The Senate

Legal and Constitutional Affairs Legislation Committee

Personal Property Securities (Consequential Amendments) Bill 2009 [Provisions]

November 2009

ISBN: 978-1-74229-215-1

This document was printed by the Senate Printing Unit, Department of the Senate, Parliament House, Canberra.

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3.54 That the government consider and respond to all of the issues raised in the submissions made to this inquiry to which they have not already responded.

Recommendation 9

3.55 The committee recommends that the Senate pass the Bill and urges the government to act on the other recommendations in this report.

CHAPTER 1

Introduction

1.1 On 28 October 2009, the Senate referred the provisions of the Personal Property Securities (Consequential Amendments) Bill 2009 to the Senate Legal and Constitutional Affairs Legislation Committee for inquiry and report by 23 November 2009.

1.2 The Bill was introduced into the House of Representatives on 21 October 2009 by the Attorney-General, the Hon. Robert McClelland MP. The government states that:

> This bill will amend 25 Commonwealth acts that deal with the creation, registration, priority, extinguishment or enforcement of interests in personal property.
>
> …
>
> This bill also makes minor amendments to the Personal Property Securities Bill 2009, which was passed by the House on 16 September.

Conduct of the inquiry

1.3 The committee advertised the inquiry in *The Australian* newspaper on 4 November 2009. Details of the inquiry, the Bill and associated documents were placed on the committee's website. The committee also wrote, on 29 October 2009, to 75 organisations and individuals inviting submissions by 9 November 2009.

1.4 The committee received 9 submissions which are listed at Appendix 1. Submissions were placed on the committee's website for ease of access by the public.

1.5 The committee held a public hearing in Melbourne on 10 November 2009. A list of witnesses who appeared at the hearings is at Appendix 2, and copies of the Hansard transcript are available through the internet at http://www.aph.gov.au/hansard.

Scope of the report

1.6 The structure of the report is as follows:

- Chapter 2 describes the background to the inquiry and comments on the major themes arising in relation to the bill; and
- Chapter 3 outlines particular issues raised with the committee about the bill.

Acknowledgement

1.7 The committee thanks those organisations and individuals who made submissions and gave evidence at the public hearings.

Note on references

References in this report are to individual submissions as received by the committee, not to a bound volume. References to the Committee Hansard are to the proof Hansard: page numbers may vary between the proof and the official Hansard transcript.

CHAPTER 2

Background

2.1 The inquiry into this Personal Property Securities (Consequential Amendments) Bill 2009 is the third inquiry the committee has conducted in the previous 12 months relating to personal property securities reform. In March this year the committee reported on its inquiry into the exposure draft of the Personal Property Securities Bill 2009 and in August reported on its inquiry into the provisions of the Personal Property Securities Bill 2009. All of these inquiries were conducted in what were, for the complexities of the subject matter, compressed timeframes.

2.2 The August 2009 majority report recommended that:

> Recommendation 1
>
> The committee recommends that the bill be passed subject to a commitment from the government to:
>
> - thoroughly consider all concerns brought to the government's attention about the bill until 30 September 2009, including the concerns raised in the submissions to this inquiry;
> - provide greater transparency by making public its response to the concerns raised and by providing as much information as possible to stakeholders about policy considerations and choices. This could be done using the department's website; and
> - include in a consequential amendments bill to be debated in the Senate cognately with this Bill and intended to take effect immediately after the commencement of the 2009 Bill all changes to the Bill identified as a result of concerns raised with this committee and subsequently directly with the department during the recommended further period of consultation until 30 September 2009.
>
> Recommendation 2
>
> That subject to the foregoing recommendation, the Bill be supported.

2.3 It is not common for a Senate committee to inquire into a consequential amendment bill because, by their nature, these types of bills primarily make legislative changes that are consequential to reform that has already been approved by Parliament. However, this bill is unusual as, in addition to many genuinely consequential amendments, it also contains proposed amendments to the primary bill. This is in accordance with the third component of Recommendation 1 above.

2.4 The reasons for this approach were explained by the Attorney-General in this Bill's Second Reading Speech:

> Following consideration of the submissions made to the [August] Senate committee [inquiry] and subsequently to my department, a small number of minor amendments to the Personal Property Securities Bill were identified and are included in the bill that I introduce today.

> The amendments will, among other things, address stakeholder comments that the operation of some provisions could be clarified and correct drafting errors.
>
> The amendments have been included in this bill because the PPS Bill is supported by a referral of legislative power by the states.
>
> Moving government amendments to the PPS Bill itself would cause some states to have to revisit their referral legislation.
>
> The method adopted here - which provides the parliament with the same opportunity to consider the changes to the bill as government amendments - will allow the states to continue the referral process without interruption.
>
> I am pleased to advise that New South Wales, Queensland, South Australia and Victoria have all passed their referral legislation. I anticipate Western Australia and Tasmania will introduce their referral legislation shortly.[1]

Timing and scope of this report

2.5 The inquiry into this Bill has proceeded swiftly because the government is seeking to have both it and the Personal Property Securities Bill 2009 (which the Senate is able to debate cognately with this bill) passed this year.[2] The final parliamentary sitting day currently scheduled for this year is Thursday 26 November.

2.6 This timeframe means that there has been less than a month between the date the provisions of the bill were referred by the Senate committee and the last date for passage of the legislation this year.

2.7 It will be apparent from this that the ability of submitters and the committee to consider this highly technical bill has been significantly constrained by the timeframe of the inquiry. In this report the committee has sought, to the extent possible, to examine the general thrust of issues and to articulate a few of the major concerns in more detail. The committee has had to devote the brief time available to the provisions of concern raised with it by submitters. These were primarily confined to the amendments contained in Schedule 4 of the Bill – amendments to the Personal Property Securities Act 2009. Although a number of submitters were able to comment on other schedules in the bill, in the main these comments did not raise issues of concern.[3]

2.8 For further detail about the entirety of the Bill the committee commends the Explanatory Memorandum to Senators. Background to many of the issues can be

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1 The Hon. Attorney-General Robert McLelland MP, Personal Property Securities (Consequential Amendments) Bill 2009, Second Reading Speech, Proof Parliamentary Debates 21 October 2009, p. 13.

