DRN-4265740

The complaint

Mr B has complained that Oxford Capital Partners LLP ('OCP') didn't carry out due diligence, best execution or act for him in good faith and with reasonable care when introducing him to an investment opportunity into an enterprise investment scheme ('EIS'). Mr B says he has been caused financial loss which he thinks is in the region of £272,000.

To put the matter right Mr B wants OCP to acknowledge it misled him as to the nature of the investment and that it should have taken more care in relation to that investment. He wants to be compensated as if the information given to him was correct.

Mr B is represented by a third party in bringing his complaint but for ease of reference I will refer to 'Mr B' throughout my decision.

What happened

Mr B was a sophisticated investor and member of OCP's 'Co-Investor Circle' ('CIC'). In June 2020, after an investment opportunity was introduced to him by OCP, Mr B invested £50,000 into an EIS. That EIS provided funding into a company I shall refer to as 'Company H' in my decision. There was a further round of funding in 2021 and as a result Mr B's class of shares changed.

Mr B wasn't happy with the change. In his view, he was disadvantaged. He complained to OCP about the lack of transparency about the investment, OCP's failure to provide him with information that was clear, fair, and not misleading about Company H. He said OCP was wrong to be involved with an investment whose structure meant investors didn't have any control over their class of shares being altered as a result of a majority shareholder vote. He said OCP had a duty of care which meant it should have prevented the impact on the structure of the investment and didn't provide best execution terms for the deal presented to him.

OCP issued its final response to Mr B's complaint on 10 November 2021. It said;

- Performance and capital restructuring

  It detailed the Series A Ordinary shares Mr B held and their 3x non-participating preference status. It provided information about the outcome of the further round of fund raising in 2021 that created a new share class which sat ahead of Mr B's shares upon exit from Company H – the A+ shares – and the change to the Series A Ordinary shares from 3 to 1x non-participating.

  While there was no guarantee at the time of the latest fund raising, the change in capital structure looked unlikely to be an issue for holders of A ordinary shares such as Mr B.

- Negligence

  It didn't agree it had been negligent and didn't consider the alteration to the capital structure to be significant. It viewed the latest funding round as positive for the

company and the right move for all shareholders. It said it was always the case with venture capital investing that OCP wouldn't have a controlling stake in the companies in which it invested, and those companies can always seek further funding which could have a dilutive effect on existing shareholdings. It had outlined those risks and the mitigating factors at the outset.

A simpler capital structure was more attractive for potential investors. It was for the lead investor of the funding to dictate the terms depending upon their valuation and motivation for the company and it was the shareholders decision whether to accept.

- Misrepresentation

  Mr B had said it hadn't been made clear in 2020 that there had been an intentional dilution by the previous lead investor via a low valuation of Company H which amounted to misrepresentation. OCP said it had made clear it felt the valuation was low compared to actual market value as per the 'Investment Opportunity Deck'. However, overall, the terms of the capital restructuring were considered a good move for Company H by enough shareholders.

- Communication

  It had provided full details of the restructure as and when it became available to OCP. It had communicated appropriately but said it could have communicated better, and sooner, and it expected better reporting in the future.

- Telephone recording

  The telephone call recording Mr B had referred to was about a complaint rather than a potential investment, so a recording wasn't required.

- In conclusion, it would have preferred for Company H to have maintained the 3x preference for the A Ordinary shares, but it had no control over the acceptance. And any disadvantages were mitigated by overall positive implications of the funding. It acted correctly and in the interests of its investors throughout. The risk of changes was pre-warned and inherent in all venture capital investing.

  There hadn't been any misrepresentation, communication was appropriate, and its telephone recording policy had been adhered to. Mr B's investment was worth more than before the 2020 funding round and Company H had a strong growth plan which it was hoped would deliver a significant return, likely to be above the fixed preference option.

Mr B wasn't happy with the outcome. He brought his complaint to this service and highlighted OCP's regulatory failings. Our investigator who considered the complaint didn't think that OCP needed to do anything more:

- She was satisfied that Mr B's sophisticated investor status was appropriate, so he was able to participate in high-risk type investments and that Mr B understood the terms of the investment.
- Mr B had been warned in both general and specific terms about the key risks involved with Company H, as well as the potential dilution of his shareholding and changes to the rights and privileges attached to a particular share class.
- OCP only provided information to Mr B, not advice. He was provided with information to allow him to assess the investment opportunity in Company H.

