

**IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY**

CIV 2003-485-1106

IN THE MATTER OF the Judicature Amendment Act 1972 and
 the Gaming & Lotteries Act 1977

BETWEEN PUB CHARITY
 Applicant

AND THE ATTORNEY-GENERAL
 Respondent

Hearing: 10 May 2004

Appearances: W M Wilson QC, A G Sherriff & S M Bisley for Applicant
 M T Parker for Respondent

Judgment: 25 May 2004

JUDGMENT OF MILLER J

[1] This is an application for judicial review. It concerns a condition imposed upon the annual renewal of the applicant's licence to operate gaming machines on 17 January 2002. The licence was granted under the Gaming and Lotteries Act 1977.

[2] The Department of Internal Affairs imposed a condition limiting expenses that could be deducted from gaming receipts to \$150 per machine per week ('pmpw') unless the licensee obtained a dispensation. Pub Charity seeks review of both the condition and the Department's subsequent decision to refuse dispensations in respect of four licensed premises at which it operates gaming machines. Those premises are Robbies Bar & Bistro at Christchurch, The Duke of Gloucester Hotel at Napier, the Kaitaia Hotel, and the Onerahi Tavern.

Factual Background

[3] In November 1987, the Minister of Internal Affairs decided to implement a licensing regime for gaming machines under s.8 of the Gaming and Lotteries Act 1977. The licensing regime was introduced as a temporary measure pending review of the Act, and was a response to the introduction of gaming machines by entrepreneurs on an unlicensed basis. The purpose of the licensing regime was to provide an element of consumer protection and to ensure that money raised through the use of gaming machines was channelled back into the community. Licences are issued only to non-profit societies that operate gaming machines to raise money for a purpose authorised by the Act. Those purposes may be charitable, philanthropic, cultural, party political, or otherwise beneficial to the community.

[4] Despite several reviews of gaming and two draft Bills, it was not until 2003 that new legislation was enacted in the form of the Gambling Act 2003. Provisions of that statute governing the operation of gaming machines do not take effect until 1 July 2004, so this proceeding is concerned only with the Gaming and Lotteries Act.

[5] There is provision in s.8 of the Gaming and Lotteries Act for regulations, but no regulations were made governing the operation of gaming machines, presumably because of the perennially awaited review of the legislation. The Department, which issues licences under delegation from the Minister of Internal Affairs, has filled the vacuum to some extent by promulgating standard license conditions relating to matters such as purchasing of machines, banking of profits, payment of expenses, record keeping and distribution of profits. Licenses also include conditions specific to a given society such as its statement of authorised purposes and its schedules of gaming machines, equipment and approved sites.

[6] A prominent feature of the licensing regime has been the Department's attempts to ensure that gaming machines can only be operated for the object of raising money for purposes authorised by the Act. It has done so partly by controlling expenses that may be claimed by a society or paid to the operator of a given site and requiring detailed financial reporting. Until 1996 the Department

capped expenses at a fixed rate that was intended to cover space used and electricity consumed by the machines. It was initially set at \$53pmpw but later increased to \$63. In 1997 the Department allowed societies to claim expenses on an actual and reasonable basis, and accepted a wider range of expenses. Societies were largely left to determine for themselves whether expenses were actual and reasonable.

[7] Site payments made by societies to operators under the 1997 regime had two components. They were “site rental”, being payment for the right to place the machine on the site, and the costs of labour to administer the machines. Site rental payments were intended to reflect the value to the society of a particular site.

[8] The applicant, Pub Charity, was the first non-profit society to receive a gaming machine licence, and it has around 3,000 gaming machines at approximately 335 approved sites. Beginning some time before 1997, however, competing societies were established. This created an opportunity for site operators to move their custom between societies, which in turn led to an increase in site payments being paid to some operators. In one case, more than \$800pmpw was being paid. This behaviour led to a 1997 complaint from Pub Charity in which its Chief Executive, Mr Bray, complained that high turnover sites were being poached by societies less scrupulous than Pub Charity.

[9] To the extent that a site payment exceeded expenses of the gaming operations at that site, the operator was effectively expropriating some of the money that had been raised for the authorised purposes for which the licence had been granted. Licences require that not less than 33% of gaming machine profit be returned to authorised purposes. By inflating expenses in this way, operators reduced the profit available for authorised purposes.

[10] These developments led the Department to review its practice of allowing societies to determine whether expenses were actual and reasonable. In 2000 the Department undertook a survey of licensees. The results of that survey showed that expenses paid did not exceed \$150pmpw at 70% of sites. For the remaining 30%, sums of \$250 or more were being paid. The survey results were shared with the industry. The Department subsequently learned that societies were under pressure to

match \$250pmpw to remain competitive. The survey return showed that up to \$250pmpw was being paid for two of the sites that are the subject of this proceeding. Pub Charity relies on this to support a claim that it had a legitimate expectation that payments could continue at that level.

[11] The Department's response was to implement a regime under which standard licence conditions were amended, effective 1 October 2001. The industry was advised of this by letter dated 23 September 2002. The new conditions emphasised that all available funds must be returned to the community, not just the 33% minimum. Expenses of up to \$150pmpw were authorised, but payments in excess of that required a dispensation. Applications for dispensation were to be supported by evidence verifying the expenses claimed. The Department proposed to base dispensations partly upon profit generated by a site. This approach appears to have been based on acceptance by the Department that site rental payments recognising the value to a society of a particular site were legitimate expenses.

[12] Pub Charity's licence was renewed on 17 January 2002, with effect from 1 October 2001. The new conditions applied.

[13] On 6 September 2002 Pub Charity sought dispensations in relation to 22 sites including Robbies Bar and Bistro, the Duke of Gloucester, and Mornington Tavern at Dunedin. In relation to these three sites dispensations of \$250pmpw were sought. They did not include any element of site rental.

