

The complaint

Mrs B complains that about an Enterprise Investment Scheme (EIS) Fund that she was advised to invest in. She says that the fund manager, Thompson Taraz Managers Limited (TTML) didn't manage the fund in line with the information memorandum.

What happened

In February 2017 Mrs B was advised, by another firm, to invest £64,350 in an EIS called Earthworm Enterprise Investment Scheme. This fund was managed by TTML, with another company that I'll refer to as 'E' acting as TTML's adviser and proposing companies to invest in.

The fund's strategy involved investing in EIS qualifying companies that were 'seeking to build and operate shovel-ready recycling and environmental facilities'. The Information Memorandum (IM) set out key risks which included:

- General risks to do with the industry itself and the type of machinery used in waste disposal and recycling, as well as the general risks associated with investing in unquoted companies.
- Risks relating to the EIS status of the companies which the fund would invest in – in particular, the fact that any tax relief could not be guaranteed in the event of an individual company ceasing to carry on the business of the type prescribed for EIS qualifying companies.
- Sector specific risks to do with changes in legislation around waste disposal.

It also detailed four investment opportunities being considered, with key information about these individual companies being set out. In accordance with the investment memorandum, TTML invested across three of the four companies which were covered in the memorandum.

TTML ceased managing the fund in September 2018, and by 2021 all three companies had gone into liquidation. This meant Mrs B's investment of £64,350 was lost so she complained.

In short she said:

- Her losses were due to mismanagement of the fund and she didn't believe TTML had complied with its due diligence obligations and its obligations as an Alternative Investment Fund Manager (AIFM).
- The IM said that the fund wouldn't employ any leverage and that the companies may borrow but in 'negligible' amounts. She said her understanding was that one of the companies had taken on significant debt obligations contrary to this.
- The IM promoted the investment as being asset backed and 'offering a significant

level of asset protection'. However she said that a charge of assets was granted to creditors, and land on which one of the plants had been built on was subject to a specific type of lease that reverted back to the lessor when there was a default. This meant there was in fact no asset protection.

- She asked about what criteria were used and what best practices were complied with in order to select the companies to invest in. She also said that two of the companies were reliant on the same company to provide heat for the plants – and challenged TTML to explain how this could've been reasonable given that a failure of that company would've caused two thirds of the value of the fund to be lost.
- One of the companies had two years to build a plant but didn't do so – and she challenged TTML to explain how this was allowed to happen.

TTML provided a detailed final response. In summary:

- It confirmed it had carried out all appropriate due diligence, but was unable to share the relevant documents with Mrs B as these were commercially sensitive in nature.
- It said that in relation to one of the firms, TTML's due diligence showed that it had pre-accreditation received from HMRC, and that its third party plan qualified for a government scheme. However, by 2019 the government at the time announced that the scheme might be withdrawn, and as a result the third party funders pulled out. It said that this was not foreseeable by it at the time the investment due diligence was performed in 2017.
- In relation to the two other firms, it outlined the reasons for why they failed and said that those reasons were not reasonably foreseeable in 2017, nor via the due diligence that was carried out. It said that until September 2018 when TTML was responsible for the management of the fund, the companies were performing as expected. It reiterated that it did not think the poor performance of the companies in question was due to anything it could've foreseen or uncovered as part of its due diligence.
- The debt that Mrs B made reference to was fully discharged by August 2017, and the new debenture which that specific company had taken on was created in October 2018, after TTML ceased to be the fund manager.
- In relation to the asset backed guarantee claim within the IM, TTML said that it had no knowledge of the arrangements entered into after its involvement. It said that there were non-typical trading conditions in 2019 and 2020 which likely made it more difficult to find buyers for the types of assets that individual companies owned. In addition, TTML said that it was clear from the IM that 'Investments in Investee Companies may be realised for substantially less than the acquisition cost or may be impossible to realise at all'.
- It disagreed that there was a common reason between the three companies for why they failed, and explained the various circumstances which affected and ultimately caused the liquidation of those firms.

Overall, TTML said that it had carried out adequate due diligence and there was always a risk of the individual firms failing, which it said was clearly set out in the IM.

