

IN THE MATTER of the Gambling Act 2003
AND on appeal by **KIWI COMMUNITY TRUST**

BEFORE A DIVISION OF THE GAMBLING COMMISSION

Members: P Chin (Chief Gambling Commissioner)
M M Lythe
M J Richardson

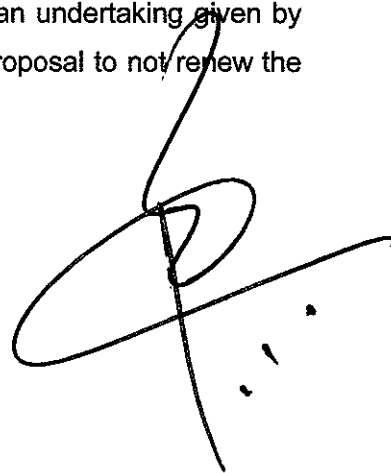
Date of Decision: 14 August 2009

Date of Notification of Decision: 2 September 2009

**DECISION
ON APPEAL BY KIWI COMMUNITY TRUST**

Appeal

1. Kiwi Community Trust Limited (the "**Appellant**" or the "**Trust**") appealed, under section 61 of the Gambling Act 2003 (the "**Act**"), against a decision by the Secretary for Internal Affairs (the "**Secretary**") refusing to renew its class 4 operator's licence. The Secretary did not renew the licence as:
 - (a) he was not satisfied that:
 - (i) the Trust's proposed gambling operation is financially viable, pursuant to section 52(1)(c) of the Act;
 - (ii) the net proceeds from the Trust's class 4 gambling will be applied to or distributed for authorised purposes, pursuant to section 52(1)(e) of the Act;
 - (iii) the Trust is able to comply with the applicable regulatory requirements, pursuant to section 52(1)(f) of the Act;
 - (b) the Trust failed to achieve an adequate level of net proceeds for the six months ending September 2008, and thereby failed to abide by an undertaking given by its legal advisor as grounds for not pursuing his earlier proposal to not renew the Trust's class 4 operator's licence.



Relevant Law

2. The relevant law is as follows:

Gambling Act 2003

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

52. Grounds for granting Class 4 operator's licence

- (1) The Secretary must refuse to grant a class 4 operator's licence unless the Secretary is satisfied that, -
 - (a) the gambling to which the application relates is Class 4 gambling; and
 - (b) the applicant's purpose in conducting Class 4 gambling is to raise money for authorised purposes; and
 - (c) the applicant's proposed gambling operation is financially viable; and
 - (d) the applicant will maximise the net proceeds from the Class 4 gambling and minimise the operating costs of that gambling; and
 - (e) the net proceeds from the Class 4 gambling will be applied to or distributed for authorised purposes; and
 - (f) the applicable is able to comply with applicable regulatory requirements; and ...
- (2) In assessing financial viability under subsection (1)(c), the Secretary must consider, among other things, the ability of the applicant to reward winners and pay levies, taxes, and other costs, as well as apply or distribute the net proceeds from the Class 4 gambling to or for authorised purposes.

56. Renewal of Class 4 operator's licence

- (5) The Secretary must refuse to renew a Class 4 operator's licence if –
 - (a) any investigations carried out by the Secretary cause the Secretary not to be satisfied about any of the matters specified in section 52; or
 - (b) the Secretary is not satisfied that the applicant will comply with all relevant requirements of this Act, licence conditions, game rules, and minimum standards.

112. Orders regarding application or distribution of net proceeds

- (1) The Secretary may apply for orders in accordance with sub-sections (2) and (3) if –
 - (a) a corporate society ceases to conduct Class 4 gambling, whether temporarily or permanently; or
 - (b) a corporate society fails to apply or distribute net proceeds from Class 4 gambling within a time period prescribed by regulations made under section 114; or
 - (c) the Secretary considers that it is necessary in order to recover net proceeds from Class 4 gambling that have been improperly paid to a person.

- (2) An application for an order must be made to –
 - (a) the High Court if the net proceeds from Class 4 gambling are, or are estimated to be, more than \$200,000; or
 - (b) the District Court if the net proceeds from Class 4 gambling are, or are estimated to be, \$200,000 or less.
- (3) On application by the Secretary under this section, the High Court of the District Court may –
 - (a) make whatever orders are necessary to recover an amount improperly paid out, applied, or distributed; or
 - (b) order the application nor distribution of an amount not yet applied or distributed.

Gambling (Class 4 Net Proceeds) Regulations 2004

10. Minimum amount of net proceeds to be distributed for authorised purposes

- (1) The minimum amount of net proceeds that a licence holder must distribute for authorised purposes is the proportion equivalent to 37.12% of its GST exclusive gross proceeds for each of its financial years.
- (2) The first financial year in relation to which a licence holder must comply with subclause (1) is the financial year that commences after the commencement of this regulation.
- (3) This regulation is subject to regulation 11.