[14] The applications were supported by a review of expenses undertaken by Mr Warwick Hodder, a consultant and former Department employee of considerable experience. Mr Hodder had prepared a template that listed the expenses a site operator might claim and invited the operators to complete it. Those expenses included a share of general overheads such as electricity, insurance, rates, bank and eftpos fees, security, and rubbish collection. He labelled these rather confusingly as 'direct' costs. For labour costs he asked the operators to undertake a time and motion study to support the hours claimed in relation to gaming operations. He also included a category for 'subjective' costs which, although unfortunately labelled, was intended to reflect time spent by bar staff and management supervising

machines, in addition to the hours justified by the time and motion study for specific tasks. Invoices and documentation for a typical month's expenses were produced for his inspection. He then visited each site and interviewed staff. He reported to Pub Charity that the expenses claimed were actual, reasonable, and necessary in each case.

[15] The dispensations were declined, partly because none of the sites achieved gaming machine profit of \$1M (exclusive of GST) per year. That was the amount of profit needed, under the Department's licence conditions, to justify expenses of \$250pmpw.

[16] Pub Charity brought an application for judicial review. On 6 March 2003 Durie J quashed the decision to refuse dispensations. The decision turned on the practice of allowing dispensations based in part on the value that the applicant placed on the site as a generator of profit. The Judge held that the Department had dealt with dispensations not according to the merits but rather on the basis of its formula related to site turnover. In the result, the Department failed to take into account the actual, reasonable and necessary costs associated with the gaming machine operation on each site. He also found that insofar as site payments were determined by reference to turnover they took on the character of commission, which is contrary to the intention of the Act. Durie J recorded that no challenge had been made to Mr Hodder's conclusion that the payments made were reasonable and necessary. The applicant did not contend before me that that finding bound the Department to grant dispensations at \$250pmpw.

[17] Following Durie J's decision, Pub Charity asked the Department at a meeting on 14 March to reconsider the applications for dispensation in relation to Robbies Bar & Bistro, the Duke of Gloucester and Mornington Tavern. This was followed up with a letter of 3 April annexing applications that were supported by documents detailing the expenses claimed for each site. The applications were said to include 'modest' site rentals, Pub Charity having taken the view that site rentals were not prohibited by Durie J's decision provided they were not based on turnover.

[18] I interpolate at this point that the Department had granted a dispensation to Pub Charity in respect of the Kaitaia Hotel on 19 November 2002, allowing a site payment of \$200mpw. Pub Charity now sought to increase the site payment, and it also sought a dispensation in relation to the Onerahi Tavern. Actual expenses at Kaitaia were said to be \$215mpw, and Pub Charity wanted to make a site rental payment to bring the payment up to \$250. The reasoning was that the site operator considered it could make better use of the space occupied by the machines. Turnover was low. I infer that the machines may not have been a significant attraction for hotel and restaurant patrons. Mr Cotching, who gave evidence for the site operator, considers that the hotel is subsidising the gaming operation. Pub Charity's position is that it will have to remove the machines unless the operator receives a site rental. In that case it will no longer be able to distribute profits to community purposes in the Kaitaia area. It funds reading recovery programmes at local schools.

[19] The Department advised on 4 April that it was required to develop a new policy for dispensations in light of the judgment. It had not yet done so. The application for dispensation would be considered in light of the policy that was eventually put in place. Pub Charity was understandably dissatisfied with this response. It pointed out that it was not open to the Department to impose a licence condition that provided for dispensations and then to refuse to consider applications for dispensation.

[20] The Department agreed to consider the applications. It advised by letter dated 11 April that it would require details of the actual costs incurred by the site operator "directly arising from the gaming machine operation". It would consider, on a case by case basis, whether those costs were reasonable and necessary. This might involve a comparison with costs incurred by other operators to decide whether or not the amounts claimed were reasonable. It explained that there were certain types of costs that it would consider necessary. They were labour costs relating to the operation of gaming machines, 'direct' costs resulting from the operation of gaming machines (such as electricity, stationery, bank fees etc, but not a proportion of all general business costs), and floor rental being the rental value of floor space occupied by gaming machines. Site payments should be limited to costs that arise

due to the gaming operation. The Department also advised that it could no longer see how site rental could be part of a legitimate site payment. It acknowledged that this was a change of position, and explained that it understood Durie J's decision to mean that site payments based on turnover bore the character of commission, which is contrary to the intention of the Act. It reasoned that it was difficult to see how any form of site rental that was designed to reflect the value that the licensee placed on a site could be permissible. It invited comments. It also invited Pub Charity to reconsider and amend its application.

[21] This letter was followed up with a circular dated 15 April to all licensees setting out the Department's new approach to dispensations.

[22] Pub Charity took the view that it had already established that any payments sought in relation to the three sites that were the subject of Durie J's decision were reasonable, and it required that the application for dispensation be reconsidered immediately. There was sufficient evidence in the original application and Mr Hodder's evidence before Durie J.

[23] By letter of 26 May, Pub Charity's solicitors took issue with the Department's proposed approach with respect to site rentals. It accepted that commission payments or payments linked to profit or turnover were prohibited, but contended that payments intended to reflect the value to Pub Charity of a particular site were permissible. It pointed out that in the case of Kaitaia the value of the site was not the profit or turnover of the machines, but rather the existence of a Pub Charity site in the Kaitaia region. The existence of the site allowed Pub Charity to distribute funds for authorised purposes in the Kaitaia community.

[24] These proceedings were issued on 6 June. Initially the Mornington Tavern was included in the proceedings, but it has since transferred to another society and is no longer involved.

[25] The Department by letter of 16 June 2003 advised Pub Charity of its intention to decline the applications for dispensation in relation to Robbies Bar and Bistro, the

Mornington Tavern, the Duke of Gloucester, the Kaitaia Hotel and the Onerahi Tavern. The Department invited comments on the draft decision.

[26] The letter was 46 pages in length, and it dealt with the applications in great detail. After rehearsing the background, the Department recorded that it was required to examine the site operators' actual costs. It did so on a case by case basis, considering whether it was reasonable and necessary for Pub Charity to reimburse those costs. In order to justify the costs societies were required to provide a "fully documented case". The Department noted that it was reasonable and necessary to pay floor rental recognising the floor space occupied by gaming machines. However, it was "unlikely" to be reasonable and necessary to pay site rental, being the value that a society places on a site. Because site rentals are not based on any clear service provided by the site operator, the amount can be driven by the 'commercial wants' of the site operator.

