

The complaint

Mr C's complains that Crowdcube Capital Limited provided misleading information about an investment opportunity it promoted on its crowdfunding platform. He says he participated in the crowdfund based on the misleading information and has now suffered a financial loss.

What happened

Crowdcube is an investment-based crowdfunding platform that promotes investment opportunities by way of pitches. Prospective investors can view information about a business and the details of the investment in these pitches on the platform before deciding whether to invest. In return for their investment they receive shares in the business.

Mr C made an investment in a food takeaway company, which I shall refer to as "Company A", via Crowdcube's crowdfunding platform in late 2017. The pitch for the crowdfunding campaign explained that:

"Having grown from 2 sites to 4 since their last round on Crowdcube, [Company A] is revolutionising the...takeout industry through its takeaway only locations with rapid delivery and custom technology. Now raising funds for further expansion."

Having already invested in Company A during an earlier round of crowdfunding in 2016, Mr C invested a further £10,000 in this fundraising round in December 2017. As Company A substantially surpassed its initial £500,000 target, the round successfully closed, and he was allocated shares.

Company A contacted Mr C in 2018 and 2019 explaining that it had decided to pivot its business model away from branded high street stores to an online delivery model. But in May 2020, Company A entered into a creditors' voluntary liquidation, following a winding up resolution being passed by its members.

In June 2021, Mr C raised concerns with Crowdcube and requested he was compensated for losses he had suffered.

In July 2021, Crowdcube responded to the complaint but didn't uphold it.

It said the pitch presented was clear, fair and not misleading. Investors had the opportunity to ask the Company A further questions, which some investors did. If investors had particular investment criteria, this would have been the appropriate juncture to ask questions to understand whether it met their investment criteria. It also said Crowdcube had no control over Company A's decision to pivot away from opening takeaway stores. Unhappy with the response, later in July 2021, Mr C contacted this service to refer his complaint to us for an independent review.

One of our investigators completed an investigation. He issued an assessment not upholding Mr C's complaint. In summary he said:

- Crowdcube needed to ensure the pitch was clear, fair and not misleading. This

- included carrying out a basic plausibility check on Company A's expansion plans.
- Crowdcube didn't obtain sufficient documentary evidence to substantiate how likely Company A's plans were to go ahead.
- As Crowdcube were aware Company A's plans for using the funds were at an early stage and this ought to have been disclosed in the pitch. But he didn't think it would have changed Mr C's decision to invest had Crowdcube disclosed that Company A's expansion plans were at an early stage. This was largely because he didn't think the evidence supported that the opening of new stores was critical to Mr C's decision to invest.
- He hadn't seen evidence of Mr C making enquiries with Company A or Crowdcube on the progress with opening new sites – including after Company A sent updates which explained it wasn't opening the sites as planned and that it was moving to a 'dark kitchen' model. He said had Mr C's decision to invest in Company A been based on the opening of physical locations, then he would've expected Mr C to have raised concerns when receiving these updates.
- He was unable to take into account issues that seem now that they're being raised with the benefit of hindsight.

Mr C didn't agree with the investigator's assessment. In summary he said he doesn't agree he would have invested despite the failings in the pitch document. He said had Crowdcube complied with its duties, it would have made it clear Company A's expansion plans were in the early stages and that this may include a change of strategy. He thinks Crowdcube should have either amended the pitch not to include incorrect information or provided a 'health warning'. Mr C doesn't agree that the fact he did not raise issues upon receipt of updates from Company A means that he should not receive compensation.

As Mr C didn't agree with the investigator's assessment, the complaint has been passed to me to decide.