Mr B didn't agree. He said;

- The investigator hadn't adequately considered the nature and practicalities of investment made by angel investors particularly in relation to a rescue round. Nor had she considered OCP's role as a lead investor.
- She had confused dilution and variation of share rights and failed to appreciate the dilution would only be relevant to shares with rights of participation.
- She had not appreciated the importance of reference in the Information Memorandum of May 2020 – the 'Deal Summary' – to dilution which consistently and erroneously implied there was participation and as a result failed to appreciate the significance of the email exchange of 4 June 2020.
- Mr B was a sophisticated investor but not a lawyer and therefore OCP was to take the lead in negotiations on behalf of the CIC investors, highlight investments' terms to those investors that were unusual or damaging to the value of the investment and to deliver the investment terms it had notified to CIC investors.
- Mr B was aware that for rescue investors participation was central to his decision to invest and had reviewed the OCP documents with respect to participation rights. The subscription agreement was silent on participation, and it would need a specialist lawyer to determine it did not include participation.
- The Deal Summary was drafted in such terms as to suggest there would be participation, albeit not in so many words. '3x sale preference' implied a preferential return unless it was identified as being subject to a prior preference in favour of another share class so could only be first ranking. 'At no time did OCP state that the 3x money preference for the A Ordinary Shares, could, without the A Ordinary Shares have any say so in the matter, become subject to a prior preference attaching to other classes of share.'
- Reference was made to other misleading statements in the Deal Summary.
- The 4 June 2000 email meant that after the initial 3x priority return, A Ordinary Shares would rank pari passu with all other equity shares in receiving further contributions which wasn't correct.
- Mr B was provided with projected returns based on modelled scenarios which would have been constructed based on participation. The level of return would have only been possible if Mr B was participating.
- Mr B was now in the position where he may only get back his original investment. If he elected to convert to Ordinary shares this would only be done on a one for one basis without reflecting his 3x money preference which would mean a loss.

OCP also responded. It said;

- Mr B was an experienced investor in private equity and would likely have been familiar with the standard terms of the investment he made.
- At the time of investing Mr B's investment was in the highest-ranking share class and carried a 3x non-participating preference. The Investment Opportunity Deck stated that future dilution would be likely, and Mr B would have to accept that any new round of funding would lead to a new class of share being created and which would rank ahead of previous share classes.
- For the new funding in 2021 there was a request to change the A Ordinary share preference to 1x rather than 3x and this was accepted by the majority of shareholders including the majority of A Ordinary shareholders.
- There was confusion about whether the investment was equity or debt. There was no

mention of debt in the documents. Equity doesn't provide a fixed return but variable depending upon company's performance. Preference implies protection in the event of downside scenario.

- Mr B hadn't suffered a loss. The investment had increased in value by around 440% since Mr B invested, without considering the EIS tax reliefs which would serve to enhance the return or provide further tax reliefs if the investment underperformed. Company H continued to attract high quality investors who were supporting the long-term growth of the business in each round of funding since Mr B's investment.

As the complaint couldn't be resolved, it has been passed to me for a decision.

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.

After doing so, I've reached the same conclusion as the investigator and broadly for the same reasons. I'll explain why below.

I'm aware I've set out the background to this complaint in far less detail than the parties and I've done so using my own words. The Financial Ombudsman Service was set up to be a quick and informal alternative to the courts. And the purpose of this decision is to explain what I think is fair and reasonable in the circumstances, not to offer a point-by-point response to everything the parties to the complaint have said. So, I will not refer to every submission, comment, or relevant consideration. Instead, my decision sets out what I think are the most important points in order to explain my decision in a way that is intended to be clear and easy to understand.

Mr B has complained that OCP breached some of the Financial Conduct Authority's ('FCA') Principles and rules in the Conduct of Business Sourcebook ('COBS'). These have a wide application and I have therefore considered all of Mr B's points with the Principles and COBS rules in mind as a relevant consideration throughout my decision.

Before I move onto my findings for this complaint, I shall provide some further background to that laid out above.

Mr B had been a member of OCP's CIC since 2016. He applied and was accepted on the basis of information obtained in OCP's Information Memorandum ('IM') of January 2016. Once accepted as a CIC member OCP's terms of business applied. And by being a member of the CIC Mr B benefited from access to COP's *'due diligence and ongoing operational involvement'*.