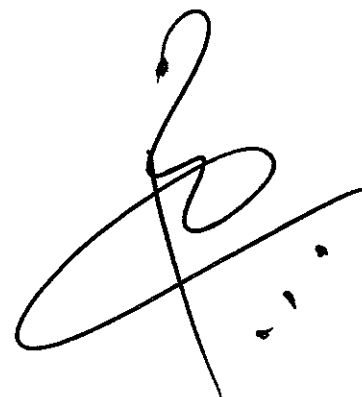
11. Timing requirements for distribution of proceeds for authorised purposes

- (1) A licence holder must distribute for authorised purposes, –
 - (a) during each of its financial years at least every quarter, all or nearly all of the net proceeds from the Class 4 gambling during the financial year; and
 - (b) within 3 months after the end of each of its financial years, any remainder of the net proceeds from the Class 4 gambling during the financial year.
- (2) The first financial year in relation to which a licence holder must comply with subclause (1) is the financial year that commences after the commencement of this regulation.

Companies Act 2003

4. Meaning of Solvency Test

- (1) For the purposes of this Act, a company satisfies the solvency test if –
 - (a) the company is able to pay its debts as they become due in the normal course of business; and
 - (b) the value of the company's assets is greater than the value of its liabilities, including contingent liabilities.

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Submissions on behalf of the Trust

3. The Trust submitted, in summary, as follows:

Ground 1 – The Trust's proposed gambling operation is financially viable – section 52(1)(c) of the Act

- Section 52(1)(c) states that the Secretary must refuse to grant a class 4 operator's licence unless the Secretary is satisfied that its proposed gambling operation is financially viable. The term "proposed" confirms that regard must be had to the future gambling operation, not past performance.
- In refusing to renew its licence, the Secretary placed too much emphasis on its historical performance, rather than on its proposed future performance.
- When looking at future forecasts, regard may be had to previous performance, but this is only one factor, and it is only relevant when the previous performance is indicative of future performance. In any event, the Trust's historical performance is irrelevant as it now only has one venue, which it did not have previously (the Opal Lounge) rather than eight different venues.
- It has no debt and has cash reserves.
- It has historically not met the requirement to return 37.12% per annum of its gross proceeds, but it will do so in the 2008/09 financial year, and is forecast to do so for the 2009/2010 financial year.
- The Department's own investigating accountant agrees that it is financially viable.
- The Commission can be satisfied, looking at the matter on a *de novo* basis, that the proposed gambling operation is financially viable for the period 1 June 2008 to 31 May 2009.

Ground 2 – Net proceeds from the Trust's class 4 gambling will be applied or distributed for authorised purposes – section 52(1)(e) of the Act

- The net proceeds will be, and must be, distributed to authorised purposes, not to any other purpose.

Ground 3 – The Trust is able to comply with the applicable regulatory requirements – section 52(1)(f) of the Act

- Section 52(1)(f) provides that the Secretary must refuse to grant a class 4 operator's licence unless he is satisfied that it is able to comply with applicable regulatory requirements. The wording "able to comply" confirms that the test is forward looking,

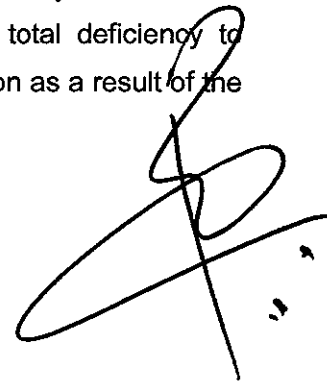
rather than historical. Looking forward, its forecast shows that it will meet the minimum requirement of 37.12%.

Ground 4 – The Trust failed to achieve an adequate level of net proceeds for the six months ended September 2008, and thereby failed to abide by an undertaking given by its legal advisor as grounds for not pursuing the Secretary’s earlier proposal to not renew the Trust’s class 4 operator’s licence

- This “ground” for refusing to renew is not a ground under section 52 of the Act, and in any event, is disputed.
- For the six months ending September 2008, it had an income of \$404,518.92 and made grants of \$171,034.86, thereby returning 42.28% to the community.
- It has not failed to adhere to any undertaking given by its legal advisor.
- The Department has contributed to its (the Trust’s) poor returns over the years.

Submissions by the Secretary

4. There is one key issue requiring resolution – do the distribution requirements in Regulations 10 and 11, once breached with respect to any given financial year, still exist beyond that financial year and into the future? The Secretary submitted that they do and as such the Appellant owes the community \$1,115,744 through accumulated breaches of Regulation 10 between 2003-2009.
5. The Secretary submitted, in summary, as follows:
 - In the six years in question, the Appellant’s gaming machine operation generated \$7,427,570. It was legally required to return at least \$2,666,400 to the community by way of grants, but paid only \$1,550,656. The \$1.1 million difference was either used to pay the Appellant’s operating costs or was retained. The Appellant has retained \$366,764 of this money as a cash reserve.
 - The Appellant’s deficit of \$1,057,698 was built up over five years (\$18,916 from 2003/2004; \$114,192 from 2004/2005; \$118,764 from 2005/2006; \$444,652 from 2006/2007; \$361,471 from 2007/2008 and -\$297 from 2008/2009).
 - During 2003-2009, the Appellant also received \$58,046 by way of returned distributions, which when added to the \$1,057,698 brings the total deficiency to \$1,115,744. This is the total sum that the community missed out on as a result of the Appellant’s breaches.



