complaint

Mr S' complaint is about the way Crowdcube Capital Limited presented an investment opportunity on its crowdfunding platform. He feels information about the company he invested in was inaccurate and Crowdcube should have checked this.

background

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 S made an investment in a food takeaway company (Company A) via Crowdcube's crowdfunding platform in 2016. This raise was to fund the opening of two new sites, having previously grown from two to four sites. Mr S received an email in December 2017 from Company A explaining it was launching another crowdfunding campaign to raise funds to open up two additional sites.

This crowdfunding campaign was also promoted through Crowdcube. The pitch 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."*

Mr S invested around £18,000 in Company A during this fundraising round and as Company A substantially surpassed its initial £500,000 target, the round successfully closed in January 2018 and he was allocated shares.

Mr S said he was led to believe that Company A was going to use his investment, in part, to open up new sites, as confirmed in its business plan. In May 2018, Mr S began emailing Company A to enquire when the new sites would open. In July 2018, he arranged to meet with one of Company A's directors to express his concerns about the lack of information given about the new sites opening. Mr S continued his enquiries and when he later found out that Company A wouldn't be opening up the new sites, he requested that Company A buy his shares back, but it declined.

Mr S raised a complaint with Crowdcube as he felt the information it had provided him with was misleading. He said that, had he known that Company A wasn't going to use his investment to open up new sites, he would never had invested.

Crowdcube looked into Mr S' complaint but didn't uphold it. In summary it said:

- Mr S undertook an assessment to confirm he understood the risks of investing crowdfunding and self-categorised himself as a sophisticated investor.
- Its terms and conditions make it clear that Crowdcube may approve statements that convey ambitions even where it does not believe or does not have a view on whether it is likely that these ambitions will be fully realised.
- Company A underwent its standard due diligence process before approving the pitch.
- Company A originally planned to open further sites as set out in its business plan, but after the fundraising round closed, its directors reviewed the costs in light of changing market conditions and decided it wouldn't be in the best interest to open the sites.
- Crowdcube spoke to Company A to understand the reasoning behind this change in the business model and didn't uncover anything that was premeditated or untoward in their decision.
- It believes it would be counter intuitive to investor protection to bind a business to execute only one business plan as this may lead to a loss of investment.

One of our investigators looked into Mr S' complaint but didn't think Crowdcube had done anything wrong. In short, he said:

- He was satisfied Mr S was aware of the risks involved in crowdfunding.
- Crowdcube doesn't endorse or own the businesses it promotes on its platform.
- Crowdcube made Mr S aware that forward-looking statements and entrepreneur opinions in the pitch may not turn out to be correct and many early stage companies fail.
- Having read Crowdcube's risk warnings and due diligence charter, it's clear Crowdcube isn't responsible for a business making a decision after receiving funding via the platform and so it had no control over how Company A should use the funds.

Mr S didn't agree with the investigator. In summary, he said:

- The majority of the information about the investment promotion was contained within Company A's business plan.
- One section of this included a geographical store rollout plan showing that three new sites were in the pipeline to be opened.
- Another section explained that half of the £500,000 Company A was looking to raise would be used to open a new site and referred to one other site already being in the pipeline.
- Company A's business plan was a restricted document which Crowdcube said it didn't conduct due diligence on. But by allowing the key details of the investment promotion to be contained in this restricted document, which was exempt from due diligence checks, meant that Crowdcube hadn't acted fairly or professionally in accordance with his best interests.
- It wasn't made clear to him that restricted documents weren't subject to Crowdcube's due diligence – he'd since looked on Crowdcube's website and found this information but explained that it wasn't easy to find.
- He fully expected Crowdcube to have seen evidence of leases and other necessary agreements to show that the new sites were either in place, or under negotiation, before promoting the investment.

- Overall he felt Crowdcube's promotion of the investment opportunity in Company A was not fair and clear and non-misleading and that its due diligence analysis could and should have detected some warning signs that the sites wouldn't be opened.

As an agreement couldn't be reached, the case was passed to me to decide.

