officer ("CEO") makes any one or more of three different determinations: first, that the amendment is within the original scope of work and within the intent and purpose of the applicable major procurement contract; second, that the amendment is a logical extension to the original scope of work of the applicable major procurement contract; and/or third, that, if entered into as a stand-alone contract, such contract would not constitute a major procurement contract as defined in the policy. Under Tenn. Code Ann. § 4-51-104(c)(2), the board must approve the amendment and, therefore, review the facts and circumstances underlying the CEO's determination. No approval by any state agencies, officers, or legislative committees is required.

c. The statutes governing the TEL and its Major Procurement Policy do not impose an express limit on the number of years a major contract may be extended. But any extension must be approved by the board after a determination by the CEO in accordance with the policy as discussed above.

d. and e. The 2004 Gtech Agreement and Scientific Games Agreement do not include an explicit option to extend, but neither do they forbid an extension.

3. Under Tenn. Code Ann. § 4-51-111, after paying its operating expenses, TEL must transfer net lottery proceeds to the "lottery for education account" in the state treasury. Thus, the operating expenses of TEL are directly related to the amounts available for transfer to the State. For this reason, the Fiscal Review Committee is authorized to review TEL operations. But procurement decisions by the TEL are not subject to the committee's prior review or approval. Similarly, while the Select Committee on the Tennessee Education Lottery Corporation may

review and investigate TEL operations, procurement decisions by the TEL are not subject to the committee's prior review or approval.

4. As discussed above, under its Major Procurement Policy, TEL may amend a "major procurement contract" if the CEO makes any one or more of three different determinations: first, that the amendment is within the original scope of work and within the intent and purpose of the applicable major procurement contract; second, that the amendment is a logical extension to the original scope of work of the applicable major procurement contract; and/or third, that, if entered into as a stand-alone contract, such contract would not constitute a major procurement contract as defined in the policy. Further, the board of directors must approve the amendment pursuant to Tenn. Code Ann. § 4-51-104(c)(2) and, therefore, review the facts and circumstances underlying the CEO's determination. The TEL minutes reflect that the board approved the amendments in question in accordance with statute and policy.

ANALYSIS

1. Tennessee Education Lottery Corporation and State Procurement Rules

This opinion addresses several questions about the duty of the Tennessee Education Lottery Corporation ("TEL") with regard to contract negotiations and awards. The first question is what obligation the TEL has to follow state procurement rules. The TEL was created and operates under Tenn. Code Ann. §§ 4-51-101, *et seq.* Under Tenn. Code Ann. § 4-51-101(c), the TEL:

> shall be a body, politic and corporate, and a quasi-public instrumentality, and not a state agency or department, which shall be deemed to be acting in all respects for the benefit of the people of the state through the operation of a state lottery and in the performance of other essential public functions entrusted to it.

The TEL is governed by a seven-member board of directors. Tenn. Code Ann. § 4-51-103. The board appoints and provides for the compensation of a chief executive officer ("CEO"). Tenn. Code Ann. § 4-51-104(a). Under subsection (b) of the statute, "[t]he board of directors shall provide the chief executive officer with private sector perspectives of a large marketing enterprise." Among its other duties, the board is required to "[a]pprove, disapprove, amend, or modify the terms of major lottery procurements recommended by the chief executive officer," and to "[a]dopt regulations, policies, and procedures relating to the conduct of lottery games and as specified in § 4-51-108[.]" Tenn. Code Ann. § 4-51-104(c)(2) & (5).

Generally, service contracts of state agencies in the executive branch of government must comply with Tenn. Code Ann. § 12-4-109 and rules promulgated by the Department of Finance and Administration. Supplies and commodities for state agencies must generally be purchased through the Department of General Services. Tenn. Code Ann. §§ 12-3-101, *et seq.* TEL contracts are not directly subject to these statutes or rules. Instead, Tenn. Code Ann. § 4-51-126 sets forth a separate procurement procedure for TEL contracts. Under Tenn. Code Ann. § 4-51-126(a)(1):

> All major procurement contracts shall be competitively bid pursuant to policies and procedures adopted by the board pursuant to § 4-51-104(c)(5) and approved by the board of standards pursuant to subdivision (a)(2). Such policies and procedures shall be designed to allow the selection of proposals that provide the greatest long-term benefit to the state, the greatest integrity for the corporation and the best service and products for the public. The requirement for competitive bidding does not apply in the case of a single vendor having exclusive rights to offer a particular service or product.

