KEY POINTS

- The fact that only one or some of the investors have day to day control does not derogate from the requirement that all persons who are participants must have day to day control to prevent operating a CIS.
- In determining whether property is managed as a whole, the relevant inquiry is what, looked at objectively, the scheme required the operator, or his agent, to do.

Authors Tim Penny and Philip Hinks

Collective Investment Schemes: the first appellate clarification since 2006

In two recent decisions, the Court of Appeal has provided clear guidance as to the manner in which the collective investment scheme (CIS) provision of the Financial Services and Markets Act 2000 (FSMA), namely s 235, operates.

ASSET LAND INVESTMENTS PLC V THE FINANCIAL CONDUCT AUTHORITY [2014] EWCA CIV 435

The facts

The Asset Land companies purchased a number of large sites of land across the UK, and sub-divided them into smaller plots. Thereafter, Asset Land set about identifying "investors" for the plots.

Its dealings with potential investors were usually started with Asset Land's salesmen making an unsolicited ("cold") telephone call. During that initial call, the "investment" proposition was put to investors. Investors were given the opportunity of purchasing one or more of the plots that comprised Asset Land's sites. Salesmen informed investors that, following the sale of the plots, Asset Land would take steps to have the sites "re-zoned" (an elastic expression generally used by Asset Land to mean that the land would have enhanced prospects of obtaining planning approval) or to obtain planning permission. Asset Land would then be responsible for procuring the sale of the sites as a whole, probably to developers. On the sale of the sites, investors who owned plots in those sites would be paid their share of the purchase price.

Over the course of a number of telephone conversations with Asset Land's salesmen, investors were given extravagant expectations as to the profits they were likely to make on the sale of their plots. On many occasions, they were told that the value of their "investments" would treble in a matter of months. In short, this was a classic case of 'land-banking'.

Decision at first instance

The FCA sought declarations that, in respect of each of the sites in question, Asset Land had established and operated CISs within the meaning of s 235 of FSMA, together with relief consequent on the making of those declarations.

So far as it is relevant, s 235 of FSMA provides as follows:

- In this Part "collective investment scheme" means any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.
- The arrangements must be such that the persons who are to participate ("participants") do not have day-to-day control over the management of the property, whether or not they have the right to be consulted or to give directions.
- The arrangements must also have either or both of the following characteristics – […] (b) the property is managed as a whole by or on behalf of the operator of the scheme.

In its defence, Asset Land placed particular emphasis on certain clauses that were contained in the contracts of sale it had entered into with investors. Copies of these contractual instruments were only provided to investors after: (i) they had been the subject of the representations described above made by Asset Land's salesmen; and (ii) they had paid for their plot(s) of land in full.

The two clauses on which Asset Land relied in particular provided as follows:

> "The Buyer confirms that there are and have been no representations made by or on behalf of the Seller on the faith of which the Buyer is entering into this Agreement except and to the extent to which such representations are herein expressly set out or form part of written replies by the Solicitors for the Seller to the written Enquiries before Contract raised by the solicitors for the Buyer or the Seller's replies to Property Information Forms." ("the Representations Clause")
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> "For the avoidance of doubt, the Seller is not obliged to and will not apply for planning permission in relation to the Property or in relation to the land as a whole of which the Property forms part, nor will the Seller provide any other services to the Buyer following the purchase of the Property by the Buyer to the extent that the provision of such services would constitute the carrying on by the Seller of regulated activities for the purposes of the [FSMA] unless the Seller is authorised under that Act and permitted by the [FCA] to carry on the relevant regulated activities. Notwithstanding the foregoing, the Seller reserves the right to (but is not obliged to) apply for planning permission in relation to any land owned by the Seller which forms part of the land of which the Property forms part." ("the Services Clause")

At first instance, Andrew Smith J granted the declaratory relief sought by the FCA (reported under [2013] 2 B.C.L.C. 480). The judge made the following important conclusions and findings:

- There were "*arrangements*" (within s 235(1) of FSMA) with respect to property (being the sites as a whole, or alternatively the plots therein), the purpose of which was to

enable persons taking part in the arrangements (namely, the investors) to participate in or receive profits arising from their acquisition and disposal of such property. The arrangements were made between Asset Land's salesmen and the investors. They came about by reason of the salesmen's oral representations, and the investors' corresponding understandings, as to how the schemes were to operate. The content of the arrangements was such that Asset Land would achieve a sale of the Sites after it had sought to enhance their value (through the re-zoning of the land or the grant of planning permission), and that the proceeds of sale would be shared between the investors.