[27] The Department observed that the applications were inadequate because they were not fully documented. Invoices were supplied for some items but most claims were simple assertions. It was within Pub Charity's ability to provide more detailed evidence, such as the time and motion study that had been conducted at each of Robbies Bar and Bistro, the Mornington Tavern, and the Duke of Gloucester. The time and motion study would verify the amount of time spent by hotel staff in performing various operations in relation to gaming machines, or supervising machines. Other examples were given of evidence that might be supplied. Nonetheless the Department had dealt with the applications as best it could. It was willing to meet with Pub Charity to discuss further information that might be supplied.

[28] Each of the sites was dealt with in a separate appendix. For present purposes it is convenient to refer to Appendix 1, dealing with Robbies Bar and Bistro, as an example. The Department's concerns regarding the costs claimed took two forms.

[29] First, the amount of time claimed for many of the tasks undertaken seemed excessive. This included 6 hours a week to start up and turn off gaming machines and remove note stackers etc, 6 hours for hopper refills, 4 hours for payouts to

players, including record keeping, 5 hours for clearing coin jams, 39 hours for clearing cash boxes and note stackers for banking, counting money, refloating and bagging refills, reconciling money and following up discrepancies, meter readings and jackpot analysis, 10 hours for record keeping including data entry, 2 hours for trips to and from the bank, 4 hours for player disputes, 20 hours for grant application advice (being grants to community groups), 3 hours for liaison with Pub Charity, 1 hour for liaison with the service providers and technician, and 8 hours on training. In addition, Pub Charity had claimed “subjective costs” of \$700 per week for supervision of the gaming machines. Hourly rates also seemed excessive for the owner/manager at \$45 an hour. Detailed comments and queries were made in relation to each of these claims. For present purposes I need only say that the queries seemed amply justified. I was advised that the maximum number of machines at a site is 18.

[30] Second, the Department was concerned that the cost claimed included general business costs that a site operator would incur regardless of whether or not gaming machines were operated on the site. Again, detailed comments were made in relation to each item claimed. While the Department was willing to accept a portion of electricity, insurance, interest, bank fees, security and some miscellaneous costs, such as phone rental, stationery, photo copying and postage, Pub Charity was claiming costs on the basis of what appeared to be a percentage of the floor space of the site.

[31] In relation to the Kaitaia Hotel, the Department advised that it proposed to reject the claim for site rental. It did not accept that a site rental was justified by the desire of Pub Charity to have a presence in the Kaitaia area. The application did not demonstrate how site rental was an actual cost for the site operator, nor why it was reasonable and necessary for Pub Charity to pay it. The site rental amounted to a financial incentive to the operators to have gaming machines on its premises.

[32] Pub Charity’s primary response was to attack the Department’s approach to the application. Its solicitors contended that the Department had failed to look at the merits. It had previously allowed payments at this level. Evidence of expenses at other sites was only peripherally relevant by way of background. Wage rates might

differ across the country. As an example, \$45 an hour for the manager of Robbies Bar & Bistro was justified, because he was an owner/manager and a multi-millionaire. The Department had erred in law by taking the view that general business overheads could not be claimed as a proportion of the business as a whole. These costs were not claimed on a percentage of floor space as the Department had understood, but rather were based on an apportionment of costs among cost centres. In the case of Robbies Bar and Bistro, there were three costs centres being bar, restaurant, and gaming machines. Accordingly, one third of direct costs had been assigned to gaming. Further, opportunity cost (the income that an operator could gain were it to sell its premises and invest elsewhere) was a legitimate expense. The Department had also erred in law by failing to have regard to the evidence before Durie J. The solicitors also pointed out that the Department had been aware for some years that site payments of up to \$250pmpw were being made by Pub Charity, and asserted that prior acceptance by the Department for a long period seriously undermined and invalidated the Department's proposal to decline the applications.

[33] The solicitors also responded to the Department's comments with respect to each site. Explanations were given, but Pub Charity did not supply the supporting evidence that the Department had requested. In some cases the solicitors pointed out that there was no underlying evidence and that the explanation given was reasonable. Some cases were also modified. For example, it was accepted that time spent processing grants could not be claimed since that is not a function of the site operator.

[34] The Department declined the applications for dispensation by letter dated 28 July 2003. This decision now forms the basis of the third cause of action.

[35] The Department pointed to a failure to supply evidence necessary to back up many of the claims. It stated that it was the obligation of Pub Charity to provide a fully documented case, and the onus was on Pub Charity to prove its case for a dispensation. Pub Charity appeared to believe that it needed only to state its claim and it was then for the Department to disprove it. Pub Charity had chosen not to supply available evidence, including the data upon which Mr Hodder had based his

reports. Its failure to establish that the costs claimed were actual, reasonable and necessary was the primary factor in the Department's decision.

[36] The Department also advised that it considered Mr Hodder was in error in dividing general business costs between cost centres. It noted that Mr Hodder was not a qualified accountant or business analyst. The Department itself had taken advice from professional accountants on this point. Basic accounting practice in relation to activity-based costing was to use some appropriate basis on which to attribute costs to different activities. The basis that was appropriate depended on the particular costs concerned. The appropriate approach for calculating direct costs that could be deducted under condition 56 was to allow only costs that arise directly from the operation of the gaming machines. This included existing costs where and to the extent that they were increased by the presence of gaming machines, such as cleaning, electricity, and security. Opportunity cost was not an expense to a site operator. In reviewing claimed costs the Department was entitled to have regard to industry averages.

[37] The Department also responded in detail to the points made by Pub Charity in responding to the draft decision of 16 June. Apart from the point already referred regarding apportionment of general business costs, the Department also responded to the claims made regarding the time required to undertake operations relating to gaming machines, and the claim for "subjective costs". Some of the points made by Pub Charity in responding to the draft decision were accepted but for the most part the Department took the view that evidence could have been supplied but had not been. It also affirmed its draft decision in relation to site rental at Kaitaia.

