

**IN THE MATTER** of the Gambling Act 2003

**AND** an appeal by **YOUTHTOWN INC**  
against a decision of the Secretary  
for Internal Affairs regarding  
conditions imposed on the issue of  
a Class 4 operator's licence

**BEFORE THE GAMBLING COMMISSION**

Members: L M Hansen (Chief Gambling Commissioner)  
D C Matahaere-Atariki  
W N Harvey  
S C L Pearson

Date of Application: 17 August 2020

Date of Decision: 6 November 2020

Date of Notification of Decision: 11 December 2020

**DECISION ON AN APPEAL BY YOUTHTOWN INC REGARDING CLASS 4 OPERATOR LICENCE CONDITIONS**

**1. INTRODUCTION**

- 1.1 Youthtown Inc appealed against a decision of the Secretary for Internal Affairs, notified on 11 August 2020, to issue a class 4 operator's licence to Youthtown with the following conditions:

**Minimum return to authorised purpose**

The minimum amount of net proceeds that a licence holder must apply and/or distribute for authorised purpose(s) is the proportion equivalent to 37.12% of its GST exclusive gross proceeds for each of its financial years, unless the Secretary has approved the accumulation of funds in accordance with licence condition 4 of these Class 4 Operator's Licence Conditions.

For the purposes of this condition, "gross proceeds", in relation to class 4 gambling has the same meaning as defined in regulation 3 of the Gambling (Class 4 Net Proceeds) Regulations 2004.

**("Condition 1")**

**Funds distributed regularly**

The holder of a class 4 operator's licence that does not mainly distribute net proceeds to the community must ensure that it applies and/or distributes net proceeds to or for the authorised purpose(s) shown on the licence regularly and frequently so that there is no accumulation of funds in the dedicated account of dedicated accounts established for the purposes of section 104 and section 105 of the Act, unless the

Secretary has approved the accumulation of funds in those accounts over a longer period of time for a project approved by the Department.

**(“Condition 4”)**

- 1.2 On 27 July 2020, prior to the issue of the licence on 11 August 2020, Youthtown applied for a licence amendment, asking that the above conditions, which were conditions of its previous (but still operative) licence, be varied to reflect regulatory changes to the regulatory obligations which apply to societies which mainly distribute net proceeds, and which had come into effect on 1 July 2020 in response to the Covid-19 restrictions imposed in early 2020. In its application, Youthtown had sought the addition of the following three conditions (**“Additional Conditions”**):
1. Notwithstanding any other licence condition to the contrary, the minimum amount of net proceeds that the licence holder must apply and/or distribute for authorised purposes, namely an amount equivalent to 37.12% of its GST exclusive gross proceeds (as set out in licence condition 1) does not apply for the licence holder’s financial year ending 30 June 2020.
  2. Notwithstanding any other licence condition to the contrary, the minimum amount of net proceeds that the licence holder must apply and/or distribute for authorised purposes, namely an amount equivalent to 37.12% of its GST exclusive gross proceeds (as set out in licence condition 1) does not apply for the licence holder’s financial year ending 30 June 2021.
  3. Licence condition 4 is subject to this licence condition. The licence holder may withhold from application or distribution to or for authorised purposes an amount of net proceeds not exceeding a maximum working capital ratio of 1.5 to 1 (calculated as current assets divided by current liabilities). The licence holder may retain that amount of net proceeds solely for the purpose of satisfying the requirement in section 52(1)(c) of the Act. The net proceeds retained must be held in a bank account established to hold gambling machine profits in accordance with section 104 of the Act. A licence holder withholding net proceeds must calculate its working capital ratio at least once every quarter.
- 1.3 On 17 August 2020, following the issue of the licence dated 11 August 2020, Youthtown lodged an appeal against the conditions in the newly issued licence. The appeal sought the insertion of the Additional Conditions or the removal of Conditions 1 and 4.
- 1.4 On 20 August 2020, the Secretary applied to stay the appeal on the basis that the licence issued on 11 August 2020 was in response to an earlier application for renewal filed in September 2019 and had been issued without regard to the application to amend licence conditions dated 27 July 2020. The application was made on the basis that there was no decision to appeal as the decision on the amendment application had not yet been made but would be made by 31 August 2020.

