

The complaint

Mr B's complaint is about the way Crowdstacker Limited presented an investment opportunity on its crowdfunding platform. He feels information about the company he invested in was misleading and Crowdstacker failed to perform sufficient due diligence on this.

What happened

Crowdstacker provides a loan-based crowdfunding facility through a peer-to-peer platform in which investors can lend to borrowers in return for interest. Crowdstacker gives information regarding investment opportunities by way of investment brochures which investors can read before selecting which loans they want to invest in.

Mr B invested £12,000 into a loan with Company A through Crowdstacker's platform in August 2017. The investment brochure explained Company A would use the loan to purchase and refurbish freehold pubs. It explained the following:

- Company A would use equity or subordinated debt to fund 30% of each acquisition, with the loaned money being used to fund the remaining 70% of the purchase price.
- An independent RICS valuation from a chartered surveyor would be obtained for each property prior to the purchase, confirming the value of the property at the time of purchase as well as the Expected Market Value (EMV) of the property.
- The loan would also be used to fund 100% of the refurbishment costs of each pub, providing that the total amount of funding did not exceed 70% of the EMV of the pub after refurbishment.
- The pubs would be operated by a separate company which I'll call Company B, which had some of the same key management as Company A.
- Interest on the loan would be paid by way of cash flow generated from the operating pubs and lenders would be paid back their capital at the end of the three-year loan term by one or a combination of the following ways:
 - The accumulated profits of Company A
 - Sales proceeds of some or all of the property assets of Company A
 - The sale of the business of Company A
 - Refinancing of the loans

The investment brochure also explained the following security would be in place for the loan:

- Each freehold property purchased would be secured by way of a first ranking legal charge registered at the Land Registry.
- The loan would be secured by way of a first ranking debenture over all the assets of Company A and the guarantor (one of Company A's subsidiaries).
- The guarantor, who was responsible for operating the non-tenanted pubs owned by Company A, would give a guarantee for Company A's obligations under the loan.

- Independent valuations would be carried out to ensure the LTV would not exceed 70% of the purchase price and EMV of the properties after refurbishment. Annual valuations on the portfolio of pubs would also be carried out and if the outstanding loan was greater than 70% of Company A's assets then the shareholders could procure a further cash injection or sell property to realise any excess capital uplift.

In October 2018, Crowdstacker emailed Mr B to explain an additional review of Company A had been triggered as Company B had gone into administration. Following this, in March 2019, Crowdstacker wrote to Mr B to explain Company A had also been put into administration.

Mr B raised a complaint with Crowdstacker as he had a number of concerns regarding its due diligence on Company A. In summary, Mr B said:

- The financial dependency between Company A and Company B wasn't fully disclosed. This was important as the failure of Company B directly caused Company A to be put into administration.
- Legal charges for the purchased freehold pubs weren't registered until September 2018. This meant Company A didn't need to adhere to the operative clauses in the legal charges, such as completing refurbish work within nine months.
- Valuations for the purchased pubs were inaccurate and the LTV of 70% was exceeded.
- Crowdstacker shouldn't have allowed Company A to overfund beyond its initial £5,000,000 target.

Crowdstacker didn't uphold Mr B's complaint. In summary, it said:

- The investment brochure made it clear that there was a link between Company A and Company B – same key individuals of the management team and that Company B would be responsible for operating the pubs.
- The purchase of the pubs was undertaken through solicitors and as outlined in the investment brochure.
- The investment brochure made it clear that the target may be extended in the future.
- The risk factors were highlighted to Mr B and the investment brochure was transparent and not misleading.

Mr B remained unhappy and so he brought his complaint to our service. An investigator looked into Mr B's complaint, but he didn't uphold it. In summary, he said:

- He was satisfied there was no financial link between Company A and Company B and the only links were those which were disclosed in the investment brochure.
- None of the securities listed for the loan were related to Company B and so he didn't agree that the failure of Company B directly caused Company A to be put into administration.
- He was satisfied Crowdstacker did take out the security detailed in the investment brochure.
- The pub valuations were conducted by Royal Institute of Chartered Surveyors (RICS) qualified surveyors and so it was fair for Crowdstacker to rely on these.
- He also hadn't seen any evidence to suggest the LTV exceeded 70%.

