SUBJECT: Allowing "pay for success" contracts for state agencies

COMMITTEE: Investments and Financial Services — committee substitute recommended

VOTE: 6 ayes — Parker, Longoria, Capriglione, Flynn, Landgraf, Stephenson

0 nays

1 absent — Pickett

WITNESSES: For — Madeline McClure, TexProtects (Texas Association for the Protection of Children); (*Registered, but did not testify*: Michelle Corson, Champion Capital; Knox Kimberly, Lutheran Social Services of the South; Erica Lee Carter, Nurse Family Partnership; Nirav Shah, Social Finance; Sarah Crockett, Texas Court Appointed Special Advocates; Melody Chatelle, United Ways of Texas; Adrianna Torres-Garcia)

Against — (*Registered, but did not testify*: Harrison Hiner, Texas State Employees Union)

On — Joe Hamill, American Federation of State, County, and Municipal Employees; Jennifer Carreon, Texas Criminal Justice Coalition

BACKGROUND: Success contracts, also known as pay for performance contracts or social impact bonds, are contracts made between a governmental entity and a private company where payment of all or part of the contract’s value is dependent on the achievement of certain performance measures. If those performance measures are not achieved, then some or all of the payment may be withheld.

The House Committee on Corrections, as one of its 2014 interim charges, was directed in the area of juvenile justice to analyze and make recommendations on outcome-based financing models that would allow the state to partner with private companies that would cover the upfront costs and assume performance risk to divert youths into cost-effective programs and interventions.

DIGEST: CSHB 3014 would create a trust fund capped at $50 million existing outside the state treasury with the comptroller as the trustee. The fund would consist of money appropriated by the Legislature and could be used to make success contract payments and for any expenses incurred in administering the trust fund or success contracts.

The bill would allow the comptroller and a state agency to jointly enter into a success contract with any person, as long as the terms provided:

- that a majority of the contract payment was conditioned on the contractor meeting or exceeding certain performance measures;
- a defined objective procedure by which an independent evaluator would determine whether the specified performance measures had been met or exceeded; and
- a schedule of the amounts and timing of payments that indicated the specific payment amounts conditioned on meeting or exceeding the specified performance measures.

A success contract could be executed only if:

- the comptroller and the Legislative Budget Board certified that the proposed contract was expected to result in significant performance improvements and budgetary savings if the performance targets were achieved; and
- enough money was in the trust fund to make all payments that would come due.

The bill would require the comptroller to make payments for success contracts only from the trust fund and only in accordance with the terms of the success contracts. Any money that was received from the contractor for penalties or overpayment would be returned to the trust fund. Any money that was in the trust fund that remained unpaid when the contract expired or was terminated would be returned to the state treasury or account from which the money originally was appropriated.

At the beginning of each regular session, the comptroller would present a report to the Legislature providing details about how successful each success contract had been in achieving the specified performance measures, as well as details about proposed future success contracts.

The bill would authorize the comptroller to adopt rules as necessary to administer success contracts. The comptroller also could adopt joint rules with another agency that could be party to a success contract.

This bill would take effect September 1, 2015.

SUPPORTERS SAY:

CSHB 3014 would result in a significant improvement in the state's ability to innovate and address a variety of future challenges. By authorizing contracts for which payment would be contingent on success, this bill would allow agencies to contract with private entities to tackle tough social problems through inventive solutions without actually risking agency resources.

This bill would require the Legislative Budget Board and the comptroller to certify that the success contract would result both in significant performance improvement and in budgetary savings if the project met its goals. Fraud, therefore, would be unlikely because each contract would receive its own independent analysis conducted by the state agency, the comptroller, and the Legislative Budget Board.

Many social problems exist for which there is no surefire solution. Instead of attempting to innovate within the agency, success contracts would allow private entities to step in and try a variety of solutions without putting state resources at risk because payment would happen only if the targets were achieved.

Success contracts could result in major achievements in tackling difficult social problems. One success contract of this type was the Peterborough Social Impact Bond, which gave private organizations the opportunity to try various strategies to reduce recidivism of some prisoners. The program resulted in an 8.4 percent reduction in recidivism over and above what likely would have happened without the success contract.

Texas has many areas for which success contracts could be useful, including early childhood and prenatal care programs, as well as elder care and home visitation projects. In fact, one of the 2014 interim charges to the House Committee on Corrections recommended developing and supporting the use of success contracts in Texas, specifically within the Texas Juvenile Justice Department.

Profit is a necessary incentive for the partnering private entity to innovate and take risks. Unless the organization believed that it would make a profit on the contract, it would have no reason to accept the contract in the first place. A competitive market would ensure that private entities' profits were not excessive.

Because of the variance in the types of contracts that might arise, any transition plan to make successes permanent would be handled by the agency on a contract-by-contract basis and would not need to be codified by the Legislature.

OPPONENTS SAY:

CSHB 3014 would create a fund to be used in conjunction with complicated finance schemes that could be vulnerable to fraud. This would present a need for protections and specific provisions within the legislation. The terms of success contracts should be carefully defined so that they did not achieve objectives that the state agency already knew were attainable through conventional means. For instance, a contractor could attempt to profit by targeting a specific population that would be easiest to serve, rather than one for which success in improving the welfare of the population would be harder to demonstrate.

Any legislation enabling success contracts should not displace current agency personnel. Because the private entity would be paid only if the target was achieved, success contracts inherently mean that the state would pay more than the amount the project actually cost because the risk of failure is transferred to the private entity. Success contracts should be aimed at going above and beyond the current level of performance and not replacing current agency efforts.

The Legislature should consider limiting returns on success contracts. These contracts should function as a tool to achieve a social good rather than merely as a means for private corporations to profit from state funds.

The Legislature also should consider how to integrate the programs into a permanent framework. Once the success contract ended, a transition plan would need to be in place so that the program could be integrated into the agency and its benefits sustained.