

## **The complaint**

Mr E complains that Thompson Taraz Managers Limited (“TTML”) mismanaged, and provided misleading information about, an Enterprise Investment Scheme (EIS) he invested in.

## **What happened**

Mr E invested £100,000 in TTML’s EIS fund (“the fund”) in April 2017. TTML managed the fund until September 2018 when responsibility transferred to another company.

The fund was a discretionary investment management service offering tax benefits to investors. Information about the fund and the terms of the discretionary management service were set out in an Investment Memorandum (IM) document, which included an Investor’s Agreement (IA) setting out the terms and conditions for the fund.

The fund aimed to invest in EIS qualifying companies seeking to build and operate recycling and environmental facilities. Mr E’s funds were invested across four companies but by 2021 three had gone into liquidation and one had a negligible value. Facing the loss of almost the entire value of his investment, Mr E complained that:

- TTML had mismanaged the fund. It appeared they were unaware of what was happening with the investments and left decisions solely to their appointed representative. Their claim that problems only occurred after they stopped managing the fund was untrue.
- TTML had refused to provide copies of the due diligence they carried out on investee companies. That caused him to question whether adequate due diligence had been conducted.
- One of the investee companies took on significant debt even though the IM said the fund would only invest in companies with negligible borrowing, and this had exacerbated his losses.
- The IM was misleading in saying the investments were asset backed.
- There was an over reliance on a single heat provider which was used by multiple companies within the fund but went into liquidation. The failure of one company had resulted in the loss of approximately 85% of the value of his fund.
- One of the plants was fully constructed in the knowledge a third party plant hadn’t been built.
- A disproportionate amount of his funds was invested in just two companies, despite the IM saying that no more than 35% of an investor’s funds would be put into any one company.

In response to Mr E’s complaint, TTML have said:

- They appointed another company (“company E”) as their Appointed Representative for specified activities. As the investment adviser to TTML in relation to the fund, company E’s role was to recommend investment selections, carry out due diligence on investee companies, prepare investment proposals and monitor the ongoing performance of investments.
- As the due diligence information Mr E requested was confidential and proprietary in nature, they were unable to provide him with copies.
- They managed the fund in line with the terms of the IM. Up until September 2018, when TTML ceased to manage the fund, the investee companies were performing as expected. In late 2019, issues relating to the financial performance of some investee companies became apparent.
- This type of investment is high risk and always carries a risk of loss, including complete loss. The risks were clearly highlighted in the IM.
- Investee companies have been affected by changes in Government regulation, unexpected delays and the withdrawal of funding due to the covid pandemic. These happened after management of the fund transferred to another provider, were outside of their control and could not have been foreseen at the time Mr E invested.
- It is not correct to say that over reliance on a single heat provider resulted in the loss of approximately 85% of the value of Mr E’s investment. The two companies Mr E was most heavily invested in failed due to different circumstances.
- In relation to Mr E’s complaint that one of the plants was fully constructed in the knowledge a third party plant hadn’t been built, TTML said they had no control over the progress of the works and were not running the investee company. There is nothing to suggest the money invested was not applied to its intended purpose.
- The allocation of Mr E’s funds was in line with the IM objective of “typically 35% exposure” in an individual company which allowed leeway to exceed 35% if necessary or desirable. The alternative would have been to leave some of Mr E’s money uninvested.

Our investigator looked into Mr E’s complaint and didn’t think it should be upheld. He said:

- He was satisfied that TTML invested Mr E’s funds in line with the strategy set out in the IM.
- No guarantees were made about how Mr E’s investment would perform and the high risk of investing in smaller, unquoted companies was explained in the IM. The fact that the investment underperformed doesn’t mean that TTML did anything wrong.
- On balance, and in the absence of sufficient evidence to the contrary, he was satisfied that TTML carried out adequate due diligence. He didn’t think they were required to disclose copies of the due diligence carried out, nor that they had acted unfairly by not doing so.
- He didn’t agree that statements in the IM about borrowing and investing in asset backed companies were misleading and he didn’t think he could fairly say that TTML had failed

to act in line with the IM.

- The IM gave TTML scope to invest more than 35% of an investor's funds into one company if they considered it necessary. He was satisfied they provided a reasonable explanation as to why 42.5% of Mr E's funds were invested in each of two companies and didn't think they had breached the IM by doing so.

