

**IN THE MATTER** of the Gambling Act 2003  
**AND** on appeal by **THE TRUSTS  
CHARITABLE FOUNDATION**

**BEFORE A DIVISION OF THE GAMBLING COMMISSION**

Members: P Chin (Chief Gambling Commissioner)  
G L Reeves  
M M Lythe

Date of Decision: 16 April 2010

Date of Notification **5** May 2010  
of Decision:

**DECISION  
ON APPEAL BY THE TRUSTS CHARITABLE FOUNDATION**

**Appeal**

1. The Trusts Charitable Foundation (the "**Appellant**" or the "**Foundation**") appealed, under section 61 of the Gambling Act 2003 (the "**Act**"), against a decision by the Secretary for Internal Affairs (the "**Secretary**") suspending its class 4 operator's licence. The Secretary suspended the licence for two days under section 58(1)(a), which provides that the Secretary may suspend a licence if he is satisfied that any of the grounds under section 52 are no longer met, and section 58(1)(b), which provides that the Secretary may suspend a licence if he is satisfied that the corporate society is failing, or has failed, to comply with any relevant requirement of the Act, licence conditions, game rules or minimum standards. The Secretary made his decision to suspend the Foundation's licence following an audit of the Foundation for the period 1 April 2006 to 31 March 2007. The grounds for suspension related to expenditure, namely:

- (a) A breach of section 52(1)(d) by payments made to Evergreen Lodge Limited ("**Evergreen**") which is considered to be excessive and not reasonable or necessary to the gambling operation.
- (b) A breach of section 52(1)(d) by payments made for leisure and entertainment activities (which seem to include both activities undertaken by the trustees and their families alone and those involving third parties), which are considered to be not reasonable or necessary to the gambling operation.
- (c) The potential for continued breaches of section 52(1)(d) through the Foundation's policy which endorses entertainment expenditure on third parties.

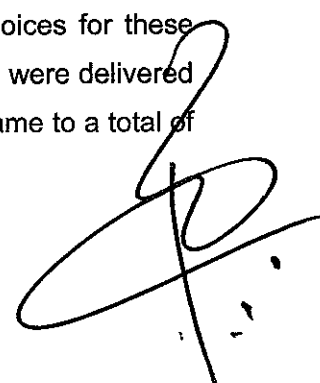
2. The parties have largely agreed on the facts. The issues on appeal concern the legal consequences of the events which the parties agree took place. There are two broad grounds of appeal. One is procedural, the other substantive:
- (a) The Foundation submitted that the Secretary breached section 59(4) by failing to notify the Foundation of matters to be dealt with by the Foundation in order for the Secretary to consider withdrawing the suspension before the end of the suspension period.
  - (b) The Foundation challenged both the decision to impose a suspension and the length of the suspension in relation to the expenditure incurred. The issue on this ground of appeal is whether the expenditure was necessary and reasonable. There are three types of expenditure at issue:
    - (i) The payments to Evergreen/Mr Acklin.
    - (ii) Entertainment and leisure expenses.
    - (iii) Other expenses.

### **Background**

3. The Commission begins by setting out the main facts on the appeal before summarising the parties' submissions on the legal consequences of those facts.

#### *Payments to Evergreen*

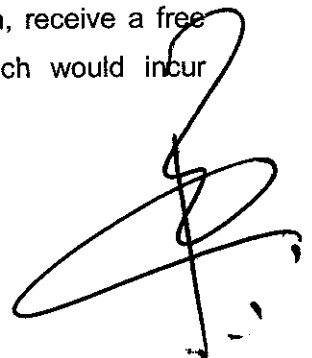
4. The payments to Evergreen were payments to a company of one of the Foundation's trustees, Mr Acklin, in return for services provided by Mr Acklin. The arrangement began in 2006. Under it, the Foundation's Board of Trustees appointed Mr Acklin as an "Executive Trustee with Special Responsibilities". His role was to identify sites with high turnover (one million or more dollars) that did not have venue agreements with the Foundation, but which might be persuaded to sign up with it. The arrangement began with a trial period of three months, during which Mr Acklin was paid \$10,000 per month (plus expenses). After three months the trustees reviewed and renewed the position. The arrangement continued until 2009. Under it, the Foundation paid the following to Mr Acklin or Evergreen in respect of Mr Acklin's services on a monthly basis (in addition to Mr Acklin's annual trustee honorarium of \$20,250):
- (a) \$11,250 (\$10,000 agreed fee plus \$1,250 GST). The tax invoices for these payments were made on an official letterhead of Evergreen and were delivered to that business's National Bank account in Queenstown and came to a total of \$425,254 for the period April 2006 to March 2009; and



- (b) reimbursement for expenses as they arose in the relevant month. These include payments for travel, accommodation and meals associated with the meetings, similar to the usual reimbursement of Mr Acklin's expenses as a trustee. These payments were paid to Mr Acklin's personal Westpac account in Dunedin and came to a total of \$43,652 for the audit period.
5. The Foundation also paid \$9,537.25 to others, in particular Mr Hodder of Modus Group, the service provider to which the Foundation contracts its administrative work, in relation to the expansion project.

*Genesis of arrangement with Mr Acklin*

6. The Secretary provided further details on the business expansion project, in relation to which the Foundation did not comment directly. The Secretary alleged that the initiative was based on Mr Acklin's knowledge of the New Zealand Racing Board ("NZRB") derived from his being a recent NZRB Board member and a current trustee of the Foundation. The background included the following matters:
- (a) NZRB's intention to upgrade TAB facilities at class 4 venues nation-wide and the anticipated opposition from venue operators who refused to foot the bill for the upgrade, estimated at \$10,000 per venue.
- (b) The Foundation's significant association with racing as reflected in the majority of its grants being distributed for racing activities, with the Foundation being the largest contributor of funding to the racing industry in New Zealand, outside the NZRB.
- (c) The Act's limitations on increases in gaming machine numbers, together with sinking lid policies imposed by Territorial Authorities, and the resulting premium value of 18 machine venues which generate in excess of \$1,000,000 per annum.
7. Mr Acklin's proposal for business expansion involved the following steps:
- (a) Mr Acklin would approach venue operators who were signed to other societies and encourage them to sign venue agreements with the Foundation.
- (b) Each venue that signed with the Foundation would, in return, receive a free upgrade to its TAB facilities, courtesy of the NZRB which would incur approximately \$10,000 per venue.

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(c) The Foundation would grant at least 50% of GMP generated at these venues to the racing industry via various racing clubs and organisations.

8. Following legal advice, as a result of which some changes may have been made to the proposal, the Foundation's Board of Trustees resolved to accept it, but limited it to sites with an annual turnover of at least one million dollars. The Board appointed Mr Acklin as an "Executive Trustee with Special Responsibilities". The Foundation began paying Mr Acklin on 10 April 2006. The payment arrangements were as set out in paragraph 4 and were in addition to the \$20,250 per annum honorarium which Mr Acklin received as a trustee. The Secretary believes the payments were made to Evergreen, rather than Mr Acklin, for reasons of tax mitigation.
9. The Secretary raised his concerns regarding the payments, which he did not consider were reasonable or necessary, in March 2007, in an audit report issued in June 2007 and in another draft audit report issued in June 2008. The Secretary noted that Audit New Zealand also expressed concerns to the Foundation in June 2007 that the payments may be in breach of the Foundation's trust deed. It was only after the Secretary's proposal to suspend on 1 May 2009 that the Foundation decided to first accumulate and then cease payments to Mr Acklin in relation to the expansion project; although the Foundation continued to dispute the Secretary's conclusions.

*Scope of consideration of payments to Evergreen/Mr Acklin*

10. The matters in paragraph 7 provide, on the face of it, a basis for concern about possible breaches of section 118, particularly subsection (3)(a), on the basis that the NZRB is a potential grant recipient of the Foundation. Section 118 provides:

**118 Certain persons must not seek, receive, or offer benefits with conditions attached**

(1) A holder of, or key person in relation to, a class 4 operator's licence or a class 4 venue licence must not knowingly receive or seek money, a benefit, an advantage, a privilege, or a gift from the following persons if the receipt has a condition attached to it and whether the receipt or condition is direct, indirect, formal, informal, or otherwise:

- (a) a grant recipient or potential grant recipient;
- (b) a person that sells, repairs, services, or maintains gambling equipment.

(2) A key person in relation to a class 4 venue licence must not knowingly receive or seek money, a benefit, an advantage, privilege, or gift from the following persons, if the receipt has a condition attached to it and whether the receipt or condition is direct, indirect, formal, informal, or otherwise:

- (a) a holder of a class 4 operator's licence if the holder operates at that venue:

- (b) a key person in relation to a class 4 operator's licence if the holder operates at that venue.
- (3) A holder of, or key person in relation to, a class 4 operator's licence, or person that sells, repairs, services or maintains gambling equipment must not knowingly offer money, a benefit, an advantage, a privilege, or a gift to the following persons if the receipt has a condition attached to it and whether the receipt or condition is direct, indirect, formal, informal, or otherwise:
- (a) a grant recipient or potential grant recipient:
  - (b) a key person in relation to a class 4 venue licence.
- (4) Subsections (2) and (3) do not prevent the holder of a class 4 operator's licence paying a key person in relation to a class 4 venue costs associated with the class 4 venue if the costs—
- (a) do not exceed the amounts specified in any venue agreement; and
  - (b) do not exceed the limits in section 116; and
  - (c) are otherwise lawful.
- (5) A person who contravenes this section commits an offence and is liable on summary conviction to a fine not exceeding \$10,000
- (6) To avoid doubt, this section applies whether—
- (a) the condition is attached either before or after the money is received by the person concerned; or
  - (b) any money is actually received by the person concerned.