Having passed the case to me for a decision, Crowdcube made the following further representations:

- It didn't conduct due diligence to verify what *"further expansion"* entailed as it is an understood action of raising finance.
- The information about opening up new sites was only contained in Company A's business plan. This was a restricted document which was only made available to members who requested this directly from Company A.
- It made it clear to investors that it doesn't review or approve restricted documents. And such documents are exempt under the Financial Services and Markets Act (Financial Promotion Order) 2005 (FSMA).
- It's not in contention that Company A changed its strategy and did not open further sites, but this is not the same as saying that the financial promotion was misleading.
- It agreed that if there was no real plausible prospect of further sites being opened, then that would have been misleading. However, it didn't think that was the case here.
- It said that it had verified Company A had grown from two sites to four between the fundraise in 2016 and December 2017. So it was completely plausible that Company A would be able to expand by adding further sites. Company A had done it before, it had experience of doing so and there wasn't any particular barrier to do so again.

Mr S also made our service aware that Company A had since entered into creditors' voluntary liquidation, following a winding up resolution being passed by Company A's members in May 2020.

I issued a provisional decision in December 2020. In it I said:

It clear to me that Mr S' decision to invest in Company A was based on his understanding that it was going to use the funds raised to open up new stores. Company A isn't authorised and regulated by the Financial Conduct Authority (FCA), so I can't consider its decision not to use the money raised in this way.

Instead, Mr S' complaint is against Crowdcube as the crowdfunding platform that promoted the investment opportunity. Crowdcube is authorised and regulated by the FCA and as such, my provisional decision will be limited to the actions of Crowdcube.

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. The Principles themselves are set out in PRIN 2.1.1R. The most relevant principles here are:

Principle 2 (PRIN 2.1.1R (2)) - "A firm must conduct its business with due skill, care and diligence."

And Principle 6 (PRIN 2.1.1R (6)) - "A firm must pay due regard to the interests of its customers and treat them fairly."

Crowdcube is 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."

And COBS 4.2.1R (1) - "A firm must ensure that a communication or a financial promotion is fair, clear and not misleading."

In determining whether Crowdcube has adhered to its regulatory obligations in Mr S' case, I've referred to the FCA's consultation paper on loan-based ('peer-to-peer') and investment based crowdfunding platforms for guidance. Whilst I appreciate Mr S invested prior to the publication of the consultation paper in July 2018, it's still relevant as it provides clarity as to the interpretation and application of existing rules and guidance which were applicable to Crowdcube at the time. In this, the FCA explained:

> *"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."*

Therefore, Crowdcube had to satisfy itself on the essential information on which the promotion of Company A was based. Mr S' complaint is particularly unusual in its circumstances because there was little in the way of essential information contained within Company A's pitch. Instead, much of the essential information on which the promotion was based was contained within Company A's business plan - a restricted document, not approved by an authorised person and so under FSMA, Crowdcube didn't need to ensure it was clear, fair and non-misleading.

The crux of Mr S' complaint is that Company A didn't use the funds raised in the way in which Crowdcube promoted it would. However, there is a distinct lack of information provided in the pitch about what Company A wanted to raise funds for. The only information given on this point is:

> *"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."*

The pitch provides no further clarification regarding what further expansion for Company A entails. Clearly, how a business intends to use funds raised through crowdfunding is essential information which should be provided to investors to enable them to make a reasoned decision to invest or not. Providing all relevant and essential information is especially important considering Crowdcube was promoting high-risk, non-readily realisable securities to Mr S.

Whilst I appreciate Crowdcube's point that further expansion is an understood action of raising finance, I think it's fair to say that this is a particularly vague statement which could be interpreted by an investor to mean a variety of intended business ventures. In Mr S' case, there's no doubt in mind that he understood this to mean Company A was going to open up new stores. I say this as he'd received an email from Company A prior to him deciding to reinvest which explained:

> *"We have decided to launch a crowdfunding campaign. We are in a really good place at the moment, showing 14% like for like growth and profitable at store level. Having said that, we need to add two more stores to become profitable enough at head office level to pursue debt financing and more organic store growth."*

In addition to this, Company A's business plan explained that Company A was, "looking to raise a minimum of £500,000 for a new store and other business improvements", and it further explained that £250,000 would specifically be used to open a new store. As I've previously mentioned, Crowdcube wasn't required to perform due diligence checks on this document. However, this doesn't distract from the fact that Crowdcube was still required to promote the investment opportunity in Company A in a clear, fair and non-misleading way and so it ought to have checked what Company A meant by further expansion.