[38] The decision required that Pub Charity implement site payments of no more than \$150 pmpw at the relevant sites without delay. In response to the decision, Pub Charity sought interim relief. In a judgment dated 21 August, Wild J granted interim declarations the effect of which was to suspend the decision. Pub Charity has continued to pay up to \$250pmpw at the affected sites.

The Statutory Scheme

[39] The long title of the Gaming and Lotteries Act 1977 states that it is an Act to make better provision for the conduct of games of chance, instant games, prize competitions, and lotteries for amusement and for the raising of funds for certain purposes while continuing to prohibit the conduct of such activities for commercial gain.

[40] The Act prohibits illegal games of chance unless they are authorised by licence issued under s.8 of the Act. It was common ground that gaming machines are games of chance.

[41] Section 8(1) provides:

The Minister may from time to time, at his discretion, on the application in writing of any society, grant to that society, in respect of any game or games of chance that would otherwise be illegal, a licence authorising it to conduct the game or games of chance specified in the licence if he is satisfied that the society's object in doing so will be to raise money for an authorised purpose.

[42] “Authorised purpose” is defined to mean any charitable, philanthropic, cultural, or party political purpose, or any other purpose that is beneficial to the community or any section of it.

[43] Accordingly, the Minister may grant a licence only where he or she is satisfied that the sole object of the society in conducting a game of chance is to raise money for an authorised purpose. Although authorised purposes are diverse, they do not include commercial exploitation of the game of chance for the benefit of the society or its members.

[44] Further, the object must be to “raise money for” an authorised purpose. I consider that the object of raising money is to generate revenue that exceeds the expenses of earning it. It is the surplus that is applied to the authorised purpose.

[45] Section 8(2) provides:

Every such licence shall be subject to the condition that no money shall be paid to or received by any person (other than an authorised employee of the society) whether directly or indirectly, by way of remuneration or commission for conducting or helping to conduct the game or games of chance, and that no remuneration by way of commission shall be paid to or received by any such authorised employee for conducting or helping to conduct the game or games of chance.

[46] Remuneration is not defined in the statute. Relying on the Shorter Oxford Dictionary, I take it to mean reward for services rendered. See also *R v Postmaster-General* (1876) 1 QBD 658. It has been held that a 'marketing fee' of \$1 that was paid to service station owners for each ticket sold was remuneration for purposes of sections 32-4 of the Act; *Harry Dods Promotions v O'Sullivan* CA379/89 12 June 1990.

[47] The Department has interpreted s.8 as authorising deduction of expenses from gaming receipts. It has been held in a different context that the remuneration of a liquidator does not include expenses; *Re Medforce Healthcare Services (In Liquidation)* [2001] 3 NZLR 145 at para 19. However, the Department takes the view that the only expenses that may be deducted are those directly caused by the gaming activity. The general issue in this proceeding is whether the Department's approach to deduction of expenses is too restrictive.

[48] Section 8(3) provides that, subject to subsection (2) and any regulations made under subsection (5), the Minister may grant a licence to conduct any game of chance either unconditionally or subject to such conditions as he may specify. The Minister may also at any time amend a licence and may at any time add to, vary, or amend any conditions that have been imposed on the licence.

[49] The Department has interpreted the legislation to confine licences to venues at which gaming is an adjunct to the business of licensed premises. That interpretation is not challenged in this proceeding. However, I consider that it is consistent with s.8(1) and (2). If a hotel were to profit directly from gaming, the game of chance would no longer be conducted with the sole object of raising money

for an authorised purpose. Consistent with this, the prohibition on recovery of remuneration or commission means that a licensee may only deduct expenses associated with gaming. It follows that gaming would not be profitable as a stand-alone activity.

[50] Under s.8(5) the Governor-General may by Order in Council make regulations for specified purposes which include:

(d) Prescribing the conditions to be complied with by persons conducting games of chance, and by those playing them:

...

(k) Providing for such other matters as are contemplated by or necessary for giving full effect to the provisions of this section, and for its due administration.

[51] Regulations have never been made under s.8. Rather, gaming machines have been regulated pursuant to detailed licence conditions imposed under s.8(3). The applicant challenges the lawfulness of this practice on the ground that s.8(3) permits conditions on a licence-by-licence basis only, and rules that are of general application to all licences may only be imposed via regulations.

The Licence

[52] The licence granted on 17 January 2002 provided that the applicant “is hereby granted a licence authorising it to conduct games of chance by way of gaming machines for the sole objective of applying and distributing at least 33% of gaming machine profit for the following authorised purposes:

Any charitable, philanthropic, cultural or party political purpose, or any other purpose that is beneficial to the community or any section of it. This shall include, but not be limited to: the provision, or the assistance in the provision of facilities, equipment, or playing or training uniforms for sporting clubs and amateur sporting teams playing in recognised, published leagues or competitions. Grants for charitable purposes including the relief of poverty or welfare assistance through donations to recognised social service or welfare agencies. Grants to educational or training organisations through the provision of scholarships or equipment which is administered by the recipient educational organisation. Grants for recognised cultural or philanthropic activities or groups within the local community.

[53] The licence also provided that with the exception of any funds retained for distribution to national societies or agencies, funds must be distributed in the general community area in which they were raised. Further, the licensee must at all times comply with the provisions of the Act and the licence conditions with the licence. Any serious breach of the licence conditions might result in cancellation of the licence. The licence conditions referred to are standard conditions that the Department has applied to all gaming machine licences since 1 October 2001.

[54] Four licence conditions are relevant for present purposes. Condition 47 provided that the applicant shall pay out at least 33% of the total gaming machine profit, for each financial year, for the authorised purposes shown on the face of the licence. Gaming machine profit is defined as metered turnover less metered total wins, so it excludes taxes and expenses.