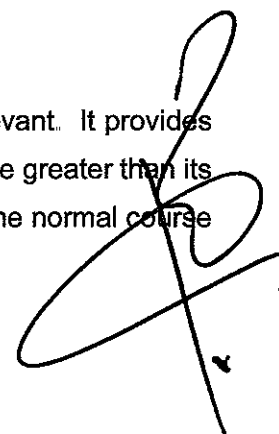
- The Appellant's fundamental problem is that its cost structure was too high to enable its legal obligations to be met and in five of the six years covered, the Appellant was left with less than 37.12% of gross proceeds after paying its expenses. The following table summarises the Appellant's position:

	03/04	04/05	05/06	06/07	07/08	08/09	09/10 forecast
Total expenses: venue payments, costs and taxes as % of gross proceeds	68.04%	82.3%	85.3%	74.3%	62.82%	66.11%	70.4%
Percentage of gross proceeds available for distribution ('net proceeds')	31.96%	17.7%	14.7%	25.7%	37.18%	33.89%	29.6%
Percentage of gross proceeds actually distributed	31.12%	23.43%	28.21%	6.69%	12.88%	37.15%	N/A

- In the year 2009/2010, the Appellant forecasts to have net proceeds of only 29.6%.
- His remaining submissions fall into four categories:
 - The solvency test – In assessing financial viability under section 52(1)(c), regard must be had to solvency.
 - Breaches are current liabilities – “Distribution deficiency” in breach of regulation 10, and “undistributed net proceeds”, in breach of regulation 11, should be treated as current liabilities.
 - If these two propositions are accepted, then:
 - Financial viability – the Appellant's liabilities exceed its assets. It is therefore not solvent, nor financially viable.
 - Future non-compliance – The Appellant is not able to, and will not, comply with regulation 10 in 2009/2010.

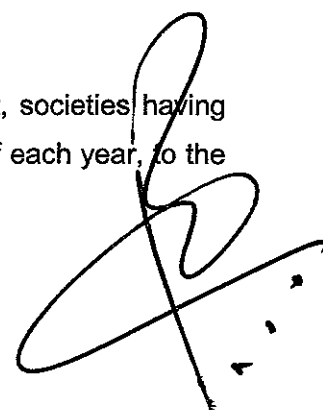
The Appellant's solvency

- The solvency test under section 4 of the Companies Act 1993 is relevant. It provides that a company (or in this case a society) is solvent (a) if its assets are greater than its liabilities; and (b) it is able to meet its debts as they become due in the normal course of business.



Distribution deficiency (in breach of regulation 10) and undistributed net proceeds (in breach of regulation 11) become current liabilities

- The Appellant distributed deficient sums in breach of regulations 10 and 11, and these distribution deficiencies become current liabilities for the Trust.
- The scheme of the Act is such that the liability to pay net proceeds is a continuing one, and this is apparent from the Act's remedies for breaches of the obligation.
- If a breach is continuing and ongoing, and he is not satisfied about future compliance, section 56 requires him to refuse to renew the class 4 operator's licence.
- Sections 52(1)(c) and 52(2) do not constrain the reading of viability to the events contained in one financial year.
- Excessive payments for expenses, to the extent that they prevent a society from returning the statutory minimum under regulation 10, may still be recovered and reclassified as net proceeds. Under section 112(3)(a), the Court may make whatever orders are necessary to recover an amount improperly paid out, on the application of the Secretary.
- The Secretary may also apply to the Court for an order for the distribution of an amount "not yet distributed" under section 112(3)(b).
- There is no time limit on section 112 orders being applied for or made, and they can take place beyond the financial year during which the improper payment or retention of funds occurred.
- The requirement to distribute a minimum percentage to the community reflects a basic tenet of the Act, according to which class 4 gambling can only be authorised when sufficient benefit is generated to outweigh the inherent harm and risk involved with this type of gambling.
- The objective of class 4 operators cannot be merely to survive at all costs – class 4 societies exist to raise funds for authorised purposes.
- The purpose of the Act (section 3(g)) includes the requirement "to ensure that money from gambling benefits the community".
- If the Trust's argument represents the true position under the Act, societies having financial difficulties would simply receive a clean slate at the end of each year, to the detriment of the community.



The Appellant's liabilities exceed its assets, and it is therefore insolvent

- The Appellant stated that it has no debt and is in a strong financial position, presenting a financial statement showing its cash assets (\$366,764) exceed its liabilities (\$164,505). However accepting his (the Secretary's) submission with respect to the Appellant's breaches of regulation 11 would mean that the Appellant owes \$438,390 to the community. Accepting his submission in respect of the Appellant's breaches of regulation 10 would mean the Appellant owes \$1,115,744 to the community.
- Even if the Commission determined that only the current available cash (\$366,764), which remains from undistributed net proceeds, should be returned to the community, this would still mean that the Appellant would be left with a current liability of \$164,505.
- These three sums represent what the Appellant should have distributed (\$1,115,744), could have distributed (\$438,390) and still can distribute (\$366,764). Either way, the Appellant is facing liabilities that exceed its cash assets.

