

Q3 | Protecting Your Money

Ben Hopps, head of Litigation and Dispute Resolution at Sykes Anderson LLP Solicitors agrees that lending money for a good return is good business, but points out the dangers if the business or person you lend to gets into financial difficulties

A S BANK FINANCE BECOMES increasingly difficult to secure, people and businesses are looking to other ways of funding their activities or getting them through short-term cash-flow problems. There is an old adage, 'never a friend and lender be' but if you are determined to ignore this

then read on.

Q A friend has asked me to invest some money in a business venture of his – what's the first thing I need to think about?

A Do your homework – find out what they want the money for. If it is for a specific project, ask to see the financial forecasts to assess viability. Ask them who else they have approached for finance and whether any banks have rejected their requests – and if so, why. Your friend requires this money and will co-operate with any reasonable request for information you make. Do your own due diligence [checking] and if a bank has rejected any request for investment capital, query why they said no.

Q My friend has already asked the bank who refused to lend him any money. He is quite desperate and has promised me a huge interest rate to lend him the money. I cannot foresee a problem. Can you?

A A huge interest rate sounds attractive but beware – if things go wrong and you have to sue to get your money back, a Court could disallow your claim for interest on the grounds that it would unfairly penalise your friend or that it was an extortionate bargain. This would depend on the wording of any interest clause and the type of agreement you both signed.

Q What do I need to consider next?

A Who are you lending the money to? If your friend wants the money for his business, are you lending the money to him, or to his company? If it is the latter, consider asking your friend to guarantee repayment of the monies – after all, that's what banks do. If your friend's business gets into financial difficulties, you can then look to him personally to repay you under this personal guarantee.

Q I am concerned that I might be going into business with my friend. I do not want this. I just want to lend him the money and be repaid on time.

A Before lending the money, draw up an agreement stating the basis on which the sums are being lent and the status of the money. Is it a loan or an investment under a joint venture? What interest rate is applicable? When is the sum repayable – on a certain date or on demand? Are there monthly repayments – if so, for how much? Will your friend be responsible for your legal costs of drawing the agreement (and just

as importantly, your costs of suing him or his business if things go wrong)? In these circumstances, it is better to get a solicitor to draft the agreement to protect your investment.

Q Ok, I've got an agreement in place and I am ready to send the monies. Is there anything else I should do?

A Perhaps the most important thing. Get security for your loan. Do this before you transfer any funds and whilst you are in the strongest bargaining position. If your friend's business gets into financial difficulties and you have to take legal action to get your monies back, you want to be repaid first if possible, or at the very least before any unsecured creditors.

Q How can I secure my monies?

A In a number of ways. The best way is to get a fixed charge over an asset of the company or better still over an asset of the relevant individual, in which there is sufficient equity to cover your loan (and any interest). If the asset is land, insist the charge is registered at HM Land Registry as well as with the Registrar of Companies. If there are a number of smaller assets in the company which together would cover your loan, consider a floating charge or a debenture. Do check the value of the asset and the equity in it, in particular query whether it is subject to a prior charge and if so for how much. Err on the side of caution.

Q What about taking a stake in a business?

A This is possible and would be normal if there is a joint venture rather than a loan and therefore where return is based wholly or partly on the profit. Care is required as minority interests in private companies are notoriously difficult to realise and monitoring the control of the company is also difficult, particularly if you want to be a sleeping investor and do not have the time or inclination to become involved in the day-to-day running of the business. A well-drafted shareholders' agreement to protect your position would be required. Depending on your bargaining position you may want to insist on the transfer of ownership of shares and/or control of the company if, for example there is any default in the repayment of any money lent to it.

If you are becoming a director you will need to be aware of your legal duties and potential liabilities for example if the company continues to trade whilst insolvent.

Q Ok, I have now lent my friend the money – how do I ensure continued protection?

A You will have a tightly-worded loan agreement in place to cover most eventualities. Monitor the company's activities, both physically and by checking the filing history at Companies House on a regular basis. At the first sign of financial difficulties, for example if a monthly repayment is missed, go and seek legal advice – it is always better to act fast to get your money back.

Q This seems a lot of hassle – I think I'll just leave my money in the bank.

A Well, that's your decision, but your money won't grow in a bank in the same way as it otherwise could. If you get the paperwork in order, you can sit back and enjoy a greater rate of return through lending money on good projects. ☐

Get security for your loan. Do this before you transfer any funds and whilst you are in the strongest bargaining position

