

COLLECTIVE INVESTMENT SCHEMES

Finally some clarity: Asset Land Investment plc v FCA¹



Overview

- ▶ The requirement for those who establish or operate a collective investment scheme (**CIS**) to be authorised by the (now) Financial Conduct Authority (**FCA**) is not new; in fact, it has been in statute in the UK in various guises since 1985.
- ▶ However, the recent case of Asset Land Investment plc (**Asset Land**) v FCA has finally provided the legal market with some clarity on how the definition of a CIS (now found under section 235 of the Financial Services and Markets Act 2000 (**FSMA**)) should be interpreted.
- ▶ The outcome is that legal practitioners and relevant professionals should now look carefully at the substance of arrangements and examine all elements of the s.235 FSMA definition when determining whether or not an arrangement is, or is not, a CIS. In this context, the 'reality' of commercial arrangements will be the determining factor when making such assessment, not the legal drafting.
- ▶ In this briefing note, we set out:
 - ▶ the background to the Asset Land case.
 - ▶ the guidance given by the Supreme Court on the interpretation of section 235 of FSMA; and
 - ▶ the likely impact on future practice.

Definition of CIS

- ▶ Under section 235 of FSMA, a CIS means "any arrangements with respect to property of any description...the purpose of which is to enable persons taking part in the arrangements...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".
- ▶ Further, under section 235 of FSMA, to be a CIS:
 - ▶ 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; and
 - ▶ the arrangements must have either or both of the following characteristics:
 - ▶ the contributions of the participants and the profits or income out of which payments are to be made to them are pooled;
 - ▶ the property is managed as a whole by or on behalf of the operator of the scheme.

¹ *Asset Land Investment plc v The Financial Conduct Authority* [2016] UKSC17 (20 April 2016)

Asset Land: the background

- ▶ Asset Land operated a land development project whereby it acquired sites on Greenfield land, divided it into plots and sold these on to individual investors (**Project**). The Project was marketed to investors by a series of brokers who stated that Asset Land would arrange: (i) for the sold plots to be 'rezoned' with a view to use them for housing; and (ii) for the sale of the land, most likely to a developer. No documentation was provided to investors prior to them paying a 10% deposit, or the remainder of the purchase price.
- ▶ Following payment of the full purchase price, investors were sent documents, including a contract for sale of the land and a "check-box form". The latter document contained:
 - ▶ a requirement for the investor to confirm they had read and understood a 'disclaimer' (appearing as a footer at the bottom of the form) which noted that Asset Land:
 - (i) did not give investment advice or offer regulated investment products to the public; and
 - (ii) would have no further dealings with the investors or the land now it had been sold to them – it was further emphasised that they were not intending to "pursue re-zoning or planning permission";
 - ▶ a 'representations clause' by which it was confirmed that no representations would be relied on from outside the written documents that had been provided to the investors; and
 - ▶ a 'services' clause highlighting that the Asset Land would not be applying for planning permission or providing any other service amounting to 'regulated activities' under FSMA.
- ▶ However, in a judgement dated 8 February 2013, Andrew J Smith decided that Asset Land's activities during the Project satisfied the requirements of a collective investment scheme for the purposes of s.235 of FSMA which, given that Asset Land were not 'authorised persons', was in breach of FSMA [see [2013] EWHC 178 (ch)].
- ▶ This decision was appealed, was subsequently upheld by the Court of Appeal, and so was taken up in the Supreme Court. Asset Land argued that the initial judgement was incorrect on the basis that:
 - ▶ it was manifestly unfair to look at those representations made by the various brokers and disregard those written contractual terms made directly between investors and Asset Land;
 - ▶ the lower courts had wrongly interpreted the judgements in the *Sky Land* case as equating 'property' with the entirety of the site acquired by Asset Land as opposed to the aggregate interests in the individual plots owned by the investors. If one were to favour the former definition, there

would be no reasonable way of asserting any one investor had 'day-to-day' control despite their holding the legal title to their own individual interest [see *Re Sky Land Consultants plc* [2010] EWHC 399 (Ch)];

- ▶ the legal rights and duties contained in the paperwork reflected the 'realities' of the scheme, so to focus on the 'purpose' or 'form' of the arrangements was likely to lead to an inaccurate analysis; and
- ▶ s.235 of FSMA should not be stretched to cover issues for which other remedies were available. Asset Land argued that to interpret s.235 FSMA in such a way would bring 'ordinary commercial transactions' within the regulatory ambit of the FCA causing commercial uncertainty and could potentially interfere with normal business decisions.