11. It is apparent from the Secretary's submissions and evidence that the Secretary has had a concern that the arrangement might breach section 118, and has undertaken investigations accordingly. However, on this appeal, the Secretary has chosen to provide the information on the alleged arrangement between the Foundation and NZRB purely by way of background and does not advance it as a ground for suspension or as otherwise relevant to the appeal. The Commission approaches those aspects on the same basis. It limits its consideration of the payments to Mr Acklin for his role in recruiting venues to the issue of whether they were reasonable and necessary.

*Trustees' expenses*

12. From the period 13 July 2005 to 16 February 2007 the Foundation spent a total of \$18,125.40 on entertainment expenses for trustees. The majority of the total was made up of restaurant bills, for the majority of which, in turn, there are no invoices. In those instances in which the Foundation did keep invoices, alcohol is frequently a large (half or greater) share of the invoices. The largest were at the "Cook'n'with Gas" in Christchurch for \$3,650, of which \$1,955.50 was spent on alcohol, and a payment of a bill for

\$1,027.50 at the same restaurant, over half of which was spent on alcohol. Other restaurant bills itemised by the Secretary vary between approximately \$300 and \$1,000.

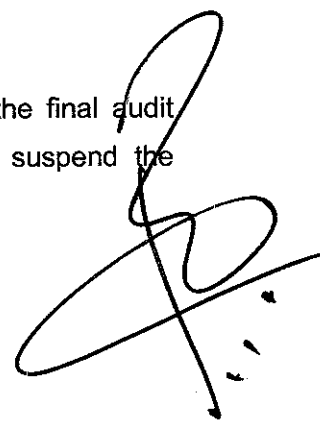
13. Other expenses included golf, spending on hotel mini bars and accommodation for trustees and their spouses in Sydney during the Australian Gaming Expo.

*Other expenses*

14. The Foundation also spent:
- (a) \$479.61 on eight USB flash drives, which it purchased from the New Zealand Racing Board and provided to venues.
  - (b) \$46,585 plus GST to two of the Foundation's associated licensing trusts (Portage and Waitakere) to be used for Christmas lunches for senior citizens at two of the society's venues.
  - (c) \$90 on valet storage in relation to a car owned by Maitaura Licensing Foundation and used by one of the trustees.
  - (d) \$6,433.95 in payment to a law firm at which one of the trustees was, at the time, a consultant.

*Procedural history*

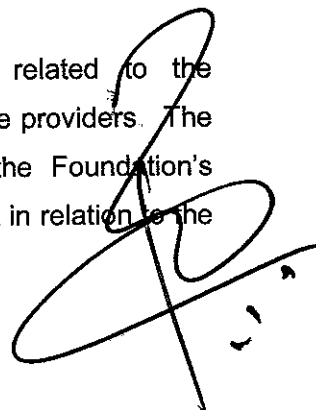
15. The procedural history of the audit is relevant to the first ground of appeal and is set out below:
- (a) 8 June 2008 – the Department provided the Foundation with the draft audit report.
  - (b) 8 July 2008 – the Foundation responded by letter to the draft audit report.
  - (c) 28 August 2008 – the Department of Internal Affairs ("**Department**") wrote to the Foundation asking for further information that had been requested in the draft audit report but not provided in the Foundation's response of 8 July 2008.
  - (d) 8 September 2008 – the Foundation responded to the Department's letter of 28 August 2008, providing the requested information.
  - (e) 1 May 2009 – the Department provided the Foundation with the final audit report and letter to the notifying the Secretary's proposal to suspend the Foundation's operator's licence for a period of five days.



- (f) 5 June 2009 – the Foundation responded to the Department's letter proposing to suspend the licence.
- (g) 14 August 2009 – the Department wrote to the Foundation informing it of the Secretary's decision to suspend the Foundation's operator's licence for a period of four days. It also informed the Foundation (in accordance with section 59(4)) of what it would need to do in order for the Secretary to consider withdrawing part of the suspension. These were:
- (i) Cancel all (presumably future) payments to Evergreen as well as ensure that no accrued amounts were paid to Evergreen.
  - (ii) Undertake that any future venue recruitment process, with Evergreen or otherwise, would not be commenced without satisfying the Secretary that the costs to be incurred were reasonable and necessary in the circumstances.
  - (iii) Stop all expenses related to entertainment of class 4 operators and service providers.
  - (iv) Establish an effective mechanism for ensuring all costs related to trustee expenses were:
    - (aa) actual, reasonable and necessary; and
    - (bb) completely transparent and auditable.

The Secretary stated that he would be prepared to reduce the period of suspension by one day if the Appellant addressed the Evergreen payments issue; a half day for addressing the issues related to venue operator expenses; and a half day for addressing the issues related to trustee expenses. The remaining two days were, in the Secretary's view, a required punitive consequence for incurring costs wrongly and would not be withdrawn regardless of the Foundation's remedial actions.

- (h) 6 October 2009 – the Foundation wrote to the Secretary giving the following commitments:
- (i) It undertook that it would stop all expenses related to the entertainment of class 4 venue operators and service providers. The undertaking was expressly without prejudice to the Foundation's position that it had not incurred expenses in the past in relation to the

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entertainment of class 4 venue operators and service providers which were not reasonable and not necessary.

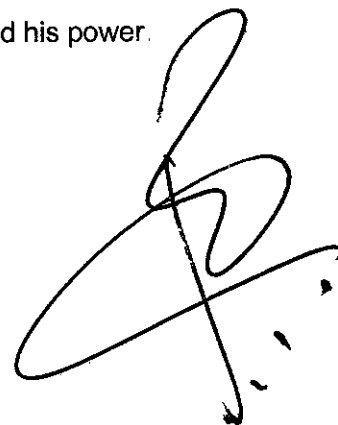
(ii) It provided a new policy for trustees' expenses. The change in approach was expressly without prejudice and without any admission that they had incurred expenses or reimbursed costs in the past that were not reasonable or not necessary.

(iii) It stated that it had cancelled all future payments to Evergreen, had not made any further payments since the Secretary directed the Foundation to cease such payments earlier in the year and would make no further payments to Evergreen based on the existing contract; and attached, for the Secretary's approval, a job description for a new position to perform Mr Acklin's former role.

(i) 22 October 2009 – the Secretary reduced the period of suspension from four to two days.

#### **The Foundation's submissions**

16. As an introduction to its submissions, the Foundation argued that the appeal concerned a grey area of law – what amounts to “reasonable and necessary” – on which no guidance has so far been offered to the class 4 sector. The Foundation submitted that the Secretary was misusing his powers, by suspending the Foundation's licence for the “collateral purpose” of obtaining the Commission's determination on an issue that the Secretary had “consciously and consistently seen fit not to resolve”. This argument was based largely on internal emails, memoranda and minutes of the Department, which the Foundation received pursuant to a request under the Official Information Act 1982. The Foundation submitted that the Secretary admitted that he had not told the industry that he did not consider the expenses at issue to be reasonable and necessary. The Foundation further submitted that the Secretary conceded that he had failed to tell the industry that that the behaviour, which he acknowledged to be widespread, was not considered legitimate by the Department. The Foundation submitted that the Secretary had decided to suspend the licence in order to bring the matter before the Commission (assuming that the Foundation appealed the suspension) in order for the Commission to determine whether such spending is lawful and in doing so had misused his power.

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*First ground of appeal: breach of section 59(4)(d)*

17. Section 59(4) provides:

- 4) If the Secretary decides to suspend a licence, the Secretary must notify the corporate society of—
  - (a) the date that the suspension takes effect; and
  - (b) the suspension period (up to 6 months); and
  - (c) the reason for the suspension; and
  - (d) the matters to be dealt with in order for the Secretary to consider withdrawing the suspension before the end of the suspension period; and
  - (e) the consequences of not dealing with the matters identified.

18. The Foundation argued that the duties in section 59(4) are mandatory and accumulative, and that the legislative regime does not allow the Secretary to reach a decision to suspend a licence on the basis that there is nothing that a corporate society could ever do to avoid the suspension. There must, by virtue of section 59(4)(d), always be factors, and ways of changing behaviour, that the Secretary will consider, and on the basis of which he may withdraw the suspension **entirely**. The Foundation submitted that the words “before the end of the suspension period” must contemplate the whole of the period of time between the notification of the decision itself, and the end point of the suspension period. This included a time, in the Foundation’s view, within which a corporate society might deal with matters identified by the Secretary before the suspension even commences, such that the suspension would never commence at all.

19. The Foundation claimed that the Secretary’s refusal to notify any such matters (in relation to the remaining two days, which the Secretary specifically stated could not be reduced) was a “fatal flaw”. The Foundation claimed that, if the Commission upheld this ground of appeal, that would dispose of the appeal because the suspension would be unlawful owing to the Secretary’s failure to notify in accordance with section 59(4)(d).

20. Recognising the Commission’s *de novo* approach to cases on appeal, the Foundation submitted that the Commission must consider whether there was anything that the Foundation could have done in terms of section 59(4)(d) and whether, notwithstanding the provision, it was nevertheless lawful to impose a suspension for past actions which were irrecoverable and irremediable in the future. The Foundation further submitted that, because the Secretary had never clarified what were likely to be acceptable necessary and reasonable costs prior to the 2006–2007 audit period, it would be unlawful for there to be a suspension in these circumstances for costs incurred in that period three years later.

