CHAPTER 3

What reform is needed?

3.1 Many submissions to the committee commented on not only the content of the exposure draft provisions, but also addressed the threshold question of whether the reform should continue, and if so, in what form. Chapter 3 examines the threshold question of what reform is needed.

Divergent views

3.1 As noted above, the proposed reform is of considerable magnitude. It has been described as 'important microeconomic reform'[1] and some submitters regard it as the most substantial reform in a decade that is not only ambitious in its scope, but will affect many difficult and complex areas of law. For example, Mr Colin Love representing the Australian Financial Markets Association observed that:

> In its scale this is one of the most significant substantive reforms to Australian law in many years. In my previous roles in government over many years I have been involved in working on financial services reform, and I was also involved in putting in place the anti-money-laundering legislation. In its scale I would consider this to be a far more complex and difficult technical and legal drafting task that the drafters of this legislation are attempting. There are numerous complex issues flowing there and there are unresolved consequences that are really not understood or have not been worked through. [2]

3.2 As noted in chapter 2 in the *Support for the reform* section, the committee has been presented with widely differing and strongly held views in relation to the detail of the reform. It was apparent to the committee that these views were developed after considerable thought and their merits were vigorously argued by their proponents. Ultimately, though, it is not possible for the committee to reconcile all of the positions put before it. Described broadly the most divergent positions were, on the one hand, that except for the national register, a case has not been made for the reform and that in the main the status quo should be retained. The other position was that both codifying and substantively amending the law is appropriate and that the exposure bill is well drafted to achieve the intended results.[3] Many views falling somewhere between these positions were also expressed to the committee.

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1 Mr Gilbert, Australian Bankers' Association, *Committee Hansard*, 22 January 2009, p. 53.

2 Mr Love, Australian Financial Markets Association, *Committee Hansard*, 22 January 2009, p. 6. Similar evidence from other submitters about the significance of the reform is outlined in chapter 2 in the section titled *Purpose and objectives of the exposure draft bill*.

3 For example, see Piper Alderman, *Submission 12*, pp 1 and 2.

3.3 As noted in chapter 2, the combined four law firms argue that a move to the proposed style of reform is not justified and that '…there are still a considerable number of concerns that need to be carefully considered and addressed, and we have some overall concerns as to the approach.'[4] Mr David C. Turner offers guarded support:

> …for this radical change which I regard as hasty and ill-conceived. The choice to move to an Article 9 regime simply because New Zealand has followed Article 9 and the Canadian variants of it, using the Saskatchewan model, is of particular concern.[5]

3.4 However, other authoritative witnesses hold an alternative view and sought to explain the difficulty in understanding and appreciating the type of reform proposed in the exposure draft bill. In this regard noteworthy evidence was given by Ms Angela Flannery, representing Clayton Utz, and Mr Craig Wappett of the law firm Piper Alderman. Ms Flannery is a lawyer who described her area of legal practice as 'commercial banking'.[6] Ms Flannery said:

> Initially – two years ago or so – I thought the legislation was terrible; I thought it was a very bad thing. I thought that personal property security law as it stood in Australia was fine. When we saw the first discussion papers we talked to our clients and our colleagues in New Zealand about what they thought of the legislation and how it had been implemented in New Zealand, for example. We were surprised at how generally positive those people were…in New Zealand every time we spoke to either a financier or a lawyer and we put the question to them , 'If you could get rid of the legislation there, would you get rid of it?' everyone said that, no, they would not. That made us look at the legislation with different eyes.'[7]

3.5 Mr Wappett has worked in banking and finance law for more than 20 years and is co-author of a book titled *Securities over Personal Property*.[8] Similarly, he explained:

> …I think it is fair to acknowledge that the proposed PPS reforms do involve a significant shift in people's thinking. Lawyers, in particular, who have been brought up with many of the common-law and equitable principles that underpin our existing law, have considerable difficulty making the conceptual shift in thinking that is involved in adopting the PPS-style reforms. But I have been through that process myself and I know a number of other practitioners, in Canada and New Zealand, who have been through that process and, whilst it does involve some initial difficulties and some

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4 Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques, *Submission 30*, p. 2.