Mr B disagreed with our investigator's opinion. He didn't agree that there was no financial connection between Company A and Company B and directed our service to the administrator's report for Company A. He said the report referred to Company B being a connected company and that Company A was regarded as being within Company B's group with the same financial accounts. He said the fact that both companies shared key management and that the securities taken out by Crowdstacker weren't in relation to Company B was irrelevant. Rather, the key issue for him was that Crowdstacker knew there was a risk of Company A failing when Company B was put into administration and yet it still allowed Company A to continue to trade for a further two to three months.

Mr B also said the ability for Company A to repay the loan interest was dependant on the refurbishment of the pubs and without the legal charges being registered as soon as they were purchased, Crowdstacker had no way of ensuring refurbishment works happened in a timely manner. He said it's obvious that the failure to refurbish and open some of the pubs significantly contributed to investors' loss and to the subsequent devaluation of the portfolio when it came to security. And so Crowdstacker failed to ensure the loan obligations were performed on behalf of investors. He added that had he known the legal charges wouldn't be added until year after the pubs were purchased, he would never have invested.

Mr B also didn't think our investigator had addressed his concerns regarding the additional loan raise and exceeding the LTV. He said that, following an investor update in February 2018, Crowdstacker allowed Company A to raise an additional £1,400,000. And this directly contributed to his loss by way of diluting the existing security, as well as resulting in exceeding the LTV of 70%.

Our investigator considered the additional points made by Mr B, but they didn't change his thinking on the complaint. As no agreement could be reached, Mr B asked for an ombudsman to reach 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.

I'd first like to reassure Mr B that I've read all the correspondence in the file when deciding the complaint. I hope he won't take it as a discourtesy that I haven't commented on every specific point raised but it's not because I've failed to take it into account. I've instead concentrated my findings on what I believe to be the key factors in reaching a fair and reasonable outcome.

Mr B has raised concerns regarding the information Crowdstacker presented to him about the opportunity to invest in Company A. The key issues centre around the connection between Company A and Company B and the security in place for the loan (including the valuations of the purchased pubs and the LTV).

When considering these points, I've taken into account the regulatory obligations placed upon Crowdstacker at the time. The Financial Conduct Authority's (FCA) Principles for Business ("PRIN") set out the overarching requirements which all authorised firms are required to comply with. The most relevant principles here are:

- PRIN 2.1.1R (2) "A firm must conduct its business with due skill, care and diligence."
- PRIN 2.1.1R (6) "A firm must pay due regard to the interests of its customers and treat them fairly."
- PRIN 2.1.1R (7) "A firm must pay due regard to the information needs of its

clients, and communicate information to them in a way which is clear, fair and not misleading.”

Crowdstacker is also required to act in accordance with the rules set out in the FCA’s Conduct of Business Sourcebook (COBS). And the most relevant obligations here are:

- COBS 2.1.1R (1) “A firm must act honestly, fairly and professionally in accordance with the best interests of its client.”
- COBS 4.2.1R (1) “A firm must ensure that a communication or a financial promotion is fair, clear and not misleading.”

The connection between Company A and Company B

As explained above, Crowdstacker was required to ensure the information provided in the investment brochure was fair, clear and not misleading. Page 10 of the investment brochure explained the purchased pubs would be operated by Company B and it made it clear that the management team of Company A had some of the same key management as Company B.

I understand Mr B feels quite strongly the connection between the two companies went beyond that which was stated in the investment brochure. He’s referenced the following parts of the administrator’s report for Company A from April 2019 to demonstrate there was also a financial connection which wasn’t disclosed to investors:

“Whilst the pubs operated independently under management agreements, for head office functions such as maintaining accounts [Company A] historically used the services of a connected company, [Company B].

[...]

“Only the Groups management accounts for 12 months to 31 July have been provided”

[...]

“The Directors have not to date submitted a signed Statement of Affairs and have stated that they are not in a position to submit on due to inadequate books and records.”

Whilst Mr B says the above extracts show Company A and Company B were part of the same group, I think it’s important to clarify that any mention of “the Group” within the administrator’s report is in reference to Company A and its subsidiary only, as explained under the definitions section of the report. So I don’t agree that any inference to Company A being part of the same group as Company B can be made here.