Mrs B remained dissatisfied and referred her complaint to this service. One of our investigators looked into the complaint, but didn't agree it should be upheld. In short, she said:

- In terms of the due diligence carried out, the investigator was satisfied that TTML had carried it out reasonably and obtained relevant information. This included summary of the business activities, financial statements, the financial position at the time, financial forecasts, assets and liabilities and personnel checks. In addition, each company had obtained assurance from HMRC that it qualified for EIS relief. She confirmed that disclosing the actual due diligence carried out was not something TTML was required to do given the commercially sensitive nature of it – but she confirmed she had seen and considered those documents when reaching her assessment.
- TTML had a discretionary mandate to manage the fund, and whilst Mrs B had questioned some of its investment decisions, the investigator did not consider that was this service's role – particularly given the benefit of hindsight all parties now had. She said that the performance of the fund itself was not evidence that it was mismanaged or that something had gone wrong.
- In relation to Mrs B's concerns about the debts incurred by one of the companies TTML had invested in, she had reviewed the statements for the year ending 30 April 2017, which was shortly after the funds were invested. She said that this showed the firm's assets amounted to £4.7m and its debts £1.8. In the investigator's view, this showed that there wasn't significant gearing or over exposure to debt. She acknowledged that the same firm created another debenture in October 2018, but as this occurred after TTML stopped managing the fund, she didn't think she could hold TTML responsible for not having foreseen or known about it.
- Finally, she said that in relation to the assets owned by the individual companies, it was reasonable for TTML to have concluded that these assets would continue to hold value in the event that the firms were liquidated. She said the financial statements of the individual companies showed that TTML had selected them on the basis of the asset backed criteria – but she also said that the IM was clear that this was not intended as a guarantee that an investor's money would be in some way protected or exposed to less risk than other available EIS investments. She said it was clear from the IM that investor's money was at risk.

Mrs B didn't agree and asked for an ombudsman to decide the matter. She said that TTML was acting on her behalf and 'held a duty of care to manage [her] investment competently, diligently and in accordance with regulatory requirements'. She said that given the outcome of her investment, she should be entitled to information to confirm what steps TTML had taken prior to investing in those individual companies, and what steps they took during the lifetime of her investment – and crucially what happened to those investments. She said she wasn't satisfied the matter could be resolved with so many unanswered questions.

She said she needed to be sure that TTML had complied with the applicable regulatory rules and obligations, including ensuring sufficient due diligence was undertaken.

She said that she considered TTML was obliged to provide this information, particularly given the position she was now in, and said she could see no reason why it would refuse if it was confident it had met its obligations.

TTML agreed with the investigator but wished to point out that it had supplied the relevant information to the service, but had covenanted with the investment manager that this

information would not be disclosed or published. It pointed out the relevant provisions in DISP which allowed the service to receive information in confidence.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Having done so I've reached the same conclusions as our investigator, and for substantially the same reasons. I'm sorry that I also don't have much to add to what the investigator has already said.

I understand Mrs B's strength of feeling on this complaint, and the reasons why she considers it should be upheld. But I don't agree that the ultimate performance of the fund is a reason to conclude that TTML did not carry out sufficient due diligence on the companies which it ended up investing in, nor that it misled her as to the risks of the fund itself.

In terms of the due diligence, I'm satisfied that there is no rule that specifically requires TTML to share these documents with Mrs B for a fund of this type – and it has explained, persuasively in my view, why it cannot share them with her. Ultimately, TTML has asked this service to accept this evidence in confidence, and the rules which govern this service's ability to look at complaints allows us to do this. Given the circumstances, I'm satisfied that it's appropriate for me to rely on this information in confidence and to take into account when reaching my findings.

Furthermore, whilst I understand why Mrs B would like to see the actual documents themselves, she has been given a detailed summary by both TTML and the investigator. She has not raised any particular objections to those summaries, or explained why in her view they did not amount to adequate due diligence. So I'm satisfied she's had an opportunity to consider and comment on the content and substance of the due diligence carried out, even she has not seen the actual documents themselves. The only argument she has put forward for why she considers TTML failed in its duty to carry out adequate due diligence and manage the fund properly is because the fund has failed, and she has lost her investment.