Under subdivision (a)(2) of this statute, TEL policies and procedures governing competitive bidding of major procurement contracts for on-line and instant ticket lottery vendors and for advertising contracts estimated to exceed $500,000 in value ("Major Procurement Contracts") are subject to approval by the state Board of Standards. The TEL may administer its own bidding and procurement, or it may use the services of the Tennessee Department of General Services or another state agency or subdivision. Tenn. Code Ann. § 4-51-126(b). Tenn. Code Ann. § 4-51-126(c) establishes a Lottery Procurement Panel. The Secretary of State, State Treasurer, and Commissioner of Finance and Administration are the panel members. Before issuing procurement documents for major procurement contracts, TEL must file the documents with this panel. The panel is authorized to comment on the documents but is not required to approve them.

2. TEL Authority to Extend Contract Term

Question 2 addresses TEL's agreement in early 2009 to extend its two major service contracts for an additional four years. In 2003, TEL went through a procurement process for its lottery gaming systems and services agreement and its instant ticket printing and associated services agreement. Effective January 20, 2004, TEL entered into a Lottery Gaming Systems and Services Agreement with Gtech Corporation (the "Gtech Agreement") and an Instant Ticket Printing and Associated Services Agreement with Scientific Games International, Inc. (the "Scientific Games Agreement"). Each of these contracts was set to expire on April 9, 2011. Effective March 3, 2009, TEL and Gtech Corporation amended the Gtech Agreement by changing the expiration date to April 9, 2015, thereby extending the term for four additional years. Effective February 26, 2009, TEL and Scientific Games International, Inc., amended the Scientific Games Agreement by changing the expiration date to April 9, 2015, extending the term for four additional years. Copies of these agreements and amendments are posted on TEL's website.

The first question is whether the TEL may extend the term of major contracts without receiving the approval of state agencies, officers, or legislative committees. As discussed above, TEL major procurement contracts must be solicited in compliance with TEL policies. These policies are adopted by TEL subject to the approval of the state Board of Standards. TEL's Major Procurement Policy is posted on its website. Section 1.0.3 E. addresses contract amendments. This section provides:

> Contract Amendment. A contract amendment is a written document that changes, adds or deletes one or more terms or conditions of an existing contract. During

> the course of the performance of a contract, it may become necessary to change, add to or delete from the terms and conditions of the contract.
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> 1. A contract amendment shall clearly detail the additions, deletions, and modifications to the subject contract.
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> 2. The Corporation may enter into a contract amendment with respect to a major procurement contract if the chief executive officer determines any or all of the following: (A) the contract amendment is within the original scope of work and within the intent and purpose of the applicable major procurement contract, (B) the contract amendment is a logical extension to the original scope of work of the applicable major procurement contract, or (C) if entered into as a stand-alone contract, such contract would not constitute a major procurement contract.

The policy defines "major procurement contract" to mean:

> any contract for gaming products or services in excess of seventy-five thousand dollars ($75,000), including, but not limited to, major advertising contracts, annuity contracts, prize payment agreements, consulting services, equipment, tickets and other products and services unique to the Tennessee lottery, but not including materials, supplies, equipment and services common to the ordinary operations of a corporation.

Major Procurement Policy, § 1.0.1 E. Thus, under its Major Procurement Policy, TEL may amend a "major procurement contract" if the CEO makes any one or more of three different determinations: first, that the amendment is within the original scope of work and within the intent and purpose of the applicable major procurement contract; second, that the amendment is a logical extension to the original scope of work of the applicable major procurement contract; and/or third, that, if entered into as a stand-alone contract, such contract would not constitute a major procurement contract as defined in the policy. Under Tenn. Code Ann. § 4-51-104(c)(2), the Board must approve the amendment and, therefore, reviews the facts and circumstances underlying the CEO's determination. No approval by any state agencies, officers, or legislative committees is required.