Mr C made further representations for me to consider. In summary he said:

- His complaint is not that he was promised new stores and instead got new dark kitchens. His complaint is that he was promised aggressive expansion in circumstances where, had Crowdcube discharged its duties to him, he would have been made aware that Company A was unable to provide any evidence to Crowdcube that it was in a position to carry out any expansion at all. It follows that he would not have invested had he known this.
- Crowdcube knew that company A had sought to raise funds on the basis of aggressive expansion and that Crowdcube had been unable to provide any evidence this was a plausible aim. The suggestion that when approached by a company seeking investment on the back of promises of aggressive expansion that it cannot remotely evidence are realistic Crowdcube can discharge its duties to potential investors by requiring the company tone down its aims and give the vague explanation its plans are 'in the early stages' cannot be correct. There was no evidence of any plausible route to expansion regardless of how vague the pitch was.
- While updates were received from Company A in 2018 and 2019 about a pivot from expansion based on new stores to expansion based on dark kitchens, both models were models for 'expansion' which is the basis on which he invested. The updates he received did not ever give any indication that the plan for expansion had changed.
- The Investigator's finding that he ought to have complained upon learning that the plan to open new 'stores' had pivoted to a plan to open new 'dark kitchens' simply does not make sense. He had been promised in the pitch a realistic expansion plan and not a single update he received from Company A gave the impression that that plan had been materially changed. The April 2019 update makes it explicitly clear that 'the core of the plan we have set out will remain the same' despite the focus

shifting to 'dark site growth'. So he had no reason to object to this. It wasn't until receiving of an email in March 2020 explaining that the company was being put into liquidation he had cause to think something had gone wrong.

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.

At the time of promoting Company A's investment opportunity, Crowdcube was authorised and regulated by the FCA. The relevant rules and regulations FCA regulated firms are required to follow are set out in the FCA's Handbook of rules and guidance.

The FCA Principles for Business ("PRIN") set out the overarching requirements which all authorised firms are required to comply with. PRIN 1.1.1G, says "The Principles apply in whole or in part to every firm". The Principles themselves are set out in PRIN 2.1.1R. 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."

Crowdcube was also required to act in accordance with the rules set out in the 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."

So before approving Company A's pitch, Crowdcube needed to satisfy itself that the information contained within it was fair, clear and not misleading. And it also needed to be satisfied that by approving the promotion and allowing its customers to invest in Company A, it would continue to be acting in its client's best interests.

In order to satisfy itself of the fair, clear and not misleading nature of the claims or assertions made in the pitch, Crowdcube would need to carry out reasonable checks. What these reasonable checks involve, or indeed what they might be in any given case, is something which is very much left to each platform to determine and would vary according to the particular circumstances. It's clear that it wasn't the regulator's intention to provide a set of tick boxes which needed to be completed for a promotion to be approved.

I've also borne in mind that the FCA said the following in its July 2018 consultation paper on loan-based ('peer-to-peer') and investment-based crowdfunding platforms:

"It is our view that it will be unlikely that a platform could argue that it has met its obligations under Principle 2, Principle 6 (PRIN 2.1.1R) and the client's best interests rule (COBS 2.1.1R), if it has not undertaken enough due diligence to satisfy itself on the essential information on which any communication or promotion is based."

The FCA also said that:

“In relation to statements about future commercial success, this should include at least a basic plausibility check. For example, if a borrower says it is going to build a block of flats within 6 months but it does not have the relevant construction permissions, it would seem reasonable for a platform to question the plausibility of the project.”

I’ve also considered the FCA’s guidance on approving financial promotions from November 2019 which explained that firms should:

“...analyse, and carry out due diligence regarding, the substance of a promotion before approving its content for communication by an unauthorised person. The extent and substance of the analysis and diligence needed to be able confirm that a promotion is fair, clear and not misleading will vary from case-to-case and will depend on the form and content of the promotion. When assessing whether a promotion is fair, clear and not misleading, a firm may need to consider (among other things):

- The authenticity of the proposition described in the relevant promotion.”

Whilst I appreciate Mr C had invested prior to the publication of these consultation papers and guidance, I still feel they are relevant as they provide clarity as to the interpretation and application of the existing rules and guidance which were applicable to Crowdcube at the time.

The FCA’s website provides consumers with useful information on crowdfunding. This includes a section on how consumers should protect themselves before investing and says they should first understand what due diligence a platform performs on investee companies. Looking at Crowdcube’s website, it makes it clear what due diligence it performs in its due diligence charter. It explains:

“The following due diligence is carried on each company before the pitch is open to investment: [...]