5 Mr David C. Turner, *Submission 33*, p. 1.

6 Ms Flannery, Clayton Utz, *Committee Hansard*, 22 January 2009, p. 26.

7 Ms Flannery, Clayton Utz, *Committee Hansard*, 22 January 2009, p. 30.

8 Mr Wappett, Piper Alderman, *Committee Hansard*, 22 January 2009, p. 11.

> conceptual rethinking, my own experience and certainly the experience of the vast majority of practitioners that I have spoken to in those other jurisdictions over the years suggests that you would be hard-pressed to find too many experienced practitioners who would prefer to revert to the pre-PPS reform situation in jurisdictions which have already adopted a similar reform process.[9]

3.6 In addition to support from some lawyers, witnesses representing different parts of industry also presented evidence to the committee strongly supporting the type of reform outlined in the draft bill. For example, the Institute for Factors and Discounters, whose members constitute the main receivables financiers in Australia with a market in 2008 of $66 billion in turnover,[10] argued that PPS reform needs to recognise the legitimate interests of receivables financiers and concluded that 'subject to the suggested changes in this submission, we believe that the Bill strikes an equitable balance in this regard.'[11] The Australian Finance Conference also noted that 'the AFC continues in its support for the reform of Australia's current personal property securities regime. The case for reform has been well made out.'[12] The Australian Bankers' Association also offered firm support.[13]

3.7 Presented with this range of evidence, the committee had a difficult task in finalising a view. Based on the evidence received, the committee considers that there are two broad options for progressing PPS reform from this point and outlines these below.

Options for reform

3.8 The committee believes there is merit in a move to an 'Article 9 style' PPS system, but found it difficult to reconcile the two major perspectives put to it about exactly which Article 9 style approach to take. One approach proposes an international model incorporating a national register, while the other essentially proceeds with the exposure draft bill. In the next sections, the committee outlines and explores the two major options presented in submissions and evidence.

Option 1: the bill as drafted

3.9 As outlined in chapter 2 the exposure draft bill has been developed over a number of years and after considerable consultation. The Department asserts that the bill as drafted reflects an effective combination of learning from overseas experience

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9 Mr Wappett, Piper Alderman, *Committee Hansard*, 22 January 2009, p. 12.

10 Mr Bills, *Committee Hansard*, 23 January 2009, p. 47.

11 Institute for Factors and Discounters, *Submission 4*, p. 8.

12 Australian Finance Conference, *Submission 9*, p. 2.

13 Mr Gilbert, Australian Bankers' Association, *Committee Hansard*, 22 January 2009, p. 56 also referred to at chapter 2, footnote 12.

and modification for Australian conditions.[14] Mr Robert Patch from the Department described the process for the development of the exposure draft bill as follows:

> The very first thing the Office of Parliamentary Counsel did was to write to their counterparts in New Zealand and ask them for an electronic copy of the New Zealand bill. That bill was the template bill where we started drafting from. The next step [was] to listen to our stakeholders and to make changes to the bill reflecting their desires for where the bill should go and what should happen. We discovered that it was not just a simple matter of making [a] minor tinker here or there, and doing that sort of process ended up with a bill that was very complicated. You could not just graft a few sections in the middle of the bill to try to accommodate stakeholders' needs, or the policy outcomes sought by stakeholders.[15]

3.10 In addition to accommodating, where possible, stakeholder requests for the New Zealand model to be adjusted for Australian circumstances, the Department believes that a principal goal of the legislation should be *transparency*, by which it means that the bill details as much as possible any assumptions underlying the provisions.[16]

3.11 This approach has resulted in thorough, but very lengthy and complicated, draft provisions and a bill that is nearly 300 pages long. A number of submitters are not persuaded that this approach has in fact resulted in increased certainty and transparency. The draft bill's detractors argue that:

- given the difficulty of the subject matter and a general lack of expertise in Australia in the operation of PPS-style reform it is unwise to stray far from the provisions that have proven to work overseas;[17]
- despite the Department's intention to increase certainty of the law, the new provisions will actually significantly increase uncertainty about the effect of the law;[18]
- developing a substantially new system drafted especially for Australia (albeit one that is informed by overseas experience) means that there is no knowledge base about the law and its effect, and users of the system and their advisers can't readily draw on international experience. There are also no secondary resources immediately available to assist users of the system to

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14 The Department has advised it is planning to recommend some relatively minor modifications that submitters have raised. For details see the *Committee Hansard*, Friday 6 February, pp 45 to 49, but its argument in support of the bill is not affected by these changes.

