Internal Affairs Briefing

Hon Chris Tremain
Minister of Internal Affairs

Title: Policy Briefing 5: Options for reform to the conflict of interest provisions in the Gambling Act 2003

Date: 1 March 2013

Key issues

- There is evidence that conflicts of interest in relation to grants remain an issue for the Class 4 gambling sector.
- The Department of Internal Affairs has found it very difficult to prosecute collusive behaviour under the existing conflict of interest provisions in the Gambling Act 2003.
- There are a variety of options to amend the Act in order to strengthen the Department’s capabilities to hold corporate gaming societies and venues to account for conflicts of interest. This will discourage undesirable behaviour and ensure that the grant making process is fairer and more transparent.

Action sought

Agree to seek Cabinet’s agreement to the proposed legislative changes outlined in this briefing, to improve the transparency of the Class 4 gambling sector.

Timeframe

By 8 March 2013

Contact for telephone discussion (if required)

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<th>Telephone direct line</th>
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Return to:
DMS file reference: POL-1083-4, 811907DB
Ministerial database reference: IA201300141
Purpose of briefing

1. This briefing proposes a number of changes to the Gambling Act 2003 (the Act) to amend the conflict of interest provisions in order to achieve the original policy intent of these provisions.

Existing conflict of interest provisions within the Act

2. There is evidence that conflicts of interest in relation to grants remain a problem for the Class 4 gambling sector. Despite this, the Department of Internal Affairs (the Department) has struggled to enforce compliance under the existing conflict of interest offences provides.

3. The Act contains provisions intended to limit conflicts of interest in relation to grants in the Class 4 gambling sector. Anyone guilty of an offence against the conflict of interest provisions is liable on summary conviction to a fine not exceeding $10,000. Central to these offences is the definition of a “key person”. Section 4 of the Act defines a key person in relation to a Class 4 society as a trustee, the chief executive of the society holding the licence or anyone else who exercises significant influence in the management of the society.

4. Section 4 also defines who is a key person in relation to a Class 4 venue licence. Included in the definition are the venue manager, venue personnel, the venue operator or the director, chief executive and senior manager of a venue operator. This definition also includes anyone whom the Secretary of Internal Affairs “reasonably believes to have a significant interest in the management, ownership or operation of a venue operator”.

5. There are two conflict of interest provisions in the Act. Section 113 is primarily intended to ensure that venue key persons are not involved in the grant-making processes of the society that operates at their venue. Section 113 also establishes that any society key person who knowingly allows someone to contravene the section also commits an offence.

6. The other conflict of interest provision is in section 118 and is broadly intended to prohibit key persons from seeking or receiving any benefit from a grant recipient or potential grant recipient, if the receipt of the benefit has a condition attached (e.g. favourable consideration of a grant application).

7. Section 118 also prohibits venue key persons from seeking or receiving a benefit from a society key person, if receipt has some condition attached. In order for an offence to be proven under section 118, it is necessary for the prosecution to prove beyond reasonable doubt that:
   a. the key person knowingly offered/received a benefit;
   b. that the offer/receipt of the benefit had a condition attached; and
   c. that the key person had knowledge of the condition.

8. Section 118 stipulates that the section does not prevent the holder of a Class 4 operator’s licence paying lawful venue costs to a venue key person.

There is evidence that conflicts of interest continue to exist in grant funding practices

9. Despite the conflict of interest provisions in the Act, the Department has not been able to eliminate conflict of interest situations. It is unclear how widespread conflicts of interest are in relation to grant funding practices. However, there is
evidence, supported by past and current investigations, to confirm that issues other than community priorities drive some society decision-making.

10. One common arrangement involves “grant-capture” schemes, where potential grant recipients invest in venues that host a society’s gaming machines. The grant recipients would then look to influence the grant-making process. In recent years, the Department has tried to prosecute a number of society key persons and venue key persons for such arrangements, with limited success.

11. The Department has also identified examples of “kick-backs” where a society agrees to provide an applicant with a grant in exchange for some benefit. These benefits may be direct (e.g. a society key person offers a community group a grant in return for a car), or indirect (e.g. branding rights).

12. Another violation of the conflict of interest provisions occurs when societies inflate venue payments. In recently published gambling compliance audits, the Department noted that it regularly identifies significant expenditures incurred by venues relating to “business development” and “customer liaison activities”. These sorts of expenses are often used by societies to acquire new venues, or to protect existing relationships.¹

Framework for analysis

13. The objective of reform would be to assist with meeting your priorities for the Class 4 sector, particularly for increasing the proportion of net proceeds that is available to the community. Each option was also be assessed by how difficult and costly (for both the Department and the societies) they will be to implement.