The FCA said in its July 2018 consultation paper 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."*

Further expansion is clearly a statement about future commercial success and as such, Crowdcube ought to have conducted at least a basic plausibility check on this. Crowdcube has explained that it believed it to be completely plausible that Company A would use the funds for further expansion. It said it verified, through lease documentation, that Company A had grown from two stores to four between the fundraise in 2016 and December 2017. So it saw no reason not to believe that Company A could do the same again following this fundraising round. Whilst I agree that this is sufficient due diligence to support the first part of the pitch statement of, "Having grown from 2 sites to 4 since their last round on Crowdcube", I don't agree that such checks are sufficient to confirm the plausibility of further expansion. I say this as just because a business was previously able to expand, by way of opening up new stores, doesn't necessarily mean it will be in a position to expand in the future.

In order to safeguard investors such as Mr S, Crowdcube ought to have asked what Company A meant by further expansion and should have checked whether this was plausible. Considering Crowdcube had seen lease documentation for the two previous stores, an example of how it could have performed a plausibility check could have been by obtaining similar documentation for any new stores it intended to open. Even if the documents weren't yet finalised, Crowdcube could have asked for evidence of agreements in principle or anything to demonstrate Company A intended to open new stores. In the absence of this information, I don't think it can be argued that Crowdcube was acting in Mr S' best interests, as it failed to ascertain how Company A would expand and how plausible these plans were.

Whilst I accept that a business may have to change its plans following a fundraise, the question I have to consider is whether Mr S would have invested in Company A had he known that Crowdcube hadn't verified what Company A meant by further expansion or checked how plausible these plans were. I've thought very carefully about this in the whole context of what Mr S thought he was investing in, and having done so, I don't think he would have invested. I say this because shortly after re-investing in Company A he contacted it to enquire about it implementing the plans to open the new stores. And as soon as he discovered Company A wasn't going ahead with these plans, he asked it to buy back his shares. This isn't to say that all investors in Company A wouldn't have gone ahead with the investment, but rather that I'm satisfied that it would have made a material difference to Mr S.

For these reasons, I'm currently minded to uphold Mr S's complaint. As such, I consider Crowdcube ought to compensate him.

putting things right

When looking to put things right for Mr S, my aim is to put him as close as possible to the position he would've been in but for Crowdcube's error.

As I've said above, I'm satisfied Mr S wouldn't have gone ahead with his investment. So as a minimum, I'm persuaded that he ought to receive the amount he invested in Company A back. I understand Company A has been wound up and as such, the shares Mr S has in Company A are worthless. If my understanding on this is wrong I'd be grateful if the parties could clarify the situation in response to this provisional decision.

The question is therefore whether Mr S ought to receive a return or interest on this money. I've considered this carefully, but I'm currently not minded to award Mr S any additional interest. I say this because I'm also satisfied that Mr S would likely have looked for another opportunity to invest at the time. And given the generally higher risk nature of these investments, and the likelihood that these companies might fail, I consider there was an equal chance that Mr S may have lost some or all of his investment anyway. I acknowledge that he might also have made a return. But without the benefit of hindsight, it simply isn't possible for me to fairly establish what return Mr S would likely have made.

So in my view, the fair and reasonable way of putting things right for Mr S is for Crowdcube to pay him the capital he invested in Company A – which I understand was £18,000.

Crowdcube's response to my provisional decision

Crowdcube didn't accept my provisional findings. It said it did conduct due diligence on what Company A meant by "*further expansion*". It maintained, in terms of testing plausibility of expansion plans at such an early stage of development, that the past performance of Company A was the best test of whether it was plausible it could expand by opening more sites. It also provided call notes to evidence the conversations it had with Company A about its early stage plans.

Crowdcube also said that, given the significant investment Mr S made in Company A and his assertions that he was investing based on it opening new sites, it's highly unusual that he made no enquiries about Company A's plans. It said it goes to great lengths to point out to investors throughout the investment process that they should do their own due diligence, but Mr S failed to do so.

Crowdcube also said it was inappropriate to hold it entirely responsible for Mr S' loss as any loss was as a result of Company A failing - not by the actions of Crowdcube. And that it had no control over the internal decision of Company A not to open up new sites.

Finally, Crowdcube questioned whether £18,000 was Mr S' actual loss as he may have been able to claim certain tax reliefs. It said the investment in Company A qualified for Enterprise Investment Scheme (EIS) relief of 30% of the amount invested and so any award should take this into account, as well as that he should have mitigated his loss by also claiming loss relief.