- fact check all statements and claims made in the pitch text to ensure it is fair, clear and not misleading by obtaining, where possible, independent evidence.”

Taking into account the above, it’s clear that Crowdcube’s due diligence needed to be sufficient to satisfy itself on the essential information on which the promotion of Company A was based. Crowdcube also needed to check that the claims made in the pitch were authentic by way of a basic plausibility test. Further, Crowdcube needed to make Mr C aware of the extent of which it performed due diligence on Company A, let him know the outcome of this and for it to be sufficiently detailed to allow him to weigh up the risks and benefits of investing in Company A.

Essentially Mr C complains that he was misled about how the funds raised through the crowdfund would be used by Company A – based on what he saw in the promotion provided by Crowdcube. I’ve reviewed the original promotion and note there is limited information on exactly what the funds would be used for. There is a short section that talks about how Company A had doubled its number of sites from two to four and it was looking for further expansion but no more detail than that.

Mr C has referred to information that was provided in an invitation email and a business plan presentation that Company A sent him – for example the references he makes to being told about an aggressive expansion. But this information comes from a restricted document. This means its contents was not approved by an authorised person (i.e. Crowdcube). Essentially

Crowdcube didn't need to ensure the information in these documents was clear, fair and non-misleading. Crowdcube were promoting an investment into a non-readily available security that was high risk in nature. So, it is correct to say how the funds were intended to be used by Company A was essential information that prospective investors, like Mr C, would need to enable them to make a reasoned decision to invest or not. But only to the extent of the information provided in the pitch – not the contents of the business plan or email.

Crowdcube has provided notification to show the due diligence it carried out before promoting the investment opportunity. A key element of this was how it satisfied itself of the plausibility that Company A would use funds for further expansion by opening new sites. Crowdcube says it discussed this with Company A, and was told by Company A that it had a number of locations in mind but plans were at an early stage, so there was limited documentary evidence available. Crowdcube said it was satisfied the plans were genuine. To support this, Crowdcube has provided notes from its call records with Company A – including those from a call in November 2017, shortly before promoting the investments. This includes the following note from this call:

“4 units currently – ‘several more in the pipeline’ – what does that mean?”

This is evidence to support that Crowdcube did perform due diligence – including that related to Company A's plans to open new sites. But what is missing is Company A's response to the above question, so it is unclear what further enquiries or indeed whether Company A responded at all. In its defence of the complaint, Crowdcube said it didn't promote the opening of specific sites at any point and rather, promoted Company A had expanded from two sites to four and intended to expand further. But I'm not persuaded by Crowdcube's arguments. It was obliged to ensure the promotion was fair, clear and not misleading. But it's not clear what “further expansion” means from the promotion. I think it is reasonable to conclude from the following extracts, “having grown from two sites to four”, and “now raising funds for further expansion” that Company A was looking to open up new sites with the funding. This is supported by the fact there is evidence that Crowdcube asked Company A questions about opening new sites. All of this leads me to the conclusion that Crowdcube didn't meet its obligations.

In my view Crowdcube should have completed a basic plausibility check on the statement of future expansion as it is relevant to the future success of Company A. I accept there may be difficulty in testing the plausibility of whether Company A would do what it says it intends to do in the promotion. I also understand that Crowdcube tested the plausibility of the statement of further expansion by combining Q&A with Company A with evidence of its track record of opening new sites. But from the information I've seen, its apparent Crowdcube knew Company A's plans for using the funds were at an early stage and were not substantiated with sufficient documentary evidence for it to conclude how plausible these plans were. I think this something Mr C should have been made aware of – but I don't think the available evidence supports that Crowdcube did this. So, this is another reason why I don't think Crowdcube met its obligations under COBS 4.2.1R (1) – the fair, clear and not misleading rule.