[55] Condition 56 provides:

Interpretation of “expenses”

- (1) The society shall apply gaming machine funds only to expenses that are actual, reasonable and necessary to the society’s gaming machine operations.
- (2) The society shall not make payments to any site operator that exceed \$150 per machine per week (excluding GST) in total, unless the society has applied for and received approval from the department for dispensation to make higher payments. Any such application must be made in writing and must be substantiated by a fully documented case. While the department will consider each application on its merits, there is no presumption that any dispensation will be granted.
- (3) The society shall not pay a service provider to perform duties listed in the site agreement as duties to be performed by the site operator.
- (4) Payment of expenses shall be made by fully auditable electronic lodgement, or by cheque. Where payments are made by cheque, the cheque must be made out in the name of the service provided and crossed ‘Account Payee Only’ or ‘Not Transferable’. All such payments must be made from the society’s gaming machine account.

[56] Condition 56 previously referred to expenses that were “lawfully incurred and necessary” to the gaming machine operations. Counsel agreed that nothing turns on the difference between the two versions of condition 56. Pub Charity accepted

that it could apply gaming machine funds only to expenses that are actual, reasonable and necessary. The issue is whether the expenses claimed meet this test.

[57] Condition 57 requires the applicant to maintain full and complete records of all expense payments and of the providers of goods and services for which expenses are claimed. Condition 18 requires the society to enter a site agreement showing the amount and nature of expenses payable and total payments to the operator.

[58] The Department also issued guidelines, which although not part of the licence clarified the Department's policy with respect to expenses. The guidelines provide that "actual" expenses are based on actual, rather than projected, expenses and are able to be substantiated. "Reasonable" expenses take into account the size of the operation and normal market values for the goods or services provided. "Necessary" means necessary to the gaming operations. The society must exercise good business practice and due care to ensure that expenses are clearly related to the society's function of raising funds for authorised purposes.

[59] The guidelines illustrate expenses that may be deducted, including levies and taxes, depreciation where a society owns the equipment, cost of credit, insurance, installation costs, servicing, and administration costs.

The applicant's contentions

[60] Pub Charity advanced three causes of action. It contended that condition 56 is ultra vires because standard conditions cannot be imposed under s.8(3); standard conditions can only be imposed pursuant to regulations. It further contended that condition 56, as applied by the Department, is an unlawful fetter upon the Department's discretion under s.8(3). Lastly and in the alternative, it attacked the refusal of the Department to grant dispensations in respect of Robbies Bar and Bistro, The Duke of Gloucester, the Kaitaia Hotel, and the Onerahi Tavern.

[61] Affidavits were filed from Ian Bray, the Chief Executive of Pub Charity, Mr Hodder, Thomas Sheehy, formerly Chief Executive of the Hotel Association of New

Zealand, and the licensees of the hotels which were the subject of the dispensation applications.

[62] For the Department, affidavits were filed from Catherine Reid, Manager, Gaming Operational Policy, Gavin Duffy, formerly Team Leader, Gaming Licensing, Steven Rogers, Senior Policy Advisor, Gaming Operational Policy, and Peter Boyle, an accountant.

Is condition 56 ultra vires?

[63] Mr Wilson submitted that the scope of an empowering clause such as s.8(3) must be ascertained from its statutory context, taking into account the objects and scheme of the relevant legislation; *Taylor v New Zealand Poultry Board* [1984] 1 NZLR 394. Section 8(3) does not authorise the Department to impose standard conditions. That may only be done by regulations under s.8(5). Section 8(3) only allows conditions to be imposed on individual licences; it follows that s.8(3) was not intended to allow the imposition of standard conditions. By imposing general conditions without doing so by way of regulation, the Department avoided constitutional safeguards, notably the Regulations (Disallowance) Act 1989.

[64] Put another way, Mr Wilson submitted that where there is power to make a regulation under s.8(5) the Minister does not have an identical power to impose a condition under s.8(3). He referred to *Official Assignee v Chief Executive of the Ministry of Fisheries* [2002] 2 NZLR 722, in which a regulation was struck down because it unlawfully transferred to the Chief Executive of the Ministry of Fisheries a power reserved to the Governor-General.

[65] I did not understand Mr Wilson to contend that nothing that could potentially be made the subject of a regulation could be the subject of a licence condition. The power to make regulations under s.8(5) is extremely wide. His point rather was that a standard condition may only be imposed under a regulation.

[66] Section 8(3) creates a discretion that is on its face unfettered. Each application for a licence must receive individual attention, but I see no justification

for reading into s.8(3) a prohibition on the use of standard conditions to deal with matters that are common to all licences. The conditions that result are still imposed on a licence by licence basis as applications are made. A licence condition that is justified does not become any less so because it is equally justified in other cases. There is an inevitability about the development of standard conditions in circumstances where the Crown has chosen not to make regulations. Some matters are common to all licensees, such as record-keeping requirements. Further, the proceeding is specifically concerned with condition 56, which in its terms provides for applications for dispensation to be made on a site by site basis.

[67] The first cause of action fails.

Is condition 56 an unlawful fetter on the Minister's discretion?

[68] The applicant attacked condition 56 on the ground that the maximum of \$150pmpw operated as a fetter on the Department's discretion, in circumstances where it is said that the Department has dealt with applications for dispensation in an extremely conservative manner. A dispensation was granted in relation to one of the hotels the subject of this proceeding, the Kaitaia Hotel, but that is the only dispensation that counsel were able to identify. Mr Wilson pointed to evidence that no dispensations have been granted since the judgment of Durie J on 6 March 2003.

[69] Mr Wilson relied on *Practical Shooting Institute (NZ) Inc v Commissioner of Police* [1992] 1 NZLR 709, 719. Tipping J held that:

The cases suggest that there are two, possibly three, categories into which discretionary powers of this kind can be put:

(1) First there are those powers which require an individual case by case examination without any predetermined fetter on the exercise of the discretion, other than what might be explicit or implicit in such criteria as may be set out in the enabling instrument.

(2) Second there are those powers which by dint of the nature of the subject-matter justify the establishment as a matter of discretion of a carefully formulated policy, but always with the reservation that no case is to be rejected automatically because it does not fit the policy. In this category all cases must be considered to see if they are sufficiently special to warrant a departure from the general policy.

(3) The third category, if it exists at all, represents cases where the discretionary decision maker is implicitly authorised to exercise his discretion to establish for himself an immutable policy admitting of no exceptions.

