complaint

Mr T'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 company and the details of the investment in these pitches on the platform before deciding whether to invest

Mr T made an investment in a company (Company A) via Crowdcube's crowdfunding platform in July 2018. Mr T was allocated shares in August 2018 following a successful fundraising round. But shortly afterwards Mr T lost all the money he'd invested as Company A went into administration.

Mr T complained to Crowdcube saying the information included in Company A's pitch was misleading. He said the pitch mentioned Company A had completed a merger which attracted additional investment. But after Company A went into administration, its chief executive officer (CEO) confirmed the merger hadn't completed at the time of the pitch and so it never received these additional funds. Mr T said Crowdcube didn't do enough to check whether the merger had in fact completed.

Mr T also raised some concerns about the emails he'd received after the fundraising round had closed. He said the first of these confirmed his investment would proceed and be legally binding unless he contacted Crowdcube before the deadline expired. However, once it had expired, he received another email explaining the valuation of Company A had more than halved. Mr T said at the time he thought the second email was just a copy of the first one and so he didn't respond. He said Crowdcube should have made it clearer that the first email was void, but regardless of this, he'd agreed to what was said in the first email and this had become legally binding before the second email was sent. Mr T said Crowdcube should have cancelled the investment due to this material change and refunded his money.

Crowdcube didn't agree that the pitch was inaccurate or misleading. It said any claims made on Company A's pitch were subject to its standard due diligence checks and were verified with evidence before being approved. It also explained the second email gave Mr T the opportunity to withdraw from his investment but as he didn't decide to do this his investment went ahead.

One of our investigators considered the complaint but didn't uphold it. He said Crowdcube didn't give advice to Mr T, so it was ultimately his decision to invest in Company A and that this was all explained in Crowdcube's Investor Terms.

Our investigator explained that Crowdcube had provided evidence of its due diligence of Company A, which included Companies House records and media articles suggesting the merger had completed. He felt Crowdcube had carried out sufficient due diligence to satisfy itself that the information included in the pitch about the merger and the additional investment it attracted wasn't false or misleading.

Our investigator also considered the emails Crowdcube sent Mr T. He said Mr T was provided with an updated legal review document which outlined the reasons for the revised valuation of Company A. He also noted that, as a result of this change, Mr T received twice as many shares for investing the same amount of money. So as Mr T hadn't contacted Crowdcube at the time to say he didn't want the investment to proceed, our investigator didn't think Crowdcube had done anything wrong.

Mr T didn't agree. He said he based his investment decision on information which was incorrect and that he was sure the merger hadn't completed at the time of the pitch. He also said it was unfair for Crowdcube to change the terms of the investment after the first deadline had expired.

So the complaint has been passed to me to decide.

my findings

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint. Having done so, I don't uphold this complaint for broadly the same reasons as the investigator. I understand this will come as a disappointment to Mr T, but I'll explain my reasons why.

I think there are two potential questions that I need to consider in order to fairly and reasonably determine Mr T's complaints.

- Was it reasonable for Crowdcube to have concluded from its due diligence that the merger had completed, and that Company A had received the additional investment this attracted?

- Was it fair for Crowdcube to allow Mr T's investment to proceed despite the change in Company A's valuation?

Before I'm able to answer these questions, I've considered Crowdcube's role and relationship it has with investors, as well the regulatory and legal framework involved.

Crowdcube's role and relationship with its investors

I can only consider the actions of Crowdcube and in doing so it's important to understand the role and relationship it has with Mr T as an investor.