Problem definition

The current conflict of interest offences are not broad enough to cover all conflict situations

14. Prosecutions under sections 113 and 118 of the Act are rare. Since 2003 there have been only fifteen concluded cases where societies and venues have been charged with breaching the conflict of interest provisions. Of these, less than half resulted in convictions (a low percentage compared with prosecutions under other sections of the Act). There are two main reasons why some cases of conflicts of interest are not covered by the existing offence provisions. These are outlined below.

15. Firstly, the definition of a key person is not sufficiently broad to cover some conflict of interest situations. The Department has investigated a number of cases where a community group has invested in a finance company which then provides finance to a venue operator. Such an arrangement could enable a community group to hold influence over a society that signs a venue agreement with the venue operator. However, it is unclear whether such an indirect relationship would currently be covered by the definition of a venue key person.

16. The definition of a venue key also makes it difficult to prosecute society key persons for knowingly allowing somebody to contravene section 113. The difficulty is created by the words “any other person whom the Secretary of Internal Affairs reasonably believes to have a significant interest”.

¹ Department of Internal Affairs, Gambling Compliance Audit of Grassroots Trust (2011), GM1326.
17. In 2011, the North Shore District Court issued a preliminary ruling on the case of Department of Internal Affairs v Dempsey. The preliminary ruling indicated that in order for a society key person to be guilty of contravening section 113, he or she must have known that the Secretary of Internal Affairs (the Secretary) believed somebody to be a venue key person. This would require the Department to have formally notified a society that it considered a person to be a venue key person before the violation of section 113 took place. This effectively makes the section unworkable as all investigations are, by their nature, backwards looking.

18. Secondly, it is currently highly difficult to use section 118 in order to encourage compliance. One of the initial policy objectives behind section 118 was to make it an offence for key persons to seek or receive a benefit that might influence who future grants are made to. The requirement that a condition be attached to a benefit was added to avoid making all gift-giving illegal under the Act.

19. Currently, it must be proven that the making of a grant was conditional on the receipt of a benefit. Proving that a society had knowledge of an informal or indirect condition is extremely difficult (if not impossible). Conflicts of interest typically involve undocumented relationships and evidence is normally circumstantial. The result of this is that societies are not prohibited from receiving lucrative benefits, so long as they are unsolicited.

Proposals

Reform the definition of a venue key person

20. We propose that the definition of a venue key person would be amended in two ways. Firstly, the definition would be amended to cover indirect relationships. This would help the Department to establish that the kinds of arrangements outlined in paragraph 15 would make a community group a venue key person.

21. Secondly, the words “whom the Secretary reasonably believes” would be removed from the definition of a venue key person. Instead, the definition would refer to an objective set of criteria (such as whether a person had a significant interest, direct or indirect, in the management, ownership or operation of a venue or venue operator…). This would remove the need for the Secretary to notify societies that it considers somebody to be a venue key person before prosecuting under section 113.

Introduce new provisions in section 118 to prohibit the receipt of influential gifts

22. We propose that section 118 be amended to remove the requirement that a condition be attached to the offer/receipt of a benefit, where the exchange is between society key persons and venue key persons. The Department would still need to prove the existence of a condition where a benefit is offered between key persons and a grant recipient.

23. Additionally, we propose that a new provision be included in section 118, that prohibits society key persons and venue key persons from receiving any benefits that a reasonable person believes could influence the grant making process.
Reform to the section 118 in order to prohibit the receipt of influential gifts

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<th>Advantages</th>
<th>Disadvantages</th>
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<td>• A venue operator should never receive any pecuniary benefit from a society other than lawful venue expenses. The need to prove the existence of “a condition” is an unnecessary additional requirement.</td>
<td>• It is unclear how the courts would interpret a “reasonable person” test in this context.</td>
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<td>• Potentially prohibits the offering of kick-backs by community groups (e.g. branding).</td>
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<td>• Brings the section closer to the original policy intent.</td>
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24. We also considered amending section 118 to remove all references to “a condition” needing to be attached to the receipt/offer of a benefit. This is not our preferred option, as it would technically make all gift-giving illegal.

Recommendations

25. The recommendations are that you:

a) **note** that there is evidence that conflict of interest in relation to grants remains a problem in the Class 4 gambling sector; **Yes/No**

b) **agree** to seek Cabinet approval to amend the Gambling Act 2003; **Yes/No**
   i) to extend the definition of a venue key person to cover indirect interests in a venue or venue operator; **Yes/No**
   ii) so that the definition of a venue key person refers to an objective set of criteria, rather than somebody “whom the secretary reasonably believes” to have an interest in a venue or venue operator; **Yes/No**
   iii) to remove the requirement in section 118 that a condition be attached to the offer/receipt of a benefit, where the exchange is between societies and venues; and **Yes/No**
   iv) to create a new provision in section 118 that prohibits key persons from receiving any benefits that a reasonable person believes could influence the grant making process. **Yes/No**