However, I'm not persuaded by this argument. Ultimately, in reviewing the evidence TTML supplied to us, I'm satisfied that it fairly and reasonably carried out the due diligence the regulator expected it to, in order to ensure that the companies it agreed to invest in met the criteria set out in the IM. The key issue is that the relevant rules are not prescriptive about the type of information TTML was required to collect and assess and so in reaching my conclusions about this, I've paid particular attention to the IM, how it described companies would be chosen and what the purpose of this particular fund was. The investigator has already set out what information TTML obtained before agreeing to invest. In reviewing this information, I'm satisfied that TTML, with advice from E, chose firms that were:

- Selected on the basis of an assessment of their financial viability.
- Operated in the market and carried out the business which was specified in the IM.
- Qualified for EIS relief at the time the due diligence was carried out and based on the relevant legislation as it was in force.
- Had the appropriate company arrangements, as well as the appropriate personnel, to run those companies in a way which gave them a chance to be successful and further the fund's objectives.

This is what the IM required TTML to do, and I'm satisfied it did so. The ultimate performance of these firms was beyond the scope of what TTML was reasonably expected to foresee.

Investing in EIS qualifying companies carries with it inherent risks which in my view were clearly laid out in the IM. It's these very risks which justify the tax relief that EIS investments can bring. Furthermore, it's equally clear to me that this particular fund carried sector specific risks which Mrs B should've been aware of or alerted to.

The fact that it operated in a particularly niche industry, which was also reliant on specific grants awarded by legislation meant that there was potential for regulatory changes to have a significant impact on the value of her investment – more so than perhaps other sectors. These risks were also clearly laid out in the IM.

Mrs B has outlined a variety of other circumstances which she says demonstrate that TTML didn't do its job properly, but in reviewing her comments I'm not persuaded. A number of facts she refers to happened after TTML stopped managing the investment. Some facts are in dispute – for example whether the same firm was providing heating to two of the companies that TTML had decided to invest in. But even if that wasn't in dispute, it isn't obvious to me why this would be unreasonable or inappropriate, even if it had been established at the time the due diligence was carried out. The fund as a whole was operating in a small and narrow industry sector, and I think it's entirely understandable that there may well be some interdependencies between firms operating in the same sector. I'm not persuaded this is evidence of insufficient due diligence being carried out, nor that the fund wasn't managed properly.

In terms of the asset backed nature of these firms, I'm inclined to agree with the investigator. The financial statements don't substantiate Mrs B's claims that these firms were over geared or over exposed to debt at the time TTML decided to invest in them – and clearly anything that happened after TTML ceased to manage the fund is not something I can hold it responsible for. I don't think the asset backed nature of these firms is something that was intended to convince Mrs B that there was no risk to her capital, and I note that the IM specifically makes this point:

'The Fund will be investing in businesses that are developing, purchasing and constructing buildings, plant and machinery. This should provide a significant level of asset protection to the Fund's portfolio of investee companies but Investors should appreciate that their capital is at risk and they should read carefully the Risk Factors set out on pages 28-30 before making their investment decision'.

Later, the IM makes clear that *'Investee companies may fail, as may the assets they own or operate and Investments in Investee companies may be realised for substantially less than the acquisition cost or may be impossible to realise at all'.*

So taking all this into account, I'm satisfied that it was fair and reasonable for TTML to have concluded that the three companies it chose to invest in met the criteria which had been set out in the IM.

I'm satisfied the level of due diligence it carried out was fair and reasonable, and furthermore that it was open and honest about the general risks associated with investing in a fund of this type, as well as the specific risks associated with this particular EIS fund given the sector it was operating in and its aims.

Whilst I understand why Mrs B remains dissatisfied, and I'd like to convey my sympathy for the substantial investment loss she has suffered, I'm not persuaded, for the reasons I've

explained, that TTML has done anything wrong. I'm also not persuaded that the performance of the fund itself is evidence of it not acting fairly and reasonably at the outset or during its involvement. For all these reasons, I don't uphold Mrs B's complaint.

My final decision

My final decision is that I don't uphold Mrs B's complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs B to accept or reject my decision before 11 November 2023.

Alessandro Pulzone
Ombudsman