Crowdcube's Investor Terms sets out the terms and conditions forming the basis of this relationship. These explain:

"8.2. The Investor acknowledges that Crowdcube approves each Pitch as a financial promotion but does not provide advice or any form of recommendation regarding the suitability or quality of the Investment…

…8.3. The Investor acknowledges and accepts that the Website includes a forum which is an integral part of an Investee's Pitch which is intended as a service to Investees to put them in contact with Investors, and thus that Crowdcube's investigation of the Investees and the content of their Pitches is limited, and accordingly Crowdcube makes no warranty or representation and assumes no liability in respect of the Investees or the content of their Pitches. The Investor must make his/her own assessment of the viability, accuracy and prospects of the Investees, their Pitches, and any relevant investment propositions and should consult his/her professional advisers should he/she require any assistance in making such an assessment or should the Investor require any services whatsoever in connection with Crowdcube. In particular, the attention of the Investors' is drawn to the disclaimer, risk warning and regulatory notice on each Pitch."

It's clear from the Investor Terms that Crowdcube provides potential investors with different investment opportunities by way of pitches, but importantly, it gives no advice or recommendations to its investors. Ultimately, the decision to invest is made at the investor's own risk and Crowdcube encourages them to do their own research. This is also explained in Crowdcube's due diligence charter:

"Crowdcube does not endorse any of the businesses raising finance on the platform, nor do we provide investment advice of any description, so before deciding to invest we strongly encourage all Crowdcube members to undertake their own research and if there is uncertainty, to receive independent advice before investing."

Crowdcube also has risk warnings on its platform to ensure investors are made aware of the risks involved in investing via crowdfunding. The following risk warning was provided on Crowdcube's platform at the time Mr T invested in Company A:

"Investing in start-ups and early stage businesses involves risks, including illiquidity, lack of dividends, loss of investment and dilution, and it should be done only as part of a diversified portfolio.".

This also included a link to read Crowdcube's full risk warning which provided more detail of the risks involved.

the regulatory and legal framework

While I've considered the Investor Terms which say Crowdcube's investigation is *limited* and that it doesn't *endorse* any pitches, I've also taken into account the wider obligations on Crowdcube.

At the time of promoting Company A's investment opportunity, Crowdcube was authorised and regulated by the Financial Conduct Authority ("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) which says:

"A firm must conduct its business with due skill, care and diligence."

And PRIN 2.1.1R (6) which says:

"A firm must pay due regard to the interests of its customers and treat them fairly."

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) which says:

"A firm must act honestly, fairly and professionally in accordance with the best interests of its client."

And COBS 4.2.1R (1) which says:

"A firm must ensure that a communication or a financial promotion is fair, clear and not misleading."

I've also considered these relevant rules and regulations when reaching my decision.

was it reasonable for Crowdcube to have concluded from its due diligence that the merger had completed, and that Company A had received the additional investment this attracted?

The main point of contention regarding the pitch is the merger. The pitch stated that:

"The merger deal, completed in May 2018, attracted an additional £6m from existing shareholders plus £9m in media for equity across Sky and Channel 5, and a multi-million pound media spend with Channel 4 in return for a stake in the combined business."

Mr T believes that the merger hadn't completed before Crowdcube promoted the investment and it either knew or ought to have known this. I understand that part of this belief stems from the comments made by the former CEO of Company A. But Crowdcube said it believed the merger had completed.

As I've highlighted above, there was an obligation on Crowdcube to *conduct its business with due skill, care and diligence*, as well as to *ensure that a communication or a financial promotion is fair, clear and not misleading*. While I've considered that Crowdcube said it will do a light touch check, I've 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."

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 T had invested prior to the publication of the consultation paper and guidance, I still feel both are relevant as they provide clarity as to the interpretation and application of existing rules and guidance which were applicable to Crowdcube at the time. As such, Crowdcube's due diligence needed to be sufficient enough to satisfy itself that the claims made in Company A's pitch were authentic.

As part of its due diligence, Crowdcube said it checked Companies House records which confirmed the merger had completed prior to promoting the investment. It also said there were several news articles available at that time which cited the completed merger. Crowdcube explains in its due diligence charter that it, *"relies on third-party tools to conduct some due diligence"*, so I think it was fair and reasonable for Crowdcube to use these sources to confirm the merger had completed.