The Appellant is not able to, and will not, comply with regulation 10 in 2009/2010

- The Appellant is not able to return the 37.12% minimum in 2008/2009, nor in the forecasted year for 2009/2010, because in both terms, the Appellant relies on its cash reserves of accumulated undistributed net proceeds to exceed the minimum requirement.
- If his main submission is accepted, these undistributed net proceeds would need to be distributed anyway, and not as part of this year's net proceeds, but as part of its original year net proceeds to meet their original year minimum distribution requirement. That is, the top-ups forecasted by the Appellant will not contribute towards the target of 37.12% for 2009/2010.
- The Appellant submitted that its past performance is mitigated by his (the Secretary's) contribution to its breaches. He accepts that he should have acted more promptly in the past, but did not do so because of internal disagreements on the best way to deal with the Appellant. However he does not accept that his actions contributed to the grounds upon which he is now seeking to refuse to renew the Trust's licence.

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Submissions by the Trust in reply

6. In reply, the Appellant submitted, in summary, as follows:

- The Secretary's submissions narrow the issue to one single point – he is of the view that a failure to distribute 37.12% of gross proceeds, and/or distribute all or nearly all of net proceeds each financial year creates a debt to the community of \$1,115,744 which, in accordance with generally accepted accounting practice, should be recorded in its financial statements.
- Nothing in regulations 10 and 11 provides that a failure to meet the requirements shall result in a debt being incurred which must be recorded in its financial accounts. Further, no such provision exists in the Gambling Act, or in any other class 4 regulation.
- The Gambling Act does, however, prescribe three clear consequences for failure to meet the requirements in regulations 10 and 11, namely:
 - operator's licence suspension;
 - operator's licence cancellation;
 - the ability to request the court to order amounts not yet applied to be distributed under section 112.
- That is, the current case is not a situation of legislation being silent on possible remedies – Parliament drafted an Act with three possible consequences. The introduction of a fourth consequence by the Commission would be contrary to the forward focused financial viability test.
- The Secretary had adequate remedies available at the time that it was failing to meet its 37.12% return requirements – during the years 2004 to 2007, he could have suspended or cancelled the class 4 operator's licence but did not do so.
- If regulation 10 provided that only 37.12% must be distributed each year, then there may be an argument that if 36.12% is distributed in one year, the shortfall would need to be made up the following year. However, the regulations provide that a minimum of 37.12% is required to be distributed, and all or nearly all of net proceeds must be distributed each year. There is therefore no need to introduce a fourth community debt consequence because the regulations currently require any shortfall (or excess) to be paid out in the following year under the "nearly all" requirement.
- The concept of a community debt is absurd. The natural and ordinary meaning of "debt" requires two parties in a debtor/creditor relationship. A shortfall in net proceeds

distribution is not a debt, as no ascertainable sum is owed to any particular person. There is no body called "the community", and such a concept would create practical problems and be unworkable.

- With the Community Debt concept, the Secretary is effectively asking the Commission to rewrite regulations 10 and 11.
- The Community Debt concept is new and this is the first time the Department has sought to have such a debt recorded, despite numerous societies failing to reach exactly 37.12% over the last four years.
- The Secretary has not presented any evidence which states that generally accepted accounting practice requires a net proceeds distribution shortfall be recorded as a debt in financial accounts.
- It obtained an expert opinion on the issue of community debt from KPMG. This opinion (with which it disagrees) suggests that section 112 of the Act creates a liability which it must recognise. In the event that section 112 does apply, it relies on the view expressed in that opinion that any contingent liability should be limited to the net of cash and accounts payable, being between \$203,000 and \$367,000. If a liability of between \$203,000 and \$367,000 were shown in its accounts, it would still meet the solvency test and be financially viable.

Analysis

7. This appeal relates to the renewal of a class 4 operator's licence. Section 56 of the Act sets out the renewal process. Section 56(5)(b) provides that the Secretary must refuse to renew a class 4 operator's licence if the Secretary is not satisfied that the applicant will comply with all relevant requirements of the Act, licence conditions, game rules, and minimum standards. Section 56(4) provides that section 52 applies to an application for renewal as if it were an application for a class 4 operator's licence. Section 52 provides that the Secretary must refuse to grant a class 4 operator's licence unless the Secretary is satisfied that all the requirements of that section will be met. The Secretary refused to renew the Trust's class 4 operator's licence pursuant to sections 56, 52(1)(c), 52(1)(e) and 52(1)(f).
8. As it has noted in previous decisions, the appeal function of the Commission under section 61 of the Act is exercised on a *de novo* basis. This means that the Commission considers the matter afresh. The Commission must apply sections 52 and 56 as if it were the Secretary and so decide whether it must refuse to renew the licence because of the matters in section 52.