- These arrangements subsisted in spite of the existence of the (ostensibly conflicting) Representations and Services Clauses set out above. In any event, those contractual terms were ultimately of no effect by reason of the application of the Misrepresentation Act 1967 (which subjects no-reliance clauses such as the Representations Clause to the reasonableness test contained in the Unfair Contract Terms Act 1977) and the Unfair Terms in Consumer Contracts Regulations 1999.
- The arrangements were such that the investors did not have "day-to-day control over the management" of the property (within s 235(2)). In spite of the strict legal position (taking into account the fact that, following the conveyance of their plots, the investors were the legal and beneficial owners of the same), under the arrangements, such control was to rest with Asset Land.
- The arrangements were such that the property was "managed as a whole by or on behalf of the operator of the scheme" (namely, by Asset Land) (within s 235(3)(b)). In particular, all aspects of the investment process that related to the sites/plots (eg re-zoning; applications for planning approval; and sale to developers) were to be managed by Asset Land.

Asset Land obtained permission to appeal from the Court of Appeal. As Gloster LJ (who gave the lead judgment of the Court) noted in para 18 of the judgment, the central issue raised by the appeal was "what is a 'collective investment scheme'?"

THE APPEAL

The Court of Appeal found for the FCA on all matters subject to the appeal. For convenience, this article adopts as headings Asset Land's various grounds of appeal relating to the meaning of s 235 of FSMA.

The judge gave the wrong meaning to the word "arrangements"

On appeal, Asset Land submitted that 'arrangements' within s 235(1) required a mutual expectation of adherence by the persons involved. Such an expectation was, it was argued, lacking in this case, since no findings had been made by the judge as to how Asset Land understood the schemes would operate (*cf.* the understandings of the investors).

This was rejected by the Court of Appeal (paras 47 to 59), as it had been by the judge below. In doing so, Gloster LJ made the following points:

- Arrangements may exist without both parties sharing the same expectation/intention as to what was to happen. For instance, a fraudulent scheme may constitute a CIS notwithstanding the participants' understanding of its operation is not shared by the fraudulent operator.
- The existence of arrangements for the purposes of this provision cannot depend upon an involved investigation into the subjective intentions and expectations of scheme operators. Instead:
- "the court has to ask … whether, looked at objectively, on the basis of what they had been told, reasonable investors participating in the scheme would understand that the scheme involved arrangements of the type described under section 235. *Necessarily the approach is an objective one*." (emphasis supplied)
- Arrangements within s 235(1) may subsist in the face of a binding contract between the participants and the operator, the terms of which are apparently inconsistent with, or contradict, those arrangements. It is wrong to regard "arrangements" in this context as inchoate or imperfect contracts that are displaced if the parties subsequently enter into a contract, and the mere fact that a contract has been concluded between the parties cannot result in the arrangements necessarily being limited to the terms of that contract.
- In any event, even if the contracts had displaced the arrangements in this case, such arrangement (satisfying the requirements of s 235) *had* existed for a period of time (ie up until the execution of the contracts of sale). The Court of Appeal held that the inquiry as to the existence and/or content of "arrangements" is not limited to a certain point in time (eg after those arrangements had been performed). On the contrary:"it is sufficient if: (i) at some point in the parties' relationship there were objectively identifiable arrangements; and if (ii) the parties acted in reliance on those arrangements."

Both of these conditions were satisfied: prior to the signing of the contracts, objectively identifiable arrangements were in existence; and during the period in which those arrangements subsisted, investors paid the entirety of the purchase price of their plots (ie they fully carried out their side of the arrangements).

The judge could not properly find that the investors had a "shared understanding" of the arrangements.