- 1.5 Counsel for Youthtown filed a memorandum in response, submitting that:
- (a) the appeal was against the decision to issue a new operator's licence on 11 August 2020 with two identified conditions;
  - (b) the Commission had previously indicated that societies who objected to a condition in a new licence should immediately appeal the insertion of the condition as soon as it was imposed;
  - (c) the 27 July 2020 application had been filed as no other avenue to raise the issue had existed at the time; and
  - (d) the issue of a licence on 11 August 2020 gave rise to an appeal right which had now been exercised.
- 1.6 The Commission directed that, unless withdrawn, the appeal would proceed (as Youthtown had exercised an appeal right), that the Commission would need to determine the appeal and that the Secretary could respond to the appeal in accordance with its later consideration of the 27 July 2020 application.

## 2. **BACKGROUND**

- 2.1 Youthtown is a society which mainly applies, rather than distributes, net proceeds to authorised purposes. Accordingly, it has not been subject to regulations 10 and 11 of the Gambling (Class 4 Net Proceeds) Regulations 2004 ("**Regulations**") which impose minimum obligations regarding distributions of net proceeds as to both amounts (by percentage) and timing.
- 2.2 Societies which mainly apply net proceeds are not subject to the Regulations but have been typically subject to similar obligations imposed by way of licence condition.
- 2.3 With effect from 1 July 2020, amendments to regulations 10 and 11 suspended their effect for the financial years ended 2020 and 2021. In addition, on the same day, new regulation 11A, enabling distributing societies to build up working capital to a ratio of 1.5 to 1 (calculated as current assets divided by current liabilities) came into force.
- 2.4 The appeal sought modification of the parallel licence conditions so that the obligations reflected those now applying to distributing societies under the Regulations.

### 3. RELEVANT LEGISLATION

3.1 The following provisions of the Gambling Act 2003 are applicable:

#### **53 Content and conditions of class 4 operator's licence**

- (1) A class 4 operator's licence must include the following information and conditions:
- (a) the name of the corporate society that holds the licence; and
  - (b) the commencement date and expiry date of the licence; and
  - (c) 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; and
  - (d) any other information or conditions added by the Secretary...
- (2) The conditions that the Secretary may add to a class 4 operator's licence include- ...
- (c) conditions concerning the management, application, and distribution of funds derived from gambling and from the investment of those funds;
  - ...
  - (g) any other conditions consistent with this Act that the Secretary considers will promote or ensure compliance with this Act.

#### **53A Continuing obligations of class 4 operator**

Every corporate society that holds a class 4 operator's licence must, in relation to class 4 gambling conducted by the corporate society, ensure that, at all times, -

- (a) the purpose of conducting that gambling is to raise money for authorised purposes; and
- (b) the net proceeds from that gambling are maximised and the operating costs of that gambling are minimised; and
- (c) the costs incurred in conducting that gambling are actual, reasonable, and necessary; and
- (d) the net proceeds from that gambling are applied to, or distributed for, authorised purposes; and
- (e) all applicable regulatory requirements are complied with.

3.2 The relevant provisions of the Regulations, in their current form, are as follows:

#### **9 Application of this Part**

- (1) This Part applies to a holder of a class 4 operator's licence that mainly or wholly distributes net proceeds to the community.

## **10 Minimum amount for authorised purposes**

- (1) For the purposes of section 114(1)(a) of the Act, the minimum amount for a corporate society that is a licence holder, for each of its financial years, is an amount equivalent to 40% of the specified amount.
- (2) **Specified amount**, in subclause (1), means the licence holder's gross proceeds (as defined in regulation 3(1)) for the financial year, excluding goods and services tax.
- (3) This regulation is subject to regulation 11.
- (4) This regulation does not limit or affect regulation 10 as in force on and after 1 December 2004 and until 3 September 2014 (and which, by way of explanation, prescribes a minimum amount equivalent to 37.12% of the specified amount for the licence holder's financial years that started during that period).
- (5) The minimum amount equivalent to 40% of the specified amount prescribed in subclause (1) does not apply for a licence holder's financial year ending in 2020 or 2021 (regardless of the month that the licence holder's financial year ends in).