The next question is whether there is a limit to how many years a contract may be extended instead of awarding a new contract through a new procurement process. No express limitation is contained in the Tennessee Education Lottery Implementation Law, Tenn. Code Ann. §§ 4-51-101, *et seq.* But a contract extension would be governed like other major contract amendments. Thus, the CEO would be required to make an appropriate determination under § 1.0.1 E. of the TEL's major procurement policy. The TEL board of directors would review this determination, as the board must approve amendments to the terms of major lottery procurements recommended by the CEO under Tenn. Code Ann. § 4-51-104(c)(2).

The next question is whether either the original Gtech Agreement or the Scientific Games Agreement, effective in 2004, contains an option to extend the term of the agreement.

We have reviewed copies of these agreements as posted on TEL's website. Neither agreement contains an explicit option to extend the term, but neither prohibits such an extension.

3. Role of Legislative Committees in TEL Procurement Decisions

The next question is whether any TEL procurement decisions are subject to the Fiscal Review Committee or the Lottery Oversight Committee. These committees are made up of members of the General Assembly. The Fiscal Review Committee is a special continuing committee created and operating under Tenn. Code Ann. §§ 3-7-101, *et seq.* It includes members from both houses. The function of this committee is to conduct a continuing review of such items as revenue collections, budget requests from the several spending agencies of the State, the recommended executive budget, appropriations, work programs, allotments, reserves, impoundments, the state debt, and the condition of the various state funds. Tenn. Code Ann. § 3-7-103(a). The Contract Services Subcommittee within the Fiscal Review Committee also generally reviews state fee-for-service type contracts. Tenn. Code Ann. § 3-7-112. The Fiscal Review Committee also has authority over decisions by state executive agencies to enter into non-competitive contracts. Tenn. Code Ann. § 12-4-109(a)(1)(G). As noted above, however, TEL contracts are not subject to this statute. But under Tenn. Code Ann. § 4-51-111, after paying its operating expenses, TEL must transfer net lottery proceeds to the "lottery for education account" in the state treasury. Thus, the operating expenses of TEL are directly related to amounts available for transfer to the State. For this reason, the Fiscal Review Committee is authorized to review TEL operations. But procurement decisions by the TEL are not subject to prior Fiscal Review Committee review or approval.

We assume the term "Lottery Oversight Committee" refers to the Select Committee on the Tennessee Education Lottery Corporation created under Tenn. Code Ann. § 4-51-133. This committee includes members from both houses. Under Tenn. Code Ann. § 4-51-133(c):

> The select committee, at the call of the co-chairs, shall periodically inquire into and review the operations of the Tennessee Education Lottery Corporation as well as periodically review and evaluate the success with which the corporation is accomplishing its statutory duties and functions as provided in this part and shall inquire into and review the educational programs and purposes otherwise provided by law and established in accordance with the provisions of Tenn. Const. art. XI, § 5.

This committee may also conduct, or cause to be conducted, any independent audit or investigation of the corporation it deems necessary. Tenn. Code Ann. § 4-51-133(d). Procurement decisions by the TEL are not subject to prior review or approval by the Select Committee on the Tennessee Education Lottery Corporation.

4. Amendments to Vendor Contracts: Instant Ticket Vending Machines

The last question concerns the 2009 amendments to the Gtech Agreement and the Scientific Games Agreement. As discussed above, the parties to these contracts extended each for an additional four years. In addition, the 2009 contracts transfer responsibility for Instant

Ticket Vending Machine ("ITVM") business from Scientific Games International, Inc., to Gtech Corporation. Responsibility for this business appeared in the original Scientific Games Agreement, which provided in relevant part:

> 17. OBLIGATIONS OF VENDOR
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> * * * *
>
> (k) Vendor will provide five hundred (500) PlayCentral[tm] instant ticket vending machines with a minimum of sixteen (16) bins each and with report gathering capabilities. As mutually agreed by TEL and Vendor, the bins on certain machines will be upgraded to contain more tickets when justified by increased ticket demand at particular retailer locations. Vendor will provide the TEL with available sales data from its host system, as requested. As determined by the TEL, vending machines will be provided on an "as needed" basis as retailer locations are established and will not be ordered until such time as retailer locations are established and TEL provides Vendor with a list of approved machine locations.