Mr E disagreed with our investigator's findings and asked for an ombudsman to make a final decision. He said:

- TTML had a duty to manage his investment diligently, competently and in accordance with regulatory requirements. That they did not do so is evidenced by their lack of understanding of the investments and their inability to explain their failure. The risk warnings contained in the IM do not override their duty of care or other regulatory responsibilities.
- He should be entitled to information to confirm what steps TTML took prior to investing and during the lifetime of the investments and what happened to them. There cannot be any legitimate reason for TTML not disclosing their due diligence. Whilst our investigator's strict interpretation of the IM may be correct, it is fair and reasonable for an investor to be provided with information that is fundamental to the performance of his investment.
- No explanation has been given for the apparent disappearance of the fixed assets of the companies he was invested in.

### **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.

I'd like to reassure Mr E that I have looked carefully at all the information he has provided. Having done so, I hope he won't take it as a discourtesy that I haven't addressed every point he has raised. Instead, I've concentrated my findings on what I consider to be the key factors in reaching a fair and reasonable outcome to his complaint.

### **TTML's responsibilities**

TTML were not responsible for giving advice to Mr E about his investment. So, it wasn't for them to decide whether the risks and other features of the fund were suitable for him. Any complaint about the suitability of the recommendation would lie against the provider of that advice.

The fund was an Alternative Investment Fund (AIF). Under the relevant rules TTML had to manage the fund in the best interests of the fund itself, to treat investors fairly, and to act with due skill, care and diligence. They also needed to incorporate a due diligence process which took account of the fund's stated strategy, objectives and risk profile. TTML were also responsible for making sure that the information they provided to Mr E was clear, fair and not misleading.

The IM described the objectives of the fund as:

"To offer Investors the opportunity to invest in unquoted EIS Qualifying Companies which carry on business in the recycling, environmental and/or waste sectors."

The IM summarised the fund's strategy in the following way:

“Monies raised by the Fund will be deployed into EIS qualifying companies that are seeking to build and operate shovel-ready recycling and environmental facilities. This provides the underlying investments with significant asset backing combined with long term predictable revenue streams secured against reputable counterparts.”

The IM also explained that company E would be acting as investment adviser to TTML. Company E's role was to select and recommend investments, carry out due diligence on them and monitor their ongoing performance.

I note that Mr E has complained that TTML left decisions solely to company E and failed in their own duties as fund manager. I should make clear that it was the responsibility of TTML themselves to manage the fund and comply with the relevant rules and regulations that I've referred to.

However, I don't think that responsibility precluded TTML from employing company E in the way it did. TTML was a fund manager, but company E had relevant experience in the specific sector that the fund would be investing in. I think it was therefore reasonable for TTML to rely on the advice and information company E provided. I'm also satisfied that the role of company E in selecting the investments was clearly set out within the IM. For example, clause 5.2 of the IA sets out that, amongst other things, when performing its investment management services TTML would have regard to the advice of company E.

### **Due diligence**

Mr E has complained that he should be able to see the due diligence carried out on investee companies. There is no regulatory or other requirement for TTML to disclose this information to Mr E in relation to a fund of this type. TTML has asked that the ombudsman accept the evidence of the due diligence reports in confidence as the rules governing our service (the “DISP rules” set out in the Financial Conduct Authority Handbook) allow us to do and I think that's appropriate. TTML says the particulars of the documents are commercially sensitive and I'm satisfied that's the case.

I've looked closely at the information provided by TTML in the light of Mr E's concern that the due diligence carried out was inadequate. As noted above, company E recommended investments and carried out due diligence so TTML would have taken account of company E's opinion before investing. Based on what I've seen, the information that TTML considered before deciding to invest in a company also included:

- A description of the business plan and proposed market for each company.
- Articles of Association and Shareholder Agreements.
- Financial information - current position, statements, forecasts, and records of assets and liabilities.
- Personnel information (employment contracts, share options and consultancy agreements).
- KYC and AML checks on the company, directors, and large shareholders.
- Checks of the company Directors with Companies House.
- Information about the company's eligibility for qualifying under the EIS scheme.

I'm satisfied that TTML considered the sort of information about potential investee companies that it would be reasonable to expect a due diligence process to cover. I think TTML would have had enough information to make decisions that they considered to be in the best interests of the fund.

Based on the evidence I've seen I'm not persuaded that TTML failed to act with due skill or care in the due diligence process they followed. And I've not seen anything that would lead me to conclude that it wasn't fair and reasonable for TTMS to decide to invest the fund's money in the companies they selected.

### **Ongoing management of the fund**

As manager of the fund, it was for TTML to make legitimate commercial decisions on behalf of investors based on the information available at the time. And, based on the evidence I've seen I'm not persuaded that TTML failed to make decisions in line with the mandate they had been given as set out in the IM.