*Second ground – challenge to the imposition of a suspension and its length*

21. The Foundation argued that a suspension in relation to the two categories of cost identified by the Secretary (entertainment expenses and expenses related to Mr Acklin) was:
- (a) Unreasonable in the *Wednesbury* sense (ie a view which no rational decision-maker could possibly reach).
  - (b) Unjustified and unwarranted on the evidence.
  - (c) Based on a failure to take into account relevant material namely the evidence of the success of the operation evidenced by the high maximisation of return to authorised purposes and the low expenditure as a proportion of revenue, and the failure of the Secretary to understand, acknowledge and accept normal, prudent professional business practices.
  - (d) Based on the Secretary's failure to acknowledge the place of the class 4 gambling industry in the hospitality/entertainment/TAB industries where the Secretary has forced class 4 societies to locate venues.
  - (e) Disproportionate.
  - (f) Wrong in fact and in law and should be set aside.
22. The Foundation set its submissions against the environment within which, in its view, class 4 societies operate. The Foundation emphasised that class 4 licence holders operate "squarely in the midst" of the hospitality and entertainment industry. Running a business, the Foundation argued, depends upon the maintenance of relationships and this is particularly so in the hospitality industry and given the "fierce competition for revenue amongst operators and thus competition for retail outlets or venues". Further, the Foundation argued, the Secretary must accept responsibility for having placed class 4 operators in the hospitality and entertainment industry, an industry which, in the Foundation's submission, relies heavily on interpersonal relations.
23. The Foundation argued that its business model, which included relationship-building, was both necessary for, and successful in, maximising its return to the community. The Foundation stated at paragraph 32:

The legislation prevents any individual or corporate body making a commercial profit or obtaining commercial benefit as a result of gaming machine proceeds. The submission of TTCF is that [within] those constraints it is, nevertheless, a business imperative in its business context that relationships are forged and relationships are nurtured and maintained with service operators and venue

operators where compliance responsibilities and loyalty and efficiency and maximised revenue generation (within lawful constraints peculiar to gambling) are an integral part of the business operation.

It was submitted that the reasonableness and necessity of the Foundation's costs must be examined against that environment.

24. The Foundation submitted that the cost of Mr Acklin's role was not only necessary, but essential, given the competitive nature of the class 4 environment, and the need for the Foundation to maintain, if not increase, its operations in order to operate efficiently and maximise its returns to the community. The Foundation submitted that no suspension should have been imposed for costs incurred in the past which were efficacious in maintaining and increasing the Foundation's market share of venues and machines and, therefore, its critical mass. The Foundation referred in support to the facts and reasons in its letter to the Department of 5 June 2009, which can be summarised as follows:

- (a) The arrangement was efficient: the Foundation did not employ a CEO; nor did it run an office with staff; nor provide equipment to staff. Mr Acklin was not only contracted to ensure TTCF signed up new venues but also to act as an Executive Trustee. Evergreen provided Mr Acklin with a car, office and most necessary equipment.
- (b) As a result of Evergreen's/Mr Acklin's "sole direct involvement" and efforts, the Foundation had gained or retained 26 venues.
- (c) The percentage of *extra* revenue attributable to Evergreen's efforts had risen each year and the total of Evergreen's costs as a percentage of revenue had decreased each year.
- (d) As a significant number of the Foundation's venue agreements were for only 12 months, it was necessary for the Foundation to maintain an ongoing relationship with Evergreen to ensure that Evergreen:
  - (i) not only was able to facilitate transfers to the Foundation of venues when their existing agreements expired (in many cases, annually);
  - (ii) but also maintained contact with potential venues which had expressed a desire to transfer to the Foundation when able to in the future; and
  - (iii) prevents existing venues from leaving for any reason which lack of contact or communication could cause.

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- (e) The only reason that the Foundation was able to maintain its remarkably high return for authorised purposes and considerably lower cost structure (both for venue expenses and for administration costs) was because it continued to add venues and increase or maintain revenue.

25. The Foundation further said that, from the outset, Mr Acklin's appointment was examined in detail by the Department, which was not able to substantiate any suggestions that any provisions of the Act were breached. Mr Acklin's contract had been renewed every 12 months, and the Foundation's business records had been transparent and accountable, whenever requested by the Secretary. The Foundation submitted that, furthermore, the Secretary had, by his letter of 22 October 2009, accepted the trustees' intention to continue the work formerly undertaken by Mr Acklin. Mr McElrea portrayed the Secretary's acceptance of the type of work undertaken by Mr Acklin in even stronger terms in his affidavit, deposing at paragraph 25 that:

... it is noteworthy that in the amended decision, dated 22 October, the Secretary has accepted the validity of the business expansion project as a necessary expense and has, it appears to us, now conceded that the alternative approach that we have postulated is likely to be reasonable.

26. The Foundation concluded, in relation to the venue expansion project, that it was unreasonable and unfair for a regulator to punish a regulated body three years after that body had incurred costs which the regulator was aware of at the time they were incurred, and which the regulator did not prohibit and which it did not indicate might be unlawful.

27. In relation to the leisure and entertainment expenses, the Foundation submitted that it had addressed all the Secretary's concerns and that its current policy, which it had placed before the Commission, was reasonable, necessary and proportionate and therefore a lawful approach to trustees' costs. The Foundation argued that many of the expenses were historic and had been addressed, and those that were not in that category were addressed for future purposes by the new policy. The Foundation recorded that a number of the costs of concern to the Secretary would no longer be incurred by the Foundation under its new policy. These included:

- (a) Costs for partners of trustees and partners of key persons.
- (b) Costs for senior citizen Christmas lunches.
- (c) Storage and cleaning costs of vehicles used by trustees and key persons on Foundation business.
- (d) Some conference-related costs.

- (e) Some costs in relation to meals and alcohol.
  - (f) Some costs incurred in relation to Modus Group expenses and Modus employee expenses.
  - (g) The invoices rendered by the legal firm of the previous chairman for administrative support to him in undertaking his role as chairman.
28. The Foundation referred in particular to the Secretary's concern at the reimbursement by the Foundation for alcohol. The Foundation stated that the Secretary has consistently expressed concern to the Foundation about the cost of liquor in association with meals and, in particular, where the liquor costs were higher than the food costs. The Foundation argued that it had, at various times, tried to engage in dialogue with Department officials in order to explore whether the Foundation and Department could agree on what was reasonable, but that the Secretary had refused to engage in such dialogue other than to reject the Foundation's suggestion of a limit on the cost of alcohol to 75% of the cost of food. The Foundation stated that it had adopted a zero reimbursement policy "in the interim" in order to persuade the Secretary to reduce the suspension by half a day, which the Secretary did. However, the Foundation submitted that it did not think a zero-reimbursement policy for alcohol was reasonable and necessary and asked that the Commission make a ruling on the matter. The Foundation submitted that the Commission could endorse its new policy in relation to trustees' expenses as a moderate and conservative expenditure policy appropriate to trustees of a charitable trust being a corporate society operating class 4 gambling.
29. In relation to the other expenses, the Foundation submitted that each was either necessary or had been reimbursed.
30. The Foundation concluded that it was a successful operator facing suspension for minor expenditure, from which no one had benefited commercially or personally and which had been incurred in the course of genuine business activities. It was not a case involving dishonesty, nor was it a case involving a clear breach of "black and white legislation". Rather, it involved principled disagreement over costs which involve "grey law", in relation to which the Secretary had offered no clear guidance, and which he had deliberately not addressed. It was not a case in which the motivation or *raison d'être* of the society or Trustees can be questioned. Rather, it was a case "where the bureaucracy (regulator) has put its stake in the ground in a business environment without proper appreciation of prudent acceptable business practices".
31. In addition to seeking that the suspension be overturned, the Foundation sought a decision from the Commission endorsing the Foundation's policies and the prudent

every day business practices by class 4 operators, when determining the reasonableness and necessity of costs incurred along the way to maximisation of return to communities. Finally, the Foundation sought a ruling from the Commission in respect of the Secretary's failure to follow section 59(4)(d) of the Act.

### **Secretary's submissions**

32. The Secretary submitted that payments made by the Foundation were inappropriate and unlawful, in that they were not reasonable or necessary in conducting the gambling or in complying with relevant statutory requirements. Those funds should, the Secretary submitted, have been distributed to the community. The Secretary considered that there were two issues for the Commission to consider in relation to each payment:
- (a) whether the payment constitutes a breach of any sort; and
  - (b) whether the breach justifies a penalty of suspension.
33. Whereas the Foundation argued that the reasonableness and necessity of its expenses must be assessed against the environment within which class 4 societies operate, the Secretary argued that the reasonableness and necessity of costs must be assessed against the legislative framework. The Secretary submitted that it is generally accepted that there are two types of costs a society may incur:
- (a) Costs associated with class 4 venues: these must be actual reasonable and necessary and are also subject to specific limits included in a Gazette Notice published by the Secretary under section 116. This type of cost is sometimes referred to by the misnomer "venue costs".
  - (b) Other costs: these are known by the misnomer "society costs". These must also be actual, reasonable and necessary but are not specifically limited by a Gazette Notice.
34. The Secretary described the terms as misnomers because in fact both types of costs were incurred by the society. This appeal concerned "society costs", ie costs not directly associated with the Foundation's class 4 venues. As such, it was complementary to The Southern Trust's appeal which was also before the Commission and which dealt primarily with venue costs.
- Preliminary legal ground – can the Secretary impose a suspension for entirely punitive reasons?*
35. The Secretary disputed the Foundation's contention that the requirement in section 59(4)(d) means that there must always be matters a society can deal with in order for the suspension to be withdrawn entirely and that therefore suspensions can only be

imposed for remedial and not punitive purposes. The Secretary submitted that his findings in relation to the Foundation's spending, if upheld by the Commission, warrant disciplinary consequences and that suspension can be used for such purposes. The Secretary considered that in this case a suspension would have both specific deterrence for the Foundation as well as general deterrence for the class 4 sector. In respect of the latter, the Secretary stated at paragraph 18:

b **General deterrence**

- i. The Commission's decision in this appeal is likely to reverberate throughout the class 4 sector and will either put an end to the current spending regime of some societies, or will legitimise it. The Secretary makes no bones about the precedent value of such a decision, and does not share the Appellant's view as to the misuse of the Secretary's power to suspend (Appellant's submissions, paragraph 12). Indeed, Mr McElrea himself calls upon the Commission to clarify the issues in dispute not just for the benefit of the Appellant but of other corporate societies running similar business practices (paragraph 10 of his affidavit).
- ii. As the High Court (Gendall J) observed in the context of the Sale of Liquor Act, general deterrence of other licensees from breaches of the law "is a factor or consideration which squarely falls within a legitimate licensing end or aim to be considered by the Authority when exercising its discretion to suspend a licence or not" (*The Mill Liquorsave Limited v Verner* [2004] NZAR 263, at [28]).

