A review by Macquarie Legal Practice
[first produced 11 Feb 2019, last revised 26 May 2021]
of
"Guidance Note – Managed Investment Schemes"
by *Atanaskovic Hartnell* [produced 2 Jan 2019]
and
"Streamlining horse syndication in Victoria"
by *Racing Victoria* [issued 2 Jan 2019]

On 2 January 2019, the Australian Trainers Association (ATA) circulated to industry a ***"Guidance Note – Managed Investment Schemes"*** (**Guidance Note**) produced by law firm *Atanaskovic Hartnell*, purportedly to assist trainers in determining if their syndication activities are subject to the managed investment schemes regulatory regime[1].

On the same day Racing Victoria (RV) issued to trainers a document titled: ***"Streamlining horse syndication in Victoria"*** *(**RV – Advice to trainers**)*, stating in *Part 2* of that document:

> ***"2) Guidance note to Victorian Trainers***
>
> *Under instruction from the Australian Trainers' Association, solicitor and former ASIC Chairman, Tony Hartnell AM has developed a Guidance note for trainers which outlines the circumstances in which they would not be captured by the managed investment scheme provisions of the Act. Specifically, where syndicates members continue to have day-to-day control of the activities of the syndicate.*
>
> *In order to demonstrate they are not subject to the provisions of the Act, RV compliance officers may require trainers to provide a simple statement articulating the way in which members retain day-to-day control of the syndicate".*

With respect to the author of the Guidance Note, there are problems with its observations and reasoning, including that:

(a) it contains numerous statements that are conclusory[2] and potentially misleading which obfuscate[3] both the modus operandi of horse racing schemes and the determining criteria of a managed investment scheme;

(b) the questions comprising the Checklist are inconsequential in determining whether a scheme satisfies the definition or falls outside of the scope of the definition. While "Yes" answers may be consistent with the scheme being a managed investment scheme, "No" answers do not necessarily lead to the conclusion that the scheme is not a managed investment scheme; and

(c) it DOES NOT explain how ALL the co-owners can retain day-to-day "control in fact" over the operation of a horse racing scheme by making ALL the decisions and implementing what is agreed, resulting in the scheme NOT being a managed investment scheme, WHEN the case law and the evidence clearly support the conclusion that:

  (i) such schemes are neither designed to operate that way in practice nor permitted to operate that way by the ARR[4]; and

  (ii) **the characteristics of a managed investment scheme are inherent in such schemes as they are both designed to operate in practice and required to operate by the ARR**.

With respect to RV, it is inviting trainers to make a statement articulating the way in which members retain "day-to-day control of the syndicate" that will likely be FALSE, as there is no apparent basis upon which it could

[1] Corporations Act 2001, including the ASIC Corporations (Horse Schemes) Instrument 2016/790.
[2] "Conclusory" means statements consisting of or containing conclusions or assertions for which no supporting evidence is offered.
[3] "Obfuscate" means to make something less clear and harder to understand.
[4] Australian Rules of Racing.

be true with the case law and the evidence clearly supporting the conclusion that such schemes are neither designed to operate that way in practice nor permitted to operate that way by the ARR.

Even if RV were to accept such a statement, this would NOT serve to either relieve the trainer from his or her obligation to comply with the law or enable the trainer to avoid the potential consequences of non-compliance.

Furthermore, RV's words quoted above [underlined] do not accurately reflect the wording of the third limb of the definition of a managed investment scheme, which states:

> *"(iii) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or give directions)".*

The same can be said of the words in the Guidance Note quoted below [underlined[5]].

Text, context, and purpose are fundamental to statutory interpretation. It is inappropriate to change the text or context of a statutory provision before attributing a meaning.

The precise wording of the definition is critical in determining its meaning, with the key words in the third limb of the definition being "day-to-day control", "operation" and "scheme", and the words in brackets serving as a **nonrestrictive modifier**[6] statement to the head statement that precedes it.

The Guidance Note provides the following observations and conclusions:

> "***Background to this note***":
>
> *[2] "It is important to understand that racing co-ownership arrangements are not "managed investment schemes (MIS) ipso facto ie; by itself alone. However, they may become a MIS in certain circumstances*".
>
> "***Day-to-day Control***"
>
> *"Co-ownership arrangements will not be a MIS (and therefore are not regulated) if the co-owners themselves retain control over the day-to-day operation of the syndicate".*
>
> "*In other words, co-owners must make, or have the "real" ability to make, the decisions relating to:*
>
> *(a) the horse's career, and*
>
> *(b) how the co-owners organize themselves*".
>
> *"Decisions about the horse's career"*
>
> *"These are decisions that can best be categorized as "racing"" and "racing related" activities. Examples include racing programs, interstate and overseas racing campaigns., gelding of an entire or the matter of retirement from racing".*
>
> *"Decisions that you would ordinarily make in your capacity as a trainer without consulting a horse's owners are not decisions relating to the racing scheme's operations. For example, decisions about the composition of the horse's feed or which shoes the horse should wear are decisions you, as the trainer, would make which do not need to be made in consultation with the horse's owners".*
>
> *"Other examples include decisions you are entitled to make without consulting the owners or a managing owner under clause 2 of Racing Australia's Standard Training Agreement (or any alternative equivalent training agreement)".*
>
> *"Decisions about the organization of co-owners"*
>
> *"Other day to day control decisions concern the legal relationship between co-owners. Decisions about who can be a co-owner, how, when and why money is paid and how co-owners formally relate to each other are examples of day-to-day control decisions concerned with the co-owner's legal relations".*

[5] Ibid.
[6] In other words, any right they (the members) may have to be consulted or give directions DOES NOT limit or restrict the legal meaning of the head statement.