Asset Land challenged the judge's finding (of fact) that all of the investors had a shared understanding of the essential features of the schemes, namely that Asset Land would seek to progress planning procedures with a view to the sites being sold; Asset Land would procure the sale of the sites, probably to developers; and investors would then be paid a share of the total price paid by the purchaser. Since Asset Land's salesmen had not all used the same lines, the understandings of the investors were not identical. For instance, some investors had been told that Asset Land would apply for planning permission; others had been told that Asset Land would merely

seek to have the sites re-zoned.

In rejecting this challenge, the Court of Appeal held that 'arrangements' may be founded upon varied or different understandings (paras 66 to 68). Such arrangements are capable of giving rise to a CIS in respect of *all* of the participants, provided the other requirements of s 235 are made out. These provisions would be emasculated of their regulatory effectiveness if the position were otherwise (particularly in relation to arrangements which are orally made).

The judge erred in finding that the purpose of the arrangements was to enable the participants to participate in or receive profits.

On appeal, it was Asset Land's case that the mere grant of planning approval (or the reallocation of the sites for development purposes) would not of itself have enabled the investors to participate in or receive profits within the meaning of s 235(1). As the Court of Appeal noted, this was a selective description of the arrangements, as found by the judge. Such arrangements were not limited to obtaining planning permission; they included the ultimate sale of the sites, at which point investors were to receive their profits.

Gloster LJ made the following further points in rejecting this ground (paras 71 to 75):

- It was irrelevant that Asset Land had no power to sell the individual plots without the consent of the investors (who were the registered owners of the same). Under the arrangements, such a sale was to take place, and that was sufficient.
- Even if the arrangements had been limited to the progression of planning procedures (no exit strategy having as yet been determined), s 235(1) would nonetheless be satisfied. In that provision, "receive profits" ought to be construed so as to include the making of notional balance sheet profits and the receipt of other economic benefit.
- Even if the re-zoning of the sites would not have increased their value, that was an irrelevant consideration. It was sufficient, for s 235(1), that the *purpose* of the re-zoning, as conveyed by the salesmen to the investors, was to increase the value of the sites.
- There was evidence that one of the investors from whom the court had heard evidence purchased plots not by way of investment but as land on which to build a family home. Such exceptions did not prevent arrangements from satisfying s 235:

> "The fact that one or two individual participants may have had different intentions as to the future use of their individual plots does not prevent the purpose of the scheme, as described by representatives of Asset Land, from satisfying the purpose/effect requirements of section 235(1). What is necessary, in order to determine whether this limb is satisfied, is an objective assessment of the purpose of the arrangements. Here the arrangements which were presented to all investors by Asset Land's brokers were the acquisition of land for investment purposes. The fact that a limited number of investors may have signed up to the plan for reasons other than investment does not prevent "arrangements" within section 235(1) from arising."

The judge erred in finding that the participants did not have day-to-day control over the management of the property

On appeal, Asset Land argued that s 235(2) was not concerned with whether the participants did not *exercise* day-to-day control over the management of the property; it was concerned with their not *having* day-to-day control over the management of the same. Further, it was submitted that no aspect of the arrangements (progressing planning procedures or procuring a sale) demonstrated day-to-day control of management, since the arrangements did not happily lend themselves to 'management' of the property.

The Court of Appeal rejected this ground (paras 80 to 89). In doing so, it held as follows:

- What constitutes "management" is dictated by the nature of the property in question. Here, the plots were specifically sold to investors as investments. Accordingly, the management in question consisted of the acts that were proposed to be taken with a view to increasing and selling the sites, and thereby realising the value of the plots as investments.
- The fact that the investors were themselves legally entitled to do all of the things that Asset Land represented it would do (eg seek planning permission) in respect of the plots was irrelevant. That was not, in reality, what was to happen under the arrangements as presented by Asset Land's salesmen.
- Even if it could be said that one or more of the investors (particularly those who had bought into the scheme in order to acquire land for the purpose of building a home) exercised sufficient day-to-day control over their plots, a scheme may nonetheless satisfy s 235(2). In this respect, the Court of Appeal endorsed the decision of Laddie J in *Russell-Cooke Trust Co v Elliott* (16 July 2001, unreported, Ch D) at [26] that: "If one asks the question 'do *those persons* have day to day control over the management?', the answer must be in the negative. The fact that one or some of them do have day to day control is not sufficient. All the persons who are participants must have day to day control."

