



HORSE RACING SCHEMES/MANAGED INVESTMENT SCHEMES/DAY-TO-DAY CONTROL

What are the criteria for determining if a horse racing scheme is a managed investment scheme?

and

How is it that the manager and the trainer [and NOT the members] are the people with day-to-day control over the operation of such schemes?

The definition

1. The determining criteria of a managed investment scheme can only be the legislated definition of a managed investment scheme set out in *Section 9 of the Corporations Act 2001 (Cth)*, complemented by the principles established by the case law, objectively applied.
2. The analysis of a scheme to determine whether or not it satisfies the definition requires that consideration be given to:
 - (a) all its key elements, including legal structure and modus operandi;
 - (b) the scheme as being the entire operation [all the activities of the scheme as comprising scheme operations];
 - (c) the necessary distinction between:
 - (i) the activities [and rights] of the individual members and those of the group;
 - (ii) control in fact and the legal right to control;
 - (iii) "day-to-day control over the operation of the scheme" and "the right to be consulted or give directions"
 - (d) the activities carried out by the operator(s) of the scheme on behalf of the members as a group.

day-to-day control

3. The fundamental distinction which underlies the whole of the definition is between:
 - (a) schemes where ALL the members in fact exercise 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 an operator 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 being temporarily limited to the point in time when the arrangements are made.

4. The day-to-day control test is not about ownership or the legal right to control. It is about whether the right to control is in fact exercised.
- 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 in fact exercise control over the operation of the scheme by making ALL the decisions and implementing what is agreed [actively managing or carrying out the routine, ordinary, everyday activities which 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 (as a group) appoint a person to operate the scheme [with the authority to manage or carry-out the routine, ordinary, everyday activities which 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).
5. 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 in the business of dealing in interests in such schemes.

Horse racing schemes

6. Horse racing schemes generally [by practical necessity and in order to comply with the ARR] are sufficiently uniform in their key elements [structure and modus operandi] to justify the conclusion that any arrangement between 2 or more people (members) to own or lease a racehorse for the purpose of participating in the undertaking of caring for, training and racing it [the horse as a whole] to best advantage for the benefit of the members (as a group) will, prima facie, satisfy the definition of a managed investment scheme.
7. The key elements that satisfy the definition are the following:
- (a) the members contributions 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; and
 - (b) the scheme is operated by a manager and a licensed trainer [with actual possession of the horse (as a whole)] on behalf of the members (as a group), whether or not they have the right to be consulted or give directions.
8. Consequently, from an operational perspective:
- (a) each member's interest is inseparable from the interests of the other members; and
 - (b) the right of members to control over their respective interests is effectively:
 - (i) subordinated to the rights of the members (as a group) and the authority of the manager and the trainer 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).
9. Conversely, the members DO NOT have day-to-day control over the operation of the scheme, or their respective interests (in the horse or the scheme in so far as they are different), prospectively viewed from the point in time when the arrangements are made. Practical necessity and the ARR require that they, either expressly or by implication:

- (a) appoint a manager and a licensed trainer [with actual possession of the horse (as a whole)] and delegate to them the authority to operate the scheme on behalf of the members (as a group); and
- (b) surrender day-to-day control over their respective 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.

10. 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 as a group in making decisions (by the requisite majority) relating to specified matters, including the racing of the horse (as a whole) [applying the **nonrestrictive modifier** statement attaching to the third limb of the definition and the principles established by the case law];

does not take it outside the scope of the definition.

11. There is no apparent basis upon which any person, including a licensed trainer, who is 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 documents to avoid the legislative intention of the statutory provisions.

12. The need for ALL the members to in fact exercise 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 such schemes which is only overcome by the members (as a group):

- (a) appointing a manager and a licensed trainer [with actual possession of the horse (as a whole)]; and
- (b) delegating to them the authority to operate certain aspects of the scheme on behalf of the group.

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See paper titled: *The regulatory regime governing the syndication of thoroughbred racehorses*, which is available at [www.racehorseownership.com], together with links to the full judgements and other documents referred to in the paper.