Mr S' response to my provisional decision

On the whole, Mr S was happy with my findings. However, he felt that interest should also be awarded, as he says he wouldn't have invested in another crowdfunding opportunity, if not in Company A.

He also added that he had made considerable effort to mitigate his loss by making best endeavours to get Company A to buy back his shares.

I wrote to both parties to clarify my provisional findings around redress which I will address in my findings below. Prior to this, Crowdcube put forward an offer to resolve Mr S' complaint but he didn't accept it. And so a final decision is still required.

my findings

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

I don't intend to repeat the findings I made in my provisional decision – they are set out above and I don't consider the information Crowdcube has provided in response to that provisional decision makes a material difference to what I've previously said. However, I do intend to address in more detail some of the issues which Crowdcube has raised in response to my provisional decision, and which it considers ought to mean this complaint shouldn't be upheld.

Whilst I've considered all of Crowdcube's points, my decision will focus on what I think are the key issues in dispute – mainly the extent to which Crowdcube performed due diligence and whether the pitch was fair, clear and not misleading.

The FCA doesn't outline the due diligence process a platform should perform, nor does it prescribe a set minimum standard of due diligence. The FCA recognised this in its March 2014 publication on the regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media:

> *"4.22 Some respondents asked for guidance to explain in more detail what the disclosure requirements and due diligence requirements are in relation to the offers made by investee companies."*

The following was the FCA's response to this in the publication:

> *"The financial promotion and disclosure rules continue to apply. Firms that communicate or approve financial promotions will need to ensure that they comply with the rules, particularly the requirement for the promotion to be fair, clear and not misleading.*
> *[…]*
> *In satisfying the financial promotion rules we expect sufficient detail to be provided to give a balanced indication of the benefits and the risk involved, including whether or not any due diligence has been carried out on an investee company, the extent of the due diligence, and the outcome of any analysis."*

So although there isn't a prescribed amount of due diligence a platform should perform, it's clear that in order to comply with the fair, clear and not misleading requirement, Crowdcube needed to make Mr S aware of the extent of which it performed due diligence on Company A. It also had to 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.

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 preforms 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."*

As I explained in my provisional decision, there was a distinct lack of statements or claims made in the pitch for Crowdcube to have fact-checked. However, the pitch did say Company A had gone from two sites to four since its last round on Crowdcube and that it was raising funds for further expansion, so it ought to have fact-checked this by way of its due diligence.

Since issuing my provisional decision Crowdcube has provided more clarity around the due diligence it performed. It says that in order to satisfy itself it was plausible Company A would use funds for further expansion by opening new sites, it discussed with Company A what further expansion would look like. Crowdcube says Company A advised that it had a number of locations in mind but as these plans were at a relatively early stage, there was limited documentary evidence available. It also says it was clear from the discussions it had with Company A that these plans were genuine. Crowdcube has provided records of what discussed during these calls to illustrate this. A record from a call in November 2017, shortly before the pitch went live, says:

> *"4 units currently – 'several more in the pipeline' – what does that mean?"*

This shows Crowdcube did perform due diligence and that, as a part of this process, it questioned Company on its plans for opening new sites. However, there was no information recorded about Company A's responses and so it's unclear what further enquiries Crowdcube made or to what extent Company A responded.

I understand Crowdcube feels strongly that 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. I'm afraid I don't agree. Crowdcube had a regulatory requirement to ensure the promotion of the investment in Company A was fair, clear and not misleading. It's not clear what "*further expansion*" means and the pitch provides no further clarity. I think any reasonable person reading "*having grown from two sites to four",* followed by (in the next sentence) "*now raising funds for further expansion*" would reasonably assume that Company A was looking to open up new sites with the funding. The fact that Crowdcube asked Company A questions about opening new sites further supports this. In other words, the pitch was at best unclear, and at worst misleading.