36. The Secretary derived further support for punitive suspensions from the Commission's decision to suspend Dunedin casino's licence (decision GC29/06) where the Commission addressed section 146(2)(c), which is identical *mutatis mutandis* to section 59(4)(d), by concluding that there was nothing Dunedin casino could then have done to cause the suspension to be removed or reduced by the Commission. The Secretary also referred to the Commission's comment, under the heading "Suspension: Remedial or Penal" at paragraph 54 of the Commission's preliminary decision in the Dunedin casino case (decision GC07/06):

If suspension cannot be used as a sanction for past breaches then it follows that the only consequence available for prior breaches is to cancel the licence or to do nothing. The Commission is of the view that it is unlikely that Parliament intended such breaches to be dealt with only by the most serious sanction available (cancellation) or by taking no action at all.

37. The Secretary also referred the Commission to its decision in the Eureka appeal, (decision GC15/09) in which the Commission confirmed that suspension had potential application for penal purposes.
38. Finally, in the Secretary's view, the fact that the Foundation now argued for the validity of some of the practices which it agreed previously to cease in order to reduce the two days' suspension (albeit while making its intentions well-known from the outset) emphasised the validity of the Secretary's decision to seek a punitive suspension in addition to the remedial one.

*Payments made to Mr Acklin through his company were not reasonable or necessary*

39. The Secretary compared the Foundation's spending on its expansion project to the spending at issue in the current appeal by The Southern Trust, and submitted that the scope of spending in the present case was far greater than by The Southern Trust.
40. The Secretary concurred with the Foundation's identification of the intense competition between societies for a finite asset as the relevant background. He accepted that the practice of spending what he described as "public funds" to shift venues from one operator to another was widespread, although he noted that the Foundation in this case had taken the practice further than in any other case of which the Secretary was aware. In the Secretary's view, however, what mattered was whether the *quantum* in respect of payments to Mr Acklin constituted a reasonable and necessary cost. The context against which the base payments of \$120,000 per annum to Mr Acklin's company must be assessed was not that of the "business realities" of the class 4 gambling sector but that of the provisions of the Gambling Act.
41. The Secretary did not appear to take issue with the Foundation's aim of increasing the number of venues at which it conducts class 4 gambling; rather, he submitted that, in trying to achieve this (and presumably any) aim, the Foundation had a duty to minimise costs. That is, it had to ensure that persons employed for the task were paid only on a reasonable and necessary basis. The Secretary did not consider that the base cost of \$120,000 per annum could be considered as subject to a "grey area" as the term was used in the Foundation's submissions. To support his assessment, the Secretary referred to the Foundation's own job description for the role if it is to be advertised. The role is more extensive than Mr Acklin's, but with a suggested pay scale (on the basis of external advice) of \$70,000 - \$80,000.
42. In the alternative, the Secretary argued that the whole practice of employing people to "find" venues was a concept contrary to the Gambling Act. The Secretary submitted at paragraphs 56 to 59:

56. ... that public funds paid to third parties for the benefit of shifting venues from one operator to the other are in most cases a complete loss to the community. The 'asset' gained – a venue agreement for three years or less – already existed in the same market, only held by a different operator. The 'incoming' society does not increase the market size, but only its relevant share of the market and even then, often only temporarily.

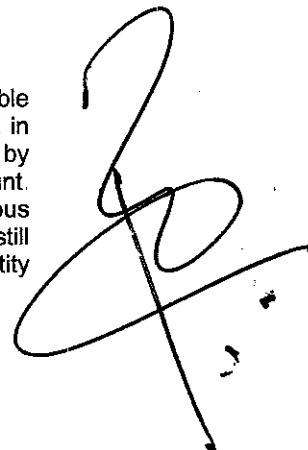
57. A venue moving to a more compliant society that pays less venue costs may indeed generate more community funds under one society than under the others. However, that difference between the societies is counterbalanced if to obtain the venue, the 'incoming' society had to pay a third party. One way or the other – either paid to third parties or to venue operators – the funds will be lost to the community.

58. Rather than using the Appellant as a 'guinea pig' as is alleged in its submissions, the Secretary could not have provided the Commission a better example of loss to the Community through payments to third party agents with a commercial agenda.

59. Had the Appellant distributed those funds to the community instead of paying them to Mr Acklin, the Community would have been better off by more than half a million dollars. The venues might or might not have joined the Appellant but gaming machines would have still operated in those venues under one society or another.

43. The Secretary contended the payments to Mr Acklin were not reasonable or necessary costs incurred in conducting the gambling or in complying with the relevant statutory and licence provisions.
44. The Secretary did not consider the expenses for entertainment to be reasonable or necessary for those purposes, nor was he satisfied with the Foundation's explanations of the other expenses that it had incurred. The Secretary submitted that using the test of the section 4 "net proceeds" definition, these expenses were not reasonable or necessary in conducting the gambling or in complying with relevant statutory requirement. Instead those funds should have been distributed to the community. In the Secretary's view the Foundation had a "history of questionable spending practices", as demonstrated by summaries of successive audit reports for the period 2003 to 2007 each of which, while acknowledging the Foundation's generally praiseworthy performance, identified excessive trustee expenses.
45. Finally, the Secretary responded to each of the Foundation's explanations for the lawfulness of the expenses identified by the Secretary:
- (a) The Foundation's good returns and commercial reality:
- (i) The Secretary acknowledged that the Foundation's distributions for authorised purposes were higher than the national average, and that its venue expenses were lower than the national average, and that it should be congratulated for this. However, the Secretary submitted that achieving good outcomes in one area must not impair scrutiny of other areas. Good returns could not counterbalance inappropriate spending, nor could good performance by trustees and agents justify using public funds for their leisure and entertainment. The Secretary continued at paragraph 115:

Instead of adopting public standards of responsible expenditure, it indeed appears that the trustees behaved in the same way directors of a commercial company would, by loosening the belt after a positive profit and loss account. While in a commercial environment such unscrupulous spending can be tolerated as long as the bottom line is still showing a good profit, in the public sector a public entity



dealing with public funds cannot adopt this standard of behaviour no matter how well it is functioning in other areas.

- (ii) Indeed, the Secretary submitted, not only is the Foundation not a commercial entity, but, as the charitable arm of public licensing trusts, it is subject to even more public scrutiny than most other class 4 operators. Although the Foundation might operate in a commercial-like manner in the course of conducting its affairs, it could do so only with the purpose of meeting its statutory duties and "achieving commercial efficiency in protecting the public funds it holds in trust."

(b) Nature of the hospitality industry:

- (i) The Secretary did not accept the Foundation's argument that a degree of entertainment and hospitality are essential to maintaining and enhancing relationships in the entertainment industry. The Secretary stated that such methods of maintaining relationships are not unique to the hospitality industry and that, in any case, a higher standard of behaviour is expected of those who "hold community funds in trust with a fiduciary and statutory duty to guard it well".

(c) Guidance from the Secretary:

- (i) The Secretary noted first that the Foundation's argument in this respect was contradictory: the Foundation, and Mr McElrea in his affidavit, complained that the Secretary's officers had not provided sufficient guidance on this type of spending, while simultaneously dismissing the ability of bureaucrats to understand the commercial nuances of running a business in the first place.
- (ii) The Secretary submitted that the evidence before the Commission established that, since 2002 at the latest, the Secretary had raised concerns over and over, but each time the trustees had rejected or ignored his recommendations. Changes to the Foundation's policies occurred only after the Secretary proposed to suspend its operator's licence.
- (iii) The Secretary concluded that trustees of the calibre of those on the Foundation's Board should have known better.