9. The Commission has previously set out its approach to appeals regarding class 4 gambling. In GC43/06, at paragraphs 17 and 18 the Commission held:

The Commission considered its role to be forward looking in determining whether to renew the licence. The language of subsection 72(1)(c) clearly indicates that its concern is whether the applicant will comply in future with various regulatory requirements. Equally, the Commission has interpreted subsection 5(b) to apply to future compliance with section 67.

When assessing whether there will be future compliance, it is, however, logically relevant to consider past compliance and behaviour. Applicants with a history of non-compliance are less likely to comply in the future, while there may be no reason to question future compliance by applicants with an exemplary history.

10. The Commission considers that the starting point of its analysis should be the primacy to be accorded to the legal requirement for distribution for authorised purposes. The return of a society's proceeds to the community is the underpinning policy justification for permitting class 4 gambling. Section 30 defines class 4 gambling, in part, as gambling "the net proceeds of which are applied to or distributed for authorised purposes." Section 52(1)(e) requires the Secretary to refuse to grant a class 4 operator's licence unless the Secretary is satisfied that the net proceeds from the gambling will be applied or distributed for authorised purposes.
11. The importance of the distribution of funds for authorised purposes is also demonstrated by the following sections of the Act:
- (a) Section 53(1)(c) stipulates that a class 4 operator's licence must include a specific description of the authorised purposes to or for which net proceeds from the class 4 gambling are intended to be applied or distributed.
 - (b) Section 106 provides that a failure to apply or distribute proceeds only to or for an authorised purpose is a criminal offence.
 - (c) Section 112 provides that the Secretary may apply to the District Court or High Court for orders for any amounts improperly paid out or for the payment out of amounts not yet distributed.
12. In the Commission's view, the generation and distribution of net proceeds for community purposes is central to the operation of class 4 licences. This is made clear by the express requirements for a class 4 licence which include satisfaction about maximising net proceeds, minimising operating costs and applying and distributing the net proceeds for authorised purposes, as well as financial viability and purpose. Regulations 10 and 11, go further and impose strict and express minimum obligations additional to the more general requirements of section 52. Regulation 10 sets a minimum requirement for distribution of

net proceeds expressed as a percentage of the gross proceeds in each financial year; regulation 11 requires distribution of "all or nearly all" of the proceeds received during a financial year quarterly within that year, with the balance being distributed within a further 3 months.

The Trust's breaches

13. In each of the years from 2004 to 2008 the Trust breached regulation 10, by distributing amounts less than the stipulated minimum proportion (33% in the years ending 2004 and 2005, 37.12% in the years ending 2006 up to and including the present) of its gross proceeds. In the years ending 2006/07 and 2007/08, the Trust also breached regulation 11 by retaining significant proportions of its net proceeds, thereby breaching the regulation 11 obligation to distribute all or nearly all of its net proceeds. The amounts that were distributed, the amounts of net proceeds that were retained (in breach of regulation 11) and the amounts that should have been distributed have been taken from Exhibit A of Mr Carr's affidavit and are set out in the tables below:

Regulation 10 breaches						
	2003/2004	2004/2005	2005/2006	2006/2007	2007/2008	2008/2009
Gross proceeds	\$1,008,466	\$1,193,289	\$1,333,101	\$1,461,347	\$1,491,456	\$939,911
Minimum amount of net proceeds that should have been distributed	\$332,793 (33%)	\$393,785 (33%)	\$494,847 (37.12%)	\$542,452 (37.12%)	\$553,628 (37.12%)	\$348,895 (37.12%)
Amount distributed	\$313,877	\$279,593	\$376,083	\$97,800	\$192,157	\$349,192
Amount distributed as % of gross proceeds	31.12%	23.43%	28.21%	6.69%	12.88%	37.15%
Regulation 10 Shortfall (difference between minimum requirement and amount distributed)	\$18,916	\$114,192	\$118,764	\$444,652	\$361,471	-\$297

Regulation 11 breaches						
	2003/2004	2004/2005	2005/2006	2006/2007	2007/2008	2008/2009
Gross proceeds	\$1,008,466	\$1,193,289	\$1,333,101	\$1,461,347	\$1,491,456	\$939,911
Net proceeds available for distribution	\$322,245	\$211,126	\$195,852	\$375,406	\$554,494	\$318,468
Actual distribution	\$313,877	\$279,593	\$376,083	\$97,800	\$192,157	\$349,192
Regulation 11 shortfall (net proceeds retained and returned)	\$8,368	-\$68,369	-\$166,665	\$305,677	\$377,800	-\$29,876

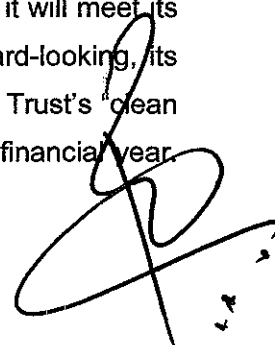
14. The top table shows regulation 10 shortfalls totalling \$1,057,698. In addition, the Trust had returned to it \$58,046 of its distributions during the period 2003 – 2009 (Secretary's submissions, paragraph 33), bringing the total shortfall to \$1,115,744. In the year ending 2009, the Trust distributed an amount slightly greater than 37.12% of its gross proceeds; however, as the bottom table shows, only \$318,468 of net proceeds accrued in that year, which amounts to 33.88% of its gross proceeds. The difference was made up from

proceeds that had been retained in breach of regulation 11 in previous years. The Secretary submitted that, in the year ending 2010, the Trust will be in a similar position: its forecasts rely on it retaining unlawfully past accumulated net proceeds to meet the future minimum distribution requirement.