2 See, for example, Senator Crossin, *Committee Hansard*, 10 November 2009, p. 3.

3 For example, the Australian Bankers' Association, *Submission 4*, pp 1 to 3, comments favourably on the intellectual property and the maritime consequential amendments. In addition, the Insolvency Practitioners Association sees 'no problems' with the proposed amendments to the *Bankruptcy Act 1966*: *Submission 5*, p. 1.

found in the committee's March and August 2009 reports into personal property securities reform.

2.9 The committee would like to particularly acknowledge the efforts submitters and witnesses made to contribute to this inquiry in the very short time available.

Comment on the August 2009 recommendations

2.10 As outlined above, the three components to Recommendation 1 of the Committee's August report were to consider further matters raised with the Department, to increase the transparency of policy decision-making and to include any amendments in this consequentials bill. The committee notes that the government response to Recommendation 1 was:

> **Accepted**: The Government will consider the concerns raised by stakeholders in submissions to the inquiry and otherwise until 30 September 2009. Responses to those concerns will be made available on the Attorney-General's website at www.ag.gov.au/pps. Any changes to the Bill identified in that process will be included in a consequential amendments Bill which will be introduced into Parliament to facilitate a cognate debate with the main Bill in the Senate, should the Senate decide to consider the Bills cognately.[4]

2.11 In accordance with its commitment, the government appears to have considered many, but not all, of the matters brought to its attention until 30 September. As anticipated, the government has included changes identified as a result of that process in this Consequential Amendments Bill.

2.12 In addition to stakeholder concerns that not all issues have been addressed, concerns have also been raised with the committee about the government's response to the remaining component of Recommendation 1 - to 'provide greater transparency by making public its response to the concerns raised'. For example, Clayton Utz, which supports PPS reform and has been a constructive participant in each of the PPS inquiries, observed that:

> The Attorney-General's Department has not addressed the issues identified in our submission and in many circumstances has not provided any reasons for that failure…The November Paper does not respond on all points made in the various submissions and some responses do not actually address the issues raised.[5]

2.13 To meet its commitment to increase transparency the Attorney-General's Department has adopted the committee's consolidated table (Appendix 4 to the August report) and, '…used a version of it to address the comments made to the committee

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4 *Government Response to the Senate Committee on Legal and Constitutional Affairs Inquiry into the Personal Property Securities Bill 2009 [Provisions]*, tabled 21 October 2009, p. 1.

5 Clayton Utz, *Submission 9*, covering letter, p. 1. The combined submission of Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques makes a similar point: *Submission 10*, p. 1.

and those made subsequently to the Department by 30 September 2009.'[6] The table comprises 115 pages and it is available to download from the department's website.[7]

2.14 The committee acknowledges the considerable effort the department has made to compile this table in the short space of time available and to meet the government's commitment to publicly respond to concerns. However, in some instances the response to issues raised is extremely brief: for example, matters have been 'noted' or the department's advice is that 'the Bill reflects the intended policy outcome' without the further explanation envisaged by the committee in its Recommendation 1.[8] The Department observed in relation to the table that, '…by necessity, some of the comments…are a little cryptic. It runs to 115 pages as it is, so we were just trying to keep it in check.'[9]

2.15 While the committee appreciates the point the Department makes and the difficulties involved, the committee draws the government's attention to the second dot point of Recommendation 1, which requested a commitment that included 'providing as much information as possible to stakeholders about policy considerations and choices.'

2.16 The committee is aware that this will require the use of departmental resources, but believes that it is important to keep stakeholders fully informed in reform of this significance.

Recommendation 1

2.17 That the government continues to provide transparency about policy decisions in relation to PPS reform by making public its response to all concerns raised about the reform brought to its attention in writing and by providing as much information as possible about the reasons for the policy choice in each instance.

Major themes

Accepting the overall framework

2.18 Over the course of the three inquiries into this topic, the committee has observed that stakeholders have generally had one of three approaches to the proposed PPS reform:

- a small number of submitters have supported the purpose of the reform and its detail from the exposure draft stage;

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6 Attorney-General's Department website http://www.ag.gov.au/pps accessed on 14 November 2009.

7 Attorney-General's Department website http://www.ag.gov.au/pps accessed on 14 November 2009.

8 For example, the entries on p.33 Part 2.3 (The Department has noted this comment) and p.42 section 47(1) (The Bill reflects the intended policy outcome).

9 Mr Glenn, *Committee Hansard*, 10 November 2009, p. 18.

- most submitters supported the policy intention, but have expressed disagreement with aspects of the reform in the detail of its implementation; and
- some commentators have consistently expressed fundamental concern about the policy direction.

2.19 The Australian Bankers Association (ABA) has consistently expressed a view generally in favour of both the purpose and content of the reform. This bill is no exception, with Mr Gilbert noting that:

> …it is fine tuning and a lot of the detail amounts to fairly sensible technical tidying up and clarification and those sorts of things. We think that it is good sense to do it now rather than later on.[10]

2.20 However, most submitters to this and the previous inquiries are in the category where they support the policy intention, but disagree with aspects of the reform in the detail of its implementation.