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### The Foundation's submissions in reply

46. In its submissions in reply, the Foundation took issue with the Secretary's pairing of its appeal with that of The Southern Trust. The Foundation insisted that the two were not related: the Foundation's appeal was not at all related to venue expenses, which were the subject of The Southern Trust appeal. Venue expenses were expressly regulated by Gazette Notices, which were specific and detailed. No comparable guidelines had ever been issued by the Secretary relating to society expenses, or trustee expenses.
47. The Foundation argued that the Commission should take into account that the Foundation was being judged in 2010 for expenses in the financial year 2006–2007. During that period, the Secretary was still using an educative, explanatory and consultative approach; it was not until early 2009 that the Foundation and other class 4 operators became aware of the new punitive approach, and it was unfair for the Foundation to be punished now for its actions at a time when the Secretary's approach was different. That is, it could not have known during the 2006–2007 period that it would be punished for the expenses that it was incurring. The Foundation submitted that, "as a principle of law", it was entitled to be judged and dealt with in accordance with the regulatory framework and environment of 2006–2007.
48. The Foundation argued that, while the Commission could give *de novo* rulings and guidance on the expenses, that power would not justify punishing the Foundation as if it had "flagrantly breached a clear rule, such as failing to bank in a timely way". The Foundation acknowledged that the Commission had jurisdiction to suspend for historic breaches, but submitted at paragraph 4, that:
- ... the Commission's declaratory and *de novo* exposition of the law on Trustees' expenses and the reasonableness of them in 2010 need not also be combined with a punitive suspension for 4 year old historic events in this case of first instance Commission consideration of the issues involved.
49. The Foundation submitted that neither the Dunedin casino case, nor the Eureka nor Whitehouse cases were comparable. The Foundation distinguished itself from the Whitehouse case on the basis that the Evergreen costs were *all* directly relevant and reasonably incurred in order to increase its profit, which in fact it did. No such link to maximisation of net proceeds or distribution to authorised purposes could be advanced by the Whitehouse trust.
50. In response to the Secretary's list of other unreasonable expenses, the Foundation refers the Commission to the explanations in its letter to the Secretary of 5 June 2009, (which it considers answers all of the costs that it incurred in during the audit period). The first seven costs (which include the two most expensive restaurant bills) are, in the

Foundation's submission, irrelevant because they were incurred outside the audit period.

51. The Foundation similarly argued that the Audit New Zealand reports were irrelevant because they relate to different criteria and were written on the basis of Audit New Zealand's claim that the Foundation is a public entity, a fact which is currently the subject of dispute between the Foundation and Audit New Zealand.

52. In relation to whether or not it is a public entity, the Foundation returned to its main point of difference (although the Foundation does not describe it as such) with the Secretary, stating at paragraph 9:

The Trustees of TTCF operate a business. They do so in an environment where business is transacted in conjunction with (modest) hospitality. They are not philanthropists. They are not part of the public sector nor legally constrained by public sector expenditure standards. They are statutorily charged with maximising the return to the community of gaming machine proceeds as a result of their business during which process they are lawfully entitled to incur reasonable and necessary costs subject to any section 116 constraints. The Secretary has not seen fit to impose any such section 116 constraints. TTCF is no longer principally only the charitable arm of some licensing trusts. TAB and non-trust venues outnumber licensing trust venues, as Mr McElrea said in paragraph 7 of his original affidavit. With new 2010 venues described in Mr McElrea's reply affidavit this disparity is reinforced.

53. The Foundation pointed out errors in the Barclay affidavit regarding expansion project expenses (relating to amounts paid to Evergreen).<sup>1</sup>

54. Finally, the Foundation submitted that the Secretary's submissions were the first time he had argued that the payments by the Foundation to Evergreen were not only not reasonable, but also unnecessary. The claim that the expenses were not necessary was not, the Foundation submitted, put to it as part of the investigation process. During its audit process, the Department did not expressly pass judgment on the general practice of venue recruitment; rather, it concentrated only on the reasonableness of such expenses. Similarly, the Foundation submitted, reasonableness was the concern of the Department's follow-up letter and final audit report, as well as Mr MacDonald's affidavit. Accordingly, the Foundation argues that, despite its *de novo* approach, the Commission's focus should be on the reasonableness, rather than necessity, of the costs.

55. The Foundation concluded, after noting that the Secretary removed commendations of the Foundation in the draft audit report before the final report, that the Commission should commend the Foundation for its business acumen and success in retaining and

<sup>1</sup> The Commission notes that the Foundation's corrections do not affect the amounts paid to Evergreen as set out in paragraph 4 of this decision. The amounts in paragraph 4 were provided by the Foundation to the Secretary in its letter of 5 June 2009.

gaining venues for a modest cost of \$425,254 (GST exclusive) in order to ensure an increased return to the community.

### **Analysis**

#### *First ground – section 59(4)(d) procedure*

56. The Foundation argued that section 59(4)(d) limits the Secretary's power to suspend to breaches capable of remedy and requires the Secretary, in every case, to specify remedial action which will reduce the suspension period to zero.
57. The first point to note is that, even if one treats section 59(4)(d) as requiring the Secretary to impose a suspension only in cases in which there are matters that may be addressed to reduce the suspension, no reasonable reading of the subsection requires an inevitable zero result. On the contrary, the words "withdrawing the suspension before the end of the suspension period" imply the opposite, namely that the suspension would start (and therefore there would be at least some period for which the licence would be suspended) but could be terminated early as a result of the matters dealt with.
58. In fact, the Commission is satisfied that section 59(4)(d) applies only insofar as such matters of the type described in the subsection exist. This is the only sensible interpretation of the section. The subsection cannot require the Secretary to notify matters when no such matters exist; nor does it provide a basis for concluding that such matters must always exist. In essence, it is argued that section 59(4)(d) should be so construed as to make suspension entirely remedial, to provide an incentive to remedy, and as having no other purpose. The Commission rejected such an argument in respect of the similarly worded section 146(2)(c) in decision GC07/06 at paragraphs 54 to 56:

If suspension cannot be used as a sanction for past breaches then it follows that the only consequence available for prior breaches is to cancel the licence or to do nothing. The Commission is of the view that it is unlikely that Parliament intended such breaches to be dealt with only by the most serious sanction action available (cancellation) or by taking no action at all.

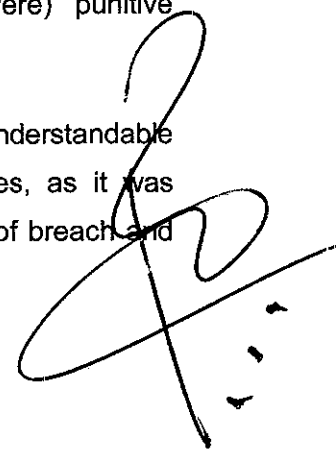
As a practical matter, it takes several months for a suspension application to be heard. This time period provides a casino licence holder ample opportunity to rectify any ongoing breaches, thus precluding a suspension if it can only be imposed for present and continuing breaches. It is unlikely that Parliament intended suspension applications to be so easily thwarted.

For the above reasons, the Commission is of the view that suspension is available as a sanction for prior breaches of the Act or licence conditions.

59. Suspension following breach has two potential purposes: punitive and remedial. Some breaches are not capable of subsequent remedy; in the case of others, there are steps which can be taken after the event to reduce or even eliminate the negative consequences of the breach. Even if the negative consequences can be eliminated by

taking steps following detection, it does not follow that punishment is inappropriate. Punitive consequences, whether for deterrence or retribution, are an important aspect of a statutory enforcement regime. Punishment for sufficiently serious breaches of the Act, Regulations or licence conditions is appropriate and justified whether or not remedial steps are possible following detection.

60. A further contextual indication to the contrary of the Foundation's argument is section 58(1)(b) itself which provides as a ground for suspension "the corporate society is failing, or has failed, to comply...". The Act clearly contemplates that the alternative consequences of cancellation and suspension are available for past as well as continuing non-compliances.
61. The Commission rejects the Foundation's argument that suspension for punitive reasons is unlawful and suspension can only be imposed for purely remedial purposes such that the licence holder in breach must always be offered a means of avoiding a suspension.
62. In this case, the Secretary ultimately imposed four days suspension which would be reduced to two days if the Foundation took a series of steps set out in the letter of 14 August 2009. The Commission will address the reduction in suspension later in its decision but it is appropriate to record at this point its surprise at the matters which were notified as the basis for the proposed reduction in suspension.
63. Whether there are suitable matters to be dealt with will usually depend on the nature of the obligations breached, whether they are historic or continuing and whether their effects are practically remediable. Where the breach relates to unlawful expenditure, the usual "matters to be dealt with" will relate to the recovery of such expenditure in the past along with the cessation of current similar expenditure. The Commission is surprised to see that the "matters" in this case largely comprise promises not to commit similar breaches in the future. This would usually be a matter to be assumed upon the detection and punishment of any breach and it strikes the Commission as odd that a promise not to reoffend in the future would be regarded as a "matter to be dealt with in order for the Secretary to consider withdrawing the suspension before the end of the suspension period." Rather, the Commission would expect that a future breach of the same obligations would result in a new (and probably more severe) punitive consequence.
64. The decision to reduce the suspension period in this case is even less understandable in circumstances where the licence holder made the required promises, as it was entitled to do, expressly without prejudice to its challenge to the finding of breach and

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the appropriateness of the Secretary's requirements under section 59(4)(c) in this appeal. In general, the Commission would expect "the matters to be dealt with" to comprise remedial steps to reverse the harm of prior breaches. While there may be cases in which such matters might constitute highly specific steps designed to reduce the risk of future breaches, these would normally be the subject of a licence condition variation under section 53(2)(c) rather than a reduction in a suspension for breach.

65. The Commission does not consider that the Secretary wrongly failed to notify the Foundation of matters to be dealt with in order for it to consider withdrawing the suspension was a breach of section 59(4)(d) in these circumstances. On the contrary, the Secretary clearly outlined what matters it would take into account and the degree to which he would consider reducing the suspension period in relation to each "matter" and went on to reduce the suspension accordingly when the Foundation dealt with the matters identified by the Secretary. The Secretary was not required to do more and, if one assumes that there had been a non-compliance of the magnitude found by the Secretary, a purely punitive consequence was appropriate.