"When do co-owners decide"

"Whether co-owners are able to make decisions is not just about what is said in the legal documents (e.g. the training agreement or con-ownership agreement). The co-owners must have actual control in practice, not merely on paper".

"Equally, Trainers are experts in their field (racehorse training). Co-owners can and should consult with trainers to benefit from trainer's advice on racing related decisions. This is no different to relying on the advice of a vet or another expert. Relying on a trainer's expert advice does <u>not</u> mean co-owners are not making decisions or that they lack day to day control".

"In short, co-owners are allowed to rely on a trainer's advice and trainers are able to give advice on racing decisions. What is important is that co-owners are able to make, and are responsible, for the decisions to rely on that advice".

"***Checklist***"

"This checklist is helpful in deciding whether a co-ownership arrangement you are involved in is a MIS or not. If you answer YES to <u>any</u> of these questions, the arrangement is likely to be an MIS promoted or managed by a trainer (with legal consequences for the trainer):

- *Do you in your capacity as a trainer singularly make the decisions about the horse or the horse's career?*
- *Do you in your capacity as a trainer make decisions about the ongoing operation of the syndicate – that is, how the co-owners organize themselves? For example, changing the terms of, or parties to, the co-ownership agreement or altering the financial arrangements between the co-owners?*
- *In practice, do the co-owners delegate all decisions about the horse's career or the ongoing operation of the syndicate to you as trainer or another person, such as a syndicate manager?*
- *Do you administer all the financial arrangements with the co-owners?"*

"If your co-owners delegate some but not all decisions about the horse's career or the ongoing operation of the syndicate to you as trainer or to another person, whether you are involved in a MIS will be a question of fact and degree. As a result, it is not possible to succinctly state a rule covering every scenario. If you are concerned you might be involved in a MIS you should seek legal advice".

The observations relating to the day-to-day control test:

(a) DO NOT make the necessary distinction between:

(i) the activities [and rights] of the individual co-owners (members) and those of the group [see ***ASIC v Chase Capital Management Pty Ltd***[7]*,* at *[67]*]; and

(ii) day-to-day "control in fact" and each of "the legal right to control" and "merely a right to participate in decision-making" [the existence of such rights in the members does not necessarily lead to the conclusion that the members have day-to-day "control in fact" over the operation of the scheme].

(b) include statements that:

(i) purport to exclude the services provided by the trainer under his or her Training Agreement from comprising aspects of the scheme's operations for the purposes of the day-to-day control test, WHEN the case law supports the conclusion that:

- "*all that the word 'scheme' requires is that there be 'some programme, or plan of action";* and
- "*…the scheme is the entire operation*";

as stated by *Owen J* in ***ASIC v Chase Capital***, at *[57]* and *[63]*; and

[7] (2001) 36 ACSR 778.

(ii) attempt to categorize the trainer as a mere "agent" who manages the property of each member individually or "investment professional" who simply provides advice to the members on enhancing the value of their own property without exercising control, WHEN the case law and the evidence support the conclusion that:

- the manager and the trainer are both clearly "operators" of the scheme who:
  - control and direct aspects of the scheme's operations on behalf of the members collectively;
  - manage as a whole the property of the group [the members' interests in common – the horse as a whole]; and
  - procure the services of other service providers such as veterinarians, farriers, jockeys, agisters and pre-trainers, etc.; and
- day-to-day "control in fact" over the operation of the scheme is exercised by the manager and the trainer, being the people who, as operators of the scheme, actually perform "*…the acts which constitute the management of or the carrying out of the activities which constitute the scheme*", as stated by *Justice Davies* in ***ASIC v Pegasus***[8]*,* at *[55].*

Also see the separate judgements in ***Burton v Arcus***[9] of *McClure JA* at *[2], [3]* and *[4],* and *Buss JA* at *[73], [74], [79], [80], [82]* and *[83]*; the ***FCA Handbook (UK) [2014]*** *– PERG 11.2* at *Q.4, Q.6* and *Q.12*; the separate judgements in ***Asset Land Investment PLC v FCA***[10] of *Lord Carnwath* at *[59], [60] and [62],* and *Lord Sumption* at *[91], [93], [94], [97], [99]* and *[102]*; and ***Racing NSW v Vasili***[11], at *[78]*].