2.21 In the third category of submitters – those who are not yet persuaded that the reform is needed and who retain considerable concern about the fundamental policy and direction of the reform - the committee has observed a degree of understandable frustration that the government has appeared to be unresponsive to attempts to revisit the need for reform of this scope and magnitude. However, there has been a recognition that there is now little to gain from persisting with opposition. As the combined law firms explained:

> As a result of our appearances before the Senate Committee and extensive consultation with the Attorney-General's [D]epartment on the PPS Bill, we understand a decision has been made to proceed with the policy considerations underlying the legislation. The issues set out in [our] schedules are not intended to revisit policy considerations but rather to help ensure that they are effectively implemented in practice.[11]

2.22 The committee commends this realistic approach as it assists the committee to focus on the most relevant issues at this advanced point in the reform process.

Legislative certainty

2.23 Perhaps a factor that has encouraged submitters to concentrate their analysis on practical matters arising from the bill is the growing level of awareness of the importance of finalising the legislative detail of the reform so that business can begin preparing for commencement of the scheme in May 2011.

2.24 The ABA made this point in previous inquiries and Mr Gilbert again emphasised this point on behalf of the ABA's member banks:

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10 *Committee Hansard*, 10 November 2009, p.3. The Australian Finance Conference has also consistently supported the policy intention of the reform.

11 Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques, *Submission 10*, p. 2.

> …we are looking forward to the legislative phase being completed as quickly as it possibly can so that our people can get some certainty and get on with the job of implementing the regime, which they are looking forward to doing.[12]

2.25 This sentiment was echoed by the Australian Finance Conference[13] and Mr Whittaker representing the combined law firms who noted that:

> …it is not possible to overemphasise the importance of getting the remaining issues resolved and, importantly, getting the IT build processes completed as quickly as we possibly can to give industry as good a chance as it possibly can have of being ready for May 2011.[14]

2.26 This approach is also endorsed by the Department:

> I reinforce the comments made by earlier witnesses around the desire for stakeholders to have the final form of the substantive PPS Bill available to them through the parliament so that they can have some certainty about making the business decisions and investment decisions that they need to make right now to prepare themselves for the commencement of the PPS regime in May 2011. The sorts of comments that have been made today have been repeated to us often. It is clearly of concern to the business community to have the certainty that the passage of this package of legislation would provide, and the momentum that that would provide for the reform as a whole, so that they can progress the work that they need to do at their end to take advantage of PPS reform.[15]

2.27 The committee appreciates the need for legislative certainty and has facilitated this by expediting this report to the extent possible. The committee is also mindful of the importance of this legislation and the substantial resources that will need to be allocated to it by industry, business and their advisers in order to implement the reform effectively. However, the committee also cautions those involved in the process to give due regard to the view expressed by Mr Loxton:

> We want things to be effective and quick, but given the choice between something that is quick and wrong and something that is effective I think we would make the choice of taking the time to make sure we have something that works well. We would not want to sacrifice efficacy and getting the legislation right for speed.[16]

2.28 The committee retains some disquiet that the balance between the speed of reform and getting the legislation right has been struck correctly. The haste with which it has been required of each of its three inquiries into this legislation heightens this disquiet.

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12 *Committee Hansard*, 10 November 2009, p. 2.

13 Mr Edwards, *Committee Hansard*, 10 November 2009, p. 5.

14 *Committee Hansard*, 10 November 2009, p. 12.

15 Mr Glenn, *Committee Hansard*, 10 November 2009, p. 16.

16 *Committee Hansard*, 10 November 2009, p. 15.

Prioritising issues

2.29 Because of the magnitude of this reform, a difficulty that has faced the committee in analysing the many issues raised with it is how to prioritise the concerns brought to its attention. Over the course of the three inquiries, the committee has received some comprehensive and thoughtful submissions that have raised a substantial number of matters. For example, Clayton Utz and the combined law firms have consistently taken a thorough approach to analysing the proposed reform, and have identified numerous issues and suggested relevant amendments.

2.30 The committee agrees with this view, and considers that this observation about the difficulty of then prioritising the importance of these matters was made to the committee by the combined law firms. In replying to a question about the relative urgency of the various issues, Mr Whittaker advised the committee:

> We did have quite a long discussion about this yesterday as we suspected you might ask us a question along those lines. Frankly we were not able to effectively prioritise them. Part of the reason for that is that the issues we have raised will be of differing degrees of significance for different types of clients. Some of the comments, for example, relating to leasing, will be particularly interesting to lessors; others will be more relevant for banks, but in our view they are all important.[17]

2.31 This means that it would not be prudent for the government to relegate any of these issues to being considered after the scheme has commenced or until the statutory review process proposed in the PPS Bill 2009 takes place. However, it appears that there is a possible solution that could adequately meet the needs of those requiring certainty and those who believe that the legislation still requires some legislative tidying up before it commences in May 2011.

Possible future reform

2.32 The committee appreciates both the government and business imperative to establish legislative certainty, but also understands that there are still a considerable number of issues of concern to stakeholders that submitters assert need resolving before the legislation is fully workable.

2.33 One course of action available to the government to meet the needs of the widest number of stakeholders is to finalise the majority of the legislative framework and for Parliament to pass the two PPS bills currently before it, but to continue to refine the detail of some aspects of the reform.

2.34 For example, the combined law firm submission suggests that 'it will be desirable…in due course to have a further Consequential Amendments Bill' for the following reasons (summarised):

- to resolve issues previously raised with the government that have not been addressed;
- to resolve new issues identified to date; and

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17 *Committee Hansard*, 10 November 2009, p. 13.