The only tenuous authority of which I am aware for the suggested third category comes from Viscount Dilhorne's words in *British Oxygen*. But rigid policy is really the antithesis of the exercise of discretion and I for one would need to see the power to adopt such a rigid policy for a discretionary assessment appear by clear and necessary implication from the enabling legislation before I was prepared to place a case into the possible third category.

[70] Mr Wilson recognised that the standard conditions themselves create new discretions to be exercised so that condition 56 falls into category (2) in *Practical Shooting*, but submitted that the application of standard conditions to all licences nonetheless operates as a fetter on the Department's discretion.

[71] Further, Mr Wilson submitted that the Department had "shut its ears" to the applications made by Pub Charity; *Westhaven Shellfish Limited v Chief Executive of the Ministry of Fisheries* [2002] 2 NZLR 158 at para 39. In support of this submission, he drew my attention to the Department's letter of 23 September 2002 attaching the licence conditions to apply from 1 October 2002. He submitted that there was no provision in this letter for the exercise of discretion under s.8(3) with respect to individual licences. I note, however, that the annexed guidelines did provide for dispensations.

[72] The threshold of \$150pmpw resulted from a survey of licensees, from which it appeared that some 70% of machines incur expenses of \$150pmpw or less. Of these, many had simply failed to claim allowable expenses. I consider that \$150 is a reasonable figure at which to set a threshold.

[73] On its face, condition 56 does not establish a policy of capping expenses at \$150pmpw, and I am unable to see that a requirement that the applicant substantiate its expenses where it seeks to recover more than \$150 is a fetter on the Department's discretion.

[74] On the other hand, the threshold would operate as a fetter if the Department's de facto policy was that it would not grant dispensations, leaving no room for the

exercise of the discretion. In that regard, the evidence shows that one of the hotels in issue in this proceeding, the Kaitaia Hotel, has already received a dispensation. None of the applications for dispensation which are the subject of this proceeding have been granted, but for reasons outlined below I am satisfied that the Department's reasons for rejecting those applications do not evidence a policy of declining dispensations.

[75] In the end, the evidence does not establish that the Department is taking an unduly conservative approach to dispensations. Were it to do so, condition 56 might well operate as a fetter. \$150pmpw is nothing more than an administratively convenient threshold. Having established a condition that authorises the deduction of actual and reasonable expenses caused by gaming operations, the Department cannot refuse applications for dispensation on the ground that actual and reasonable expenses caused by gaming operations exceed that figure.

[76] The second cause of action fails.

Res Judicata

[77] Mr Parker contended that issue estoppel arose in relation to the first and second causes of action, based on the judgment of Durie J. The Judge was not asked to deal directly with the lawfulness of condition 56, but Mr Parker submitted that its lawfulness was a necessary step in his reasoning. Alternatively, the applicant's attack on condition 56 in this proceeding was said to be an abuse of process because the issue ought properly to have been raised in the previous application. Mr Parker relied upon *Joseph Lynch Land Co v Lynch* [1995] 1 NZLR 37.

[78] Mr Wilson submitted that issue estoppel or res judicata does not ordinarily arise in judicial review proceedings, relying on *R v Secretary of State for the Environment, ex parte Hackney London Borough* [1983] 1 WLR 524, and *R v Secretary of State for the Home Department, ex parte Momin Ali* [1984] 1 WLR 663. He also argued that Durie J did not deal directly with the lawfulness of condition 56, so that the only argument available to the Department was that it would be an abuse to attack condition 56 when the applicant could have done so previously.

[79] In *Hackney London Borough*, the Court of Appeal held that issue estoppel is not available in judicial review proceedings. The Court relied partly on procedural features of judicial review in English practice. The absence of pleadings renders it difficult to identify a particular issue that was decided. Proceedings are brought in the name of the Crown and the Court doubted that there was any true *lis* between the Crown and the respondent or between the *ex parte* applicant and the respondent. However, the Court also doubted that a decision in such proceedings could be said to be final since the nature of the relief in many cases leaves the matter open for reconsideration by the statutory or other body concerned. It relied on a passage from de Smith Judicial Review of Administrative Action 4th ed. (1980) at 108, in which the author opined that the concept of *res judicata* in administrative law is so nebulous as to occlude rather than clarify practical issues, and that it should be as little used as possible.

[80] There are several New Zealand decisions in which the Court appears to have assumed that issue estoppel is available in judicial review; *M&J Wetherill Co Ltd v Taxation Review Authority* (2003) 21 NZRC 18,311, *Fraser v Robertson* (1991) 3 PRNZ 175, *CIR v Abattis Properties* (CA4/02, 31 July 2002), *Butler v Removal Review Authority* [1999] NZAR 68.

[81] Assuming that issue estoppel is available, it is necessary for the Department to show that the issue had been determined with certainty in the earlier litigation; *Joseph Lynch Land Co* at 42 per Tipping J. I do not consider that the Department is able to do so. The validity of condition 56 was not put in issue before Durie J. He accordingly assumed its lawfulness, but he made no finding to that effect.

[82] It is well established that the objects of *res judicata* are finality of litigation and fair use of curial procedures. Where issues are so clearly part of earlier litigation that they ought to have been raised in that litigation, it may be an abuse of process to raise them for the first time by a new proceeding; *Fraser v Robertson* at 178, *Henderson v Henderson* [1843-60] All ER 378. Mr Parker relied in the alternative on this principle. I accept that the issue could have been raised earlier. However, the previous litigation was fought on narrow grounds, and the Court should be slow to discourage that. It was not unreasonable for Pub Charity to take a narrow

approach given that the point it took was sufficient to compel the Department to address dispensations on their merits. It now exercises its right to attack a different decision. It is not a case where the very existence of the second proceeding is an abuse, or where evidence that might have been called by the Department in the first proceeding is no longer available. I consider that there is nothing unfair to the Department in having to meet an argument that might have been made in the earlier proceeding.

[83] This defence fails.

Refusal to grant dispensations

[84] In the alternative to the first and second causes of action, Pub Charity contended that the Department's decision to decline dispensation was unlawful. Mr Wilson submitted that the decision was unlawful for four reasons.