Mr B was a retail client of OCP's which gave him referral rights to this service. The IM was only intended for certain investors – such as Mr B – who was a self-certified sophisticated investor. The IM provided information only and investors were recommended to seek independent financial advice. OCP's role was to introduce investors to investment opportunities on a non-advised basis which meant OCP had to check the appropriateness of the investment for the investors, but not the suitability. The investment opportunities offered were on the same terms as OCP's discretionary managed funds.

Mr B's investment was made on the basis of the CIC 'Investment Opportunity Deck' – an Information Memorandum – which was distributed to members of the CIC in May 2020 in line with OCP's Terms of Business of the CIC as detailed in the IM dated January 2016.

<u>Mr B's sophisticated investor status</u>

Mr B had been a self-certified sophisticated investor with OCP since 2016.

When Mr B gave his CIC Dealing Instruction on 10 June 2020, he also signed and dated the Self-Certificated Sophisticated Investor Statement for the purposes of the restriction on the promotion of non-readily realisable securities. The FCA, outlines a firm's duties for the assessment and acceptance of a retail client as a self-certified sophisticated investor under COBS 4.12.11G.

In particular when promoting to a self-certified sophisticated investor a business must take reasonable steps to;

> '…satisfy itself that the investor does in fact have the requisite experience, knowledge or expertise to understand the risks of the non-mainstream pooled investment in question. A retail client who meets the criteria for a self-certified sophisticated investor but not for a certified sophisticated investor may be unable to properly understand and evaluate the risks of a non-mainstream pooled investment which invests wholly or predominantly in assets other than shares in or debentures of unlisted companies.'

Mr B signed to accept the following;

> 'I am a self-certified sophisticated investor because at least one of the following applies:
>
> a) I am a member of a network or syndicate of business angels and have been so for at least the last six months prior to the date below;
>
> b) I have made more than one investment in an unlisted company in the two years prior to the date below;
>
> c) I am working, or have worked in the two years prior to the date below, in a professional capacity in the private equity sector, or in the provision of finance for small and medium enterprises;
>
> d) I am currently, or have been in the two years prior to the date below, a director of a company with an annual turnover of at least £1 million.'

But I don't think the content of the above statement – in isolation – should be used as a basis on which to say it was reasonable for OCP to have relied on the statement. So, I've gone on to consider whether it was reasonable and appropriate for OCP to have relied upon Mr B's self-certificated sophisticated investment statement – taking account of his circumstances – and that it reasonably should have gone ahead in providing Mr B with the investment opportunity that it did.

I've reviewed the 'appropriateness questionnaire' Mr B completed for OCP in December 2016. It's recorded under 'types of shares' of Mr B's investment experience that he had 15 years of discretionary managed portfolio experience, 30 years of smaller quoted companies, 20 years of AIM or Euronext listed companies and 30 years of unquoted companies experience. His capacity in which he had that experience was as an investor/shareholder and director. His annual net disposable income was between £500,000 and £1m and his approximate net investable assets other than his principal home was more than £10m.

I'll not provide all of the details in my decision in order to protect Mr B's identify, but in the investigator's opinion letter, she laid out Mr B's LinkedIn profile which made clear that he had 30 years of experience in investing in and raising money for unquoted businesses. He had been professionally involved at senior levels with small businesses. And I note from correspondence that Mr B stated that he had 'a career in private equity'.

Taking all of this into account – and over and above Mr B's signature to confirm his understanding of the implications of signing the self-certified sophisticated investor statement – I'm satisfied that OCP acted reasonably in its assessment of Mr B's appropriateness in the first instance by providing the investment opportunity to him.

Mr B's shares

The June 2020 round of rescue funding, which took place after a previous lead investor had pulled out, was part of a £4.3m funding for Company H at a pre-money valuation of £500,000. The shares that resulted from that round of funding were the Series A Ordinary shares which at that time carried a 3x preference.

Mr B has said he understood that the preference shares were 'participating' preference shares rather than 'non-participating'. So, I have to consider whether OCP said something which misled Mr B and which caused him to invest.

In the event of an exit for a non-participating shareholder they would receive their initial investment, or any pre-agreed multiple, and then the balance would be split between other shareholders. If the exit proceeds were more than the preference amount, then the preference investor would likely convert to Ordinary shares to participate on a pro-rata basis of the overall proceeds received rather than be capped at the preference amount.

If participating, then upon exit, the shareholder would receive their initial investment (or pre-agreed multiple) and then participate on a pro-rata basis in the remaining balance over and above the preference pay-out. Mr B invested on his understanding that he was purchasing first ranking participating preference shares and upon exit, he would receive three times the amount he originally invested, and a pro-rata share of any remaining proceeds, but this didn't turn out to be the case.