- to resolve further issues that are identified as organisations 'become more familiar with the PPS Bill, and…start to work with it in preparing for its implementation, [answer] questions from clients and [consider] practical issues…[18]

2.35 On behalf of the combined law firms Mr Whittaker further observed that:

> …it may not be practicable to address all…issues in the current amending bill and we also acknowledge that the department has indicated that it may be amenable to addressing some of our issues through the regulations—and indeed the discussion paper on the regs that came out last week takes some steps towards that end. We hope that we will be able to continue the discussions with Robert Patch and his colleagues in the department to see whether our remaining concerns can be addressed either through the regs or, potentially, through the additional piece of legislation that we are aware will need to be passed early in the new year to effect the necessary amendments to the Corporations Act.[19]

2.36 This approach seems to the committee to be a practical one that balances the competing needs of stakeholders. As Mr Glenn advised the committee, the Department is open to considering future amendments:

> If any amendments arise out of these further considerations, the vehicle for that would be the bill amending the Corporations Act, so that is the next piece of the PPS legislative scheme.[20]

2.37 The committee welcomes the fact that the government is willing to continue to consider some modifications and is not simply leaving outstanding matters to be considered in the proposed three year review. The committee agrees that any bill amending the Corporations Act is a legislative vehicle that could be used for further amendments agreed to by the government. In addition, some minor aspects of legislative clarification sought by stakeholders may be appropriately achieved through the regulation making process. The process for the draft regulations is discussed below in the next section of this chapter.

2.38 The committee also notes that in light of the scope and magnitude of this reform, additional amendments may continue to be identified and another consequential amendments bill may be warranted next year.

Recommendation 2

2.39 The committee recommends that the government continue its approach of completing the majority of the PPS reform while continuing discussions on the outstanding issues and undertaking further legislative action where this is needed.

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18 Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques, *Submission 10*, p. 1.

19 *Committee Hansard*, 10 November 2009, p. 12.

20 *Committee Hansard*, 10 November 2009, p. 17.

Regulations

2.40 In relation to the proposed PPS regulations Mr Glenn explained to the committee that:

> A revised regulations paper has been published on our website which is our current thinking on the content of the regulations, and it will form the drafting instructions for the drafters to proceed to put them together. Our intention would be to begin releasing actual drafts of the regulations early in the new year for stakeholders to look at. They may come progressively. Ultimately, the regulations as a whole will need to be considered by the states and territories, pursuant to the PPS intergovernmental agreement.[21]

2.41 It is relevant to note that, as described by the Department, the PPS statutory package will broadly include two kinds of regulations:

- regulations that 'go to the operation of the [PPS] register'; and
- regulations relating to 'the treatment of a number of market based transactions.'[22]

2.42 The Department's view is that the form of the PPS register regulations is 'fairly well outlined in the regulations paper' and Mr Patch does not expect that the detail of the regulations themselves will provide any greater information than the paper itself.[23] Draft regulations 'are expected to be made available for public comment by March 2010.'[24]

2.43 The second broad category outlined by the Department will constitute another, later, tranche of regulations 'dealing with matters other than the PPS Register, for example regulations underpinning the application of the PPS Bill to 'mortgage backed securities''.[25] These will require further consultation with stakeholders.[26] The Department has advised the committee that:

> Subject to the progress of those consultations, we expect the second tranche of regulations to be available for comment in the second quarter of 2010.[27]

2.44 Because the PPS reform is being progressed by a referral of powers from states and territories, there are consultation requirements that need to be factored into the process of making the regulations and which affect the timeframe for their implementation:

> The PPS Intergovernmental Agreement requires that the Commonwealth consult, and in some cases seek the agreement of, the States and Territories

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21 *Committee Hansard*, 10 November 2009, p. 18.

22 Mr Patch, *Committee Hansard*, 10 November 2009, p. 19.

23 *Committee Hansard*, 10 November 2009, p. 19.

24 Attorney-General's Department, *Additional Information*, 12 November 2009, p. 1.

25 Attorney-General's Department, *Additional Information*, 12 November 2009, p. 1.

26 Attorney-General's Department, *Additional Information*, 12 November 2009, p. 1.

27 Attorney-General's Department, *Additional Information*, 12 November 2009, p. 1.

> in advance of any regulations being made under the PPS Act. We expect to be in a position to present the PPS Regulations to the States and Territories for approval before the middle [of] 2010. This would allow the regulations to be tabled in Parliament early in the third quarter of 2010.[28]

2.45 In relation to this category of regulations Mr Glenn assured the committee that:

> … [while] they are admittedly important matters for the particular areas that they are dealing with. They are not necessarily matters that go to the broad sweep of the reform. They are in particular market segments and in particular transactions. The shape of the PPS scheme is described in the legislation and it is that which the business community is asking us to produce and give certainty about so that they can move on in their business planning.[29]

2.46 The committee notes the Department's advice about the status of the regulations and intended process for their implementation.

Comment on the Attorney-General's Department contribution

2.47 As in the previous inquiries, a number of submitters made a particular point of acknowledging the level of consultation with stakeholders undertaken by the department. For example, Mr Gilbert offered:

> …a commendation to the department themselves, the Attorney-General's Department, for the work and the consultation process that they undertook as well. It has been of a very high standard, and I think I have said once before it is a model that other parts of government might like to give strong consideration to. [30]

2.48 The committee also acknowledges the considerable time and effort the Department has invested in the Senate inquiry process over the three inquiries. In particular, Departmental representatives have attended all of the public hearings. The committee believes this has greatly assisted the inquiry process as officers have been able to anticipate questioning and, where appropriate, could also discuss issues directly with stakeholders.

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28 Attorney-General's Department, *Additional Information*, 12 November 2009, p. 2.

29 *Committee Hansard*, 10 November 2009, p. 19.

30 *Committee Hansard*, 10 November 2009, p. 4.

CHAPTER 3

Specific issues

Introduction

3.1 The committee has been able to briefly examine some of the key issues that emerged as a result of the inquiry. Fortunately, the committee was familiar with most of the background to them from its previous consideration of the proposed PPS reform.

3.2 Once again it has been relevant to the inquiry process that this reform is underpinned by a referral of powers from participating states and territories. This has had an impact on the committee's approach to considering the content of this Bill: the committee supports the passage of this Bill and the primary legislation (the PPS Bill 2009), but recommends that the government continues to identify further amendments to the reform in response to the matters raised with the committee and the Department.