- a) The decision was irrational in the *Wednesbury* sense; *Associated Provincial Picture Houses v Wednesbury Corporation* [1948] 1 KB 223, *Wellington City Council v Woolworths New Zealand Limited (No.2)* [1996] 2 NZLR 537.
- b) The Department took into an account an irrelevant consideration, namely Mr Duffy's personal and unsubstantiated views as to what constitute actual, reasonable and necessary costs of running a gaming machine operation; *Poananga v State Services Commission* [1985] 2 NZLR 385.
- c) The Department failed to take into account or give sufficient weight to material relevant considerations; *CREEDNZ v Governor-General* [1981] 1 NZLR 172. These were the fact that the evidence in support of the applications was prepared by an independent specialist former employee of the Department who had sworn an affidavit attesting to its accuracy and relevance, the Department's failure to accept that the claim was fully documented when wage records and documents were

supplied which supported the applications, and the Department's history of acquiescence in payments of up to \$250pmpw coupled with its failure to outline the changed circumstances which altered the actuality, reasonableness, or necessity of site payments being maintained at those levels.

- d) The Department breached Pub Charity's legitimate expectation that, in the absence of changed circumstances, it would be entitled to continue making the same level of site payments to each site as had been previously approved by the Department.

[85] Mr Wilson's submission on irrationality was that Pub Charity had produced evidence of expenses in the form of Mr Hodder's opinion, the opinion was credible, and the Department had rejected the claim. No reasonable decision-maker would refuse to accept an expert opinion going to the heart of its decision without making such enquiries and without any basis for its refusal. Further, the Department's position conflicted with the evidence before it. In particular, it adopted a methodology for apportioning costs that was inappropriate and had no regard to the practices and practicalities of the industry. The Department acted unreasonably in refusing to accept a site rental for the Kaitaia Hotel.

[86] With respect to irrelevant considerations, the Department is said to have insisted that Pub Charity had failed to provide adequate evidence in circumstances where Pub Charity had in fact done so, in the form of Mr Hodder's opinion and evidence of actual costs claimed. Further, the Department is said to have adopted the personal views of Mr Duffy as to what costs are actual, reasonable and necessary, in lieu of Mr Hodder's opinion. It was also said that the Department's view that no portion of costs may be recovered where they would be incurred whether or not a gaming machine was present on the premises was an irrelevant consideration.

[87] With respect to legitimate expectation, Pub Charity says that it had a legitimate expectation that in the absence of changed circumstances, it would be entitled to continue making site payments at historic levels.

[88] The legitimate expectation concerned was an expectation as to substantive outcome, not process. Mr Wilson relied upon English authorities which hold that a legitimate expectation as to substantive outcome can form the basis of judicial review; *R v North & East Devon HA, ex parte Coughlan* [2001] QB 213, 242; *Council for Civil Service Unions v Minister for the Civil Service* [1985] AC 374, 401; *Rowland v Environment Agency EWCA CIV 1885* (19 December 2003). *Rowland* establishes that the test for determining whether a legitimate expectation has been breached is whether the public authority has acted so unfairly that its conduct amounts to an abuse of power. In considering that question, the Court must bear in mind the interests of the general public, which the public body exists to promote.

[89] Neither counsel referred me to New Zealand authorities. It has been held that legitimate expectation is confined to process; *Lawson v Housing New Zealand* [1997] 2 NZLR 474; *Lumber Specialties v Hodgson* [2000] 2 NZLR 347. But the possibility of a legitimate expectation as to substantive outcome was recognised in *Talleys Fisheries v Cullen* (High Court Wellington, CP 287/00, 31 June 2002, Ronald Young J, and *New Zealand Association for Migration and Investments v Attorney-General* (High Court Auckland, M 1700/02, 16 May 2002, Randerson J). In the latter decision, Randerson J observed that the approach of the Court in legitimate expectation cases involving policy changes will be very much fact dependant.

[90] A claim based on legitimate expectation faces insuperable difficulties where the substantive outcome that the applicant seeks is beyond the Department's power to give; *Rowland* at paras 136, 152. To the extent that the payments of up to \$250pmpw sought by Pub Charity have the character of remuneration for the site operator, s.8 prohibits the Department from authorising them.

[91] I approach the matter by considering whether the Department's approach to calculation of expenses is consistent with the legislation and the licence. I then consider the matters that the Department is said to have ignored or taken into account, as the case may be, before returning to the question of legitimate expectation.

Calculating expenses recoverable under the legislation

[92] Pub Charity did not contest the Department's policy of granting gaming machine licences only where gaming is an adjunct to another business. I have already discussed the legislative framework. For reasons outlined there, I also consider that the Department's policy is consistent with the statute. It follows that gaming is to be treated as a marginal activity.

[93] The statutory prohibition on paying remuneration or commission to any person for conducting gaming machine operations also leads to the conclusion that the Department may allow recovery only of expenses that are caused by the gaming operation. To allow recovery of expenses that would have been incurred anyway is to remunerate the operator because it increases the operator's profit from its principal business activities, the revenues of which would otherwise have been required to cover these expenses.

[94] It follows that the Department may allow costs of a kind that would not have been incurred but for the gaming operation. Further, it may allow costs that are common to the gaming operation and the principal business, where and to the extent that those costs are shown to have increased as a result of the gaming operation. It may not allow recovery of costs that would be incurred whether or not the gaming operation was present. This latter category includes all costs that are both fixed (in the sense that they do not vary as a result of the gaming machine operation) and common to the gaming machine operation and any other business conducted on the site. Rates may be an example.

[95] Licence condition 56 allows recovery of costs that are actual, reasonable, and necessary to the gaming machine operation. The requirement that only costs actually incurred may be recovered is consistent with s.8, as is the requirement that they be necessary to the gaming operations. I consider that a cost is necessary for purposes of condition 56 if it is caused by the gaming operation. Pub Charity did not dispute that it is within the Department's discretion under s.8(3) to require that costs must also be reasonable. Reasonableness is an objective standard. It allows the Department to disallow actual costs if they were inefficiently incurred. It also allows

the Department to use its knowledge of costs and work practices at other sites as a frame of reference.

