***ASSET LAND V FCA*: COLLECTIVE INVESTMENT SCHEMES AND SOME LONG OVERDUE GUIDANCE FROM THE SUPREME COURT**

The Financial Services and Markets Act 2000 (the "**Act**") is neither the most eloquently drafted statute nor is it the simplest to follow. The same holds true for the suite of secondary legislation that accompanies it. The problem is particularly acute where the legislation adopts general definitions intended to be flexible enough to cater for the ever-changing financial landscape. It is arguable that nowhere is this problem more evident than with the statutory definition of collective investment schemes ("**CIS**"), where the definition is intended to capture a wide range of different investments, ranging from vanilla unit trusts, to more esoteric investments such as certain tax mitigation and land banking schemes (to name just a few).

The Supreme Court decision in ***Asset Land Investments plc and another v Financial Conduct Authority***[1] provides authoritative guidance in relation to the principles which will ultimately determine whether a given investment meets the statutory definition of a CIS. The Supreme Court (in particular, Lord Sumption) seized the opportunity to consider in a reasoned and principled manner the statutory definition of CIS, and proffered some important guidance of general application to the definition of CISs going forward.

The Definition

The definition of CIS is set out in s.235 of the Act, which provides (so far as relevant):

(1) *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 from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.*

(2) *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.*

(3) *The arrangements must also have either or both of the following characteristics –*

(a) *the contributions of the participants and the profits or income out of which payments are to be made to them are pooled;*

(b) *the property is managed as a whole by or on behalf of the operator of the scheme*

[1] [2016] UKSC 17.

The definition interacts with other provisions in the Act (and its secondary legislation) in the following way:

(a) S.19 of the Act sets out a general prohibition that no person may carry on a 'regulated activity' unless that person is authorised or exempt. S.22 of the Act defines 'regulated activity' in general terms as an "*activity of a specified kind*" which "*relates to an investment of a specified kind*" or "*is carried on in relation to property of any kind*";

(b) In order to ascertain what is specified, one must look to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001[2] (the "**Order**");

(c) The Order identifies specified activities as including: (i) activities such as promoting, advising on, managing or dealing in 'investments'; and (ii) "*establishing, operating or winding up a [CIS]*"[3];

(d) The Order identifies specified investments, which includes shares, bonds and other debt instruments, government and public securities, warrants and tradeable certificates for any of the foregoing, mortgages, options and futures, contracts for differences, <u>units in a collective investment scheme</u>, and similar financial instruments;

(e) Where a person engages in a regulated activity without authorisation or exemption, the infringer commits a criminal offence[4], and any contract made in the course of carrying on the activity is unenforceable[5], and the infringer may also be required to pay compensation and restitution[6]; and

(f) Finally, s.417 of the Act is a general interpretation section which covers the entire Act, and it adopts the definition set out in s.235 for all other purposes.

The inherent difficulties of the statutory definition were expressed by Lord Sumption in the following terms: "*The definition and its statutory predecessor of 1986 have been regarded as highly unsatisfactory provisions by professional advisers ever since they were first enacted, mainly because of their generality, lack of definition and dependence on secondary legislation to take transactions outside of the scope of the legislation which ought not to be there*"[7].

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[2] SI 2001/544.
[3] Art.51ZE.
[4] S.23 of the Act.
[5] S.26(1) of the Act.
[6] S.26(2) of the Act.
[7] At para. 79. These difficulties are not as pronounced when one considers unit trusts, open-ended investment companies and recognised overseas schemes, where there are detailed provisions set out in Part XVII which complement the general definition set out in s.235.