3.3 Because of the nature and process of the PPS reform, the committee has not limited itself to only considering matters directly arising from the Consequential Amendments Bill currently before it. Issues that are not the subject of amendment in the Consequential Amendments Bill were raised with the committee as part of this inquiry because of their omission from this bill. It is on this basis that the committee has considered them.

3.4 If the process did not involve a referral of powers and consultation with the states and territories the committee might have taken the more usual course of recommending changes to this Bill to amend the primary legislation or amendments directly to the primary legislation.

3.5 As discussed in the previous chapter, it seems to the committee that there are likely to be several opportunities to make further amendments to the PPS legislation before the scheme commences in May 2010 and these could include matters relating to both the PPS Bill 2009 and the Consequential Amendments Bill 2009.

Outstanding issues raised with the committee

Purchase Money Security Interest (PMSI)

Registration of a PMSI – proposed section 62 of the PPS Bill 2009

3.6 The Australian Finance Conference (AFC), with its related associations, the Australian Equipment Lessors Association and Australian Fleet Lessors Association, represents more than 100 financial institutions operating in Australia, which finance all types of plant and equipment in Australia and have a total portfolio 'of about 100 billion'.[1]

3.7 The AFC totally supports the concept of a purchase money security interest (PMSI – pronounced *pimsey*), which will be a new concept in Australian personal

1 Mr Bills, *Committee Hansard*, 10 November 2009, p. 5.

property securities. However, the AFC has a major concern about the detail of the registration requirements for a PMSI contained in the Personal Property Securities Law Bill 2009.[2] Put concisely, the problem as explained by the AFC is:

> For goods that are not inventory, a…PMSI must be registered within 10 days after the grantor acquires **possession** of the goods. But...to enable PMSIs to fulfil their purpose this should be changed to within 10 days after **attachment**.[3]

3.8 The concern arises because of the AFC's view that:

> Attachment is the time the financier provides the funds. The financier always knows when this occurs, but does not know when possession occurs. Manufacturers/sellers will sometimes give possession prior to funding if the finance has been conditionally approved, but the financier will not know in which cases. Financiers also provide corporate customers with a finance facility under which the grantor is authorised to draw upon to acquire equipment as required; the financier will not be aware of the transaction or the equipment until the relevant documents arrive from the grantor.[4]

3.9 It is the AFC's submission that there is much support from its members for the PMSI concept if the problem about whether the 10 day timeframe starts from the time of possession or the time of attachment can be resolved:

> Financiers really want to utilise the PMSI mechanism because of the super-priority it promises, but if the trigger date is possession they cannot be absolutely sure they will validly register, in which case they will have no priority let alone a super-priority.[5]

3.10 Mr Patch outlined to the committee why he believes there would be 'unintended practical consequences' for the consumer if this approach were adopted:

> Perhaps it would help to outline the factual scenario that this works on. We have someone looking to buy a piece of equipment—just say it is a car from a motor vehicle dealer. Under the bill, the finance company has 10 days to make their registration on the register after the purchaser of the car takes possession. So, after the car goes out of the yard and the paperwork goes to the finance company, they have 10 days to make their registration. They could make their registration before it goes out of the yard. That is open to them. What the AFC are asking for is that the 10 days start when the finance company approves the loan. So the car goes out of the yard and the paperwork is sent to the finance company, and sometime later the finance company approves the loan and then has 10 days to make the registration.

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2 The relevant provision is in proposed Division 3- Priority of purchase money security interests, section 62 of the Personal Property Securities Bill 2009.

3 Australian Finance Conference, *Submission 8*, p. 2. For a detailed explanation of this issue see *Submission 8*, pp 1 to 4.

4 Australian Finance Conference, *Submission 8*, p. 2.

5 Australian Finance Conference, *Submission 8*, p. 3.

> What that means is that there would be, in a practical sense, an unlimited period of time during which the register would not disclose that the finance company will have an interest in this car. Someone else may acquire an interest in this car in the meantime, yet the later registration by the finance company will trump the interest of someone who has quite properly searched the register and discovered nothing.[6]

3.11 While the committee appreciates the government's reasoning behind its policy approach, the AFC is not persuaded that it is fully justifiable. It particularly troubles the AFC that the 'consequence of incorrect PMSI registration is extreme, ie the financier is unsecured.'[7] The AFC has noted that members will 'not be confident in utilising the PMSI mechanism'[8] and that in New Zealand a similar provision is undermined because financiers 'do not rely on PMSIs, but instead use subordination agreements, a costly and much less efficient mechanism.'[9] The AFC believes that the Australian market will also 'rely heavily on subordination agreements.'[10]

3.12 The Department does not share the view that the provision will be avoided in Australia. Mr Patch explained that:

> …we doubt that we would end up with an approach where Australian financiers were taking subordination agreements. The size of the market in New Zealand and the number of participants make it practicably convenient for them to have subordination agreements with each other as a matter of course, but when the market and the volume of transactions become large it becomes more difficult to have that sort of arrangement routinely establishing subordination agreements.[11]

3.13 Mr Glenn confirmed the Department's analysis of this issue and his confidence that the PPS register will be utilised:

> Ultimately, with the size of the New Zealand economy they seem to have reached a position where they have a moderately efficient workaround to the problem. In Australia that opportunity is not going to arise, and a more efficient way would be to use a register.[12]

3.14 The Department has also articulated a number of ways in which a financier can ensure that its PMSI interest is effective under the proposed arrangement even if it is not aware of the exact date of possession. For example:

- the financier can register the PMSI in anticipation of the arrangement being finalised; or

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6 *Committee Hansard*, 10 November 2009, p. 20.

7 Australian Finance Conference, *Submission 8*, p. 3.

8 Australian Finance Conference, *Submission 8*, p. 2.

9 Australian Finance Conference, *Submission 8*, p. 1.

10 Australian Finance Conference, *Submission 8*, p. 4.

11 *Committee Hansard*, 10 November 2009, p. 23.

