MACQUARIE LEGAL PRACTICE

HORSE RACING SCHEMES ARE SUBJECT TO REGULATION AS MANAGED INVESTMENT SCHEMES

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

2. It is comprised of a set of compliance rules for unincorporated arrangements (schemes) involving collective investment resulting from a person (promoter[1]) raising funds from investors which are then applied and managed by the operator of the scheme on behalf of the members as a group.

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

The Definition

4. 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.

5. The term "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); …".*

6. 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.

7. 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 the scheme is designed to operate in practice);

   (b) the scheme as being the entire operation [all the activities of the scheme as comprising scheme operations]; and

   (c) the necessary distinction between:

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

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

(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].

8. The fundamental distinction which underlies the whole of the definition of a managed investment scheme 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; or

(ii) used in a common enterprise;

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 as a group, (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.

9. 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 the 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" control 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 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.

10. The day-to-day control test also 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.

11. 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.

12. 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] in the business of dealing in interests in such schemes.

Horse racing syndicates

13. Horse racing schemes generally [by practical necessity and to comply with the Australian Rules of Racing (ARR)] are sufficiently similar in their key elements to justify the conclusion that any programme or plan of action formulated by a person for the purpose of 2 or more people acquiring a thoroughbred horse and using it for racing, [including the ancillary arrangements necessary for achieving that purpose] will, prima facie, satisfy the definition of a managed investment scheme.

14. The key elements that satisfy the definition are:

    (a) one or some of the members contributions are either:

        (i) pooled [typical of **partnership*** or **unit trust***-based "investment" arrangements]; or

        (ii) used in a common enterprise [typical of **co-ownership*** contract-based "common 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).

15. **Co-ownership** is the most common legal form of racehorse ownership involving 2 or more people. A horse racing scheme based on **co-ownership** inevitably involves the joint participation by all the co-owners, as tenants-in-common, in a commercial enterprise for the common purpose of using the horse "as a whole" for racing with the objective of earning income (winning prize money), and hence is a **common enterprise** (scheme).

16. The realities of horse racing schemes that are **co-ownership** contract-based "**common enterprise**" arrangements, as they are designed to operate in practice, are:

    (1) People acquire from the promoter/operator (or other holder of an ownership interest) proportionate ownership interests in a thoroughbred horse, as tenants-in-common, for the purpose of using it for racing on the basis that they will:

        (a) assume various obligations, including to contribute:

            (i) the right to use their individual ownership interests in the horse in a common enterprise (scheme) to enable the ownership interests of <u>all</u> tenants-in-common comprising the horse "as a whole" to be managed by a person as the "operator" of the scheme on behalf of the group; and

            (ii) money (on an ongoing basis) towards the scheme's operating expenses, in the same proportions as the ownership interests held [Clauses 3.3, 7.1 and 7.2 of the **TOR COA**];

            as consideration to acquire rights (interests) to benefits produced by the scheme; and

        (b) acquire rights (interests) to benefits produced by the scheme, including to:

            (i) participate as members of the scheme in racing the horse "as whole" for the benefit of the group [benefits derived as the holders of rights or interests in property]; and

            (ii) receive any income (net prize money) earned, in the same proportions as the interests held [a financial benefit produced by the scheme]. [Clause 3.2 of the **TOR COA**].

    (2) The contributions by <u>all</u> tenants-in-common of the right to use their individual ownership interests in the scheme's operations, and the legally binding contractual promise to contribute money (on an ongoing basis) towards the scheme's operating expenses, in the same proportions as the ownership interests held, as consideration to acquire rights (interests) to benefits produced by the scheme, while not money, are of **money's worth**, and a "fair equivalent" of what is received.

    (3) 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 the horse "as a whole", and incapable of being separately managed.

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

(a) 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

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

17. 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 .

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

(a) control 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.

19. 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.

20. 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 operators of the scheme, actually perform "… ***the acts which constitute the management of or the carrying out of the activities which constitute the scheme***" [***ASIC v Pegasus***[2] *[55]*]. Also see ***Burton v Arcus***[3] *[2], [4], [79], [82],* and *[83]*, which cites with approval ***ASIC v Pegasus*** and provides additional authoritative guidance in relation to the application of the principle of "control in fact" when determining the meaning of day-to-day control within the context of the third limb of the definition; ***Stewart v Spicer Thoroughbreds Pty Ltd***[4] *[24], [29]* and *[45];* and ***Racing NSW v Vasili***[5].

21. Conversely, <u>all</u> the members <u>do not</u> have day-to-day control over the operation of the scheme, prospectively viewed from time when the arrangement is made. Practical necessity and the ARR require, including the TOR Rules, that the members:

(a) agree to:

(i) appoint a person (manager) to control 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) 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).

