

20 April 2015

Protecting inter-company & personal loan arrangements under the PPSA

While most SMEs rely on bank finance for their working capital, many businesses are also supported by loan funds from their directors or from their family and friends. Unfortunately, not all of these arrangements have been well documented and this has led to problems for lenders in cases where they have sought to enforce their rights of recovery against a defaulting borrower (and/or their liquidator or administrator).

It appears that many lenders are unaware that they can improve their security position (and their chances of recovering the monies that they have lent) by taking advantage of the protection that is available to them under the *Personal Property Securities Act 2009 (Cth)* (“PPSA”).

Properly drawn loan documents and security agreements that are registered on the PPS Register (PPSR) will greatly improve the lenders security position.

In most cases it is likely that your business’ Bank will have taken security over your company’s assets in the form of a General Security Agreement (“GSA”) and they will have priority in the event of default under their finance facility.

However, you can take steps to ensure that you and other lenders to your business rank immediately behind your Bank and will not simply become unsecured lenders in the event that the trading entity gets into financial difficulties.

So what are some of the issues that you need to address to ensure that lenders to your business are as protected as they should be? We suggest that you consider the following questions:

1. Have you properly documented the loan transaction?

While the terms and conditions vary from loan to loan, the parties should record the essential terms of the arrangements between them in a formal loan agreement or deed. We are constantly amazed to note that where substantial loans have taken place between related parties, the precise terms of the loans that are to apply have not been documented. In many cases book entries are all that exist.

A basic loan agreement should at the very least detail the following:

- The commencement date of the loan facility
- Any existing advances that have been made
- The extent of the facility being offered
- The applicable interest rate
- The default rate and default arrangements
- The repayment date and repayment arrangements
- Particulars of the security provided and the transaction documents supporting such security.

2. Have you properly documented the security arrangements?

It is recommended that the principal transaction loan documents be a loan agreement or deed, a GSA and, if applicable, a deed of priority with your principal financier (usually your business’ Bank).

The terms of your GSA should be carefully considered to ensure that they provide the necessary security. It should particularize the “security Interest” that the Borrower (“the Grantor”) is providing- usually over the Grantor’s “personal property” or over a particular item or items. It should also detail the terms and conditions that are to apply. For example, it should make it clear that the GSA is “security agreement” for the purposes of the PPSA that can be registered on the PPSR. It should also detail the lender’s powers that can be used in the event of a default by the borrower.

3. Have you obtained the consent of your Bankers to the finance arrangements that you have entered into?

Before entering into any new loan arrangements, it is essential that you first check the terms of any existing Bank facility to ascertain whether the Bank's consent is necessary to be obtained to the new lending arrangements. Unless such consent is obtained, the trading entity may breach the terms of an express obligation or negative pledge that it has given to its Bank not to provide or seek further security without its consent. If such obligations are breached, then the Bank may terminate the existing loan facility or may impose some additional financial penalty.

Accordingly, a letter should be written to the business' Bank seeking its consent to execute a loan agreement with the new lenders and its consent to the granting of a GSA in favor of such lenders. In the normal course of events, we would expect such consent to be granted as it would be made clear that the Bank's priority position under its GSA would not be prejudiced.

4. Have you properly minuted the transactions from both the lender's and borrower's point of view?

You should ensure that both the lending and borrowing entities prepare and execute appropriate minutes recording the execution of the necessary loan documents and the GSA. The minutes should also confirm that the necessary consents from the trading entity's Bankers have been obtained so as to confirm that there have been no breaches of the Bank's covenants or negative pledges. Copies of the relevant documents should also be exhibited.

5. Have you properly recorded the transaction in the books of both the lending and borrowing entities?

Once the loans have been made, it is essential that appropriate journal entries be immediately made in the books of account of both the lending and borrowing entries.

6. Have you correctly registered your security interest on the PPSR and done so in accordance with the requirements of the PPSA?

It is essential that once the security documents have been executed, that a financing statement be immediately lodged on the PPSR. There are strict time limits for PPSR registrations. It is also essential that the registration details including the parties' names, ACNs, ABNs etc. and the collateral descriptions are correct. Incorrect lodgment of this document can cause the registration to be invalid and not provide the protection that you are seeking. It is recommended that you outsource the task of registration to an experienced third party PPSR registration provider.

(We outsource all of our registrations to **PPS Solutions**, who provide a total managed service to all of our clients).

Conclusion

It is simply good business practice to properly document the terms of any loan arrangements that have been made between related entities to ensure certainty as to the arrangements agreed upon. However, if one also takes the steps set out above, the lenders to your business (who are in many cases are your family and friends) will be better protected than they otherwise would be in the unfortunate event of your trading entity getting into financial difficulties.

Philip Sheezel

Principal

PS Law

0412 578 240

philip@pslaw.com.au

This article has been prepared by the above author. It may not be reproduced or copied without the express authorization of the author. For further information any of the matters raised in this article or for advice on any issues relating to the PPSA, contact Philip on 0412578240 or email him at: philip@pslaw.com.au