12 Mr Glenn, *Committee Hansard*, 10 November 2009, p. 23.

- the merchant (such as a car dealer) can register its interest in the goods and can then transfer it to the financier.

Committee view

3.15 The committee notes the Department's view that there could be 'unintended practical consequences' for consumers if the AFC's approach is adopted and agrees that a policy balance in favour of the accuracy of the register is appropriate.

3.16 The committee also notes that although it may involve some 'double handling' for financiers, it appears that there are ways in which the AFC's members (and others seeking to rely on this provision) can, relatively easily, avoid the extreme consequences of missing the 10-day timeframe.

3.17 However, given that ineffective registration can arise because of circumstances beyond the immediate knowledge of the financier (for example, that the grantor has obtained early possession of the goods) the committee is concerned that the consequences are potentially so extreme: in these circumstances the financier can lose its security entitlement and become an unsecured creditor. The committee suggests that the government considers mitigating the severity of this situation. Failure to do so could give rise to the risk that industry will seek alternatives to the PMSI system, which could be to the detriment of those requiring finance and could undermine the usefulness of the PPS register.

Recommendation 3

3.18 That the government considers mitigating the severity of the consequence of a defective PMSI registration in goods.

3.19 That this issue is the subject of consideration during the (proposed) statutory review of the PPS legislation.

Meaning of purchase money security interest - Section 14(2) of the PPS Bill 2009

3.20 The current proposal in the PPS Bill 2009 is to exclude PMSIs for a security interest in collateral that 'the grantor intends to use predominantly for personal, domestic or household purposes'.[13] Piper Alderman has proposed that PMSIs should be able to be obtained for finance for consumer goods:

> The effect of paragraph (c) in sub-clause 14(2) is that it will not be possible to have a purchase money security interest in collateral that the grantor intends to use for personal, domestic or household purposes except as now proposed under sub-clause 14(2A). One consistent approach for purchase money security interests for both commercial and consumer finance would make the legislation less complex.[14]

13 Paragraph 14(2)(c).

14 Piper Alderman, *Submission 1*, p. 1.

3.21 The AFC and the Combined Four Law Firms also support this approach.[15]

3.22 The Department explained that the proposed approach is the result of a policy decision taken after careful thought:

> There is no doubt that it does add complexity and that in doing that it is not something that is done lightly, because the bill does give a very high emphasis on consistency of approach. To depart from that was something taken by the government in a very measured decision to favour the commercial financier over the consumer financier in the very restricted circumstances of that subparagraph.[16]

Committee view

3.23 The committee appreciates the argument that consistency is desirable and that this provision is an exception to the usual PMSI rule and the government's usual 'high emphasis on consistency of approach.'[17] The committee also notes the Department's comment that:

> Clause 14(2)(c) represents a policy choice preferring all-assets security granted to secure commercial finance over consumer purchase money security interest (which the Department understands are rarely enforced).[18]

3.24 The Explanatory Memorandum describes the policy intention behind this approach:

> Section 14(2)(c) is intended to promote [the] availability of finance to small business, be ensuring that general [PPS Act] security interests are not eroded by later PMSIs granted to acquire personal use assets.[19]

3.25 It seems to the committee that although the government's approach is one that may appear to favour a commercial financier's interest, the policy actually takes into account the interests of the consumer and is intended to support them. The committee therefore supports the approach taken in proposed paragraph 14(2)(c) of the PPS Bill 2009 and the proposed inclusion of sub-clause 14(2A) of this Consequential Amendments Bill.

3.26 If industry or its advisers have a different understanding of the enforcement of consumer PMSIs (which form part of the basis for the government's approach) or has evidence that a contrary outcome is likely for consumers, the committee requests that this is brought to the Department's attention for possible future reform.

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15 For the Australian Finance Conference view see *Committee Hansard*, 10 November 2009, p. 7 and the combined view of Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques is discussed at: *Committee Hansard*, 10 November 2009, p. 12.

16 Mr Patch, *Committee Hansard*, 10 November 2009, p. 18.

17 Mr Patch, *Committee Hansard*, 10 November 2009, p. 17.

18 Attorney-General's Department, *Personal Property Securities Bill 2009 Comments and Responses Table - All*, entry for clause 14(2)(c), p. 27.

19 Personal Property Securities (Consequential Amendments) Bill 2009, *Explantory Memorandum*, p. 27.

Recommendation 4

3.27 The committee recommends that the operation of section 14(2)(c) is the subject of particular consideration during the (proposed) statutory review of the PPS legislation.

Competition between agricultural PMSIs - proposed sections 85 and 86 of the PPS Bill 2009

3.28 A concern raised with the committee was that 'the legislation provides for agricultural PMSIs but does indicate which interest takes priority and these sections appear to allocate priority equally.[20]

3.29 During evidence to the committee, Mr Patch identified that it is likely that there is a mechanism already in the PPS Bill 2009 that will resolve this concern:

> The structure of the bill is that we have the default priority rules, which provide the priority rules if another provision in the bill does not give someone an outcome. You will go to clauses 85 and 86. If they do not give you an outcome then you go back to the default priority rules and they give the first people who were claiming the agricultural PMSI to register the priority.[21]

3.30 It appears to the committee that this potential problem has been addressed. The combined law firms have also confirmed to the committee that they 'accept that no further amendment is necessary to address this point.'[22]

Vesting provisions in section 267

3.31 Clause 267 of the PPS Bill 2009 provides that: 'An unperfected security interest will vest in the grantor of that interest if the grantor subsequently becomes insolvent.' The problem with this as explained by Mr Whittaker representing the combined law firms is that:

> While the amending bill goes some way towards dealing with the structural issues that we saw in those provisions it still does not deal with the fact that the clause could make it impossible for an all-assets security to attach to assets after a grantor becomes insolvent, because they will not have attached until after insolvency which means that they cannot be perfected. That means that, under clause 267, that they would disappear into the hands of the liquidator. We believe that this is probably an unintended consequence of the drafting but it is a very important consequence and could have very serious ramifications for not just the taking of security but also the orderly conduct of liquidation processes. We would urge the

20 For example, see the evidence of Mr Whittaker, *Committee Hansard*, 10 November 2009, p. 14.

21 *Committee Hansard*, 10 November 2009, p. 21.