At the next round of funding in August 2021, led by a party other than the lead investor referred to above, a new class of share was created, Series A+, which went ahead in the ranking and above the Series A Ordinary shares in the capital restructure and had 1x preference.

As part of the funding, the lead investor required a change to simplify the capital structure in order to make it attractive to potential investors if future funding was required. The restructure removed the 3x preference of the A Ordinary share class which Mr B held and reduced it to 1x preference, so the same as the A+ share class which took precedence in Company H's capital structure.

In the event of liquidation, the A Ordinary shareholders could be disadvantaged by the changes to the rights associated with the shares because of the capital structure.

It is this that Mr B is unhappy about. He says it was presented to him that he would be investing in shares 'with a first ranking 3x money participating preference'. He has referred to an email conversation he had with OCP in June 2020 as evidence that this was his understanding as given to him by OCP.

During that conversation Mr B was forwarded the 'investment summary' – I assume the Investment Opportunity Deck of the potential investment into Company H. In a follow up question about the fundraising and structure he asked;

- '*there is a 3x priority. Post the 3x priority how does the equity split work.*

In response he is told;

> '*It works on a straight pro-rata basis for distributions.'*

I accept that the above email conversation isn't detailed, and my understanding is that Mr B took this to mean that the share class of the investment would be paid out pro-rata after taking the preference into account ie as a participating preference share. Mr B has said that unless a preferential return is described as being subject to a prior preference in favour of another class of share it can only be a first ranking preference.

But, after taking account of the other documents Mr B received prior to the investment, the articles of Company H and 'CIC Opportunity May 2020', I disagree. I'm satisfied that the email response to Mr B's question meant that after the pay out of the 3x priority, the remaining balance was then distributed pro-rata. And in any event, I can't see in those documents any reference was made to the shares being described as either participating or non-participating – only 'A ordinary shares' or 'New Preference shares.'

Company H's CIC Opportunity May 2020 document has a section entitled 'Key Risks' and includes the following;

'KEY RISKS	***POTENTIAL MITIGATING FACTORS***
Dilution of future fund raising	
• *The company will likely fundraise again next year depending on route to insourcing. Current cash runway to end of 2021.*	• *Low pre-money enables establishment of a position sizeable enough to sustain some dilution.*
Previous model failure	
• *Previous strategy and unit economics devised and built by the CEO and his team was not successful.*	• *Team aiming to overcome mistake in entry point with a more scalable business and potentially much higher LTV and margin in this model.*
Investor syndicate behaviours	
• *Syndicate lead has shown a hard edge moving strongly against previous investors (specifically a lead investor who pulled out of funding) with punitive deal terms all but wiping out existing shareholders.*	• *Supportive and strong existing investor base behind post-pivot business.* • *Actions have enabled very low cost buy-in.* • *New institutional investors also showing interest.'*

And I also note in that document under the heading of 'Attractive valuation and terms' it says;

> *'A £3m funding round at a pre-money valuation of £0.5m, with 3x preference for new investors led by….The terms of this significant down-round largely prices out previous investors but represents a very attractive valuation for new investment.'*

And under the 'Risk to capital' heading in the January 2016 the IM it said;

'It is also possible that the value of your shares could be reduced by dilution, where companies raise further equity capital in fundraising rounds...'

I think all of the above make clear the specific risks of dilution and which I'm satisfied could include a change to the then current share class's rights to participation. But those risks were in return for the 'low cost buy-in' and 'attractive valuation'.

There is only reference to preference shares in the documents and those documents remain silent on the matter of non-participating or participating preference shares. It's clear the new round wouldn't be advantageous to previous investors which suggests to me that this wasn't an unusual or unexpected occurrence, and that future funding could lead to the same for current investors.

And I accept that it is for the lead in a round of funding to decide the terms of that round which no doubt would be beneficial to the lead and any shares resulting from that round would rank ahead of previous investors in exchange for its financial commitment. However, it is for the company and the shareholders to decide whether to accept those terms – even if they might not be to their immediate advantage in return for the cash inflow of the lead and beneficial longer term – and in this case, those terms were accepted by the majority which I understand also included a majority of the A Ordinary shareholders.