"Scheme"

In ***ASIC v Takaran Pty Ltd***[12], *Barrett J* said:

> *[15] "The essence of a "scheme" is a coherent and defined purpose, in the form of a "programme" or "plan of action", coupled with a series of steps or course of conduct to effectuate the purpose and purse the programme or plan… Whatever is incidental and necessary to the pursuit of the profit (or "benefits") will therefore be comprehended by the scheme, …".*
>
> *[16] "It must also be emphasized that a scheme having the characteristics bringing it within the s9 definition of "managed investment scheme" will not necessarily possess those characteristics alone. … A managed investment scheme … may involve elements beyond the core attributes that give it its essential character. Elements which lie beyond those attributes but contribute to the coherence and completeness which make a "programme" or "plan of action" must form part of that "scheme". Every programme or plan of action must be taken to include the logical incidents of and consequences of and sequels to its acknowledged components".*

"Operate"

In ***ASIC v Pegasus****, Justice Davies* said:

> *[55] "The word "operate" is an ordinary word of the English language and, in the context, should be given its meaning in ordinary parlance. The term is not used to refer to ownership or proprietorship but rather to the acts which constitute the management of or the carrying out of the activities which constitute the managed investment scheme. …".*
>
> *[56] "I have concluded that Mr McKim operated the managed investment scheme. He was the living person who formulated and directed the scheme and he was actively involved in its day to day operations. He supervised others in their performance. I have also concluded that Mr McKim is not exempted by s601ED(6). He did not "merely" act as the agent or employee of the Pegasus. He was the directing mind and will of Pegasus and of the scheme".*

"Day-to-day control"

[8] [2002] NSWSC 310.
[9] Appeal Judgement) [2006] WASCA 00071.
[10] [2016] UKSC 17. On appeal from: [2014] EWCA Civ 435. Unlike Australia, the Supreme Court is the final court of appeal for civil cases in the UK.
[11] Racing Appeals Tribunal NSW 12 June 2019
[12] [2003] 1 Qd R 135 at 146.

In ***ASIC v Chase Capital***[13], *Owen J* said:

> *[67] "… The question is whether the members have day-to-day control. It is not difficult to discern the distinction that the legislature was attempting to make. Very broadly, it is between the investment activities of an individual and that of a group. By the express terms of the applications, the investors have delegated "management" of the investment to CCML. There is no reservation of day-to-day or any other control or functions. I am not sure that the appointment of a committee of some of the investors to monitor the investments would make much difference. The question still remains: who has the day-to-day control".*

In ***Enviro Systems Renewable Resources Pty Ltd v Australian Securities & Investments Commission***[14], *Martin J* said:

> *[36] "In my opinion, when the scheme documentation is analysed in its entirety, the intent of the scheme is that Enviro will control the day-to-day operations of the scheme from beginning to end. Enviro offers a total package which is presented in such a way that potential participants are encouraged to take up the entire package. Notwithstanding the assertions that participants will be running their own businesses. Enviro does not intend that the participants should take an active role in the day-to-day operations of any aspect of the scheme. The success or otherwise of the scheme is entirely dependent upon Enviro. In reality, although it is possible that some participants may choose to take an active role, the scheme is designed to attract passive investors".*
>
> *[37] "The purpose or object of the legislation and the regulatory regime created pursuant to the legislation would be easily defeated if the court felt obliged to rely solely upon a strict view of the legal rights and duties created by the documentation and was required to ignore the realities of the scheme as it was designed to operate in practice".*

In ***ASIC v IP Product Management Group Pty Ltd***[15], *Byrne J* said:

> *[22] "It will be recalled that under paragraph (iii) the existence of a right in a member to be consulted or to give directions as to the operation of the scheme does not necessarily lead to the conclusion that that member has day-to-day control over its operation. The law contemplates, therefore, some greater involvement".*

In ***Burton v Arcus****:*

> *McClure JA* said:
>
> *[2] "I have had the advantage of reading the judgement of Buss JA. I agree that the appeal should be upheld for the reasons he gives. I propose to make some additional observations on the third limb of the definition of managed investment scheme, namely whether the members had day-to-day control over the operation of the scheme. This limb of the definition links the prohibition in s601ED(5) and the relief (winding up) in s601EE of the Corporations Act 2001(Cth). Under s601ED(5) a person must not operate a managed investment scheme unless it is registered. If a person operates an unregistered managed investment scheme, that scheme can be wound up under s601EE. The word "operate" in the context of s601ED(5) and s601EE is to be given its ordinary meaning. The term is not used to refer to ownership or proprietorship but rather to acts that constitute the management of or the carrying out of the activities comprising the managed investment scheme: see* ***Australian Securities and Investments Commission v Pegasus Leveraged Options Group Pty Ltd (2002) 41 ACSR 561 at 574****".*
>
> *[4] "A managed investment scheme must be registered prior to commencement of the operation of the scheme. The phrase "day-to-day" means routine, ordinary, everyday management or operational decisions. I am of the view that the term "control" in the definition means authority to decide and direct and not merely to participate in decision-making".*
>
> *Buss JA* said:
>
> *[82] "In my opinion, the circumstance that the promoter or operator of a scheme manages the scheme (or certain aspects of it) on behalf of the members does not mean that the members by their agent, the promoter or operator, have day-to-day control in fact over the operation of the scheme. In other words, the management activities of the promoter or operator in relation to a scheme are not to be imputed to the members in determining whether the members have such day-to-day control".*

[13] (2001) 36 ACSR 778.
[14] [2001] SASC 11.
[15] (2002) 42 ACSR 343.