In his judgment, Lord Sumption usefully describes the legislative background leading up to the Act[8]. For present purposes, it is sufficient simply to highlight the following:

(a) The tension between particularity and generality is an inherent feature of our financial services legislation. Prior to the enactment of the Financial Services Act 1986 (the "**1986 Act**"), Prof. LCB Gower was commissioned to examine the then existing arrangements for statutory investor protection. His report[9], which was largely followed in the 1986 Act, made extensive recommendations for overhauling the existing law. One of his principal objections to the existing arrangements was that their coverage was arbitrary, in the sense that it regulated certain modes of investment while leaving unregulated other forms of investment which were functionally similar. In other words, it was too precise, and could be circumvented rather easily. On this point, the White Paper which preceded the 1986 Act declared: "*The definition of 'investments' will set the boundary of the regulated area. It is therefore fundamental to the proposed system of regulation. In defining 'investments' the Government proposes, with minor exceptions, to adopt Professor Gower's approach. The definition...will be specific (to provide certainty...) and wide (to achieve consistency of treatment...*";

(b) In so far as whether our modern system of financial services regulation should extend to physical assets (including land), Prof. Gower was of the view (which was subsequently adopted in the 1986 Act) that provided that the acquirer obtains exclusive control over the asset, and was not in reality buying rights under an arrangement whereby someone else controls and manages them, they should not be treated as investments worthy of regulatory protection; and

(c) The principles set out above, not only informed the drafting of the 1986 Act, but they also informed the drafting of the 2000 Act. The result is that CISs are treated very differently than other types of regulated investments which are specified clearly in the Order. As to this, Lord Sumption explains: "*...the draftsman resolved to deal with the regulation of [CISs] comprising physical assets as part of the broader system of statutory regulation governing unit trusts and open-ended investment companies, which they largely resembled. In keeping with the policy objectives identified by Professor Gower, there is an important difference, which runs through the whole of the Act between financial instruments and physical assets. With very limited exceptions, regulated activities must relate to assets specified [in the] Order...Regulated activities as defined do not relate to physical or other non-specified assets. [CISs] are the one exception to this. They may comprise arrangements with respect to 'property of any description'...the [Act] regulates only the indirect sale or holding through [CISs] of non-specified assets. It has no application to the direct acquisition, management or disposal of non-specified assets such as land*"[10].

[8] See, in particular, paras 80 to 85.
[9] Entitled 'Review of Investor Protection'.
[10] At paras 85 and 86.

The Facts

The case involved a land-banking arrangement pursuant to which the appellant company purchased a number of greenfield sites with the object of increasing their value by persuading the local authority to re-zone it for housing development. The sites would then be sold as a whole at a profit to a developer. The company subdivided the sites into plots and offered the individual plots for sale to investors. Mr Banner-Eve, the second appellant, was the controlling director and owner of the company. A number of plots were sold to investors, but the sites have not been rezoned, and there is little (if any) prospect of development in the short-term.

Although there were differing accounts by individual investors, the plots were sold on the basis of extravagant expectations as to profit and the short-term nature of the investment. Despite the varying accounts from investors, at first instance, Andrew Smith J found that they all shared a consistent understanding of the structure of the scheme, which involved the following features:

(a) The company would seek to progress planning procedures with a view to the sites being rezoned;

(b) The company would then procure their sale, probably to developers; and

(c) The investors who sold plots at the site would be paid a share of the total consideration paid by the purchaser.

Although the arrangements were such that the investor acquired the plot and was legally in control of the plot (to the extent that the investor could refuse to agree to sell the plot once the site had been rezoned and attracted a developer), the practical reality was that the investors would invariably sell their plots, because it was the only realistic way that they could extract a return from their investments.

Like many such arrangements which are designed in such a way as to avoid the regulatory consequences of a CIS, the scheme documents involved disclaimers and the like which were intended to give the impression that the company had no role to play once the plots had been sold to investors.

The FCA (as it then was) became aware in early 2007 that the company was selling land to investors, and was representing itself as responsible for seeking rezoning for residential development and for arranging a sale to a developer. Such activities clearly fell within the definition of a CIS. Following correspondence with the company's solicitors, the FCA accepted assurances that the representations would cease. In June 2011, however, the FCA formed the view that the agreed restrictions were not being observed, and reopened its inquiry. Proceedings were commenced in June 2012, following a worldwide freezing injunction against the company and Mr Banner-Eve.