## **11 Timing requirements for application of distribution of proceeds for authorised purposes**

- (1) A licence holder must apply to, or 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.
- (3) The timing requirements for the application on distribution of proceeds in subclause (1) do not apply during a licence holder's financial year ending in 2020 or 2021 (regardless of the month that the licence holder's financial year ends in).
- (4) This regulation is subject to regulation 11A.

## **11A Retention of net proceeds**

- (1) A licence holder may withhold from application or distribution to or for authorised purposes an amount of net proceeds not exceeding a maximum working capital ratio of 1.5 to 1 (calculated as current assets divided by current liabilities).
- (2) The licence holder may retain that amount of net proceeds solely for the purpose of satisfying the requirement in section 52(1)(c) of the Act.
- (3) The net proceeds retained must be held in a bank account established to hold gaming machine profits in accordance with section 104 of the Act.
- (4) A licence holder withholding net proceeds must calculate its working capital ratio at least once every quarter.

#### 4. APPELLANT'S SUBMISSIONS

4.1 In summary, the following was submitted for the Appellant:

- (a) Youthtown is a society that mainly applies net proceeds. It is not a club, so it does not operate gaming machines at its own non-commercial clubrooms. It operates gaming machines at 27 commercial venues and pays venue operators a venue payment equivalent to 16% of its gross proceeds. Its cost structure is similar to distributing societies which operate class 4 gambling in external commercial venues.
- (b) The licence conditions issued with the new licence dated 12 August 2020 are similar to the obligations imposed on distributing societies under the Regulations prior to their amendment on 1 July 2020. They do not reflect the Covid-19 relief provided to distributing societies by amendments to the Regulations which came into effect on 1 July 2020.
- (c) Conditions imposed by the Secretary under section 53 must be fair and reasonable both to the licence holder and the community.
- (d) The licence conditions were imposed as standard, universally applicable conditions to all applying operators in accordance with the 2016 policy of the Department of Internal Affairs ("**DIA**") without regard to Youthtown's particular circumstances. Prior to 2016, the Secretary operated under a 2010 DIA policy which provided greater flexibility. Copies of the 2010 and 2016 DIA policies were annexed to the affidavit of Debbie Catherine Nelson in support of the appeal.
- (e) The 2016 Policy is unlawful because it results in the imposition of a universal obligation regardless of circumstances. The flexible approach set out in the 2010 policy is no longer followed and flexibility is now reserved for DIA responses to breaches of the universally imposed conditions.
- (f) The conditions were imposed 6 weeks after the obligations in the Regulations were amended in response to the Covid-19 restrictions, which closed all gambling venues, but did not reflect the changes in obligation under the Regulations.
- (g) It is unfair to impose minimums, even as percentages, in circumstances where forecasting is impossible because of pandemic uncertainty. Youthtown lost an estimated \$3.556 million in gaming revenue as a result of the first lockdown and an estimated \$874,000 as a result of the second lockdown. Costs remain relatively fixed for operators.

- (h) The condition is not necessary because all licence holders are subject to section 53A, especially (a) and (c).
- (i) As Youthtown itself is the main benefactor of net proceeds, those obligations are self-policing. Its net proceeds as a percentage of gross proceeds has consistently exceeded the venue condition minimum over the last five years.
- (j) Breaching a licence condition has serious consequences including criminal liability. It also necessarily affects the Secretary's powers to renew the licence (by reference to sections 52(1)(f) and 56(5)(c)).
- (k) It is reasonable to permit Youthtown to have a working capital ratio of 1.5 for its gambling operation. The current licence condition has resulted in it operating with negative working capital in the past.
- (l) The changes proposed would align Youthtown with mainly distributing societies, to whom its operation is comparable, in terms of its risk of breach.