[83] "My construction of the third element in para (a) of the definition gives effect to the evident legislative purpose or object embodied in the definition and Ch 5C. If:

(a) the third element in para (a) of the definition was concerned with the legal right to control and not control in fact; or

(b) the management activities of the promoter or operator in relation to the scheme were to be imputed to the members in evaluating whether the third element was satisfied or not, with the consequence that if the promoter or operator had "day-to-day control over the operation of the scheme" then the members, by their agent, the promoter or operator, would have day-to-day control,

the legislative framework for the regulation of managed investment schemes would be seriously, if not entirely, eroded".

In the UK Supreme Court case of ***Asset Land v FCA***, the approach adopted by *Lord Sumption* in that part of his judgement dealing with determining "*day-to-day control over the management of the property*" makes it clear that the objective assessment is temporarily limited to the point in time when the arrangements are made.

The relevant aspects of the case centered in the meaning of "*day-to-day control over the management of the property*" under the *Financial Services and Markets Act 2000 (UK), (FSMA)*, which is the UK equivalent of the Australian legislation.

The case involved a land-banking arrangement pursuant to which the appellant company *Asset Land Investments Plc (AL)* acquired greenfield sites and sold them to investors in small parcels (plots). Despite various disclaimers in the documents, there was a clear understanding between AL and the investors that:

(a) AL would:

(i) move to have the whole property rezoned for housing development; and

(ii) [when that was done] would arrange for a developer to buy the whole property; and

(b) each investor would then receive a share of the profit from the sale of the property assuming it would be worth more than the prices they paid for their plots.

AL argued that the arrangements were not a collective investment scheme. However, the court held that AL was operating such a scheme.

In their separate judgements in ***Asset Land***, *Lords Carnwath and Sumption* take the opportunity to consider the statutory definition of a collective investment scheme and proffer some significant guidance of general application of the definition going forward.

Lord Carnwath said:

[59] "Have … control in subsection (2) is not a technical term … it must be taken to refer to 'the reality' of how the arrangements are to be operated, which may or may not involve rights or powers enforceable in law … The FCA'S guidance (PERG 11.2) draws the correct contrast:

> *"If the substance is that each investor is investing in a property whose management will be under his control, the arrangements should not be regarded as a collective investment scheme. On the other hand, if the substance is that each investor is getting rights under a scheme that provides for someone else to manage the property, the arrangements would be regarded as a collective investment scheme".*

[60] "The judge found that the facts of the present case brought it within the FCA's second category. He was entitled to do so … Their ability as individual owners to determine ultimately whether or not to participate in a sale cannot be equated with control of its management in the meantime. In any event as the judge found, it would make no sense for them in practice to opt out of the realization of the profit which was the only purpose for the arrangements".

[62] "Conversely, turning to subsection (3)(b), under the arrangements as found by the judge control of the management activities for the property as a whole lay with the company. It was acting as the operator of the scheme, not as mere managing agent for the individual owners. It is true that its control was not underpinned by any legal rights over the units making up the property. That did not affect the

substance of the arrangements, even if it might have been an obstacle to their effective implementation…".

Lord Sumption said:

> *[94] "'Control' of property means the ability to decide what is to happen to it … that does not only mean the legal ability to decide. It extends to a case where arrangements are such that the investor will in practice be able to do so. But the critical point is that the absence of day-to-day control in subsection (2) has to be a feature of the arrangements. This is necessarily prospective, viewed from the time when the arrangements are made. Either those arrangements confer or allow control on the part of the investors or they do not. The test cannot depend on what happens after the arrangements have been made. Nor would a test based on the actual exercise of control be realistic. Some kinds of property require little or nothing by way of management. Some situations do not require any exercise of management control. The question must necessarily be in whom would control be vested were control to be required…".*
>
> *[97] "Subsection (3)(b) provides that what has to be 'managed as a whole' is the property the subject of the scheme, not the scheme itself so far as that is different".*
>
> *[99] "The fundamental distinction which underlies the whole of section 235 is between (i) cases where the investor retains entire control of the property and simply employs the services of an investment professional (who may or may not be the person from whom he acquired it) to enhance value; and (ii) cases where he and the other investors surrender control over their property to the operator of the scheme so that it can be either pooled or managed in common, in return for a share of the profits generated by the collective fund …".*
>
> *[102] "On which side of the line does this case fall? In strictly legal terms, the three core representations did not call for any surrender of control over the plots to an investment intermediary. On the contrary, each investor remained the entire owner and sole controller of his plot and simply counted on Asset Land to enhance its value and find him a buyer. But the transaction cannot be viewed only in legal terms and the judge found that the practical consequences of the arrangement went wider that the express terms of the three core representations. He discounted the significance of the investors 'legal right to dispose of their plots as they pleased, because he considered that the arrangement embodied in the core representations could not work if the investors exercised the rights they theoretically possessed: see paras 162, 169 of his judgement. The dominion of the investors over their plots, although apparently complete, was in reality an illusion … On that ground … I agree that the schemes with which we are concerned are collective investment schemes".*

