DRN-3558477

The complaint

Mr T complains that Crowdcube Capital Limited failed to carry out enough due diligence to ensure a company he invested in through the platform was creditworthy. He understands that his investment involved some risk and so he feels it fair for Crowdcube to reimburse him for half of his losses.

What happened

Crowdcube is an investment-based crowdfunding platform that promotes investment opportunities by way of pitches. Prospective investors can view information about an investee 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 investee business.

In August 2018, Mr T invested around £100 in a company I shall refer to as "Company A", through Crowdcube's platform. In return, he received shares in Company A.

Mr T raised a complaint with Crowdcube in September 2021 as he was unhappy that Company A filed for insolvency very shortly after the fundraising round ended with Crowdcube. He said this was suspicious and that Crowdcube ought to have been aware of Company A's financial issues through its due diligence.

Crowdcube considered Mr T's complaint but explained that it didn't think it had acted unfairly. In summary, it said:

- It conducted an appropriate level of due diligence on Company A and when verifying the pitch.
- It expressed concerns regarding the failure of Company A and the circumstances that led to its liquidation.
- Crowducbe attended the meeting of shareholders on 23 December 2020 to ensure its position was made clear and that the interests of all shareholders were taken into account.
- Crowdcube also wrote to the liquidator for Company A regarding these concerns, so that the directors' behaviour was given due consideration in any insolvency proceedings.

Mr T remained unhappy and so he referred his complaint to this service for an independent review.

An investigator at this service looked into Mr T's concerns but didn't think Crowdcube had acted unfairly. In summary, they said:

- They were satisfied Crowdcube had conducted sufficient due diligence to check the accuracy of the statements made in the pitch.
- The pitch explained that Company A was preparing to launch its product into the US market and that the raised funds would be used to support this.

- The pitch explained that Company A had filed an application for approval by the US Food and Druga Administration ("FDA") and it was waiting for the outcome of this. They had seen a copy of the acknowledgement letter from the FDA to support this.
- They appreciate FDA approval subsequently wasn't granted but she was satisfied the pitch didn't say approval was guaranteed and so Crowdcube didn't mislead Mr T.
- They understood Mr T's concerns regarding Company A entering into liquidation so quickly after the fundraise, but explained this wad directly linked to the denial of the FDA approval.
- Crowdcube had explained that the money raised was 'bridge-funding' with the goal of tiding Company A over until it received FDA approval in the US and that the money had been used for operational expenses in this time – for example payroll.
- Crowdcube said Company A's plan was to recoup this money through sales – which was contingent on it receiving FDA approval. So, when this didn't happen, it directly led to the failure of its business.
- They felt the risk factors which contributed to the failure and the general risks of investing in crowdfunding were highlighted throughout the promotion.

Mr T didn't accept the investigator's findings. In summary, he said:

- The denial from the FDA didn't come out of the blue and Crowdcube should have asked Company A more about the how the application process was progressing.
- The pitch didn't explain that the whole project would be doomed if the FDA would not approve the product. Company A specifically said in a discussion forum on Crowdcube's website that that it wasn't dependent on the FDA approval and would continue to work within the EU market.

The investigator responded to Mr T's further comments. In summary, they said:

- The pitch didn't give information about what Company A specifically intended to use the money for i.e. what aspects of its rollout into the US this would support. So they didn't think it was something Crowdcube could have fact-checked or verified.
- They wouldn't have expected Crowdcube to monitor the FDA approval process as its role was to fact-check the claims being made that Company A was seeking FDA approval. The pitch didn't disclose any further information regarding the progress of the FDA licence application.
- Company A was expected to provide a warranty to investors and Crowdcube that all material issues relating to the company have been disclosed and so it would have been Company A's responsibility to inform Crowdcube if there were issues with the application or factors that were set to have a materially adverse effect on the company's performance.
- It wasn't Crowdcube's responsibility to assess the viability of the project. The pitch didn't explain what would happen if the FDA didn't give approval. So it was up to investors to decide if they were still happy to invest without knowing what might happen if FDA approval wasn't obtained, or to ask questions of the company if this information was important to them.
- Crowdcube's due diligence charter made it clear that it wouldn't review forum discussions, so Crowdcube wouldn't be responsible for any misleading information given there.
- Furthermore. nowhere in the pitch did it state that in the event of FDA denial, Company A would look to pivot into the EU. So they felt this wasn't something Crowdcube ought to have or could have factchecked as part of checking the pitch.