4.2 In reply to the Secretary's submissions (summarised below), the following submissions were made:

- (a) As the Secretary accepts that the licence conditions should be amended, the only real issue is whether the Act permits the making of licence conditions which authorise retention of net proceeds.
- (b) Section 53(2)(c) permits conditions concerning the "management" of funds derived from gambling.
- (c) Maintaining sound working capital is no different in principle from retaining funds for a special project as expressly permitted by licence conditions. Alternatively, section 53(2)(g) is wide enough to permit the proposed condition regarding working capital.
- (d) If retention cannot be approved expressly, licence condition 4 should be removed. However, Youthtown prefers the additional proposed conditions to removal of licence conditions 1 and 4. Doing so addresses all those affected by Covid-19 and would resolve the working capital issue permanently. It would align Youthtown with most other multi-venue operators.

4.3 The parties were asked by the Commission to lodge additional submissions relating to the broader policy context of the appeal. In response, the Appellant submitted as follows:

- (a) A society that applies net proceeds from multiple commercial venues has a cost structure similar to a distributing society and should be subject to similar obligations. All societies should be permitted to have positive working capital.
- (b) Societies that mainly apply proceeds vary considerably in size and scale and the same net proceeds obligations should not be imposed on all applying societies. A case-by-case approach should be taken.
- (c) It is highly relevant whether a society operates machines at its own venue or at external commercial venues. Single venue societies lack flexibility to spread costs.
- (d) The 2016 Policy has resulted in the imposition of a universal standard, with flexibility reserved for DIA's response to breaches of the universal obligation.
- (e) A standardised percentage return should not be applied to all applying societies. It should vary according to circumstances. The purpose of using licence conditions to impose obligations relating to net proceeds, rather than regulations, was to provide for flexibility which regulations would not allow.
- (f) Licence conditions should differ based on:
  - (i) the number of gaming machines operated;
  - (ii) their location and associated population demographics;
  - (iii) whether access to the machines is limited or open to the public;
  - (iv) the type of gambling machines used; and
  - (v) harm minimisation practices.
- (g) Although the application requirement is expressed as a minimum percentage rather than a fixed sum, the financial model is very tight. Sudden major shifts in revenue undermine the ability to meet the requirements because many costs are fixed. Both applying and distributing societies face the same issues. Although applying societies have non-gaming assets, and may have non-gaming revenue, those are not allowed to be used to meet the net proceeds distribution licence conditions.

- (h) Rather than amending licence conditions (as Youhtown seeks) to resolve the problems faced by societies following the Covid-19 restrictions, the Secretary has purported, by letter, to allow clubs to use net proceeds for non-authorised purposes. The advice given by the Secretary in the letter is incorrect as it fails to account for section 106.

## 5. THE SECRETARY'S SUBMISSIONS

5.1 Submissions were received from the Secretary as follows:

- (a) The issues for determination are whether the currently imposed conditions are fair, reasonable and proportionate and, if not, whether the proposed new conditions are fair, reasonable and proportionate.
- (b) The current conditions are not fair, reasonable and proportionate. Conditions 1 and 4 should be removed or suspended, but the third Additional Condition proposed by Youhtown should not be imposed.
- (c) The conditions proposed by Youhtown mirror regulations 10, 11 and 11A (which do not apply to Youhtown).
- (d) The Appellant's outline of the law is correct.
- (e) Youhtown would be disadvantaged by the current licence conditions compared to other multiple venue societies (which mainly distribute net proceeds) and is not in a position to be able to forecast properly as a result of possible Covid-19 restrictions.
- (f) If Condition 1 did not apply, Youhtown would still be bound by section 53A.
- (g) Either Condition 1 should be removed from the current licence or proposed conditions 1 and 2 should be incorporated. The latter would suspend the effect of Condition 1 until the end of the financial year in 2021.
- (h) The Condition 4 should similarly be removed for the time being but could be reimposed following the pandemic.
- (i) Proposed Additional Condition 3 mirrors Regulation 11A, but Regulation 11A is not solely a Covid-19 relief measure (unlike the other changes which came into effect on 1 July 2020) and is not time-limited (as Regulations 10(3) and 11(3) are).