<u>The activities that constitute the act of "training" a racehorse and the person in "control" of those activities</u>

The only industry specific case law found by the writer that provides authoritative guidance in relation to these characteristics inherent in horse racing schemes is the decision of *Mr. D.B. Armati* in ***Racing NSW v Vasili*** and the two Racing Appeal Authority Queensland cases referred to in that decision. The case involved charges that were the subject of prior hearings against licensed trainer *Mr Con Karakatsanis* and registered owner *Mr Angelis Vasili*, it being determined that *Mr. Vasilis* was in fact the trainer of various horses owned by him when he was not the holder of a current trainer's licence and that he improperly held licensed trainer *Mr. Karakatsanis* out to be the trainer of those horses. In his judgement, *Mr. Armati* referred to two Queensland decisions which were referenced in submissions in the following terms:

> *[78] "…The Appeal Panel referred to these cases in the following terms:*
>
> > *"21 …Racing Appeal Authority Queensland … The appeal of Mrs Julie Nash, a decision handed down 8 January 2001, the Authority described training in the following way:*
> >
> > *"There is no single action that provides and defines the concept of training a racehorse. Training encompasses a range of tasks that collectively make up the practice of training a thoroughbred. These include feeding, grooming, caring, stabling, treating, exercising, setting trackwork regimes, assessment of form, nominating, accepting and an increasing list of singular minor tasks. A trainer that participates in all the tasks can, when considered collectively, make up the practice of training".*
> >
> > *"22 …Racing Appeal Authority in the Appeal of Robert Heathcote, delivered on 18 June 2002:*
> >
> > *"As has been commented on above, there are numerous tasks which make up the training of a racehorse. To these should be added that the essential matter which relates to who is the person training a racehorse, is who is the person in "control" of the horse. The meaning of "control" in*

this context is simply not the physical control of the horse but who has the dominance in those non-exhaustive activities referred to in the decision of Nash that make up the act of training".

Conclusion

There are significant inconsistencies, highlighted above, between the Guidance Note and the comprehensive analysis of the same subject-matter set out in ***Part 1*** and ***Appendix C*** of the paper titled: *"**The regulatory regime governing the syndication of thoroughbred horses**"* published by this firm. Our analysis in that paper is relied upon to resolve the inconsistencies.

The following observations and conclusion are based on our analysis.

The managed investment scheme regulatory regime is embedded within the Corporations Act 2001.

It is a set of compliance rules for unincorporated arrangements (schemes) involving collective investment established by a person (promoter[16]) raising funds from investors which are then applied and managed by the operator of the scheme on behalf of the members as a group.

The purpose of the rules is to ensure minimum standards of investor protection in relation to the establishment and operation of such schemes.

The determining criteria of a managed investment scheme can only be the legislated definition of a managed investment scheme complimented by the principles established by the case law, objectively applied.

"Managed investment scheme" is defined in section 9 as:

> *"(a) a scheme that has the following features:*
>
> *(i) people contribute money or money's worth as consideration to acquire rights ("interests") to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not);*
>
> *(ii) any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the "members") who hold interests in the scheme (whether or not as contributors to the scheme or as people who have acquired interests from holders);*
>
> *(iii) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or give directions); …".*

The definition is deliberately wide and all-embracing and designed to catch virtually all arrangements targeting collective investment. It would by itself catch virtually all business models and structures, including **co-ownership**, **partnership**, and **unit trust**-based arrangements.

The analysis of a scheme to determine if it satisfies or falls outside the scope of the definition requires that consideration be given to:

(a) all its key elements, including:

(i) legal structure;

(ii) the nature of the members interests [contributions and rights to benefits]; and

(iii) modus operandi [the realities of how it is designed to operate in practice];

(b) the scheme as being the entire operation [all the activities carried out in relation to the scheme as comprising the scheme's operations]; and

(c) the necessary distinction between:

(i) the activities [and rights] of the individual members and those of the group; and

(ii) day-to-day "control in fact" and each of "the legal right to control" and "merely a right to participate in decision-making" [the existence of such rights in the members does not necessarily

[16] The promoter test is in section 601ED(1)(b)

lead to the conclusion that the members have day-to-day "control in fact" over the operation of the scheme].

The fundamental distinction which underlies the whole of the definition is between:

(a) schemes where ALL the members have day-to-day control over the operation of the scheme by making ALL the decisions and implementing what is agreed; and

(b) schemes where the members contributions are either:

(i) pooled for use as the property of the scheme; or

(ii) not pooled but used in a common enterprise that constitutes the scheme;

with the day-to-day [routine, ordinary, everyday] activities of the scheme being managed or carried out by a person who is an operator of the scheme on behalf of the members collectively, (whether or not they have the right to be consulted or give directions).

The objective assessment in determining day-to-day control is necessarily prospective, viewed from the time when the arrangements are made.