The judge erred in finding that each of the arrangements provided for the property to be managed as a whole by or on behalf of Asset Land.

In this ground of appeal, Asset Land argued that the judge ought not to have found that the arrangements provided for the sites/plots to be managed as a whole by or on behalf of Asset Land (within s 235(3)(b)). This was because, contrary to the representations made by Asset Land's salesmen, the evidence was that once Asset Land sold a plot, it did nothing further with it.

This ground was also rejected by the Court of Appeal (paras 92 to 93). What was relevant, for the purposes of this part of s 235, was what was to happen *under the arrangements*; not what actually happened in practice. Further, the fact that some of

the (home-building) investors intended to exercise management over their own plots did not detract from the management that Asset Land was to exercise under the arrangements that it made with the investors as a whole.

THE FINANCIAL CONDUCT AUTHORITY V CAPITAL ALTERNATIVES LIMITED [2015] EWCA CIV 284

The facts

This case concerned (*inter alia*) an African Land Scheme, in which African Land Ltd had leased 3,000 acres of land in Sierra Leone for a term of 50 years. It had proceeded to sub-let plots of an acre in size to investors. The plots were described in the scheme's brochures as "prime rice farming land". Investors were to own their own plots and would be entitled to 40-50% of the net profits from the harvest of those plots. African Land appointed a third party to manage the site.

As to the operation of the scheme, the judge at first instance (Nicholas Strauss QC sitting as a Deputy Judge) found that the harvest from each plot was segregated and investors were paid for the rice harvested on their plot(s) at a standard price. Although this was an inconvenient and inefficient way of going about things, it had been adopted because it was believed to be the key to the scheme not being a CIS.

The FCA sought declarations that this scheme, along with connected Carbon Credit Schemes, constituted a CIS within s 235 of FSMA.

Decision at first instance

The judge was satisfied that the scheme involved "arrangements" within s 235(1) and (2) of FSMA. The important issue which arose for determination was whether those arrangements had the characteristic specified in s 235(3)(b), ie whether "the property is managed as a whole by or on behalf of the operator of the scheme."

On that issue, the defendants' case was that individual plots were individually managed because each investor received a return based on the value of the crops (if any) grown on his individual plot of land. None of an individual's income was derived from any part of the farm other than their own plots or from the individual plots being part of a larger whole.

In this regard, the defendants placed significant reliance on the FCA's Perimeter Guidance Manual, produced pursuant to s 139A of FSMA with a view to providing guidance (which guidance is in no way binding on the court – [35]) as to the operation of FSMA. In particular, the Manual contains the following guidance:

> "I run a scheme where each person owns individual properties or parts of properties in the property investment club. Each person owns property either directly, or indirectly (for example, through a limited company or a limited liability partnership of which he is the owner or through a limited partnership). Is this scheme likely to be a collective investment scheme?
>
> No, *unless the properties belonging to each person, company, limited liability partnership or limited partnership is managed as a whole by or on behalf of the operator of the scheme*. So, the mere fact that the operator is managing a number of properties and achieves economies of scale in his management charges or in things such as insurance cover would not mean that the properties are being managed as a whole. Neither would the fact that the operator may be able to offer reductions in sale price because of bulk discounts negotiated with developers. *This is provided the operator is managing each property on an individual basis.*
>
> As an example, if a managing agent manages a block of flats on the basis that the only profit or income each individual flat owner obtains is what arises from the management of his property, there is no management as a whole. However, if the managing agent managed the flats in such a way that each individual flat owner received an income from total lettings, regardless of whether that person's flat was let or not, the properties are managed as a whole and the arrangements are likely to be a collective investment scheme." (underlining added)

The defendants argued that, by reference to this guidance, if the only profit or income which an individual investor obtains is what arises from the management of his own property (ie his own rice plot), there is no management as a whole within s 235(3)(b). A scheme along those lines may be contrasted with one where the investor takes a *pro rata* share of the collective profit generated by the site as a whole (irrespective of the performance of that part of the site which is owned by him).