15. The Trust seems to have treated regulation 10 as if it were merely a target, something to aim for, but of no real concern if missed. The Commission takes a different view. One of the effects of regulation 10 is to make the distribution of 37.12% of the gross proceeds in a financial year a first, not last, priority. Because the minimum percentage must be distributed, it is not available for other purposes. In the view of the Commission, the use of any part of the 37.12% minimum distribution to meet expenditure on costs produces amounts improperly paid which are potentially the subject of an application under section 112. While class 4 operators are required generally to maximise net proceeds for distribution and minimise costs, regulation 10 creates a strict floor for the use of gross proceeds to meet operating costs. Class 4 operators are not entitled to use any of the minimum percentage of net proceeds required for distribution for authorised purposes to meet other expenses. As it is clear that the Trust has a history of doing so, the Commission is surprised that there have not already been consequences both for its licence and with regard to the recovery of amounts improperly paid.
16. Regulation 11 imposes a different, but related, obligation. Essentially it prohibits class 4 operators from hoarding net proceeds and building up cash reserves for their future operations (therefore prohibiting them from using past proceeds to cover future excessive expenditure). Again, it is clear that the Trust has hoarded net proceeds in the past, the extent of its breaches in 2006/07 and 2007/08 being particularly gross and serious.

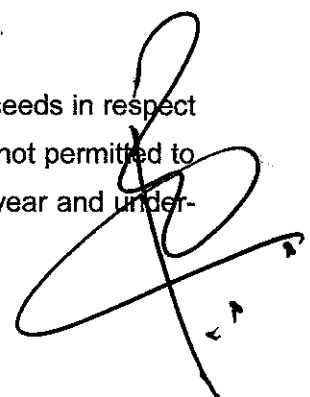
Do the breaches create a continuing liability?

17. As the submissions to the Commission developed, both parties focused strongly on the financial consequences of the breaches, with particular regard to the effect on the future financial viability of the Trust. Although, in the Commission's view, that is not the only consideration relevant to its decision, it first considers the effect of the past breaches on the financial viability of the Trust.
18. The Trust did not deny that it has breached its distribution obligations in the past. It argued, however, that the breaches, if not addressed within the financial year in which they occur, do not create continuing liability. The Trust further argued that it will meet its obligations in the future and that, as the test for renewal is entirely forward-looking, its licence must be renewed. The Secretary took issue with what he terms the Trust's "clean slate" approach, whereby the Trust starts afresh at the beginning of each financial year.



The competing arguments of the Trust and Secretary require analysis of the scheme of the regulations regarding distributions.

19. The approach taken by the Commission to the nature of regulation 10 (as set out in paragraph 15 above) leads to the conclusion that a class 4 operator who uses more than 62.88% of the gross proceeds in a financial year to meet operational expenditure is potentially subject to an application by the Secretary under section 112 in respect of the regulation 10 shortfall which would focus, not on the need to distribute more minimum proceeds (the "Community Debt"), but on the recovery of amounts improperly paid (excessive expenditure) so that it could be later distributed. Section 112 provides expressly for the recovery of improperly paid amounts, not just the enforced distribution of undistributed funds, and there is no obvious policy reason why a statutory remedy to recover improperly paid amounts should not be used. On the other hand, the Commission agrees with the Trust that it is not necessary to impose a consequential financial obligation in order to ensure that the community is not deprived of future proceeds because regulation 10 is a minimum, and regulation 11 requires the distribution of any additional net proceeds in excess of the regulation 10 minimum in future years. The Commission is also mindful that there may be significant practical difficulties in recovering payments made several years ago.
20. The Commission prefers, in this case, to leave that issue open for final determination in another case as it is in no doubt that, whether or not expenditure in breach of regulation 10 creates future financial obligations, failures to distribute as required by regulation 11 certainly do.
21. Regulations 10 and 11 impose obligations to distribute net proceeds in respect of the year in which the net proceeds are generated. Section 4 of the Act defines "net proceeds" by reference to turnover. Regulation 11(a) requires a licence holder to distribute "during each of its financial years at least every quarter, all or nearly all of the net proceeds from the class 4 gambling during the financial year". Regulation 10 provides that "the minimum amount of net proceeds that a licence holder must distribute for authorised purposes is the proportion equivalent to 37.12% of its GST exclusive gross proceeds for each of its financial years". The references in each of regulations 10 and 11 to "net proceeds" are to net proceeds generated within the relevant financial year. Such an approach is only to be expected in the light of the prohibition of the retention of such net proceeds by regulation 11. Even if the wording were not express, such an implication would arise.
22. The regulations therefore create discrete obligations in relation to net proceeds in respect of the year within which the proceeds are generated. A licence holder is not permitted to work to a cumulative total. It cannot, for example, over-distribute in one year and under-