The day-to-day control test is not about ownership or proprietorship, or the legal right to control of the scheme.

- The purpose of the day-to-day control test is to make an important distinction about the nature of the investment each member of the scheme is making.

- If the substance is that ALL the members have day-to-day "control in fact" over the operation of the scheme by making ALL the decisions and implementing what is agreed [actually managing or carrying out the routine, ordinary, everyday activities that comprise the scheme's operations], then the scheme WILL NOT be a managed investment scheme.

- However, if the substance is that the members contributions are either pooled for use as the property of the scheme, or not pooled but used in a common enterprise that constitutes the scheme, to produce financial benefits, or benefits consisting of rights or interests in property, and the members collectively appoint a person to operate the scheme [with the authority to actually manage or carry-out the routine, ordinary, everyday activities that comprise the scheme's operations] on behalf of the group, then the scheme WILL be a managed investment scheme (whether or not they have the right to be consulted or give directions).

- It is a negative test in the sense that for the arrangements to be a managed investment scheme they must be such that the members DO NOT have day-to-day "control in fact" over the operation of the scheme, prospectively viewed from the time when the arrangements are made.

The day-to-day control test includes consideration as to whether a person who provides management services in relation to the property is either:

(a) a mere "agent" who manages the property of each member individually or "investment professional" who simply provides advice to the members on enhancing the value of their own property without exercising control; or

(b) an "operator" of the scheme who manages as a whole the property of the group.

The management activities of a person who is the "promoter" or "operator" ARE NOT to be imputed to the members in determining whether the members have day-to-day control over the operation of the scheme.

If the key elements of a scheme satisfy the definition, then its establishment and operation will likely be subject to regulation, EXCEPT if it qualifies as a "private" scheme. To qualify as a "private" scheme it MUST NOT require registration under section 601ED. In other words, it MUST NOT have more than 20 members and the person who established it MUST NOT be [a promoter[17]] in the business of dealing in interests in such schemes.

Horse racing schemes

Horse racing schemes generally [by practical necessity and in order to comply with the ARR] are sufficiently uniform in their key elements to justify the conclusion that ALL arrangements between 2 or more people (members) to own or lease a racehorse for the purpose of participating in the undertaking of maintaining,

[17] The "promoter" test is in section 601ED(1)(b).

training and racing it [the horse as a whole] for their mutual benefit will, prima facie, satisfy the definition of a managed investment scheme.

The key elements that satisfy the definition are:

(a) the members contributions [of money or money's worth] are either:

(i) pooled for use as the property of the scheme [typical of **partnership** or **unit trust**-based "investment" arrangements]; or

(ii) not pooled but used in a common enterprise that constitutes the scheme [typical of **co-ownership** contract-based "enterprise" arrangements];

to produce financial benefits, or benefits consisting of rights or interests in property;

(b) the scheme is operated by a manager and a licensed trainer on behalf of the members collectively; and

(c) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or give directions).

The realities of horse racing schemes [typically **co-ownership** arrangements] as they are designed to operate in practice are:

(a) the members contribute to the common enterprise that constitutes the scheme:

(i) the right to use their individual interests in the horse in the operation of the common enterprise; and

(ii) money [in the same proportions as the interests held] to pay operating expenses, including horse expenses;

to facilitate their interests being managed in common [the horse as a whole] for the benefit of the group;

(b) each member's rights to benefits produced by the scheme include the rights to:

(i) participate as a member of the scheme in racing the horse as whole for the benefit of the group [a benefit derived as the holder of rights or interests in property]; and

(ii) receive distributions of any income (net prize money) earned, in the same proportion as the interest held [a financial benefit produced by the scheme];

(c) each member's interest in the property of the group [the horse as a whole] which is the subject of the scheme's operations, not the scheme itself so far as that is different, from an operational perspective, is inseparable from the interests of the other members; and

(d) the right of the members to manage their interests individually is:

(i) subordinated to the rights of the members collectively and the authority of the manager and the trainer [with actual possession and control of the horse as a whole] to operate the scheme on behalf of the group; and

(ii) limited to voting on those matters specified in the relevant Owners Agreement or Training Agreement as requiring the members' approval (by the requisite majority).

See the *Australian Rules of Racing* (**ARR**), particularly AR.63 - Manager and AR.61 – Trainer; *Schedule 2 – Trainer and Owner Reform Rules* (**TOR Rules**) and the provisions of the *TOR Co-owners Agreement* (**TOR COA**) [particularly clauses 3.4, 3.5 and 3.9] and the *TOR Standard Training Agreement* (**TOR STA**) [particularly clause 2.9]; and *Schedule 3 – Syndicate Rules* (**SR**). These documents are available at www.racingaustralia.horse .

The manager and the trainer are both clearly "operators" of the scheme who:

(a) control and direct aspects of the scheme's operations on behalf of the members collectively;

(b) manage as a whole the property of the group [the members' individual interests in common – the horse as a whole]; and

(c) procure the services of other service providers such as veterinarians, farriers, jockeys, agisters and pre-trainers, etc.

Neither of them is a mere "agent" who manages the property of each member individually or "investment professional" who simply provides advice to the members on enhancing the value of their own property without exercising control.