The judge found that, for the purposes of s 235(3)(b), "the property" was not the individual plots which had been sub-let to investors. Rather, it was "the property which was the subject of the arrangements enabling all participants to receive income or profits" (at [48]). In this case, therefore, "the property" extended to the farm buildings situated on the site, roads, irrigation areas and other parts of the site which did not form individual plots but which were necessary to enable the operation to run, thereby generating profits for the investors. Having regard to what the relevant property was, the judge concluded that there was collective management of the rice farm as one entity, as opposed to management of the individual investors' individual interests (at [52]).

The Appeal

On appeal, the Court of Appeal upheld the judge's finding as to what constituted "the property" for the purposes of s 235(3)(b). In Christopher Clarke LJ's view (at [50]):

> "Section 235 is concerned with an arrangement with respect to property, the purpose or effect of which is to enable investors ("*whether by becoming owners of the property or any part of it or otherwise*") to participate in or receive profits or income arising from, *inter alia*, the management of the property. In that context "*the property*" (which the section does not require to be owned by any investor) is perfectly apt to cover a farm from the management of which, including the buildings, roads etc., the investor, who becomes the owner of part of the property, is to receive the share of profit attributable to the proceeds of his plot."

Biog box

Tim Penny practises from 11 Stone Buildings, Lincoln's Inn. He was involved in *Asset Land Investments Plc v The Financial Conduct Authority* [2014] EWCA Civ 435 and also *The Financial Conduct Authority v Capital Alternatives Ltd* [2015] EWCA Civ 284. Email: penny@11sb.com Philip Hinks practises from 3 Verulam Buildings and was also involved in *Asset Land Investment*. Email: phinks@3vb.com

As to whether the requirement contained in s 235(3)(b) was satisfied, the Court of Appeal held as follows:

- The phrase "the property is managed as whole" uses words of ordinarily language. No gloss on that language is necessary or desirable (at [116]), and it is not appropriate to attach to the words some form of exclusionary test based on whether the elements of individual management in the scheme were "substantial" (at [72]): "It is not necessary that there should be no individual management activity — only that the nature of the scheme is that, in essence, the property is managed as a whole, to which question the amount of individual management of the property will plainly be relevant."
- In determining the issue, it is doubtful whether much assistance is gained by saying that the question must be looked at from the point of view of the operator as opposed to that of the investor. Rather, echoing the Court of Appeal's preference in *Asset Land* for an objective appraisal of the facts, it is preferable to say that: "the relevant inquiry is as to what, looked at objectively, the scheme required the operator, or his agent, to do" (at [53]).
- It was plain that the relevant property, namely the rice farm, was managed as a whole. As the scheme brochures pointed out: "We harvest – you profit". There was a single manager for the whole farm with complete autonomy over its management. Management decisions were taken by reference to the interests of the project as a whole rather than the interests of any individual investor. Investors had no contract, or contact, with GMX, and played no part whatever in the management. The roads, farm buildings and machinery were used for all investors, and were not used in any way differently by reference to the interests of any individual investor. Finally, investors were allocated their plots by the operator (without investors choosing the same), and their cultivation fees were applied towards the management of the rice farm generally, rather than towards their individual plots (at [74-75]).

CONCLUSION

The guidance given by the Court of Appeal in *Asset Land* and *Capital Alternatives* as to the operation of s 235 of FSMA is to be welcomed. The last time that this provision received appellate clarification was in 2006, when *FSA v Fradley* [2006] 2 B.C.L.C. 616 was determined. CISs can potentially come in all shapes and sizes, ranging from the sophisticated investment opportunities that were the subject of the *Asset Land* and *Capital Alternatives* cases to managing agent who is put in charge of a handful of flats. These recent decisions provide invaluable assistance to businessmen concerned that their operations may fall within the scope of s 235, and to practitioners who are asked to advise on such matters.

Notwithstanding the above, the guidance contained in these decisions is unlikely to be the final word on this subject: the Supreme Court has given leave to appeal in Asset Land with the appeal to be heard in early 2016. Watch this space... ■

Further Reading

- The innovator litigation: collective investment schemes and claims arising from a contravention of the general prohibition [2012] 8 JIBFL 482.
- Collective investment schemes: a missed opportunity? [2012] 4 JIBFL 219.
- LexisNexis Financial Services blog: Reclaiming funds following fraud.