[2] [2002] NSWSC 310.
[3] (Appeal Judgement) [2006] WASCA 0071. Also see (Original Decision) [2004] WASC 244.
[4] [2022] NSWSC 558.
[5] Racing Appeals Tribunal NSW 12 June 2019.

22. However, a scheme may not possess these characteristics alone. The fact that it may also possess other characteristics such as terms which 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 [see ***ASIC v Chase Capital***[6] *[57]* and *[63]*, and ***ASIC v Takaran Pty Ltd***[7] *[15]* and *[16]*].

Notes:

1. *Generally, when an offer of interests is made in a thoroughbred horse being syndicated for racing the following arrangements are predetermined by the offeror/promoter and understood by the investors:*
   - *(a) the nature of the legal relationship between the parties, as this defines the nature of the investors' interests being acquired in the horse and the scheme, and to a significant extent the modus operandi of the scheme; and*
   - *(b) the first appointees as manager and trainer.*
   - *(c) the members:*
     - *(i) liability to perform obligations, including to contribute the right to use their individual ownership interests in the horse in a common enterprise (scheme), so that the manager, as an operator of the scheme, can manage <u>all</u> their ownership interests in common [the horse "as a whole"] on behalf of the group; and money (on an ongoing basis) towards the scheme's operating expenses, in the same proportions as the ownership interests held; as consideration to acquire rights (interests) to benefits produced by the scheme; and*
     - *(ii) rights (interests) to benefits produced by the scheme, including to participate as members of the scheme for the purpose of using the horse "as a whole" for racing with the objective of earning income for the benefit of the group; and receive any income (net prize money) earned, in the same proportions as the ownership interests held;*

   are contractual and apply from the time when the ownership interests in the horse are transferred to the members; and
2. *In the case of a scheme formulated as a co-ownership contract-based "common enterprise" arrangement:*
   - *(a) the establishment of the scheme is, in practice, inextricably linked to and happens, as of right, simultaneously with the transfer of the interests in the horse from the offeror/promoter to the investors;*
   - *(b) the members:*
     - *(i) liability to perform obligations, including to contribute their individual ownership interests in the horse to be used in a common enterprise (scheme) to enable the ownership interests of <u>all</u> tenants-in-common to be managed as a scheme [as consideration to acquire rights (interests) to benefits produced by the scheme]; and*
     - *(ii) rights (interests) to benefits produced by the scheme, including to participate as members of the scheme for the purpose of using the horse "as a whole" for racing with the objective of earning income for the benefit of the group; and receive any income (net prize money] earned, in the same proportions as the interests held;*

     are contractual and apply from the time when the interests in the horse are transferred; 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), prospectively viewed from the time when the arrangements are made.*
3. *Accordingly, the acquisition of interests by co-owners in a thoroughbred horse being syndicated for racing is an offer and acquisition of interests in a managed investment scheme [**Stewart v Spicer Thoroughbreds Pty Ltd**[8] [24], [29]* and *[45]] in the same way as the acquisition of units by limited partners was found to be an offer and acquisition of interests in a managed investment scheme in **ASIC v McNamara**[9] [16]* and *[17] and [22].*
4. *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.*
5. *The promoter or nominee will generally also be the manager [even if the promoter does not retain an interest in the horse].*
   - *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.*

22. 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 <u>does not</u> equate to the members having control over the management of the scheme in the meantime [see judgement of *Lord Carnwath* in ***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.

[6] (2001) 36 ACSR 778.
[7] [2003] 1Qd R 135 at 146 [17].
[8] Ibid, n 4, p 4.
[9] [2002] FCA 1005.

23. The Owners Agreement or Training Agreement will likely 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 empower the manager to sell or otherwise dispose of the horse "as a whole" if the members agree (by the requisite majority) that the horse be sold or transferred.

24. **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 a misrepresentation of the arrangements to avoid the legislative intention of the statutory provisions.

25. 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 is impractical in the context of owning and managing a racehorse which is overcome by the members [as required by the **ARR**]:

(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.

26. This conclusion is consistent with ASIC's position set out in RG 91[10]:

> *[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."*

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Tony Fleiter specializes in acting for participants in the thoroughbred horse industry. His clients include some of Australia's leading breeders, owners, studmasters and trainers.

For a more detailed analysis of this subject-matter see paper titled: "*The regulatory regime governing the syndication of thoroughbred racehorses*", at www.racehorseownership.com , with links to the full judgements and other documents referred to in that paper.

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[10] Regulatory Guide 91 [2016] – Horse breeding schemes and horse racing schemes.