*Second ground of appeal – Was the expenditure reasonable and necessary?*

66. The Commission considers that the correct starting point from which, and the background against which, the necessity and reasonableness of costs must be considered, is the statutory and regulatory framework of class 4 gambling.
67. Class 4 gambling is defined (section 30) as follows:

### **30 Meaning of class 4 gambling**

In this Act, **class 4 gambling** is—

- (a) gambling that is not gambling of another class and that satisfies the following criteria:
  - (i) the net proceeds from the gambling are applied to or distributed for authorised purposes;
  - (ii) no commission is paid to, or received by, a person for conducting the gambling;
  - (iii) the gambling satisfies relevant game rules; and
- (b) gambling that utilises or involves a gaming machine; or
- (c) gambling categorised by the Secretary as class 4 gambling

The definition emphasises the obligation to distribute all net proceeds of class 4 gambling for authorised purposes and the prohibition on paying commissions to those conducting the gambling. The definitions of "net proceeds" and "authorised purposes" (section 4) and the obligation to distribute net proceeds only for authorised purposes

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(section 106 and section 52(1)(e)) are therefore fundamental to the existence of class 4 societies.

68. Section 4 defines “net proceeds” and “authorised purposes” as follows:

**net proceeds**, in relation to gambling, means the turnover of the gambling plus interest or other investment return on that turnover plus proceeds from the sale of fittings, chattels, and gambling equipment purchased from that turnover or investment return less—

- (a) the actual, reasonable, and necessary costs (including prizes), levies, and taxes incurred in conducting the gambling; and
- (b) the actual, reasonable, and necessary costs incurred in complying with whichever of the following apply to the gambling:
  - (i) this Act or any other relevant Act;
  - (ii) an operator's licence;
  - (iii) a venue licence

**authorised purpose** means,—

- (a) for class 1 gambling, class 2 gambling, and class 3 gambling, any of the following purposes:
  - (i) a charitable purpose;
  - (ii) a non-commercial purpose that is beneficial to the whole or a section of the community;
  - (iii) promoting, controlling, and conducting race meetings under the Racing Act 2003, including the payment of stakes;
  - (iv) an electioneering purpose;
- (b) for class 4 gambling, any of the purposes specified in paragraph (a)(i) to (iii)

69. Section 4 defines net proceeds by taking the whole of turnover and revenue, and excluding two limited types of costs: those that are actual, reasonable and necessary in *conducting* the gambling, and those that are actual, reasonable and necessary in *complying* with the relevant statutory and licensing requirements. The Act does not define “necessary”. However it is a strong word, which has been held by the courts to set a high standard, in excess of what might be merely desirable, convenient, or reasonable. The Court of Appeal held in *Environmental Defence Society v Mangonui County Council* [1989] 13 NZTPA 197, 203 per Cooke P, that “... ‘necessary’ is a fairly strong word falling between expedient or desirable on the one hand and essential on the other”. In the Commission’s view, “necessary” carries a similar meaning in the context of class 4 gambling expenditure.

70. Any expense that does not fall into one of those two limited categories of costs set out in the section 4 definition of net proceeds forms part of the net proceeds and is subject to the obligation to distribute for authorised purposes pursuant to section 106, which provides:

**106 Corporate society must apply or distribute net proceeds from class 4 gambling to or for authorised purpose**

- (1) A corporate society must apply or distribute the net proceeds from class 4 gambling only to or for an authorised purpose specified in the corporate society's licence.
- (2) A corporate society that fails to comply with subsection (1) commits an offence and is liable on summary conviction to a fine not exceeding \$10,000.
- (3) A Court that convicts a corporate society of an offence under this section may—
  - (a) make whatever orders are necessary to recover an amount of proceeds wrongly applied or distributed or to safeguard an amount not applied or distributed; and
  - (b) order the application or distribution of an amount of proceeds not yet distributed.
- (4) The effect of a conviction under this section is that—
  - (a) the class 4 operator's licence and all class 4 venue licences held by the corporate society are cancelled; and
  - (b) the corporate society does not have a right to appeal the cancellation.

71. Section 106 is key to the statutory scheme for class 4 gambling. It renders as an obligation the definitional element set out in section 30(a)(i) – the distribution of net proceeds – and provides potentially harsh consequences for non-compliance. A corporate society that does not apply or distribute net proceeds for authorised purposes is liable to summary conviction; the net proceeds not applied or wrongly applied can be subject to court orders for distribution; and a convicted society's licence is cancelled with no right of appeal.

72. The combined effect of section 106 and the definition of "net proceeds" in section 4 is that class 4 societies can only incur costs that are actual, reasonable and necessary in conducting the gambling or in complying with statutory and regulatory requirements. If a class 4 society incurs a cost that is notional, or is not reasonable or necessary in conducting the gambling or for compliance, that cost would form, by definition, part of the "net proceeds" and would result in breach of section 106 if paid.

73. Under section 116, the Secretary may by notice in the *Gazette*, set limits on, or exclude, the costs that class 4 societies may incur. The costs that he may exclude or limit

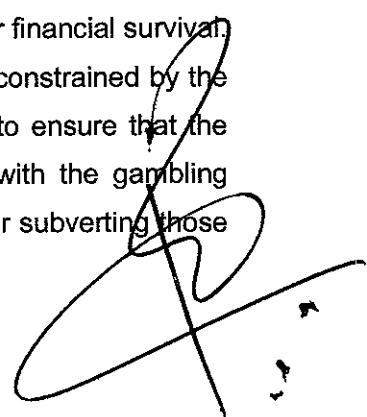
include costs associated with the class 4 venue; costs associated with repairing and maintaining gambling equipment; and costs of operating the society. The Secretary has not set any limits or exclusions in relation to the type of costs at issue in this appeal.

74. In addition to the requirement to distribute net proceeds (as defined) only for authorised purposes, class 4 gambling operators must also maximise those net proceeds. Under section 52, the Secretary must refuse to grant a licence (section 52), or must refuse to renew a licence (under section 56), if the Secretary is not satisfied on each of the grounds listed in that section. The Secretary may also suspend or cancel a class 4 operator's licence if he is satisfied that any of the grounds in section 52 are no longer met and, in deciding whether to suspend or cancel a class 4 operator's licence, he must take the matters in section 52 into account. The grounds, which therefore constitute in effect a series of continuing obligations, include:

- (a) the applicant's purpose in conducting the class 4 gambling is to raise money for authorised purposes; and
- (b) the applicant will maximise the net proceeds from the class 4 gambling and minimise the operating costs of that gambling; and
- (c) the net proceeds from the class 4 gambling will be applied to or distributed for authorised purposes.

75. The complementary requirements to maximise and distribute net proceeds to the community, together with the definition of class 4 gambling as, amongst other things, gambling the net proceeds of which "are applied to or distributed for authorised purposes" make clear that distribution of funds to the community is fundamental to the existence of class 4 societies. They are not commercial ventures, but exist to hold licences and conduct gambling in either society venues or, under venue agreements in the premises of others, for the purpose of raising money for distribution for community purposes.

76. The Commission recognises that the factors set out in the evidence, which have resulted in a scarcity of high turnover venues, have resulted in competition between societies to secure agreements with the operators of those venues and that societies feel under pressure to compete with each other in order to ensure their financial survival. However the nature of the competitive steps available to societies is constrained by the Act and their statutory obligations. Those obligations are intended to ensure that the community, and not venue operators or other persons connected with the gambling operation, receives the net proceeds of class 4 gambling. Relaxing or subverting those



controls in order to allow societies to use the proceeds of gambling to compete with each other would tend to threaten that objective.

77. The Act does not explicitly authorise expenditure by societies on competing with one another to secure venues and the gaming receipts therefrom. Such expenditure would only be permitted if it is part of “the actual reasonable and necessary costs ... incurred in conducting the gambling” or in legal compliance.
78. The key issue for the Commission is therefore whether expenditure, the main purpose of which is to gain desirable venues for the society from other societies or to protect its existing venues from other societies, falls within the areas of expenditure excluded from net proceeds as defined. If it does, then using what would otherwise be net proceeds to compete for desirable venues might be necessary. That seems to have been the perspective adopted by the Secretary who then focussed his attention on keeping that expenditure within reasonable bounds. However, once competitive spending is seen as necessary, the amount which is reasonable cannot easily be objectively determined by a third party; what is reasonable will be whatever is required to win the resulting competition with other societies and leave the society in better financial health than otherwise. If societies are free to undertake competitive spending to secure venues, the result is likely to be an inevitable increase in costs to the detriment of the community as a whole with the most likely beneficiaries being the operators of desirable venues. As much seems clear from the Foundation’s evidence, in Mr McElrea’s second affidavit, regarding the inevitability of spending in competition (albeit that Mr McElrea attributes such competition to the statutory scheme for venue agreements rather than tacit or express approval by regulatory authorities of the funding of competition) at paragraph 17:

We are not allowed to contract with venues for any period longer than three years. That means, at the very least, there will be a three yearly bidding process between any venue we have, and other Societies, and the same is true of venues whom we do not currently have contracts with but would like to attract. It is not a choice of the market or the Societies that there is such volatility in the venue market with venues shifting from Societies all the time. Our experience is that 18 machine venues, which are a particularly valuable commodity, having regard to the provisions of the Gambling Act, are sought after by all Societies. For so long as the law remains in its current form, the practise of all of the Societies in protecting their existing venues and endeavouring to get more venues will continue.

79. A further description of the competitiveness of the class 4 gambling environment is provided in Mr McElrea’s second affidavit for the Foundation at paragraph 27:

... TTCF is not trying to do anything more or less than any other society; it is simply trying to ensure its future survival by ensuring it has a viable and successful presence in the market place.