The February 26, 2009, First Amendment to the Instant Ticket Printing and Associated Services Agreement provides in relevant part:

> 3. INSTANT TICKET VENDING MACHINES
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> (a) The parties agree to amend Vendor's obligations related to the instant ticket vending machines ("ITVM") supplied to TEL under Section 17(k) of the Agreement as follows:
>
> (b) The ITVM supplied by Vendor under the Agreement shall be replaced by equipment provided by another TEL Vendor ("New Vendor"), therefore, as of the date of this First Amendment, Vendor shall be relieved of any obligation to supply ITVM to TEL under Section 24(k) [sic] of the Agreement and shall not be liable to the TEL for any related failure to supply, maintain, service or repair ITVM under the Agreement. Vendor will be responsible for the removal and transportation of ITVM from the installed location to Vendor's warehouse. Neither the New Vendor nor the TEL shall have any responsibility for removing the ITVM from such installed locations.
>
> (c) As of April 1, 2009, Vendor shall be relieved of any obligation under the Agreement in relation to, and shall no longer be responsible for, maintaining, servicing or repairing the ITVM. Vendor agrees to continue to supply spare parts to TEL or New Vendor, as the case may be, for the ITVM as reasonably required, and at no additional cost, through December 31, 2009. Thereafter, Vendor shall be authorized to receive compensation for any spare parts ordered for ITVM at a

> price and in accordance with the terms agreed upon by the parties, or by Vendor and New Vendor, as the case may be.

The March 3, 2009, Amendment to and Extension of Lottery Gaming Systems and Services Agreement with Gtech Corporation provides in relevant part:

2. Instant Ticket Vending Machines (ITVMs).

> a. The Vendor will provide, install and maintain up to eight hundred (800) EDS-Q ITVMs at no additional charge to the TEL based upon the terms and conditions set forth on Exhibit A of this Amendment and Extension Agreement. The Vendor shall service and maintain the machines in accordance with Exhibit B attached to this Amendment and Extension Agreement.
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> b. The TEL agrees that the title and risk of loss to each ITVM provided under the Agreement shall remain with the Vendor at all times throughout the Term of the Agreement and subsequent to the termination thereof.
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> c. The Vendor grants to the TEL, for the Term of this Agreement and any extensions thereof, a fully paid-up, irrevocable, nonexclusive license, without right to sublicense, to use the Software contained in the ITVMs provided by the Vendor to the TEL under the Agreement solely as an integrated component of the ITVMs. The Software shall be contained in the ITVMs and may not be removed, edited, modified, altered, reverse engineered or otherwise disassembled without the prior written consent of the Vendor.
>
> d. Except as expressly provided under the Agreement, including Section 3(b) above, the TEL acknowledges that it shall have no right, title or interest in or to any intellectual property rights relating to any of the ITVMs. All intellectual property rights whatsoever arising in relation thereto are and shall remain the sole property of the Vendor or its licensors, as appropriate.

The request asks whether TEL, instead of amending the two existing vendor agreements to bring about the transfer of responsibilities, should have treated the change as a new contract to be awarded through its procurement process.