In a judgment given on 8 February 2013, Andrew Smith J decided that the activities amounted to a CIS, in breach of the general prohibition, and restitutionary orders followed. The decision on liability was upheld by the Court of Appeal. The company and Mr Banner-Eve subsequently appealed to the Supreme Court. The only issue on appeal was whether the activities carried out by the company amounted to a CIS within the meaning of s.235 of the Act, and thus regulated activities for the purposes of the general prohibition. Although the issue on appeal was a narrow one, as Lord Carnwath explained in his judgment: "*This appeal raises the general question whether the FCA's understanding of the law is correct...It has potentially wide-ranging significance for the application of the Act to this and similar arrangements*"[11].

The Decision

The outcome of the appeal is perhaps the least interesting aspect, as it was hardly surprising that the appeal would be dismissed, and the arrangements would be characterised as a CIS. It is notable, however, that Lord Carnwath reached this decision much more easily than Lord Sumption (no other Law Lords provided substantive judgments).

Arrangements

As to the meaning to be attributed to 'arrangements' in s.235(1), Lord Sumption had the following to say: "*Arrangements is a broad and untechnical word. It comprises not only contractual or other legally binding arrangements, but any understanding shared between the parties to the transaction about how the scheme would operate, whether legally binding or not. It also includes the consequences which necessarily follow from that understanding, or from the commercial context in which it is made. In these respects, the definition is concerned with substance and not with form. It is, however, important to emphasise that it is concerned with what the arrangements were and not with what was done thereafter. Of course, what was done thereafter may throw light on what was originally understood...But it must be possible to determine whether arrangements amount to a [CIS] as soon as those arrangements have been made. Whether the scheme is a [CIS] depends on what was objectively intended at that time, and not on what later happened, if different*"[12].

Pausing there for a moment, this guidance should provide some welcome relief to those involved in advising on investments which could be characterised as CISs. Up until this point, there had been earlier judicial pronouncements, of lower authority, which suggested that one must look at the actual operation of the scheme to assess whether it satisfied the statutory test[13] (relying on the words "*purpose or **effect***"): see in particular *The Russell-Cooke Trust Company v Elliott (No 2)*[14] . The approach suggested by Lord Sumption is more nuanced, and makes it clear that the objective assessment is

[11] At para. 12.
[12] At para. 91.
[13] See, in particular, the decision of Ouseley J in *R (on the application of Chancery (UK) LLP) v FOS* [2015] EWHC 407 (Admin).
[14] Ch D, 16 July 2001 (unreported)

temporally limited to the point in time when the arrangements were made. This must surely be right, as it would be desperately unfair to advisers if they could be held accountable in circumstances where a scheme is ultimately operated in such a way that is materially different from the arrangements proposed. Nonetheless, the term ‘arrangements’ remains very wide in scope. In particular, no formality is required[15]. Communications do not need to give rise to any legally enforceable agreement[16].

On the case-specific issue of whether the company entered into arrangements within the meaning of s.235(1), the Supreme Court had little difficulty determining that it did on the basis that the judge was entitled to conclude, based on the shared understanding of the investors (which was materially different to the disclaimers in the scheme literature), that arrangements were made when the plots were marketed and sold to investors, the object of the arrangements being that the company would achieve a sale of the site after seeking to enhance its value by improving the prospects for housing development.

Property

The issue on appeal was whether the judge was correct to determine that the relevant ‘property’ for the purposes of s.235(1) (i.e. the arrangements) was each of the sites taken as a whole, and not the individual plots (or a combination of the plots plus the ancillary rights attached to them). As the investors held the legal title to the plots, if the latter was accepted, it would be much more difficult to establish that the investors did not have day-to-day control, which is a necessary requirement of a CIS.

The Supreme Court was firmly of the view that the relevant property was the site. On this point, Lord Sumption held that “*the reason is that the property referred to in sub-s (1) is the property from whose acquisition, holding, management or disposal the profits or income were to be derived. On the judge’s findings, that was the whole site. It was the whole site that was to be rezoned, and it was the whole site which was to be sold to a developer. The profit which each investor would derive from these transactions would be derived from an aliquot share of the entire sale price for the site*”[17].

