



State of New Jersey
DEPARTMENT OF THE TREASURY

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NJ Lottery Agrees to Northstar Contract Changes to Settle Adverse Action

TRENTON – The New Jersey Lottery has amended the sales and marketing contract with Northstar New Jersey Lottery Group to settle an adverse action resulting from its denial of Northstar’s plan to install monitor games at retailers throughout the state.

This amendment, adjusting net income targets, ensures a continued path forward for the New Jersey Lottery and its partnership with Northstar in light of the Lottery’s denial of the use of monitor games and a changing national lottery market.

As a result of this settlement, the revised agreement:

- Requires Northstar to guarantee existing revenue to the State of New Jersey in FY 16;
- Provides escalating guarantees by Northstar to the State in the next two fiscal years;
- Shrinks the cap on Northstar’s share of revenue earned above projections – its “incentive compensation” structure – by 40%, and;
- Recognizes the national trend of declining lottery revenue and the denial of monitor games as an income-generating tool, reflected in lower net income targets.

Northstar filed a notice of adverse action because its plan to implement monitor games in FY15 was denied. Monitor games were included in Northstar’s bid proposal, and revenues from monitor games were part of its FY15 Business Plan. The New Jersey Lottery rejected that part of the plan. The Division is taking a holistic view of how new products will affect the state’s entire gaming industry – not just the Lottery.

As a result, Northstar exercised the “adverse action” section under the Services Agreement contract. The contract with Northstar defines an adverse action as any affirmative action by the State or the Division of Lottery “which is reasonably expected to have a material adverse effect on the Lottery’s Net Income and Manager’s ability to earn and collect incentive compensation...” Northstar asserts that the non-approval of monitor games is reasonably expected to have such a material adverse effect.

The Lottery and Northstar engaged in discussions to resolve the dispute in accordance with the Services Agreement. Today’s announcement is the result of a negotiated settlement between the State and the vendor, which provides all sales, advertising and marketing services to the Lottery. The Lottery still retains full management control and oversight of those operations.

The contract amendment also acknowledges the severe and dramatic decline in sales of Powerball and Mega Millions tickets throughout the lottery industry, a trend that began in early 2014 and has negatively impacted the ability to produce anticipated revenues. Both games have suffered from “jackpot fatigue,” resulting in a \$116 million sales decline in New Jersey in FY15 over FY14. The decline continues in FY16 with sales for those games running 23% behind last year. With no monitor games to help offset the loss of national game revenue and without this amendment, Northstar’s partnership with the State would have faced economic peril.

Under the amendment, Northstar has agreed to guarantee Lottery’s net income for the next three fiscal years and will make up any deficits, should they occur. Under the agreement, Northstar will guarantee a minimum of:

- \$960 million in net income to the State for FY16, which includes a \$2.5 million pre-payment by Northstar that will be made on or prior to Dec. 31, 2015;
- \$965 million in net income for FY17;
- \$985 million in net income for FY18.

In addition, both parties agreed to settle the amount of the net income shortfall for Fiscal Year 2015 at \$5.89 million, which will be satisfied through the remaining income shortfall credit amount that Northstar was provided under the initial contract. Northstar also will make a one-time payment of \$12.9 million to Lottery prior to Dec. 31, 2015, in final settlement of FY15.

Northstar’s incentive compensation – how much it can earn by exceeding net income targets – also will be capped at just 3% of net income, compared with 5% under the initial contract. In addition, the Upper Level Incentive Compensation rate of 30% is eliminated entirely. If the State decides to approve monitor games in the future, the net income targets may be adjusted accordingly.

Lottery Executive Director Carole Hedinger said the Division agreed to the amendments because its marketing partner provides valuable and cost-effective services that the Division could not replicate on its own.

“With lower levels of support from Northstar, Lottery’s revenues could drop considerably,” Hedinger said. “This amendment affirms Northstar’s commitment to continue to invest in technology and services to support the New Jersey Lottery.”

She also said that disengaging from the Northstar contract, as some critics have suggested, is not a viable option for the State because the Lottery would have to hire dozens of skilled sales, marketing, advertising, technology and retailer relations experts to replicate what Northstar provides. The State would have to lease space for 75 new employees – who would receive State pension and health benefits – as well as procure nearly as many vehicles for them to travel around New Jersey supporting retailers.

Director Hedinger estimated that an early termination of the contract would cost the State more than \$120 million, not including the cost of consultants, to replicate the technology and skilled personnel that Northstar provides.

“It would cost far more for the State to try and duplicate the technology upgrades and sales and marketing expertise that Northstar provides,” Hedinger said. “Therefore, doing it all in house is not an option. Northstar is a valued partner that has delivered meaningful and necessary technology and retailing upgrades that will benefit the citizens of our state.”

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