That acceptance was out of OCP's control as it wasn't a majority shareholder – it didn't hold more than 50% of the investor shares – and as referred to in Schedule 6 of the Subscription and Shareholders' Agreement of 7 May 2020 which says;

*'**Consent Matters***

Matters requiring consent of an Investor Majority

(a) Alter the rights, preferences or privileges of the New Prefer Shares and/or A Ordinary Shares;

(b) other than as contemplated in the New Articles, consolidate, sub divide, convert or buy-back any of the Company's share capital;

(c) other than pursuant to a Share Option Plan and on exercise of options granted thereunder, permit or cause to be proposed any alteration to its share capital or the rights attaching to its shares or waive any right to receive payment on any of its shares issued partly paid;

….'

So, taking the above into account, I'm not persuaded that Mr B was given the impression that the preference shares he was investing into were participating preference shares rather than non-participating. And I'm satisfied Mr B was made aware of the potential of future funding rounds and the impact that could have on his own shareholding.

But even if I am wrong about that point, if Mr B's shares had been participating preference shares in 2020, as the majority of A Ordinary shareholders accepted the change in 2021, then those changes would have gone through, irrelevant of the participating or non-participating status of the shares.

<u>Company H's share options</u>

Mr B says that OCP failed to protect investors in the restructuring. When investing Mr B had assumed that upon exit, he would be participating and that his ultimate participation would be the entire pool of Company H's Ordinary shares. However, Mr B has found that the pool could be reduced by 30% as shares could be reserved for company employees. This had been included in the Subscription and Shareholder's Agreement Mr B says he received but didn't notice it in the body of the detailed document. He thinks that as a retail client OCP should have made him aware of this.

Clause 8 Employee Share Options of the Subscription and Shareholder's Agreement says;

> *'Options over Ordinary Shares (subject to a maximum option pool of up to 554,989 Ordinary Shares (being the current pool) plus an amount of Ordinary Shares equal to thirty per cent. (30%) of the issued share capital of the Company from time to time) may be granted to directors, employees and consultants of the Company pursuant to a Share Option Plan in such number and upon such terms as may be decided by the Board with the written prior consent of the Investor Majority.'*

While I acknowledge Mr B's first-hand knowledge and significant experience of similar investments, I note the January 2016 IM made Mr B aware that he *'…should consider seeking advice from an authorised financial adviser who specialises in advising on investing in private companies.'* And it also said that by *'submitting your completed Application Form to us you:…confirm that you will independently carry out such due diligence into any investment opportunity as you consider appropriate.'*

And I think that applies here. Mr B was given the necessary information prior to investing and it was for him to decide the level of due diligence he wanted to carry out. Either himself or by an independent adviser. I appreciate the document itself was detailed but I'm of the opinion that is the nature and risk of these types of investment and where Mr B had set himself up as a self-certified sophisticated investor. The onus was on him to satisfy himself.

OCP's role and obligations

OCP didn't provide advice to Mr B about the investment, but it did introduce him to the opportunity of it. And in doing so it had an obligation 'to provide best execution to Mr B by virtue of its due diligence process and negotiation of the terms of any investment' made on behalf of Mr B. It was to act in good faith and with reasonable care and due diligence. Mr B says OCP has breached its obligations under the FCA's Handbook of Rules and Guidance – its Principles for Businesses and Conduct of Business Sourcebook rules.

But, overall, I think what Mr B has experienced are the vagaries of investing into a high-risk investment and I am satisfied that he had the knowledge and experience to be aware of the possibility that the investment might not meet his expectations. And I'm also satisfied that OCP provided him with sufficient information in advance of him making that investment for him to understand the risks he was exposing his capital to. OCP wasn't in the position to block the 2021 round of funding or the proposal of the lead investor to alter the capital structure of Company H.

Mr B has provided estimates of his losses and said that the greater the value on exit the greater his loss will be due to the capital restructuring. But taking all of the above into account, I'm satisfied Mr B was provided with sufficient information in advance of his decision to invest and had the knowledge, experience and capacity to be aware of the risks involved in investing.

I don't agree that OCP has been negligent or not acted in his best interests. The decision to alter the capital structure, change the rights associated with and reduce the amount of

preference attached to his A Ordinary shares was taken by the company and its shareholders. I can't agree that OCP can be responsible for that decision or didn't make Mr B aware of it being a possibility.

It follows, I don't uphold Mr B's complaint. I appreciate this will come as a disappointment to him as its clear he feels strongly about it. But I hope I have been able to explain how I have reached the decision that I have.

My final decision

For the reasons given, I don't uphold Mr B's complaint about Oxford Capital Partners LLP.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr B to accept or reject my decision before 19 September 2024.

Catherine Langley
Ombudsman