I've seen a copy of the report on investee companies from June 2018 and financial statements for the companies for the financial year ending in April 2018. The companies appeared to be developing their business as planned and I can't see that there was anything at that stage that would have alerted TTML to serious issues with the companies or that ought to have prompted them to act differently.

As I've already noted, the management of the fund transferred to another company in September 2018. I can't fairly hold TTML responsible for events after that date; for whatever went on to cause the companies to fail; or for the apparent failure to realise any value from the companies when they failed.

From what I've seen, it appears that a number of the potential risks associated with this kind of investment have been realised. I think such risks were made clear in the IM at the time Mr E invested. For example:

- The summary of the fund on page 8, under key risks, said there was no guarantee that the objectives of the fund or the investee companies would be achieved, and investors may lose some or all of the money invested. It also referred to sector specific risks and said companies' revenue streams may be reduced by changes in legislation.
- The section of the IM about risk factors (from page 28) listed a number of risks to the fund. These included sector specific issues, the risks of investing in smaller, unquoted companies, and risks relating to conflicts of interest.

The fact that some risks appear to have materialised does not mean that TTML failed to make decisions in line with the mandate they had been given. And based on the evidence I've seen I don't think I can fairly say that TTML failed to follow the investment mandate or acted negligently. Nor do I think it would be fair to expect TTML to be able to explain events that happened after they stopped being involved in the fund.

### **Other complaint points**

Mr E complained that one of the investee companies took on significant debt despite the IM saying the fund would only invest in companies with negligible borrowing.

It appears that one of the investee companies had about £1.5m of debt in 2017. Based on what I've seen, I think it's most likely that the vast majority of the debt related to a debenture

that was taken out in 2016 and fully discharged in August 2017. The debenture enabled the company to construct and develop its business and defer the associated costs until EIS funding had been raised.

So, although the debenture was a form of borrowing, it was taken for a specific purpose until EIS funding had been received and for a relatively short period of time. As such, I don't think it would be fair and reasonable to say that TTML had failed to act in line with the IM.

It appears that the same company took out a further debenture in October 2018 but that was after management of the fund transferred to another provider so TTML cannot be held responsible for that.

I've considered Mr E's complaint that the IM was misleading in saying the fund would invest in asset backed companies. Under the heading "asset-backing" the IM said the fund would invest in businesses developing, purchasing and constructing buildings, plant and machinery. I've not seen any evidence which would suggest funds were not used in that way.

The IM went on to say that although this would provide a significant level of asset protection to the investee companies, investors should appreciate that their capital is at risk.

So, although TTML referred to investing in companies that were asset backed as a way of describing the fund's intended strategy, I think it also made clear that the fund was a high risk investment. I don't therefore think the IM was misleading on this point.

Mr E has said that two of the investee companies were reliant on one third party company building a plant to provide them with energy. Although TTML have disputed the impact of this on Mr E's investment, I'm not persuaded in any case that this risk made the decision of TTML to invest in those companies unfair or unreasonable. The fund was focused on a relatively small industry sector, and I don't think it would be uncommon for there to be a number of interdependencies between firms operating in the same sector and geographical area. I'm not persuaded that the extent to which those investee companies relied on the same third party power plant meant the investment decision was an unreasonable one for TTML to make.

I have also considered Mr E's complaint that a disproportionate amount of his funds was invested in just two companies. TTML have said that two of the fund's investee companies had almost utilised their EIS limit and so 42.5% of Mr E's funds were invested in each of two companies. The alternative would have been not to have invested all of Mr E's funds, which would have impacted on the tax relief he was eligible for.

The IM said that "typically no more than 35%" of an investor's funds would be invested in one company. I note that the risks section of the IM said funds would be invested in a target of three companies, but special circumstances may mean holding investments in fewer and not benefit from same diversification.

I'm satisfied that TTML's explanation of their actions is reasonable and, taking account of the wording in the IM, I don't think I can fairly say they failed to invest Mr E's funds in line with the mandate they had been given.

## **Summary**

I would like to reassure Mr E that I've looked carefully at everything he has said. I can understand why he feels strongly about what has happened to his investment. But I don't think I can fairly say that TTML failed to provide sufficiently clear information to Mr E before he decided to invest, or that they failed to manage his investment in line with the mandate they were given.

I don't think it would be fair to hold TTML responsible for Mr E's losses, or to expect it to be able to explain events that happened after it stopped managing the fund. I realise this will be a very disappointing decision for Mr E, but I won't be upholding his complaint.

## **My final decision**

For the reasons I've explained, my final decision is that I don't uphold Mr E's complaint against Thompson Taraz Managers Limited.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr E to accept or reject my decision before 15 August 2023.

Matthew Young  
**Ombudsman**