As Mr T remained unhappy, the complaint has been passed to me to decide.

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.

To be clear I can only consider the obligations Crowdcube had towards Mr T as an investor when arranging the investment. I can't consider any actions of Company A. With this in mind, I've considered Crowdcube's obligations.

At the time of promoting the 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 clients 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."*

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 guidance, I still feel it's relevant as it provides 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 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: […] to 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 make Mr T 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.

The crux of Mr T's complaint is that Company A didn't get FDA approval for its product launch in the US and this led to its insolvency. He says Crowdcube didn't make him aware that Company A was reliant on this to survive and that it ought to have conducted due diligence on the FDA application process.

Having looked carefully at the pitch, it's clear that there were no guarantees given that FDA approval would be granted. Rather, the pitch made it clear that Company A was awaiting regulatory approval. Crowdcube has provided a copy of the FDA acknowledgment Company A received and I think this was sufficient to check the statement made in the pitch that an application had been made. So I don't think Crowdcube mislead Mr T regarding this. I appreciate Mr T feels that Crowdcube ought to have enquired further into progress of the application process but I don't agree. The pitch gave no details regarding the stage of the application nor did it give any assurances to the success of that application. So I don't think Crowdcube was required under its obligations the FCA rules and guidance or by way of its own due diligence charter to make any further enquiries around this. As the investigator explained in their assessment, Company A was expected to provide a warranty to investors and Crowdcube that all material issues relating to the company had been disclosed under the following company term:

"7.2.3. in advance of a Pitch going live on the Website and throughout the duration of the Pitch and until monies are drawn down from the Investors to Company, the Company has disclosed to Crowdcube all debt, fully diluted equity issued and options granted or contemplated, any civil or criminal litigation and threats of litigation and all other material issues impacting upon Company (and Company's directors,

employees and contractors) which could reasonably be considered to be a factor in an investment decision by a retail, sophisticated or institutional investor."

So, I agree with the investigator that it would have been Company A's responsibility to inform Crowdcube if there were issues with the FDA application.

I've also considered Mr T's concern that Crowdcube didn't make him aware that the success of his investment was solely reliant on Company A obtaining FDA approval for its product. However, I don't think it was Crowdcube's responsibility to assess the viability of Mr T's investment. Rather, it was responsible for fact checking the statements contained within the pitch to enable Mr T to weigh up whether he wanted to invest or not. The investor terms also explained this responsibility lay with Mr T:

"The Investor must make their own assessment of the viability, accuracy and prospects of the Companies, their Pitches, and any relevant investment propositions and should consult their professional advisers should they require any assistance in making such an assessment or should the Investor require any services whatsoever in connection with Crowdcube."

The pitch didn't explain what would happen if the FDA didn't give Company A the approval and so it was Mr T's responsibility to make enquires into this event if he had any concerns or if it was a key consideration in deciding to invest. Ultimately, Mr T decided to invest in Company A in the absence of knowing what might happen if FDA approval wasn't obtained.

I think it's also prudent to point out that no information was provided in the pitch regarding Company A's financial standing. The pitch did mention other funding Company A had received but it didn't give any details regarding its income and liabilities. If it had, then I would have expected Crowdcube to fact check these which may have uncovered Company A's reliance on income generated following the FDA approval of its product. However, this is not the case here and if Mr T had any concerns about Company A's financials then he ought to have made enquiries regarding this before investing.

I've also considered Mr T's points regarding information contained within Crowdcube's investor forum. However, as the investigator explained, Crowdcube's due diligence charter was clear on the scope of the checks it would undertake which didn't include the forum:

"we do not – review any of the restricted documents, pitch videos, pitch updates, forum discussions or the content of investor events that aren't organised by Crowdcube."

So taking into account all of the above, I'm satisfied that Crowdcube providing fair, clear and not misleading information to Mr T regarding his investment in Company A. I'm also persuaded that, despite it being unfortunate that Company A didn't obtain FDA approval and subsequently went into liquidation, in approving the promotion and allowing its clients to invest in Company A, Crowdcube was acting in Mr T's best interests.

My final decision

My final decision is that I do not uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr T to accept or reject my decision before 22 December 2023.

Ben Waites

Ombudsman