[96] I inquired of counsel what cost allocation principle the Department is obliged in law to follow. Mr Wilson submitted that it must accept any cost allocation that would be acceptable to the Commissioner of Inland Revenue for taxation purposes. Put another way, it must accept any commercially reasonable allocation. However, the Department is required by s.8 to ensure that site operators are not being remunerated and that money raised is applied to authorised purposes. Its practices with respect to expenses must reflect those requirements. I reject this submission.

[97] The requirement that the Department may allow only expenses that are caused by gaming operations means that the onus is on the applicant for a licence to establish that the costs claimed are actual, reasonable, and necessary. The onus derives not from the \$150mpw threshold in condition 56 but from the statutory prohibition on paying remuneration or commission to any person for conducting gaming. Recovery of a cost that is not caused by gaming would be remuneration, for purposes of s.8, in the sense that it would meet an expense that otherwise would have been recovered from the operator's other business revenues.

[98] Plainly there is room for a practical approach. Trade-offs may be made between accuracy and the cost of proving expenses, or in the interests of administrative efficiency. The \$150mpw threshold is an example of the latter. The Department must also recognise that cost causation can be difficult to prove. To insist on proof to a level that is practically impossible would be to deny recovery of legitimate expenses.

Site rentals

[99] I accept Mr Wilson's point that Durie J's decision, to the extent that it held that site rental payments are illegal, was confined to payments that are based on turnover. Further, the Kaitaia site rental is not based on a desire to prevent a high turnover site moving to a competing society. Kaitaia is a low-turnover site. Pub Charity wishes to continue making payments to schools in the Kaitaia region and

needs a site in the region so that it can do so. The payments are unquestionably beneficial to the community.

[100] However, it does not follow that site rentals not based on turnover are permitted. A site rental may help Pub Charity serve an authorised purpose by providing it with a site in a region that has specific needs. But the question is whether it is an expense. It plainly is from Pub Charity's perspective. However, s.8(2) prohibits payment of remuneration to the site operator. Accordingly, the question is whether any given payment has the quality of remuneration in the hands of the operator. The payment that Pub Charity wants to make at Kaitaia is an opportunity cost in that it is intended to compensate the operator for loss of profit that the operator might earn from a better use of the site. Because it substitutes for a profit that would otherwise have been earned it is a profit in the hands of the operator. Taking a purposive approach, I see no basis for distinguishing it from the opportunity cost that a high turnover site might claim if approached by another society willing to pay a premium for placing its machines on the premises.

[101] I find that site rental payments are not authorised by s.8.

The Department's approach to allowable expenses in its 28 July decision

[102] In its decision of 28 July the Department took the view that only expenses caused by the gaming operation were recoverable. It included in this category expenses of a kind that would have been incurred anyway, to the extent that these were increased by the gaming operation. It rejected Pub Charity's view that general overheads should be apportioned to gaming on a cost centre basis. I find that it was correct to do so.

[103] For reasons just outlined, I also consider that the Department correctly rejected the claim for site rental.

[104] Lastly, I consider that the Department was also entitled to insist on evidence being supplied to support the costs claimed. I have considered whether the Department may have taken too rigorous an approach to the question of proof, but

the evidence does not establish that it did so. It accepted some claims where evidence was not available and the claims advanced appeared reasonable on their face. I consider that it was entitled to call for evidence where evidence might reasonably be expected to exist.

[105] The difference between Pub Charity's figures and expenses recoverable under the Department's approach is material. In his affidavit filed for the purposes of this proceeding, Mr Boyle undertook his own calculation of allowable expenses, based on the data that had been supplied by Pub Charity. He calculated that allowable expenses were significantly less than the amounts claimed by Pub Charity. In the case of Robbie's Bar and Bistro, for example, he calculated the allowable costs at \$105.34pmpw rather than \$250. This figure resulted partly from a reduction in direct costs claimed and partly from disallowing recovery of general overheads. However, should the application be renewed it may be that evidence can be supplied in relation to some items.

[106] It follows that the claims based on unreasonableness and relevant or irrelevant considerations must fail. The considerations taken into account by the Department were permissible. It did not take into account material irrelevant considerations. The decision that it reached was open to it.

Legitimate Expectation

[107] On the assumption that judicial review based on legitimate expectation as to a substantive outcome is available in New Zealand, Pub Charity must show that the Department's conduct was so unfair as to amount to an abuse of process.

[108] I consider that Pub Charity is unable to do so. All that Pub Charity could point to was a history of payments of up to \$250pmpw. The Department was plainly aware of these payments, but they were made at a time when it was the Department's practice to allow societies to police expenses. There was nothing in the nature of a representation that the practice would be allowed to continue. Licence conditions are routinely changed; indeed, one of Mr Bray's complaints regarding the licensing regime was that the Department tinkered too readily with it. The evidence did not

show that Pub Charity had altered its position to its detriment in the expectation that payments would continue, let alone that it had been induced to do so by the Department. In the circumstances I conclude that there is no unfairness to Pub Charity in the Department's decision to decline dispensations.

[109] I add that, to the extent that the expenses sought by Pub Charity exceeded those that were actual, reasonable, and necessary, the Department had no power to authorise them.

[110] The third cause of action fails.

Result

[111] The application is dismissed.

[112] Mr Wilson urged me, in the event that the application failed, to make orders that would obviate the need for Pub Charity to seek to recover overpayments from the operators concerned. I decline to do so. It is not clear to me that I have jurisdiction in circumstances where I have held that the Department acted lawfully. Further, Pub Charity sought and obtained interim relief knowing that it faced the risk of having to recover payments. At the time it did so, the Department indicated that it was willing to discuss with Pub Charity any issues that it may have with respect to recovering overpayment. Mr Parker advised that that remains the Department's position.

[113] The Department is entitled to costs. Counsel may file memoranda if costs cannot be agreed.

Delivered at 5.00 pm this 25th day of May 2004

F Miller J

Solicitors:

Buddle Findlay, Wellington for Applicant
Crown Law Office, Wellington for Respondent