Turning to Company A's financial information included in the pitch. A careful distinction needs to be made between the overall financial position of Company A and the statements made in the pitch which relate to funding. Crowdcube explains in its due diligence charter that it doesn't review the ongoing funding requirements of companies that raise investment through the platform:

"The following information, unless specifically mentioned in the pitch, is not always reviewed as part of our standard due diligence, so investors should assume that the following have not been checked:

- *cash position and cash burn of the company;"*

The pitch didn't include any information about Company A's cash position or cash burn and as such, I'm not persuaded Crowdcube was under any obligation to ensure Company A was profitable. So if the absence of this information caused Mr T any concerns, I would have expected him to have conducted his own enquiries before proceeding with the investment. Crowdcube did make it clear in its risk warnings that *investing in start-ups and early stage businesses involves risks*, and part of that risk is that businesses involved are often those which are unable to get bank or traditional forms of funding and so are likely to be in a precarious financial position on the whole.

The pitch did, however, mention existing investments in advertising, as well other sources of funding. So Crowdcube needed to ensure this information was fair, clear and not misleading. Crowdcube explained that the £9 million in equity for media and the additional multi-million pound media spend was in relation to potential advertising Company A would benefit from. But as it went into administration soon after the fundraising round closed it was unable to use this.

Crowdcube also provided evidence showing Company A had benefitted from £5.5 million of investment prior to the promotion. This was in the form of convertible loan notes and debentures from existing shareholders, as well as a £500,000 loan facility from Company A's bank. Whilst I appreciate the pitch didn't make this distinction, on balance, I don't think it would have affected Mr T's decision to invest. I say this as it represented only a small amount of the overall finances and ultimately, this money was available to the company albeit by means of a loan facility from a bank rather than through shareholder investment.

It's also important to point out this information was included in the legal review document Crowdcube emailed to Mr T in July 2018. Therefore, if he had concerns about this, I would have expected him to have raised this with Crowdcube before investing.

So overall, I'm satisfied that, based on the evidence available to Crowdcube at the time, it was reasonable for it to have concluded that the merger had completed, and that Company A had received the additional investment this attracted. As such, I'm satisfied Crowdcube met its regulatory requirements when promoting the investment opportunity and that it ensured the content of the pitch was clear, fair and not misleading.

was it fair for Crowdcube to allow Mr T's investment to proceed despite the change in Company A's valuation?

Crowdcube sent Mr T an email in July 2018 confirming the fundraising round had closed and giving him an opportunity to review his investment before proceeding. The email asked Mr T to review several documents, including Company A's articles of association and a legal review document. It gave Mr T a deadline of 2 August 2018 for him to let Crowdcube know if he didn't want to proceed with his investment and failure to do so would result in it become legally binding.

I understand Mr T didn't contact Crowdcube and so once the deadline passed, he believed his investment had proceeded and had become legally binding. However, Crowdcube then sent Mr T another email on 10 August 2018. This email explained that since the fundraising round had closed, Company A's valuation had reduced from £104,000,000 to £51,800,000 and as a result Mr T would receive twice as many shares. The email also included an updated legal review document to reflect these changes. A new deadline of 14 August 2018 was given and as Mr T didn't contact Crowdcube his investment proceeded after this date.

I also understand Mr T feels strongly that Crowdcube unfairly allowed the investment to proceed when there had been such a material change in facts. And that the first email was legally binding and could not be altered. However, Crowdcube's Investor Terms provide clarity on these points.

The Investor Terms explain that the completion of the investment is subject to completion conditions:

"*5.3. If a Pitch is successful, the Investee will instruct Crowdcube to circulate a copy of the Investee's proposed Articles of Association, bond instrument or fund documentation to each Investor by email, and to request that each Investor inform Crowdcube by email within the time period specified in the email if they no longer wish to proceed with the Investment. If Crowdcube receives no response from the Investor within the specified time period, the Investor will be deemed to have confirmed his/her order and the Investee will accept his/her order and such order will become a legally binding contract to invest between the Investee and the Investor upon expiry of the time period set out in the email, with completion of the investment conditional upon the Investee receiving payment from the Investor and subject to the completion conditions set out in clause 5.5 below. The Investor agrees that the contract to invest between the Investee and Investor formed in accordance with this clause shall incorporate any warranties given in the legal review document (the "Legal Review") attached to the email sent by Crowdcube to each Investor pursuant to this clause (the "Warranties"), subject to the terms and limitations of such Warranties as set out in the Legal Review."*