The decision

- ▶ The judges in the Supreme Court were unanimous in their dismissal of the appeal and all found that Asset Land's arrangements constituted a CIS. They examined the statutory definition and applied each individual aspect to the case:
 - ▶ **Arrangements** - the idea that the scheme qualified as 'arrangements' within the meaning of s.235 was never disputed as there clearly existed an understanding between investors and Asset Land involving the various plots of land and an expected capital return.
 - ▶ **Property** – the judges were not persuaded that the 'property' in question was the individual plots sold to investors. *Lord Sumption* stated that as the whole site was proposed to be rezoned and sold to a developer, the profit each investor would derive would be their share of the profits from the sale of the entire site – and therefore it was the entire site that was the 'property' for the purposes of the arrangements.
 - ▶ **Day-to-day control** – it was found that the investors had no day-to-day control:
 - ▶ *Lord Carnworth* was not persuaded that the fact the investors had legal control over their individual plots was enough to prove their day-to-day control of the assets. He suggested that control under FSMA was not limited to legal control and, following the *Sky Land* case, said the reality of the arrangements meant that it would make no commercial sense for investors to opt out of the scheme and elect not to sell if an offer was made. The circumstances meant that, whilst control was held by investors in theory, in practice as they were not linked to any exercise of management control (individually or collectively), and, in fact, were not able to distinguish their plots from

the entirety of the site, they were in no position to exercise it.

- ▶ *Lord Sumption* took a different stance and felt that it was irrelevant whether day-to-day control was practically possible following entry into the arrangements, instead the key element would be whether or not the arrangements were made with the idea of investors exercising any control in mind. The question for him was 'who would control be vested in were control to be required'? In this regard, taking into consideration that the 'property' was now agreed to be the entirety of the site, *Lord Sumption* found that it was not reasonable to think this level of managerial control would vest in individual investors by virtue of owning the legal title to one plot.

- ▶ **Management of the property** – as there was never any intention to pool the contributions of the investors (their plots), whether or not this limb of the definition was satisfied depended on whether the property was 'managed as a whole'. It was made clear by all the judges that this idea of management did not mean management of the scheme but rather management of the actual assets i.e. the site. Considering the intention behind s.235(3) FSMA, the judges felt that the loss of control by investors in relation to the management of the property meant that Asset Land were not kept on as a contractor, but went beyond this and took over responsibility from the legal owners of the property – hence this limb was satisfied.

Future practice

- ▶ **What is to be considered when deciding what falls under s.235?**

The judgement made it clear, for the first time, that in deciding what constitutes a CIS, the courts are willing to look past form and focus on the substance of an arrangement. In practice, this means that clever legal drafting will no longer distract from reality if the two do not match – if legal rights are "in reality an illusion" and oral representations are closer to the parties understanding of the arrangement then the latter will be of primary evidentiary importance.

- ▶ **What is the relevant time period to be examined?**

Arrangements are to be examined at the time they were made and, whilst what is done after such time may provide context, the relevant question to ask is 'what was the understanding of the parties and the mechanics of the arrangements at the time they were entered into'? This is helpful to practitioners as it enables them to advise on the likelihood of a transaction being a CIS based on what it is envisioned and entered into as, not based on what it may become in the future.

- ▶ **What property does it apply to?**

This case firmly brought 'land-banking' schemes within the purview of s.235 FSMA, and further elaborated on what was to be taken as 'property'. The outcome is that the property for the purposes of s.235 FSMA will be that asset that the individual investors will derive profit from, this being regardless of what actually might be being dealt with. For example, in Asset Land the investors were technically making money as a result of their individual plot being sold however, as the value of the arrangements came from the entirety of the Asset Land site being sold, this was not deemed to be the most relevant factor.

- ▶ **What is meant by "control" and "management"?**

The concept of control within the meaning of FSMA is not restricted to simple legal control. The judges were unified in their dismissal of the idea that holding a legal right to an asset means you are in control of it. Rather, it must be considered whether the reality of the situation actually allows for any control to be exercised by an investor who is acting reasonably.

Intertwined with this idea of control is the idea of management of assets. It is crucial here to distinguish between the management of the arrangements and the management of the assets – only the latter will satisfy s.235(3)(b) FSMA.

Conclusion

- ▶ In the future courts will look towards the substance of arrangements and examine all elements of the s.235 FSMA definition with the intention of piercing the legal jargon to get to the 'reality' of the situation.
- ▶ Following the Asset Land decision, the FCA are likely to adopt a broader, more assertive approach in relation to land-banking schemes, with s.235 FSMA applicable to a wider class of assets than was previously thought.

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