As discussed above, under its Major Procurement Policy, TEL may amend a "major procurement contract" if the CEO makes any one or more of three different determinations: first, that the amendment is within the original scope of work and within the intent and purpose of the applicable major procurement contract; second, that the amendment is a logical extension to the original scope of work of the applicable major procurement contract; and/or third, that, if entered into as a stand-alone contract, such contract would not constitute a major procurement contract as defined in the policy. Further, the TEL board must approve modifications to major lottery procurements under Tenn. Code Ann. § 4-51-104(c)(2) and, therefore, review the facts and circumstances underlying the CEO's determination. Minutes from meetings of the TEL board of

directors reflect that the board approved the amendments in question on February 23, 2009. The minutes of that meeting summarize the recommendations of Ms. Hargrove, the TEL CEO, as follows:

> Ms. Hargrove stated that as part of the Corporation's plans for continuous improvement, management was attempting to reduce costs, while increasing sales, which will generate more income to the TEL's beneficiary programs. Currently, in the industry over 70% of the nation's lottery sales come from traditional convenience stores that sell gas. The volatility of gas prices has had more of an impact on lottery ticket sales than the downturn of the economy. Over the last few years the sales team had attempted to recruit "big box" retail stores such as Dollar General, CVS, Walgreens, Wal-Mart and Home Depot into the TEL family, but has had little luck. In recruitment of the big box stores various types of equipment was tested and the equipment preferred by these retailers is not part of TEL's current inventory. As part of its quest to move into this market an evaluation was done by TEL management on how to best acquire that equipment. The TEL's online gaming system is operated by GTECH, and in order to provide the type of connectivity required by the big box store retailers the TEL needed to acquire this equipment from GTECH. GTECH informed the TEL that the cost to purchase the equipment was $12 million. Given the current economic conditions, management did not want to spend $12 million, but needed to be in the position to offer the desired equipment.
>
> After much research and discussion management determined that if the Corporation amended the contract with GTECH to allow four (4) more years on the current term the TEL could receive the equipment and the maintenance and service that was needed without any expenditure from the Corporation. Moreover, an assessment was made of the existing equipment and it was determined that the online equipment and terminals were in very good condition and were viable for at least another four years after the scheduled contract termination.
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> .
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> At the same time management determined that it was more efficient to have both the online gaming system contract and the instant ticket contract run concurrently because of software issues. Consequently, we approached Scientific Games about amending the instant ticket contract for an additional four (4) years. In doing that management was able to obtain a reduction in price not only in the four (4) years of the extension but also in the two (2) remaining years on the current contract as well as software for a players club; rights to use the company's licensed property *Monopoly* game, and continued support for the "Play it Again" program.
>
> That being said, Ms. Hargrove recommended that the Board approve the execution of amendments to the GTECH and Scientific Games contracts.

(Minutes of the Meeting of the Board of Directors of the Tennessee Education Lottery Corporation, February 23, 2009, pp. 5-6). In response to a question about the board's authority to approve the amendments, Ms. Wilson, Executive Vice President and General Counsel for TEL, cited the Major Procurement Policy and stated that the CEO had made a determination that the amendments were a logical extension to the original scope of work and within the intent and purpose of the contract, as required by the policy. (Minutes, p. 6). The minutes reflect that the CEO answered several other questions about the amendments, including the following:

> Mr. McNabb [a board member] next asked Ms. Hargrove why the machines are needed and why does the lottery not already have them. Ms. Hargrove stated that this equipment is for the big box stores or multi-lane environments. When there are one or two cash registers the current equipment works because the lottery terminal is next to the cash register or between the two. When there is a multi-lane environment it is very difficult to follow the traditional lottery model. In multi-lane environments or big box stores in order for the lottery to recruit them the Corporation had to follow a different model. This equipment is new and the connectivity that it has is what the Corporation needs to recruit this new customer. Tests are currently being conducted by some of the big box stores and they love the equipment and are ready to move forward.

Id. The board then approved the amendments. The minutes include a board resolution regarding the amendments. This resolution includes the following statements:

> WHEREAS, in accordance with the TEL's Major Procurement Policy the Chief Executive Officer has made a determination that the proposed contract amendments are within the original scopes of work and within the intent and purpose of the above noted major procurement contracts.
>
> RESOLVED, that the Board hereby accepts the Chief Executive Officer's recommendation to amend the above noted contracts and be it further resolved that she is authorized to execute the same.

The TEL minutes, therefore, reflect that the amendments were approved in accordance with TEL's Major Procurement Policy and Tenn. Code Ann. § 4-51-104(c)(2).

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