22 Allens Arthur Robinson, Blake Dawson, Freehills, Mallesons Stephen Jacques, *Additional Information*, 16 November 2009, p. 1.

committee to consider whether this provision could be finetuned in the amending bill.[23]

3.32 During this inquiry the Department advised the committee that:

> In relation to 267 we are happy to acknowledge that there is room for improving 267 to address an issue raised by the law firms and by Piper Alderman. Where we think further work needs to be done is in identifying how the problem should be fixed. We have had some discussions with, I think it is the group of four, and they have suggested one way of resolving it. We are not sure that that is the way so we need to think further about how the problem should be fixed.[24]

3.33 The committee commends the government for continuing to respond to this issue, and notes that it intends to involve relevant stakeholders in this process as much as possible.

Commingled goods – proposed sections 101 and 102 of the PPS Bill 2009

3.34 In this inquiry the combined law firms maintained their recommendation that the law in relation to commingled goods should be altered. The issue relates to the provisions for valuing each party's interest in an undifferentiated mass of goods. The view of the combined law firms is that:

> …the bill would work—and work well—if it said that if security were enforced over that undifferentiated mass then each party would be able to participate according to the amount that they put in, whereas at the moment it looks at participating according to the amount secured and the value at the time they put it in. If you think about one person putting in 5,000 tonnes of wheat and another person putting in 1,000 tonnes which was subject to their security, and there is now a parcel of 6,000 tonnes of wheat that is sold, the easy and fair solution would be to say that they should share in the ratio of five to one; one should get five-sixths of the whole and one should get one-sixth of the whole. That is not the way it works at the moment, but we think it would be a great advance if it were done that way.[25]

3.35 The Department disagrees with this alternative policy approach and maintains that it is appropriate that when someone is being accounted to for the value of his or her contribution to the undifferentiated mass the value should be calculated on the basis of the terms of the contract for the supply of the goods. As Mr Patch explained:

> …the bill says that when it comes to divvying up the goods, you are not entitled to receive more than what you are owed…[26]

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23 *Committee Hansard*, 10 November 2009, p. 12. Piper Alderman also expresses concern about this: *Submission 1*, pp 1 and 2.

24 Mr Patch, *Committee Hansard*, 10 November 2009, p. 17. See also, for example, Clayton Utz, *Submission 9*, p. 5.

25 Mr Loxton, *Committee Hansard*, 10 November 2009, pp 13 and 14.

26 *Committee Hansard*, 10 November 2009, p. 23.

3.36 In continuing to consider this issue the law firms and the Department provided further material to the committee, which appears at Appendix 3. Put simply, the combined law firms' view is that a party can be disadvantaged if his or her secured property becomes mixed with other property as compared to identical secured property that is kept separate.[27] The Department is not convinced that the view of the law firms is accurate and also notes that the provisions in the PPS Bill 2009 'now reflect as closely as possible the provisions in the New Zealand Personal Property Securities Act 1999.'[28]

Committee view

3.37 The committee is concerned about the issues raised by the combined law firms and would like to ensure that the policy justification for proposed sections 101 and 102 is appropriate. However, in the time available the committee has not been able to assess the relative merits of arguments before it.

3.38 The committee notes the Department's point that the proposed provisions were adopted to reflect overseas legislation (in this instance the New Zealand provisions) in accordance with the committee's previous recommendation to this effect.[29] The committee acknowledges this, however, emphasises that the relevant recommendation was to use overseas provisions 'as often as possible…'[30] It appears that this area of the proposed law could be one in which departing from the overseas model is warranted.

3.39 In making this observation, the committee's preference is that the legislation is varied as little as possible and only to address any unfairness arising from the operation of the proposed approach. For example, the government could consider altering clauses 101 and 102 to remove the limit of the priority in the goods to the value of the goods on the day in which they became part of the product or mass.

Recommendation 5

3.40 The committee recommends that the government assess and respond to the issues raised by the combined law firms in relation to proposed sections 101 and 102 of the PPS Bill 2009.

3.41 That this issue is the subject of consideration during the (proposed) statutory review of the PPS legislation.

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27 Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques, Supplementary Submission, 23 November 2009.

28 See generally *Answers to Questions on Notice* provided by the Attorney-General's Department 18 November 2009, and see p. 5 in relation to the comparison with the New Zealand provisions.

29 *Answers to Questions on Notice* provided by the Attorney-General's Department 18 November 2009, pp 4 and 5.

30 Recommendation 1, *Exposure draft of the Personal Property Securities Bill 2008*, Senate Legal and Constitutional Affairs Committee, March 2009, p. 29.