- (j) Regulation 11A was made under section 114(1)(l) of the Act, which expressly relates to retention of net proceeds to maintain financial visibility. Section 53, which authorises licence conditions, does not contain a similar explicit reference.
- (k) It is arguable that section 53 does not authorise proposed Additional Condition 3 and that such provisions were intended to be effected only by means of regulation. The proposed condition may be *ultra vires* accordingly.
- (l) The same effect can be achieved by renewal (or suspension) of Condition 4 (and some minor amendments of to the following condition 5), which could otherwise remain.

5.2 The supplementary submissions, filed as a result of the further request for submissions by the Commission, were to the following effect:

- (a) The requirements imposed by the Regulations are a set of minimum standards to ensure that societies operate gaming machines to generate money for the community. They are intended to provide a “level playing field”.
- (b) The two main types of societies are clubs that operate machines at their own premises and apply net proceeds to their own purposes, and independent societies that operate in commercial premises and mainly distribute net proceeds. Youthtown is an exception because it mainly applies net proceeds from operating gaming machines in commercial venues.
- (c) As it mainly applies net proceeds, it is not subject to the requirements of the Regulations. Applying societies were not included in the Regulations as it was thought that they should have more flexibility than distributing societies, particularly to accumulate funds for long term projects. Imposing obligations by licence conditions, which are reviewed annually, provides flexibility which would not be available under the Regulations.
- (d) Despite that, there are good policy reasons why the same regulatory requirements should be imposed on applying societies that operate in multiple commercial venues. While Youthtown operates similarly to distributing societies, its income is not restricted to net proceeds, so it has an in-built financial “buffer” which distributing societies lack.

- (e) Under the 2016 policy, discretion is exercised when deciding what venue conditions are to be imposed on applying society regarding net proceeds. A minimum return requirement is always imposed but the percentages vary in practice. The percentages range from 25.75% through 37.12% (and even higher) but, in the 2019 year, all but 17% of applying societies had a 37.12% requirement imposed.
- (f) Class 4 gambling is not intended to be entertainment. If more than 75% of gross revenue is consumed by the gaming operations, the Secretary considers that it does not generate sufficient income for the community so its purpose should be assumed to be entertainment.
- (g) Flexibility is also applied in the response to non-compliance. One-off, unexpected non-compliance is not subject to any enforcement action. Consistent non-compliance, however, is likely to have consequences for the licence holder.
- (h) The Secretary does not permit, by licence conditions, the accumulation of funds solely for financial visibility reasons.
- (i) The 2020 Amendments to the Regulations were in response to requests for Covid-19 relief. All class 4 gambling was required to cease from 25 March to 14 May 2020 and class 4 gambling would continue to be adversely affected by ongoing Alert Level 2 requirements thereafter. The number of persons accessing offshore gambling sites increased noticeably during Alert Levels 3 and 4. That is something that could result in a long term change in consumer behaviour.
- (j) Societies are recognised to have fixed costs and limited flexibility to reduce them. As a result, non-compliance is likely in the current circumstances even though the obligation is expressed as a percentage of gross proceeds.
- (k) While minimum application and timing requirements in licence conditions should be suspended for applying clubs, a licence condition should not permit retention of net proceeds to satisfy financial visibility. Applying societies have other sources of revenue. In addition, DIA has now advised societies that general expenses, including payments for the support of staff, could be considered part of their general administration expenses and thus constitute payments for authorised purposes for a limited period.