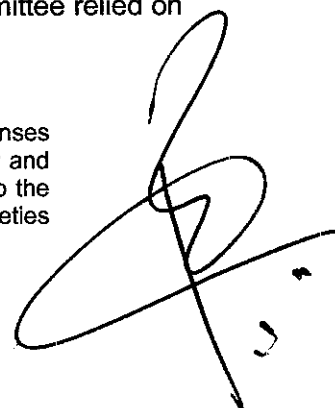
And at paragraph 32 to 33:

... the competition for venues is even more intense than it was between 2004 – 2007 when 3 year venue agreements were more the norm. Like other societies, TTCF constantly has venues coming up for renewal and sadly it is not a simple matter of presenting the venue operators with a new agreement to sign on the day before the old one expires. They are commercial operators trying to survive in an extremely competitive sector. As explained previously, they don't really get to make such a decision without first being serenaded by a number of other society representatives. The situation is almost akin to the battle for supremacy that exists between Breweries; Coca Cola and Pepsi; and Cigarette Manufacturers because whilst they are all in the same business achieving essentially the same things, they are driven by the need to be the biggest and best. It would seem that Gaming Machine societies all abide by the same expectations and needs.

Until the concept of perpetual venue agreements or some other regulatory restriction regarding the movement of venues from one society to another is introduced, the Trustees believe we have to compete or go out of business. As my evidence shows earlier, all the main competitor societies employ people with various titles to undertake such activity as were contracted [for] with ELL [Evergreen].

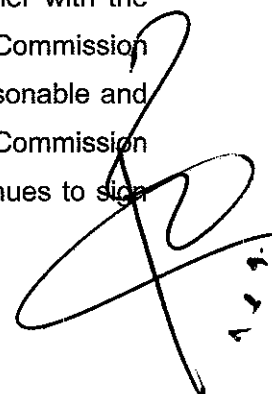
80. The issue turns on the scope of the words "incurred in the conduct of the gambling" (or, less likely, in the legal compliance alternative). A broad interpretation would extend "costs ... incurred in conducting the gambling" to expenditure on competition for desirable venues whereas a narrower interpretation would limit such costs to the operational requirements of the existing gambling undertaken by the society. For reasons set out below, the Commission has concluded that the narrow interpretation is the correct one and that societies are not permitted to use gambling proceeds for expenditure, the principal purpose of which is competition with other societies for desirable venues.
81. The Commission considers that, in all likelihood with an eye on the consequences of likely competition for valuable venues, the legislation places strict limits on the costs that class 4 societies may incur. Legislative commentary on the Responsible Gambling Bill indicates that competitive spending (albeit in the context of spending on venues) was a concern at the time of the Act's introduction and supports the view that the Act was intended to place stringent controls on class 4 gambling operators, in order to avert spiralling spending. For example, the Government Administration Committee reported in its commentary to the Bill that the majority of the Committee was not persuaded by arguments of some submitters that, rather than the Secretary being able to prescribe operators' costs, the Bill should place only a general duty on operators to incur such costs as are fair and reasonable in the circumstances. Instead, the Committee relied on advice by the Department:

The Department advises that its experience to date suggests that, if expenses are left to gaming machine societies to determine, the costs of the society and its sites - especially site rental for the 18 machine sites – can 'blow out' to the detriment of funds for the community. In the absence of firm controls, societies



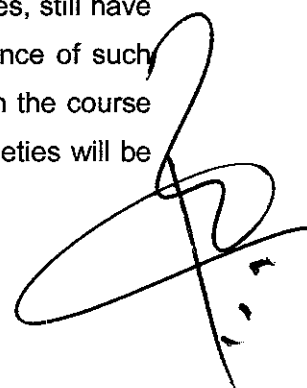
can find it very difficult to avoid paying high site-based charges if they wish to retain or obtain a high-turnover site.

82. Although these comments are specifically in relation to site expenses, the mischief that the Bill (and later Act) was intended to prevent – incurring costs in relation to competition for venues at the expense of the community – is clear. The Commission considers that such comments support its view that the Act should be interpreted in such a way as to minimise the ability of community funds being spent on such competition.
83. Longstanding concerns about competition for class 4 venues resulting in excessive spending have also received judicial recognition. In *Pub Charity v the Attorney-General* CA103/4, 8 November 2004, the Court of Appeal considered an appeal by a class 4 society against a decision of the High Court dismissing an application for judicial review. In its judgment, the Court set out a revealing discussion of the class 4 gambling environment prior to the enactment of the Gambling Act 2003 and the actions taken by the Secretary in order to curb “competitive” spending. The Court accepted (at [8]) that the ability for venues to move their custom between societies had led to an increase in site payments being paid by some operators competing for venues and that, by inflating expenses in this way, operators reduced the profit available for authorised purposes. The Court considered that the standard licence condition, requiring the society to apply gaming funds only to “expenses that are actual, reasonable and necessary to the society’s gaming machine operations,” entitled the Department to limit allowable costs to those caused by the gambling operation. The Court’s comments, like those of the Government Administration Committee referred to at paragraph 81 above, relate specifically to venue expenses but reveal a consistency of object.
84. It is worth noting that the 2003 Act’s definition of net proceeds did not adopt the broader purposive element (“to the society’s gaming machine operations”) which had been used in the licence condition previously imposed by the Secretary. In the Commission’s view, the words “incurred in conducting the gambling” and in legal compliance are more limited and restrictive in their scope than “the society’s gaming machine operations” and deliberately so. Spending on competition for venues may arguably have come within the former licence condition but does not fit within the deliberately narrower language used by the 2003 Act.
85. In the Commission’s view, interpreting reasonable and necessary costs in conducting the gambling to include costs in competing for venues is consistent neither with the statutory context, nor with the legislative and regulatory history. The Commission considers that, in the light of the discussion above, the phrase “actual, reasonable and necessary in the conduct of the gambling” should be read narrowly. The Commission does not consider that paying someone for the sole task of persuading venues to sign

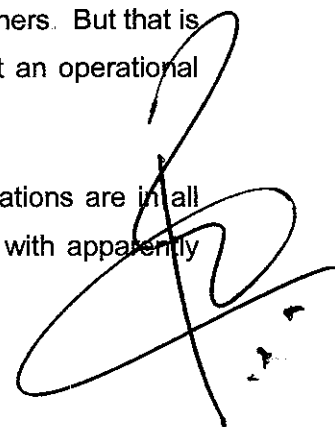
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agreements with a particular trust, in order to maintain or increase "market share", is a reasonable and necessary cost in the conduct of the class 4 gambling or legal compliance.

86. The Commission notes the Foundation's argument that other societies have paid employees, who, amongst other things, perform business development roles. The Commission is not in a position to comment specifically on the roles of employees of other societies. The Commission accepts that a necessary cost of conducting gambling includes paying staff or agents to oversee the gambling operation in venues, to ensure that the legal obligations are being met and to enter into new venue agreements (which are a statutory requirement if the gambling is conducted somewhere than the society's own premises). It is possible that such necessary expenditure may also produce incidental business development and protection benefits.
87. However, the Commission does not think it necessary for the conduct of the class 4 gambling or for meeting the associated legal obligations, for societies to use gambling proceeds to pay someone simply to conduct a business development role. There does not seem to be any suggestion that the services of Mr Acklin, for which his company charged the society, extended beyond keeping an eye on what was happening in the class 4 gambling sector, approaching venues and attempting to persuade them to sign agreements with the Foundation. The preparatory notes to his reports to the trustees, Mr McDonald's notes of his interviews with Mr Acklin and a job description provided by Mr Acklin to one of the trustees, all of which are annexed to Mr McDonald's affidavit for the Secretary, suggest that Mr Acklin's role was solely concerned with promoting the Foundation to new venues and obtaining agreement in principle.
88. The Commission has considered what its conclusion concerning the meaning and application of the provisions set out above will mean for societies and the acknowledged scarcity of valuable venues. The Commission's decision does not mean that competition for venues is prohibited or at an end. However, the decision imposes a significant limitation on the use of resources by societies in that competition. Societies may only use gambling proceeds to meet the actual, necessary and reasonable costs of conducting the gambling and legal compliance. They cannot use gambling proceeds on pure business development or competitive spending. Societies that wish to maintain or increase their "market share" of venues, in order to be able to run more efficiently or to increase their capacity to distribute net proceeds to their authorised purposes, still have available to them other means such as persuading venues of the importance of such purposes, and developing relationships with venue personnel incidentally in the course of activities on which it is permitted to expend gambling proceeds. All societies will be similarly restricted.