Accordingly, day-to-day "control in fact" over the operation of the scheme devolves to the manager and the trainer, being the people who, as the operators of the scheme, actually perform "*… the acts which constitute the management of or the carrying out of the activities which constitute the scheme*" [see ***ASIC v Pegasus Leasing***, at *[55]*].

Conversely, ALL the members DO NOT have day-to-day "control in fact" over the operation of the scheme, prospectively viewed from the time when the arrangements are made. Practical necessity and the ARR require that the members:

(a) agree (by the requisite majority):

(i) to appoint a person (manager) to control and direct aspects of the scheme's operations, including those relating to its legal structure and administration, dealings with racing officialdom, the trainer and other service providers, as required, on behalf of the group [in accordance with the ARR and the terms of the TOR COA or other agreement adopted by the members]; and

(ii) to the manager on behalf of the group appointing a licensed trainer, [including agreeing to the terms of the Trainer's Training Agreement and Fees Notice], to take actual possession and control of the horse as a whole for the purpose of managing or carrying out those activities that collectively comprise the act of training a racehorse [in accordance with the ARR and the terms of the TOR STA or other agreement adopted by the parties]; and

delegate to them the authority to operate the scheme on behalf of the group; and

(b) surrender day-to-day control over their individual interests to the manager and the trainer so that those people can manage the members' interests in common [the horse as a whole] for the benefit of the group, (whether or not they have the right to be consulted or give directions).

However, a scheme may not possess these characteristics alone. The fact that it may also possess other characteristics, including terms that provide for the members to:

(a) pay their contributions towards operating expenses directly* to the relevant service providers [proportionate direct invoicing and payment of fees and expenses];

(b) be paid their distributions of any income (prize money) directly* via the stakes payment system;

[*an alternative to the manager administering these arrangements via a designated scheme bank account] or

(c) participate in decision-making in accordance with the procedure (and requisite majority) set out in the applicable Owners Agreement or Training Agreement;

does not take it outside the scope of the definition.

Notes:

1. *It is not significant to this analysis:*
   - *(a) whether the manager and the trainer are the same person or different people;*
   - *(b) whether the members acquired their individual interests from either the manager or the trainer, or another person; or*
   - *(c) whether or not the members are required to pay a fee to the manager for performing the manager's duties.*
2. *In the case of schemes established by promoters dealing in shares/interests it is common for the promoter or nominee to also be the manager [even if the promoter is not a member of the scheme].*
   - *In such cases, the first-named registered owner may be the manager in name only, with the promoter or nominee controlling and directing "in fact" those aspects of the scheme's operations that are the manager's responsibility under the relevant Owners Agreement and the ARR. This is often the case with schemes established by licensed trainers acting as promoters.*
   - *It is also possible for a person outside of the ownership group who is the manager to be recorded as the first-named registered owner with "nil" equity and the other registered owners as owning "100%" of the horse. This is often the case with schemes established by promoters who are unrelated to the trainer to give them an ongoing commercial profile with the horse during its racing career.*
3. *The following observation is quoted from an advice provided by Mr Hartnell to MLP in 2014: "As a practical matter, circumstances where the members appoint a 'manager' who they are not required to pay and the 'manager' must consult the members 'before making significant decisions' may still be consistent with the members not having day-to-day control". In other words, the fact that the manager may not be entitled to remuneration and must consult the members before making significant decisions does not necessarily lead to the conclusion that the scheme is not a managed investment scheme.*

Furthermore, while the Owners Agreement and Training Agreement [both now mandatory under the TOR Rules] set out various powers and duties of the manager and the trainer AND specify that certain decisions cannot be taken by the manager or the trainer without the approval of the members [by the requisite majority] [e.g. change of trainer, gelding, relocation of the horse to race in another jurisdiction, race entry fee above a specified amount, veterinary treatment above a specified amount, etc.], this DOES NOT equate to the members having control over the management of the scheme in the meantime [see ***Asset Land v FCA***, at *[59], [60]* and *[62]*]. There are usually few, if any, other restrictions on the authority of either the manager or the trainer to operate the scheme.

The Owners Agreement or Training Agreement may also include terms that:

(a) empower the manager or the trainer to pursue remedies against a member who is in breach of a payment obligation; or

(b) restrict the members in dealing with their individual interests in the horse or require the sale of the horse as a whole if the members agree (by the requisite majority) that the horse be sold.

The case law and the evidence clearly support the conclusion that the characteristics of a managed investment scheme are inherent in horse racing schemes as they are both designed to operate in practice and required to operate by the ARR. Consequently, there is no apparent basis upon which any person, including a licensed trainer, who is "a promoter" in the business of establishing or operating such schemes, could successfully argue [in any legal forum] that the resultant schemes are outside the scope of the definition. Any such argument would likely be an artificial construction of the arrangements to avoid the legislative intention of the statutory provisions.

The need for ALL the members to exercise day-to-day control over the operation of the scheme by making ALL the decisions and implementing what is agreed would be impractical and a significant impediment to the operation of the scheme which is only overcome by the members:

(a) appointing a manager and a licensed trainer [with actual possession and control of the horse as a whole]; and

(b) delegating to them the authority to operate aspects of the scheme on behalf of the members collectively.