I also don't think it can be argued that Crowdcube met its obligations under Principle 6 (PRIN 2.1.1R (6)) – the client's best interest rule. Crowdcube needed to safeguard investors, like Mr C, interests. To do this I think it should have asked what Company A meant by further expansion and checked whether this was plausible. For example, Crowdcube could have performed a plausibility check by obtaining lease documentation (like it did for the two previous stores) to establish if it intended to open at new sites. Or it could have asked for evidence of agreements in principle or anything to demonstrate Company A intended to

open new stores. I haven't seen that it did this, so it follows that I find it didn't act in Mr C's best interest by failing to.

To be clear, I haven't agreed with Mr C's view that Crowdcube is responsible for ensuring the accuracy of promised aggressive expansion. This statement didn't form part of the pitch approved by Crowdcube. As I've previously mentioned, Crowdcube wasn't required to perform due diligence checks on the business plan document. So, I haven't found that it is responsible for the statements and information Mr C claims are misleading from this document.

Whilst I think there was a failing in Crowdcube's due diligence, in order to uphold the Complaint, I'd need to be satisfied that Mr C wouldn't have invested had Crowdcube made him aware that Company A's expansion plans were at an early stage and weren't substantiated with documentary evidence. I've thought very carefully about this, but on balance, I'm persuaded he would have still invested despite Crowdcube's failing. I know this will be disappointing for Mr C, but I'll explain why I've reached this outcome.

I understand Mr C says he wouldn't have invested had he known Company A's expansion plans weren't substantiated, but I have to consider that he's complaining with the benefit of hindsight, with Company A having been liquidated. The failure of Company A in itself isn't evidence that Mr C wouldn't have invested. This is just the materialisation of the key risk of investing in crowdfunding opportunities.

I acknowledge Mr C says he isn't complaining about the move from opening new stores. So, when the notices from Company A were sent in 2018 and 2019 to explain it had decided to pivot its business model, this didn't cause him concern as it was still realistic expansion. I agree the decision to pivot isn't relevant to the failing I've identified as Crowdcube wasn't aware of Company A having any intentions to change plans at the time of promoting the investment.

I've already explained that from the information in the pitch, it is reasonable to conclude that Company A was looking to open up new sites with the funding. There is no other reference to different forms of expansion. So to bring it back to the failing I've identified, what I need to decide is whether Mr C would've still invested had he been told that Company A's plans to open new stores were at an early stage and that Crowdcube hadn't seen any documentary evidence to substantiate the plans. When the 2018 and 2019 updates were provided, this was a material change to the plan for expansion. Despite receiving these updates, Mr C didn't contact Company A or Crowdcube to query this change. I would have expected to see some evidence to support this – such as queries raised at the time of investing or after being notified of Company A pivoting its plans. But if as Mr C now says, the type of expansion wasn't a concern to him, then it doesn't seem understanding that plans for new stores were at an early stage would have put him off investing – especially if the opening of new stores wasn't critical to his decision to invest.

Whilst the pitch explained what Company A wanted to use the funds raised for, it also provided financial information which may have influenced Mr C's decision to invest. This included information regarding Company A's revenue and sales growth:

“Our revenue in 2016 was £1.23m with EBITDA of - £300k...We have seen sales grow by 75% to October and are profitable at store level since October.”

The pitch also spoke ambitiously about the potential market of the takeout industry and Company A's position in it. Mr C has also explained that he had previously invested in Company A through Crowdcube. As far as I'm aware he isn't complaining about the first investment he made into Company A in 2016. So, investing for a second time suggests he

had faith in the potential of the company. In my view, it's clear there may have been a number of reasons as to why Mr C may have decided to invest in Company A. And as Mr C didn't raise any concerns at the time Company A deviated from the plans provided in the pitch, this further supports that he invested in Company A as he had confidence in the overall financial prospect of the business and would've done so even if he had been told the expansion plans were at an early stage.

So taking into account all of the above, I haven't found evidence to persuade me that clearer information about the expansion plans would have changed Mr C's decision to invest.

My final decision

My final decision is that I don't uphold Mr C's complaint against Crowdcube Capital Limited.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr C to accept or reject my decision before 5 August 2022.

Daniel Little
Ombudsman