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89. Spending gambling proceeds on entertainment and leisure similarly fails to meet the essential statutory test. It is not inherently necessary for the conduct of the class 4 gambling or regulatory compliance. The evidence and submissions in this area are less clear than desirable. In response to the Foundation's submission recorded at paragraph 50 above, the Commission can see no reason why the Secretary should ignore, when making a decision about suspension, spending that occurred outside a particular audit period. In any case, the Commission, as part of its *de novo* approach, is not confined to matters that occurred during a particular audit period.
90. Entertainment expenditure of gambling proceeds is permitted to the extent that it is a reasonable and necessary cost of conducting the gambling and maximises returns while minimising costs. It is not permitted if it is aimed at benefitting either the trustees and their families or venue operators with whom the Foundation has or hopes to have venue agreements. It is not clear what the purpose of the challenged entertainment expenditure has been but much of it is not easily reconciled with what is allowed and, even in those cases, there seems to have been no focus on minimising costs. The Foundation has apparently operated on the basis that its spending does not need to be constrained as set out above.
91. While the Act shows a real concern with strictly controlling expenditure of gaming machine proceeds, it also requires societies to maximise returns while minimising costs (section 52(1)(d)). It is important to emphasise, however, that the maximisation of net proceeds is not the primary rule to which all others are subject. The obligations in section 52(1)(d) are limited by sections 106 and 52(1)(e). It is no answer to using net proceeds for an unauthorised purpose to establish that the effect of the unlawful expenditure has been to increase the net proceeds available (although that may be relevant to penalty).
92. The Commission appreciates the fact that, in relative terms, the Foundation has been financially successful, with an impressive history of distribution relative to costs. Nothing in this decision should be taken as a criticism of the use of contractors, rather than employees, to carry out the necessary functions of societies whenever this can be shown to be efficient. The Foundation argues, however, that it is free to conduct its affairs like any commercial operator, save that it is ultimately not for profit and must distribute its "profits" to the community rather than to shareholders or owners. But that is not the case. The Act contains express constraints and obligations at an operational level which do not apply to other businesses.
93. The Commission is not concerned with whether the Foundation's operations are in all respects within the requirements of its trust deed; nor is it concerned with apparently

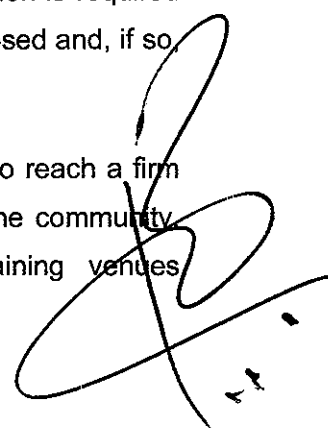


moralistic judgements about the proportion of expenditure on alcohol as opposed to food in the course of entertainment. It is concerned with whether expenditure results in non-compliance with the Act, Regulations or licence conditions. In this case, the Foundation has apparently considered only whether the expenditure is reasonably necessary for its successful operation rather than considering whether it is necessary for the conduct of the gambling and legal compliance. In the Commission's view, expenditure on pure business development, rewards and incentives for success in gaining or retaining venues and the entertainment of trustees or third parties is not necessary for the conduct of gambling or legal compliance. Such expenditure is not available as a response to competition for desirable venues.

94. The Foundation's submissions indicating that it had some entitlement to certainty of the limits of its expenditure in advance are not realistic. The limits on expenditure are express in the Act but what is reasonable and necessary in any particular case is always a matter of judgement in the circumstances. These are judgements which societies are expected to make. Societies should not expect to be punished for good faith assessments made on reasonable grounds but they cannot expect to be given spending entitlements by the Secretary in advance. In this regard, section 116 is intended to allow the Secretary to impose maximum caps on expenditure, over and above the less specific restrictions imposed by the Act. Such limits are additional caps, not matters of guidance as to what is reasonable and necessary in all situations.
95. It is clear to the Commission that expenditure driven by competition for desirable venues is a longstanding issue. It rejects the suggestion that imposing a penalty is something unfair and out of the blue. The Foundation has robustly asserted its claims to entitlement to conduct its business as it thinks fit while the Secretary attempted to persuade it to change its ways. Its success, relative to other societies, appears, at least in part, to have been derived from its decision to spend aggressively in pursuit of "market share" and it must bear the consequence of the punitive consequences of running that particular risk.

### **Penalty**

96. As the Commission has found that the subject expenditure resulted in a failure to comply with the Act, specifically sections 106 and 52(1)(d) and (e), the Commission is required to consider the question of penalty, whether a suspension should be imposed and, if so, for how long.
97. In considering the issue of penalty, the Commission has not been able to reach a firm conclusion on the extent to which the breach has resulted in harm to the community. The Secretary submitted that the Foundation's expenditure in gaining venues

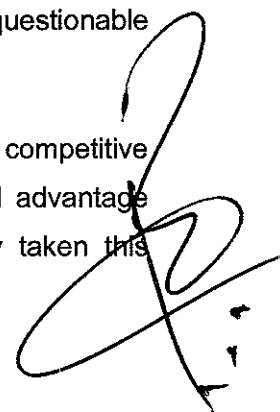


represented a total loss to the community. The Foundation's contention to the contrary argued that the amount spent was offset by its greater percentage returns of gaming proceeds to the community than the societies from which it gained the venues. The Foundation's calculations were based on a set of assumptions which the Commission was not prepared to accept but, while not conclusively establishing that the breach produced a clear net benefit, the argument is sufficiently cogent to create real doubt that the Secretary's submission is necessarily correct. The Commission is ultimately not persuaded one way or the other on the evidence and therefore regards the financial impact of the breach on the community as a neutral factor in determining the penalty.

98. It is clear that, in many respects the Foundation's conduct mirrors that of many other societies who have been engaged in increasing competition for desirable venues. The venue operators have, as one would expect, not been slow to seize the opportunity for advantage. This no doubt explains the prevalence of one year venue agreements when the Act allows for venue agreements of up to three years. It is also true that little effective action has been taken to constrain competitive spending with the result that societies have had to choose between a conservative and compliant course of action or meeting the actions of their competitors. It appears that the Secretary has not taken a sufficiently firm or clear position on the legality of spending purely in aid of competition for venues and has focussed instead on the reasonableness of such expenditure (rather than on its necessity for the conduct of gambling), without appreciating that what is reasonable in a competitive environment is dictated by the competitive response of other players.

99. Nevertheless, a punitive response is required for several reasons:

- (a) The Commission wishes to emphasise the importance of the principles which it is setting out in this decision.
- (b) The conduct, in this case, while not involving deliberate breach or want of good faith, nevertheless involved a deliberate and calculated decision to reject the Secretary's challenges and calls for restraint in favour of seizing the competitive advantage until forced to stop by the imposition of real consequences. Whenever societies choose this path, they must face the consequences of their call. The Foundation took the risk of questionable conduct to its advantage.
- (c) This is particularly so when the conduct has occurred in a competitive environment and the society concerned has obtained operational advantage from its conduct. In this case, the Foundation has apparently taken this

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particular conduct further than any other society and has reaped the benefits accordingly.

- (d) In a competitive environment, enforcement of obligations which conflict with competitive urges is critical if compliance is to be expected. The results of the historical non-punitive approach are sadly obvious. If one expects societies to resist competitive pressure to engage in questionable expenditure or other conduct, the consequences must be plain and reliably imposed.
- (e) There is a question of fairness overall, to those societies who have been compliant, or at least less aggressively non-compliant, and to those whose non-compliances are or have been subject to investigation and punitive consequences.

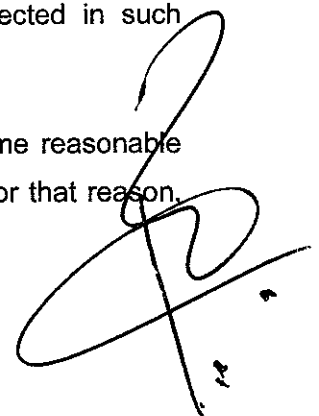
100. It follows that the Commission will impose a penalty of suspension and expects that the Secretary will investigate similar breaches by other societies and impose appropriate penalties against other societies who have not complied.

101. The Commission has struggled to understand the basis for the suspension imposed by the Secretary, either as to its initial period of four days or its reduction to two days by application of section 59(4)(d). In paragraphs 62 to 64 the Commission expressed surprise that the matters listed in the Secretary's letter of 14 August 2009 were seen as appropriate matters under section 59(4)(d), especially when it was clear that the forward-looking matters were adopted under protest and without prejudice to the outcome of this appeal.

102. In the circumstances, the Commission would have expected that the principal matter to be dealt with pursuant to section 59(4)(d), would have been the potential recovery of the expenditure which resulted in non-compliance. The recovery of expenditure in breach of section 106 and section 52 could readily be expected to result in a significant reduction in what suspension would otherwise be imposed. A reduction for the establishment of new measures to reduce the likelihood of future breaches would merit a reduction, albeit of a less significant amount.

103. A mere promise to cease committing the breach in question does not seem to the Commission to merit a reduction as future compliance is to be expected in such circumstances anyway.

104. It is important that the period of suspension be principled and bear some reasonable relationship to the consequences of comparable breaches by others. For that reason,

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the Commission is at a loss to understand the decision to start with a suspension of four days when regard is had to the following matters:

- (a) In the Whitehouse Tavern case, the Secretary imposed a suspension of 30 days which was reduced to seven days by application of section 59(4)(d). The section 59(4)(d) matters amounted to an insubstantial proportion (\$5,000) of the total excessive expenditure of \$33,000. The expenditure, for the most part, lacked much "colour or right" but was for a much less substantial amount than the present case. The Commission reduced the suspension to four days in order to reflect its disapproval of the Secretary's conduct in giving notice that dealing with the section 59(4)(d) matters would result in **no suspension at all** and then, resiling from that after the event, reducing it to seven days.
- (b) In The Southern Trust case, currently on appeal before the Commission, the Secretary imposed a suspension of five days for excessive and competitively inspired expenditure in the amount of about \$200,000, of which approximately half was subsequently recovered.
- (c) In the Eureka case, the Secretary imposed venue licence suspensions of one or two days (increased by the Commission to two and three, days respectively) for omitting to keep information up to date. The conduct was not intentional and did not affect the return of funds to the community.

105. In the circumstances, the Commission considers that an appropriate suspension is six days. As the appeal has had the effect of suspending the effect of the Secretary's order, it is necessary for the Commission to stipulate the commencement of the suspension which it has upheld on appeal. The days of suspension need not be taken consecutively but must all be taken within one calendar month of the decision.

### Decision

106. For the reasons already provided, the Division dismisses the appeal and suspends the Trust's Class 4 operator's licence for six days.

**GAMBLING  
COMMISSION**

Peter Chin  
Chief Gambling Commissioner

for and on behalf of the  
Gambling Commission

5 May 2010