Day-to-Day Control

A number of earlier decisions[18] have considered this requirement and concluded that it is directed to actual control and effective control. Lord Sumption, however, disagreed with these conclusions for the following reasons: “*Control of property means the ability to decide what is to happen to it. I would accept that does not only mean the legal ability to decide. It extends to a case where the 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...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*

[15] *FSA v Fradley* [2005] EWCA Civ 1183 Arden LJ at [33]
[16] *Re Duckwari plc (No 2) [1998] 2 BCLC 315 at 319*
[17] At para. 93.
[18] See, for example, the decision of Hamblen J in *Brown v InnovatorOne plc* [2012] EWHC 1321 (Comm) at para. 1170, which was approved by the Court of Appeal in these proceedings.

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. For the answer to turn on what exercise of control turned out to be required, would add an arbitrary element to the test which can hardly have been intended"[19].

In the result, Lord Sumption was satisfied that the investors did not have day-to-day control for the simple reason that the requirement is intertwined with the arrangements. As the arrangements were that the company would take an active role and the investors a passive role, it naturally followed that the investors lacked day-to-day control over the property with respect to which the arrangements were made. Lord Carnwath arrived at the same result in a slightly different way, by focusing on the substance of the arrangements rather than the fact that the investors all held title to the individual plots.

Management of the Property as a Whole

As the contributions of the investors were not pooled, in order for the arrangements to qualify as a CIS, it was necessary to demonstrate that the property was managed as a whole by or on behalf of the company. It is this requirement which caused Lord Sumption the greatest difficulty because he was of the view that the company's role in finding a buyer was not an act of management if all they were expected to do was to put a proposal for sale before the investors for them to approve or reject as they saw fit. The position should be contrasted with a situation where the arrangements empowered the company to effect a sale on the investor's behalf, where it could not be argued that selling or procuring the sale of an asset was not an act of management. His view was that "*the distinction is necessary if there is to be a workable distinction between collective investment schemes and cases in which an intermediary such as an estate agent simply supplies professional services without assuming control over the assets*"[20].

[19] At para. 94.
[20] At para. 101.

Despite the fact that in strict legal terms the investors had not surrendered control over the plots to the company, Lord Sumption was of the view that the transaction could not be viewed only in legal terms, and was happy to defer to the judge at first instance (as was Lord Carnwath) and his finding that the practical consequences were such that the investors would never exercise the rights that they theoretically possessed: "*the dominion of the investors over their plots, although apparently complete, was in reality an illusion*"[21]. As a result, he was of the view that the statutory requirements had been satisfied and that the arrangements amounted to a CIS.

Conclusions

Although land banking arrangements are not identical, following the decision of the Supreme Court, it is perhaps most unlikely that any such arrangement will not be characterised as a CIS. The result is hardly surprising. Like many others before them, the appellants in this case had designed the scheme with the purpose of trying to put it out of the reach of the Act and the FCA. The inherent flexibility which is an essential part of the statutory definition was more than capable of rising to the challenge of overcoming the artificiality that was introduced to attempt to achieve that purpose.

Practitioners should welcome the guidance that has emerged from the highest court in the land. CISs have finally had their moment in the legal spotlight, and although there still remains a considerable amount of uncertainty, perhaps this is an inextricable feature of a statutory definition which is intended to cater for the specific and the general.

The implications of the decision are potentially wide-reaching, and are not limited to land banking schemes. The guidance to emerge from Lord Sumption's judgment is particularly useful. In two important respects, he appears to have shifted the established jurisprudence in a more reasoned direction. It must surely be correct that one should not look at how a scheme actually operates for anything other than as an index of how it was intended to be operated at the moment that the arrangements were made. The focus of any assessment should be temporally limited to this point in time, or else the result could be arbitrary and desperately unfair. In a similar way, it must also be correct that the assessment of day-to-day control should be underpinned to the arrangements, and involves a prospective exercise viewed from the time that the arrangements were made (rather than from some later date when the scheme is operational). Such guidance should be embraced for a host of reasons, not least because it will make it easier for those engaged in financial services to better understand whether an arrangement is a CIS or not.

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[21] At para. 102.