These completion conditions included:

"5.5.2 the Warranties being true and there being no actual or contemplated material change to the Investee or the investment round, either before or after the expiry of the email set out in clause 5.3 above and prior to the issue of shares to Investors (whether change is material to be determined by Crowdcube in its sole discretion);"

The Investor Terms go on to explain the action Crowdcube can take when a condition isn't met:

"5.6 Crowdcube (and not the Investee or Investor) has absolute discretion to determine whether the conditions set out in clause 5.5 above are satisfied at any time during the completions process prior to the issue of shares to Investor by Investee. If Crowdcube determines a condition is not satisfied, Crowdcube may in its absolute discretion:

5.6.1 recirculate the email to Investors as set out in clause 5.3 above, to include, as required by Crowdcube, the Articles of Association of the Investee alongside a disclosure statement detailing the failed condition. This email shall also request that each Investor inform Crowdcube by email within the time specified in the email if they no longer wish to proceed with the Investment. If Crowdcube receives no response from the Investor within the stated time period, the Investor will be deemed to have confirmed his order…"

The original legal review document emailed to Mr T in July 2018 explained under the warranties section that the pre-money valuation used for calculating the share price would be £103,000,000 (rather than £104,000,000 shown on the pitch). Crowdcube was then informed by Company A that the valuation had been reduced by over half. I consider this to be a material change and the Investor Terms make it clear that any material change should be disclosed to investors before the investment proceeds – regardless of whether the previous deadline has expired. So, by making Mr T aware of this and providing a further deadline to proceed, I think Crowdcube acted fairly and in-line with its Investor Terms.

It's also important to note that the FCA said the following in its July 2018 consultation paper on loan-based ('peer-to-peer') and investment-based crowdfunding platforms:

"We expect platforms to complete any necessary due diligence before they market investments to investors. In addition, the platform may become aware of new information that materially affects the borrower's credit risk after it has finalised its due diligence process, but before money has been irrevocably committed by investors. In this case and under the Principles of Businesses (PRIN), and the client's best interests rule (COBS 2.1.1R), we expect platforms to give investors the option not to proceed with the investment, as the conditions they based their investment decision on have changed."

Whilst I appreciate Mr T thought the second email was a simply a copy of the first one and so he may not have read it, I'm satisfied he had a responsibility to read and check any correspondence he received regarding his investment. If he had done, he would have had an opportunity to not proceed with the investment. However, I've not been provided with any evidence to show Mr T raised any concerns with Crowdcube about the valuation before the second deadline had expired or at any time prior to Company A going into administration.

On that basis, I'm satisfied it was fair for Crowdcube to allow Mr T's investment to proceed despite the change in Company A's valuation.

conclusions

Having carefully considered the key questions set out on page two of this decision, I find that:

- It was reasonable for Crowdcube to have concluded from its due diligence that the merger had completed, and that Company A had received the additional investment this attracted. Crowdcube made it clear in its Investor Terms that it would rely on third party tools as part of its due diligence and the evidence available to it at the time authenticated the claims made in the pitch.

- It was fair for Crowdcube to allow Mr T's investment to proceed despite the change in Company A's valuation, as it duly notified him of the material change and gave him an opportunity to cancel if he was unhappy. Mr T failed to notify Crowdcube that he didn't want the investment to proceed and so I don't find Crowdcube at fault.

So I don't uphold Mr T's complaint about the way in which Crowdcube presented the investment opportunity.

my final decision

My final decision is that I don't uphold Mr T's complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr T to accept or reject my decision before 7 June 2020.

Ben Waites
ombudsman