
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?

1. The managed investment scheme regulatory regime is embedded within the Corporations Act 2001.
2. It is a set of compliance rules for unincorporated arrangements (schemes) involving collective investment established by a person (promoter¹) 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 complemented by the principles established by the case law, objectively applied.
5. "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;

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

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

day-to-day control

8. 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).
9. The objective assessment in determining day-to-day control is necessarily prospective, viewed from the time when the arrangements are made.
10. The day-to-day control test is not about ownership or proprietorship, or the legal right to control of the scheme.
 - o 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.
 - o 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.
 - o 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).
 - o 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.
11. 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.
12. 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.
13. 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 schemes

14. Horse racing schemes generally [by practical necessity and to comply with the ARR] are sufficiently uniform in their key elements to justify the conclusion that all arrangements made between 2 or more people who own or lease a thoroughbred horse for the purpose of using it for racing will, prima facie, satisfy the definition of a managed investment scheme.
15. The key elements that satisfy the definition are the following:
- (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 “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).
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:
- (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 a whole [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 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).

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 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.

19. 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*", as stated by Justice Davies in **ASIC v Pegasus**², at [55]. Also see the words of McClure JA in **Burton v Arcus**³, at [2].

20. 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:
 - o 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
 - o 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).

² [2002] NSWSC 310.

³ (Appeal Judgement) [2006] WASCA 0071. Also see (Original Decision) [2004] WASC 244.

21. 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.

Notes:

1. Generally, when an offer of interests is made in a thoroughbred horse being syndicated for racing:
 - (a) both the manager and the trainer, and the arrangements as to how the scheme will operate, are pre-determined; and
 - (b) the acquisition of the interests is inextricably linked to those arrangements, as the investors are required to simultaneously opt-in to the "common enterprise" arrangements that constitute the scheme to derive the benefit of their individual interests via the "common enterprise" racing the horse "as a whole".
2. 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.
3. The promoter or nominee will generally also be the manager [even if the promoter does not retain an interest in the horse].
 - o 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.
 - o 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.
4. 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.

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 does not 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.

23. 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.

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 an artificial construction 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 would be impractical and a significant impediment to the operation of such schemes 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.
26. This conclusion is consistent with the opinion of ASIC set out in RG 91⁴:

[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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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.

⁴ Regulatory Guide 91 [2016] – Horse breeding schemes and horse racing schemes.