15 Mr Patch, *Committee Hansard*, Friday 6 February 2009, p. 56.

16 Mr Patch, *Committee Hansard*, Friday 6 February 2009, p. 58.

17 For example, see Professor Anthony Duggan, *Submission 1*, p. 3 and *Committee Hansard*, 23 January 2009, p. 2; and Mr David C. Turner, *Submission 33*, p. 3.

18 For example, Mr Loxton, Allens Arthur Robinson, *Committee Hansard*, 23 January 2009, p. 28.

understand the law at the time they are most needed (that is, when the system is introduced);[19]

- the bill suffers from significant drafting issues making it difficult to understand the proposed law;[20] and
- stakeholders have had insufficient time to consider such a large and complex bill in detail (the exposure draft version of the bill was released in November 2008). Because the provisions of the draft bill are substantially different to existing PPS reform models it is possible that there are errors and other issues that would become apparent if there had been time for stakeholders to understand whole of bill.[21]

3.12 However, in support of the exposure bill the committee noted the view of Mr Craig Wappett, an experienced and persuasive practitioner, that:

> As a general comment on the bill, it is quite long and it is quite daunting and complex. The key principles underpinning the bill are quite straightforward and once people become familiar with them I think they will find that a lot of the perceived complexity in the bill disappears. The bill is certainly substantially longer than some Canadian or New Zealand counterparts. Even though the substantive approach and the context of the bill are substantially the same, the actual drafting is a much longer style. I know some submissions have commented on that and various people have views about whether that is a good thing or not. I appreciate that obviously the Office of Parliamentary Council has a particular way of drafting and that is reflected across the board in Australian legislation. I was not proposing to really get into commenting on the drafting style per se. But in terms of the substantive issues, my view is that they have been narrowed significantly and I would be surprised if there are more than 15 or 20 issues outstanding at the moment.[22]

Option 2: primarily adopt an existing international model

3.13 The primary advocate of this approach is Professor Anthony Duggan who is an academic with international expertise in personal property securities law. Professor Duggan has particular experience in personal property security law in Australia and Canada.[23] Professor Duggan's suggestion is essentially that Australia adopt and apply nationally one of the Canadian or the New Zealand models and that it only be

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19 Professor Anthony Duggan, *Committee Hansard*, 23 January 2009, p. 2.

20 Drafting issues are discussed in detail in chapter 4.

21 For example, see Professor Anthony Duggan, *Submission 1*, pp 5 and 6, Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques, *Submission 30*, p. 2 and Mr David C. Turner, *Submission 33*, p. 2.

22 Mr Wappett, Piper Alderman, *Committee Hansard*, 22 January 2009, p. 14.

23 See Professor Duggan's written submission for more details of his relevant experience: *Submission 1*, p. 1.

amended in ways that will definitely improve it. The main way in which Professor Duggan believes the exposure bill is a definite improvement on other models is that it proposes the establishment of one national register.[24]

3.14 One of Professor Duggan's chief concerns is with unintended consequences. As he explains:

> The New Zealand approach has substantial benefits…Close adherence to the North American model makes sense, because it enables the local lawmaker to free-ride on Canadian and United States learning and experience. By contrast, departure from the model creates uncertainty and increases the risk of error. These concerns are exacerbated if the drafting is done under time constraints and without access to the kind of expertise the Canadians and Americans had at their disposal when drafting their laws.[25]

3.15 The other benefits of this option identified by Professor Duggan are that:

- using an existing model increases certainty;
- international experience and resources are available to inform the law; and
- the international models are not as complex.[26]

3.16 Professor Duggan recommends that this approach could also be complemented by:

> …[including] a provision for a comprehensive review at the end of three to five years and appoint a committee of local and international experts to do the review. One advantage of doing things this way is that, after three to five years experience with the legislation, it should be easier to find local experts in Australia than it is now.[27]

3.17 The perceived disadvantage of this approach articulated to the committee was chiefly a concern that an international model would not adequately meet Australian circumstances.[28] On the basis of the evidence submitted to the committee by several major stakeholders that PPS reform of the scope proposed is unnecessary, the committee considers that it is likely that another disadvantage of this model would be major resistance from some of those affected by the bill due to concern about change and a lack of familiarity with international models and international experience.

3.18 Professor Duggan is familiar with the development of the exposure draft bill and the work invested in its development. He was asked whether, in light of the work

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24 Professor Duggan, *Committee Hansard*, 23 January 2009, p. 2.