I acknowledge that the administrator’s report does mention that Company A historically used the services of Company B for maintaining accounts and said it was a “connected company”. My role is not that of a forensic accountant but having looked at accounts included in the administrator’s report, it’s clear to me that these refer to the profit and losses of Company A and its subsidiary only. So whilst the accounts may have been maintained by Company B, I’ve seen no evidence to show the accounts were one in the same for Company A and Company B. Having considered information on the Companies House website for both Company A and Company B, including all administrator’s reports for both

companies, I've also found no mention of Company A and Company B being part of the same group, or as a subsidiary of one or the other. So I think it's fair and reasonable to assume the administrator was referring to the same connection as disclosed in the investment brochure.

On a final point on this matter, I understand Mr B has questioned why Crowdstacker initiated a further review of Company A following Company B being put into administration, if the two companies were not financially connected.

Many companies will use other the services of other companies in the day-to-day running of their operations. I don't think it would be fair for a pitch to mention every such company or for a crowdfunding platform to always have to investigate the financials of these connected companies. But where the use of another company's services is integral to the operation of a company, then following the failure of a connected company, I think it would be prudent for a crowdfunding platform to assess the impact of this.

In Mr B's case, Crowdstacker explained it performed this additional review to allow it to understand the impact the failure of Company B had on the operations of Company A. As explained in the investment brochure, Company B was responsible for operating the pubs Company A purchased and refurbished. The pubs operating effectively was an integral part of raising revenue for Company A to repay interest on the loan and so I'd expect Crowdstacker to review matters concerning this. So whilst I don't think Crowdstacker needed to perform due diligence checks on Company B before promoting the investment in Company A, I think it was appropriate for it to assess the impact the failure of Company B had on the operations of Company A. And, on balance, I'm not persuaded that the review was triggered due to a connection that went beyond that which was disclosed in the financial brochure.

So taking into account all of the above, I'm satisfied Crowdstacker gave Mr B fair, clear and not misleading information regarding the connection between Company A and Company B.

The security, valuations and LTV

Page 13 of the investment brochure explained what security would be in place for the loan to Company A. The first security listed was legal charges over property:

"Your Loan will be secured on each property purchased by the Company, by way of a first ranking legal charge over the property, in favour of the Security Trustee on behalf of the Lenders. Each charge will be registered with the Land Registry."

I can confirm that I've seen copies of the title deeds for each property showing that a first ranking legal charge was registered with the HM Land Registry in September 2018. I understand Mr B believes the legal charges should have been registered much sooner after the properties were purchased. Mr B has pointed to covenant 8.3 (d) within the legal charges which explains:

"The Borrower must complete all works to the Charged Property within a reasonable period to time but in no event exceeding 9 months."

Mr B says this provided further security for investors as it gave Crowdstacker the ability to exercise power of sale if Company A failed to refurbish the properties within nine months of purchase. He says that, had he known the legal charges would not be drawn up and registered upon purchasing the properties, he wouldn't have invested.

I've thought carefully about this point and whilst I think it would have been prudent of Crowdstacker to have registered the legal charges much sooner than it did, I don't agree that this would have made a material difference to Mr B's decision to invest. I say this as, at the time of investing in Company A, Mr B wasn't aware of what, if any, operative clauses would be included in the legal charges. The investment brochure simply said that first ranking legal charges would be registered against each of the properties and I'm satisfied this did happen. So I don't think it misled Mr B in this regard.

I have to be careful not to use hindsight when thinking about whether Mr B would have invested had he known the legal charges wouldn't be registered straight away. Having now seen sight of the legal charges, it's clear what operative clauses were included, but without that hindsight I don't think Mr B would have been in a position to understand what impact the late registration of these charges would have had on his investment. Ultimately, the legal charges were in place for security in case Company A defaulted on the loan. Whilst they were added later than expected, they were still registered prior to Company A being put into administration and so they were in place when security needed to be realised.

Mr B has also raised concerns regarding the valuations and LTV of the properties purchased by Company A. I understand he's questioned the accuracy of the valuations and has suggested that the LTV of 70% was exceeded when Crowdstacker allowed Company A to raise an additional £1,400,000 over its £5,000,000 target. Again, I've fully considered Mr B's points, but I haven't found anything to persuade me that Crowdstacker has acted unfairly.