## 6. ANALYSIS

- 6.1 Clearly there is much common ground between the parties on one of the central issues on appeal. Both parties accepted that Conditions 1 and 4 should either be removed or suspended until the end of the 2021 financial year (mirroring the 1 July 2020 amendments to the Regulations). The Appellant expressed a preference for suspension by means of its proposed conditions, rather than by interim deletion, and the Secretary expressed no objection to adoption of that means of resolving the position.
- 6.2 Although the suspension of Conditions 1 and 4 is not controversial, the submissions leave the Commission in a state of uncertainty about the Secretary's intentions in relation to possible amendment of similar conditions in the licences of other applying societies. Although conceding that imposition of Conditions 1 and 4 was unfair and unreasonable, the impression created by the Secretary's submissions is that the earlier letter to applying societies advising that, for the time being, authorised purposes will be treated far more broadly than in the past, is seen as sufficient.
- 6.3 In the light of the concessions made by the Secretary regarding the fairness and reasonableness of Conditions 1 and 4, it has not been necessary to address the effect of the letter sent to applying clubs. Accordingly, this decision should not be seen as endorsing the effectiveness or appropriateness of the Secretary's letter to resolve the difficulties faced by applying clubs as a result of the Covid-19 restrictions. As was submitted for the Secretary, the decision to impose these obligations by licence conditions, reviewed annually, was to allow for appropriate flexibility to meet individual circumstances and, contrary to the submissions made for the Appellant that the conditions had been standardised since 2016, it appears that, as recently as 2019, the Secretary has had regard to the individual circumstances of licence holders when imposing conditions of this kind.
- 6.4 The main point of controversy on the outcome of the appeal is the inclusion of proposed Additional Condition 3, reflecting Regulation 11A. The Secretary supported removal of Condition 4 (with consequential amendment of the following condition 5), arguing that its removal would avoid the need for the proposed Additional Condition 3. The Secretary also raised doubts about *vires*, arguing that approval to retain net proceeds in order to have adequate working capital could only be imposed by regulation and that the licence condition powers in section 53(2) do not extend to permitting retention of net proceeds to preserve a fixed standard of working capital (as had been done for distributing societies by Regulation 11A).

- 6.5 The Commission does not share the Secretary's doubts about the extent of the powers to impose licence conditions under section 53(2). In the Commission's view, the provisions of section 53(2)(c), or alternatively (g), are wide enough to permit the proposed licence condition. Because of the decision to use licence conditions, and not the Regulations, to impose net proceeds amount and timing obligations on applying societies, the creation of exceptions to those obligations cannot be effected using the Regulations. Regulation 11A was required to create an exception to Regulation 11 but, for sound policy reasons, both regulations apply only to distributing societies. In those circumstances, the Commission considers that the *ultra vires* doubts raised by the Secretary would be an undesirably artificial objection to the insertion, by a licence condition, of an exception intended to relieve against an obligation which had been created by a licence condition.
- 6.6 Apart from the legal *vires* objection, the remaining issue turns on the underlying policy considerations. The parties differ about a desirability of a policy which would allow retention of net proceeds to meet a fixed working capital amount. The Secretary's opposition to such a policy rests on whether applying societies have, and should be able to use, non-gambling financial buffers not available to distributing societies.
- 6.7 The Commission last considered the operation of the equivalent of Conditions 1 and 4 in its decision of an appeal by The Brunner Rugby League Club (decision GC08/11). Like the Appellant, the club in decision GC08/11 mainly applied net proceeds and operated gaming machines at commercial venues (albeit on a much smaller scale – only 5 machines at 2 venues), rather than at its own premises, but, unlike the present appeal, the appeal related to a decision not to renew the licence as a result of concerns about the likelihood of the conditions being breached. Ultimately the appeal succeeded, as the result of new factual developments in the period between the original decision and the appeal. Although granting renewal of the licence on appeal on the facts before it, the Commission recorded a number of observations arising from the submissions received. Among those, it recorded concern about the practice of funds being advanced from a club's general funds, and the accumulation of unapplied funds, both in order to improve the apparent viability of the gambling operation.
- 6.8 The submission for the Secretary, that applying societies should be expected to use a financial buffer arising from the fact that they will usually hold assets and receive income outside of their gambling operations, does not sit easily with those comments. The Commission is ultimately not persuaded by the Secretary's proffered reasons for allowing distributing societies, but not applying societies, to accumulate net proceeds in order to have the level of working capital provided for in Regulation 11A. It considers that applying societies should not be subject to greater restrictions on retention of net proceeds for working capital purposes than distributing societies.

**7. DECISION**

- 7.1 For the foregoing reasons, pursuant to section 61(4), the Commission varies the decision of the Secretary to issue an operator's licence to Youthtown on the conditions then imposed by retaining Conditions 1 and 4 but inserting the proposed Additional Conditions.
- 7.2 The Commission directs the Secretary to re-issue the licence with the Additional Conditions inserted and appropriately numbered.



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**Lisa Hansen**  
Chief Gambling Commissioner

for and on behalf of the  
Gambling Commission

11 December 2020