I appreciate the difficulty a platform faces in testing the plausibility of whether an investee company will do what it says it intends to do in its pitch. And I 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. However, its apparent in Mr S' case that 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. Yet Crowdcube didn't make Mr S aware of this anywhere in the pitch. And in not making him aware, I 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* or under COBS 4.2.1R (1) – *the fair, clear and not misleading rule.*

The pitch didn't provide sufficient detail to give Mr S a balanced indication of the benefits and the risk involved in Company A. As far as Mr S was concerned, Crowdcube had fact-checked Company A's plans for expansion in line with its due diligence charter and it was reasonable for him to believe these included plans for opening new sites. There was no reason for him to believe these weren't sufficiently substantiated or that there was a risk that Company A might not open up any new sites.

As I've said above, I think Mr S was reasonably entitled to conclude that further expansion would involve the opening of new sites. And given everything Crowdcube said it did before approving a pitch, I'm persuaded he thought Crowdcube had satisfied itself about Company A's plans for further expansion. In my view, Mr S was entitled to know that there was in fact no evidence of any concrete plans for further expansion. Mr S would then have been able to decide for himself whether to believe Company A's aspirational claim knowing that there was, in fact, nothing but its previous expansion to support this. Mr S contacted Company A several times after investing to ask when it would be opening the new sites. And when he found out Company A wasn't going to open these, he immediately asked it to buy back his shares. So I'm persuaded this was a key reason for him to decide to invest. And therefore, I'm satisfied that if Mr S had known that there were in fact no concrete plans for this further expansion, and that as part of Crowdcube's due diligence, no evidence of these further plans had actually been uncovered, he wouldn't have invested.

putting things right

As explained above, I'm satisfied Mr S wouldn't have gone ahead with his investment in Company A. So the starting point is to repay him the £18,000 capital he invested. However, I understand the investment qualified for EIS (Enterprise Investment Scheme) tax relief and so Mr S could have claimed up to 30% of the money he had invested in tax relief – so it's fair for Crowdcube to deduct this full amount.

But if Mr S can provide evidence directly to Crowdcube that he wasn't able claim the full 30% tax relief, then Crowdcube should only deduct the actual amount he was able to claim.

If for any reason HMRC were to subsequently disallow that tax relief claimed, upon evidence of such, Crowdcube need to pay him the amount deducted in light of the available reliefs taken within 28 days of Mr S notifying them and providing evidence.

I understand Crowdcube has also said that loss relief should be deducted. I've considered the evidence Mr S has given me, and I'm not persuaded on balance that Mr S did in fact claim loss relief. I appreciate Crowdcube believes that this relief might be available in the future. This would depend on Mr S' future circumstances which aren't known at this moment in time. My role is to decide matters in a fair and reasonable way and with a minimum of formality, as well as to give some finality to the complaint. I consider it fair and reasonable that I also bear in mind my findings above, that none of this would've occurred if Crowdcube had correctly promoted this investment to Mr S. Therefore, I don't consider it would be fair and reasonable to require Mr S to be under an ongoing duty to disclose or provide more information in the future about his personal circumstances. For these reasons, I'm satisfied that only the relief which Mr S has actually claimed and received ought to be taken into account by Crowdcube for the purposes of paying compensation.

I've also considered Mr S' points regarding interest. However, I'm not persuaded it would be fair and reasonable to award this in all the particular circumstances of this case. I say this as I have to consider putting him back in the same position he would have been in had he not invested in Company A. And I must do so without the benefit of hindsight. It's clear he was looking to invest in a crowdfunding opportunity at the time of investing in Company A and I'm aware he had previously invested in crowdfunding opportunities before this - as recently as a couple of months before investing in Company A. I understand Mr S says he wouldn't have invested further in crowdfunding beyond this investment, however, I'm not persuaded this would had been the case had his investment in Company A not ended badly. As I've said, I'm satisfied he would likely not have invested in Company A – but probably would've invested in another, similar crowdfunding opportunity.

As explained in my provisional decision - given the generally higher risk nature of these investments, and the likelihood that these companies might fail, I consider there was an equal chance he may have lost some or all of his investment had he invested in another crowdfunding opportunity other than in Company A. I acknowledge that he might also have made a return. But without the benefit of hindsight, it simply isn't possible for me to fairly establish what return he would likely have made, if any. For these reasons, I consider that fair and reasonable compensation be a return of Mr S's initial investment, subject to the deduction of any tax relief that he claimed at that time.

my final decision

For the reasons given above, I uphold this complaint and direct Crowdcube Capital Limited to put things right as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr S to accept or reject my decision before 12 April 2021.

Ben Waites
Ombudsman