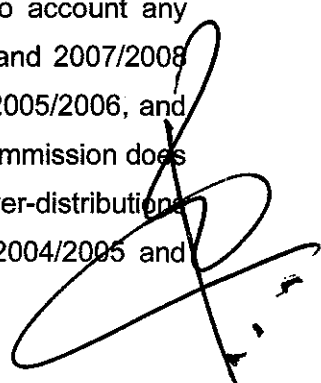
distribute in the following year to the extent of its previous over-distribution. The retention of the net proceeds in the following year would be in breach of that following year's regulation 11 requirement to distribute all of that year's net proceeds, regardless of any over-distribution in a previous year.

23. Similarly, the regulation 10 requirement that a licence holder distribute net proceeds equivalent to at least 37.12% of that year's gross proceeds is a requirement that relates to that same year's net proceeds. A licence holder cannot meet the regulation 10 requirement to distribute at least 37.12% of its net proceeds in a later year by using funds retained from an earlier year. Doing so would not meet the regulation 10 requirement because the licence holder would not be meeting the regulatory minimum from that year's net proceeds. It would also involve a breach of regulation 11 because the funds retained from the earlier year must have been retained in breach of the requirement to distribute all or nearly all of that earlier year's net proceeds.
24. In the Commission's view, the discrete obligations in relation to each year create an ongoing liability in relation to net proceeds retained (or not applied to authorised purposes). Net proceeds retained in breach of regulation 11 remain attributable to the year in which they were generated. The licence holder therefore remains liable under regulation 11 to distribute them, albeit late. There is nothing in the regulations or the Act to suggest that such liability ceases with the end of the financial period in which it was incurred.
25. Treating the Trust as having a continuing liability in respect of its regulation 11 breaches is consistent with section 112. Section 112 creates a remedy to enforce a liability in respect of the sum of each regulation 11 distribution shortfall. This is clear from the words of section 112(1)(b) which provide that the Secretary may apply to the court for orders under the section if a corporate society fails to apply or distribute net proceeds from class 4 gambling within a time period prescribed by the regulations made under section 114. The time periods provided for in regulation 11 are at least every quarter "during each of [a society's] financial years" and "within 3 months after the end of each of its financial years". Under section 112(3)(b) the Court may, on an application by the Secretary, make orders for the distribution to recover an amount not yet applied or distributed.
26. In the Commission's view, section 112 provides for the Court to make orders for distribution of an amount or amounts that the Trust failed to distribute within or following any of its previous financial years. The Commission does not accept the Trust's argument that the Court cannot exercise its power under section 112 in respect of failures to distribute funds in past years. To the contrary, section 112 is clearly aimed at rectifying

past breaches because it will only be at the end of a time period prescribed by the regulations that a class 4 operator could be said to have failed to apply its net proceeds within that time period.

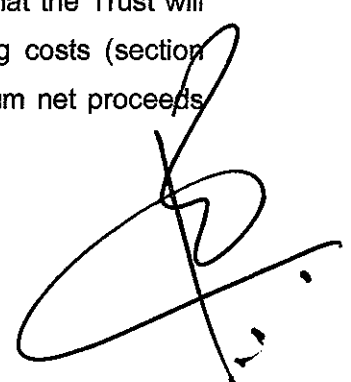
27. While it may be arguable that it is unnecessary to treat regulation 10 as creating a continuing obligation for minimum distribution shortfalls in order to ensure that all future net proceeds are distributed, that reasoning rests in part on assumed compliance with regulation 11. If regulation 11 is not treated as creating a continuing financial liability, it would be rendered largely ineffective as operators in breach would be rewarded for their breach by being allowed to benefit from the resulting cash reserves, the accumulation of which regulation 11 is clearly intended to prohibit.
28. In this case, the Trust argued for non-cumulative regulation 10 liability while attempting to secure the cumulative benefit of a series of regulation 11 breaches. If regulation 10 breaches do not result in cumulative financial liability, it is essential that regulation 11 creates ongoing and continuing liability to distribute in respect of the year in which the proceeds were derived. The alternative would be to permit what the Trust is endeavouring to obtain here: the ability to use funds accumulated in breach of regulation 11 to meet future regulation 10 obligations. The Commission is not prepared to approach matters of construction or application so as to produce such an outcome. It regards regulations 10 and 11 as creating discrete, non-cumulative obligations. Money wrongfully withheld from one year's receipts cannot be used to discharge another year's obligations.