The investment brochure explained the following regarding the portfolio of pubs being independently valued:

"An independent valuation of the properties will be carried out to establish the value prior to purchase and an Expected Market Value after refurbishment. The Loan to Value (LTV) will not exceed 70% of the purchase price on purchase and 70% of the Expected Market Value of the properties after refurbishment.

A further independent valuation on the portfolio of pubs will be carried out on an annual basis. If the outstanding Loan is greater than 70% of the Company assets, the shareholders take the following actions:

- *Shareholders may procure that further cash is injected into the Company by issuing shares or subordinated debt.*
- *Company may choose to sell a property in order to realise any excess capital uplift."*

Crowdstacker has explained that internal valuations were provided in January 2018 and a revised independent valuation was conducted on one of the completed pubs in January 2018. I've seen copies of the independent valuations carried out by a RICS chartered surveyor on each property. Having done so, I'm satisfied that these were sufficiently detailed to establish the prices prior to purchase and the expected market values. And so, I think it was fair for Crowdstacker to rely on these to ensure Company A met the LTV requirements. I've also seen evidence of the amount Company A contributed to the purchases, as well as completion statements which support that the LTV requirements were adhered to.

As part of Crowdstacker's further review of Company A, following Company B being put into administration, it decided to also seek its own independent red-book valuations for the

pubs to determine a prudent value for the pubs. The valuation was delivered at the beginning of December 2018 and showed a shortfall in values. Some of the shortfall was attributed to the closed pubs, as three of the seven pubs were still in the process of being refurbished prior to Company A going into administration. I've seen no evidence which shows that any of the pubs that remained under refurbishment had breached the individual pub conditions as set out in the investment brochure.

Crowdstacker has also explained that four pubs had been opened by the end of 2017. From the information supplied, the pubs, on balance at that point, had traded well and had been in-line with forecasts post refurbishment at the time under Company A's ownership. One of the pubs had traded ahead of target and this led to a revised valuation. Two of the pubs, were being refurbished and were recorded on the balance sheet at cost and not at EMV.

Crowdstacker has confirmed that the additional £1,400,000 raised was spent on the continued refurbishment of the two pubs, as well as purchasing an additional pub. This additional pub was purchased for around £446,000 with an EMV of £1,600,000 post refurbishment. Again, I can confirm that I've seen evidence which supports these valuations.

Taking into account all of the above, I'm satisfied the LTV requirements were adhered to. I say this as the unopened pubs, as mentioned above, were included in the 68% LTV calculation at cost – i.e. purchase price plus costs spent on refurbishment to date. As each pub was opened, they were to be valued at the EMV indicated in the initial valuation reports which would have added to the asset base and lowered the LTV when compared to Company A's gross assets. Furthermore, the LTV test was intended to be conducted on a pub level basis during the year to allow for each pub to be refurbished and opened so as to add value to the company assets. Again, I've seen no evidence to show there was a breach in the conditions of the loan in this respect.

On a final note on the security in place for the loan, I can confirm that I've also seen evidence to show that Crowdstacker were appointed as a security trustee over Company A and its guarantor, and that a first ranking debenture was registered over the assets of both. And that I've seen evidence that Company A's subsidiary gave Crowdstacker a guarantee of Company A's obligations under the loan. And so I have no concerns regarding these two securities mentioned in the investment brochure either.

I understand Mr B has also questioned why Crowdstacker allowed Company A to increase its loan facility as he feels this didn't demonstrate due skill, care or diligence. The investment brochure clearly explained on the FAQ page that the target could be extended in the future:

"What is the fundraising target?"

The Loans have an initial target of £5m, which may be extended in the future."

So Mr B ought to have considered any risk associated with this when he decided to invest. The purpose for the additional loan was to continue with refurbishment of two unopened pubs, as well as purchasing an additional pub, so I think it was fair for to do so as it was done so with the intention of providing further income in order to repay investors. I've also seen evidence of a Gross Assets Test conducted in December 2017 which supports the financials given in Crowdstacker's March 2018 investor update email.

Having considered everything, I'm not persuaded Crowdstacker has acted unfairly in the way in which it presented the investment opportunity in Company A and I'm satisfied it performed sufficient due diligence before doing so and throughout the loan term.

My final decision

My final decision is that I don't uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr B to accept or reject my decision before 16 August 2021.

Ben Waite

Ombudsman