25 Professor Anthony Duggan, *Submission 1*, p. 3.

26 Professor Anthony Duggan, *Submission 1*, pp 3 to 5.

27 Professor Duggan, *Committee Hansard*, 23 January 2009, p. 2.

28 For example see Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques, *Submission 30*, pp 15 and 16.

already invested in the bill, he still proposed starting again and adopting an international model and his evidence was significant:

> I understand there is pressure to get the new law into place quickly and I also understand that a lot of people would prefer a home-grown product and not just a copy of some other country's efforts. The trouble is that it seems to me there is just not enough time or expertise to achieve this and, even if there were, at the end of the day the differences between the Australian version and the Canadian one probably would not be all that great.[29]
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> If it were me I would say yes, start again. I understand the difficulties of doing that. But it is a question of going ahead now with this product for the sake of getting in quickly or taking a little bit of extra time, maybe going back to the drawing board, to get it right. I think in the longer term interest of everybody it is better to do the latter. What can I say about other people's views? I have glanced quickly through most of the written versions of the submissions that you have received. Very few of them come to grips with the legislation overall. Most of them just talk about particular issues. Most of them express support for the general idea of a single comprehensive national register. But none of them really engage with the detail of the legislation. Probably the only one that does is the submission from the four large law firms. When people say that they support the legislation and so far as they can see there are only half-a-dozen or so issues that need to be fixed, you really need to ask whether people who are saying this are on top of legislation of this kind and really understand the concepts and how this legislation works.[30]
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> To wind up, for what it is worth this is what I think Australia might think about doing: for now, to enact a PPSA based on one or another of the Canadian models, build in a provision for a comprehensive review at the end of three to five years and appoint a committee of local and international experts to do the review. One advantage of doing things this way is that, after three to five years experience with the legislation, it should be easier to find local experts in Australia than it is now.[31]

Committee view

3.19 As noted above, the committee believes there is merit in a move to an 'Article 9 style' PPS system, and there are benefits in both options. Option 2 encompasses changes that would definitely improve the chosen overseas model (such as having one national register rather than individual state registers), but essentially copies an existing model. It seems, in the main, that the New Zealand and Canadian models are working effectively, are more simply drafted and offer the assistance of established secondary materials and existing case law. As suggested by Professor Duggan, after

29 Professor Duggan, *Committee Hansard*, 23 January 2009, p. 2

30 Professor Duggan, *Committee Hansard*, 23 January 2009, p. 4.

31 Professor Duggan, *Committee Hansard*, 23 January 2009, p. 2.

the imported model had been in place in Australia for a few years it could be reviewed and any aspects that were unsatisfactory could be amended at that time.

3.20 Alternatively, the approach reflected in the exposure draft bill (option 1) of starting with the New Zealand model and substantially amending it has been undertaken with the intention of better reflecting what are seen as Australian requirements. There are advantages to this approach, but at this stage very serious concerns about the possible adverse effects of the bill have been presented to the committee. These concerns are heightened by the fact that many submitters felt that the timeframe for considering this exposure draft is so tight that they have not had the time to fully analyse and understand all of the provisions in the bill and to identify all possible concerns.[32] If the bill as drafted has unintended consequences then amendments to the exposure draft may be needed relatively soon after its introduction, and the process for this is complicated by the fact that the regime will be based upon a referral of powers from the States. There is also an argument that 'it affects individual business dealings in a way that cannot be altered with a touch of the regulator's brush.'[33]

3.21 The committee is cognisant of the considerable effort that has been invested by the Department, governments and stakeholders in developing the reform and of the challenges in changing course at this stage of the policy development. The committee endorses the idea of an effective Australian PPS model, but has very strong reservations about proceeding with the bill in its current form. In particular, the committee is concerned about the warnings issued by those with considerable experience in the area of personal property securities about the danger of serious adverse consequences.

3.22 The committee considers that the exposure draft bill could form the basis of effective PPS reform legislation. However, the committee is strongly of the view that the bill needs to be substantially redrafted, clarified and simplified before it is presented to Parliament. In Chapters 4 and 5, the committee outlines its views on some specific aspects of the exposure draft and proposes a range of recommendations for changes.

32 This aspect of the process is considered in more detail in the section titled *Timing* in chapter 4.

33 Mr Loxton, Allens Arthur Robinson, *Committee Hansard*, 23 January 2009, p. 27.