This conclusion is consistent with the opinion of ASIC set out in RG 91[18]:

> *[RG 91.26] "A horse racing syndicate is an arrangement under which a group of people agree to contribute money in return for a share of prize money won by a racehorse. The syndicate members may contribute money to obtain a percentage ownership stake in the racehorse, or the owner of the racehorse may lease the racehorse to the operator of the syndicate. Sometimes, other benefits are available to members of a syndicate, such as an entitlement to attend social events."*
>
> *[RG 91.27] "Generally, a horse racing syndicate will be a managed investment scheme under s9 of the Corporations Act. ASIC Corporations (Horse Schemes) Instrument 2016/790 provides conditional relief to the promoter and manager of a small-scale horse racing syndicate from the requirement to register the syndicate under the managed investment provisions in Ch 5C of the Corporations Act."*

To be eligible for the relief the promoter of the scheme must comply with the terms of the ASIC Instrument.

Risk to unlicensed promoters of small-scale schemes

A person MUST NOT carry on a business [as a promoter] dealing in interests in such schemes, without being:

(a) a licensed promoter or authorized representative of a licensee; and

(b) an approved promoter[19] or approved authorized representative of a lead regulator[20].

[18] Explanatory Memorandum for ASIC Corporations (Horse Schemes) Instrument 2016/790 issued on 26/08/2016.
[19] A definition of promoter was added to the Australian Rules of Racing (AR) in 2002 along with AR69P, following the issuing by ASIC of Class Order 02/319 [Horse racing]. In 2019 AR69P was renumbered and repositioned as SR9. In August 2020 Racing NSW further amended the Australian Rules of Racing renumbering and repositioning SR9 (with some amendments) as LR53A and added an additional local rule as LR53. LR53 continues to reference AR69P [which is now SR9] and LR53A continues to reference ASIC Class Order 02/319 [which was replaced by ASIC Corporations (Horse Schemes) Instrument 2016/790 on 25/08/2016].
[20] Racing NSW, Racing Victoria, Racing Qld Board, Racing SA Ltd, Racing and Wagering Western Australia, Tasracing Pty Ltd, Thoroughbred Racing NT, Canberra Racing Club Incorporated.

To do so would be illegal and contravene the ARR.

Unlicensed promoters are exposing themselves to not only the risk of incurring penalties for breaches of the law and the ARR, but also the risk of:

(a) ASIC, the manager, or a member of the scheme, applying to the court for an order requiring the winding up of the scheme[21] because it was established and is being operated illegally; and

(b) investors exercising their statutory rights to declare void the agreements pursuant to which they acquired their interests[22] and claim compensation[23] for any financial loss [initial share price and all ongoing contributions to expenses] resulting from the investment.

This statutory right to compensation is available to investors for a period of six years from the date of the initial investment.

The fact that in most cases these promoters DO NOT have unencumbered ownership of the horses in which they are offering interests, [having acquired them at auction for the purpose of syndication utilizing either credit facilities offered by the sales companies or vendor terms], and ARE NOT using a lead regulator approved PDS and designated application moneys trust account until the subject share offer is fully subscribed and the horse paid for adds to the seriousness of the problem, and also represents a significant additional risk to investors which does not arise when promoters comply with the regulations.

Furthermore, it will likely be:

(a) false and misleading for an unlicensed promoter [and possibly also a dishonest or improper action under the ARR[24] for a licensed trainer] to represent to:

  (i) RV (in its dual capacity as Principal Racing Authority and lead regulator); or

  (ii) potential investors;

  that the investors will, as members of the scheme, have day-to-day control over the operation of the scheme, or the horse that is the subject of the scheme's operations, when the scheme is neither designed to operate that way in practice nor permitted to operate that way by the ARR; and

(b) misleading and deceptive conduct, or unconscionable conduct, under the *Australian Securities and Investments Commission Act 2001* for an unlicensed promoter to:

  (i) purport to sell interests in a horse the promoter does not own (at the time when the investors agree to purchase and pay for their interests);

  (ii) promote investment in a product that is being offered or will operate illegally; or

  (iii) represent to potential investors that, as members of the scheme, they will have day-to-day control over the operation of the scheme, or the horse that is the subject of the scheme's operations, when the scheme is neither designed to operate that way in practice nor permitted to operate that way by the ARR.

Macquarie Legal Practice
Tony Fleiter – Principal
Tel: 02 9235 2500
Email: tony.fleiter@maclegal.com.au

For a more detailed analysis of this subject-matter see Part 1 and Appendix C of paper titled: *"**The regulatory regime governing the syndication of thoroughbred racehorses**",* at www.racehorseownership.com or www.maclegal.com.au .

A version of that paper with links to all cases and other documents cited in it is also available at www.racehorseownership.com .

[21] section 601EE of the Corporations Act.
[22] section 601MB of the Corporations Act.
[23] section 1325 of the Corporations Act.
[24] AR229(1)(a)