The Commission's findings in relation to the Trust

29. The Trust's past retention of net proceeds in breach of regulation 11 therefore creates an ongoing liability. This is particularly relevant to two of the section 52 requirements for the grant and or renewal of an operator's licence:
- (a) Financial viability: section 52(1)(c);
 - (b) Ability to comply with applicable regulatory requirements: section 52(1)(f).
30. By the Commission's rough calculation, the Trust's resulting regulation 11 debt is higher than that calculated by the Secretary, because the Secretary made his calculations on a cumulative basis. For each year he calculated the difference between the net proceeds available for distribution and the amount actually distributed, taking into account any returned distributions. He added the shortfalls in the years 2006/2007 and 2007/2008 and from this total subtracted over-distributions in the years 2004/2005, 2005/2006, and 2008/2009. For the reasons given at paragraphs 22 and 28 above, the Commission does not consider that this is the correct method of calculation. The Trust's over-distributions (the amounts distributed in excess of the net proceeds generated) in 2004/2005 and
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2005/2006 should not be subtracted from the 2006/2007 and 2007/2008 regulation 11 shortfalls because the regulation 11 requirement for each of 2006/2007 and 2007/2008 requires distribution of all of the net proceeds from *those* years. The Commission considers, however, that the over-distribution in 2008/2009 should be subtracted from the total of shortfalls in the earlier years as, to the extent that the Trust distributed more money to the community than it earned in net proceeds in 2008/2009, it must have distributed some of the previous years' retained net proceeds. If one adds the shortfalls of 2006/2007 and 2007/2008, and the returned distributions of \$58,046, and subtracts from this total \$29,876 of retained net proceeds in 2008/2009, the result is \$653,601.

31. Whether the regulation 11 liability is \$653,601 (as calculated above) or the Secretary's cumulative calculation of \$438,390, it is substantially in excess of the Trust's assets, which are said to amount to \$366,764. The Trust's proposed gambling operation is therefore not financially viable. The Commission must refuse to renew the licence because it is not satisfied that the requirements of section 52(1)(c) are met.
32. In addition to not being viable financially, the Trust's own forecasts demonstrate that it will not be able to meet its future regulation 10 requirements. In the period 2009/2010 the Trust expects to be able to return \$135,505 of that year's proceeds, which equates to 29.6% of gross proceeds. Its forecast that it will distribute an amount equal to 37.12% of that year's gross proceeds relies on the application of net proceeds that it has retained from previous years in breach of regulation 11. Even if it did so, the result would not be in compliance with regulation 10, as regulation 10 is a minimum requirement relating to net proceeds generated within the year in question. For this reason the Commission is not satisfied that the Trust is able to comply with the applicable regulatory requirements for the purposes of section 52(1)(f) and the renewal of the licence must be refused.
33. In the Commission's view, the Trust's consistent and serious breaches of regulations 10 and 11 over six years give rise to other grounds to refuse to renew the licence, in addition to those concerning financial viability and the ability to comply with regulatory requirements. The Commission is not satisfied that the Trust's purpose in conducting class 4 gambling is to raise money for authorised purposes (section 52(1)(b)), as its past practice indicates its primary purpose is to ensure its own survival (with distributions having the lowest priority, behind meeting all other financial obligations of the Trust and even the creation of cash reserves). Nor is the Commission satisfied that the Trust will maximise net proceeds from class 4 gambling and minimise operating costs (section 52(1)(d)) because it has consistently failed to produce even the minimum net proceeds required by law in any of the last six years.



Other issues arising from the submissions

34. The Commission rejects the Trust's argument that refusing to renew the Trust's licence would be tantamount to creating a new remedy under the Act. The Trust's liability to pay the funds which it has retained in breach of regulation 11 is a consequence that arises naturally upon breach and is reinforced by section 112. The liability exists independently of any action or inaction on the Secretary's part.
35. The Commission sees no reason to restrict the consequences of breach to those outlined by the Trust and set out at paragraph 6 of this decision. The requirement to distribute all or nearly all of net proceeds is fundamental to class 4 gambling. Adopting a restrictive view of consequences, such as the Trust argues for, whereby a breach will only have consequences if acted upon within the year of its occurrence, would be inconsistent with the statutory scheme and the policy justification for permitting class 4 gambling.
36. In this vein, the Commission does not consider the Secretary's failure to act sooner in relation to the breach is relevant. The Commission is surprised that the Secretary allowed the Trust to continue its operation for as long as he did in the light of its persistent and serious breaches of regulations 10 and 11, including a return of only 6% of gross proceeds in one year. It notes the explanation given, namely a number of internal debates within the Department. The Commission hopes that this decision will reduce the scope for such debates in the future and encourage the Secretary to undertake more active monitoring of distribution requirements and more timely intervention when societies breach their minimum return and distribution requirements.

Decision of the Division

37. For the reasons already provided, the Division unanimously declines the appeal. The Commission expects that the Secretary will take action, if necessary under section 112, to require the distribution for authorised purposes of the undistributed funds of the Trust.

A large, handwritten signature in black ink is written over the text of the signature and extends upwards into the text of paragraph 37. The signature appears to be 'Peter Cain'.

**GAMBLING
COMMISSION**

Peter Cain
Chief Gambling Commissioner

for and on behalf of the
Gambling Commission

2 September 2009