Corporations Act amendments

3.42 Concern about the approach to amendments to the Corporations Act related to the PPS reform was raised with the committee. Issues brought to the committee's attention include:

- whether all PPS related provisions will be co-located in the PPS legislation rather than split between the PPS legislation and the Corporations Act; and
- why proposed amendments to the Corporations Act are not included in this bill or the PPS Bill 2009.[31]

3.43 As to the first point, the combined law firms expressed the view that:

> The opportunity should be taken to have all security interests, from whatever grantor, dealt with in the one spot, in which case the Corporations Act, other than giving a nod to the PPS Act, should remain silent on it.[32]

3.44 The Department explained that 'it would be a tidier outcome for the Corporations Act to be amended [but] it is not strictly necessary for the new scheme to operate.'[33] The Corporations Act amendments are being dealt with in a separate bill because:

> …there are in fact separate consultation arrangements and governance arrangements around amendments to the Corporations Act which arise under the corporations agreement between the Commonwealth and the states. We have developed those amendments and they will shortly go through the Ministerial Council on Corporations for agreement by the states and the Commonwealth before being released for public consultation. The amendments are with the Attorney at the moment, before being released.[34]

Committee view

3.45 The committee is satisfied that this issue is being progressed appropriately, but as this is part of a separate process it appears that it would benefit stakeholders to be kept informed about the progress of this issue. The committee suggests that the Department should give consideration to using a PPS newsletter, a copy of which was tabled during the committee's first inquiry, to achieve this.

Recommendation 6

3.46 That the government regularly provides information to stakeholders about the progress of the Corporations Act amendments relevant to the personal property securities reform.

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31 Mr Loxton, *Committee Hansard*, 10 November 2009, p. 15. See also, for example, Clayton Utz, *Submission 9*, covering letter, p. 1.

32 Mr Loxton, *Committee Hansard*, 10 November 2009, p. 15. Clayton Utz also supports this approach: *Submission 9*, covering letter, p. 1.

33 Mr Glenn, *Committee Hansard*, 10 November 2009, p. 19.

34 Mr Glenn, *Committee Hansard*, 10 November 2009, p. 16.

Privacy

3.47 There have been a number of concerns raised about privacy issues relating to PPS reform, which were canvassed in the committee's PPS reports. While protecting individual privacy was always a government priority, there were a number of ways in which submitters, and the committee, thought the approach should be improved.

3.48 This has already occurred to a significant degree, and in relation to this Bill the federal Office of the Privacy Commissioner advised the committee that:

> The Office supports the amendments to the *Privacy Act 1988* (Cth) made under Schedule 5 of the Consequential Amendments Bill. The Office also welcomes the Bill's clarification that section 157 of the Personal Property Securities Act 2009 (Cth), if enacted, will provide for interferences with privacy in relation to individuals only, not to corporations (Schedule 4 of the Bill, item 40).[35]

3.49 Nonetheless, there are still issues of concern raised by the Office of the Victorian Privacy Commissioner. In brief, the issues raised with the committee in that submission are that:

- the proposed clause 26 amendment is too broad: consideration should be given to including an express provision addressing the issue of credit profiling and prohibiting the use of the PPS for direct marketing;[36]
- the proposed clause 30 amendment may inadvertently result in substantial delays for a complainant: consideration should be given to ensuring that 'individuals retain the right to seek a personal remedy under the Privacy Act for a breach of section 172(3);[37] and
- small businesses should not be from complying with the authorised search requirements of the PPS Register: an amendment similar to that made recently *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) should be included in the PPS Bill.[38]

3.50 The committee notes the federal Office of the Privacy Commission supports the amendments to the *Privacy Act 1988* (Cth), but recommends that the concerns of the Office of the Victorian Privacy Commissioner be considered in detail by the government before the PPS reform commences.

Recommendation 7

3.51 The committee recommends that the concerns of the Office of the Victorian Privacy Commissioner to the committee be considered in detail by the government.

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35 Office of the Privacy Commissioner, *Submission 2*, p. 1.

36 Office of the Victorian Privacy Commissioner, *Submission 3*, pp 1 and 2.

37 Office of the Victorian Privacy Commissioner, *Submission 3*, p. 2.

38 Office of the Victorian Privacy Commissioner, *Submission 3*, pp 2 and 3.

Other matters

3.52 Once again, the committee has received substantially more material than it was possible to discuss in detail in this necessarily brief report. The committee notes that even in the short timeframe available for this inquiry the following submitters identified a number of concerns additional to those discussed above:

- Australian Securitisation Forum: raised a number of issues of concern (some matters raised previously that 'remain outstanding' and some new matters arising from this Bill);[39]
- Clayton Utz: supports this Bill, but do not believe the amendments 'are sufficient to address the problems raised by stakeholders.'[40] The submission identifies a number of major issues and a table of typographical or minor errors;[41] and
- the combined submission of Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques: identifies three categories of issues – continuing concerns, matters they have recently identified and further issues that will come to light.[42] The law firms have consolidated the issues of concern to them into three schedules which are attached to their submission.[43]

3.53 The committee commends all of these issues to the government for consideration and action where appropriate. The committee also considers that it would greatly assist businesses and their advisers if as much information as possible about policy decisions can be made publicly available.

Recommendation 8

3.54 That the government consider and respond to all of the issues raised in the submissions made to this inquiry to which they have not already responded.

Recommendation 9

3.55 The committee recommends that the Senate pass the Bill and urges the government to act on the other recommendations in this report.

Senator Trish Crossin
Chair

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39 Australian Securitisation Conference, *Submission 7*.

40 Clayton Utz, *Submission 9*, covering letter, p. 1.

41 Clayton Utz, *Submission 9*, pp 1 to 7.

42 Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques, *Submission 10*, p. 1.

43 Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques, *Submission 10*, schedules 1 to 3, pp 1 to 8.

ADDITIONAL COMMENTS BY LIBERAL SENATORS

1.1 This report is the third presented on the PPS reform process inquiry, the first having been the report on the exposure draft of the main Bill, which was tabled in March of this year.

1.2 The current inquiry was conducted in a little under a month from referral by the Senate, continuing a pattern of undue haste and scant regard for witnesses or for committee processes that has characterised all three inquiries. Short inquiries are sometimes necessary for urgent reforms of a limited nature, but this reform is large, exceedingly complex and has also been several years in the making. Yet the Senate is expected to come to terms with and approve this important legislation almost as an afterthought on the Government's part.

1.3 Liberal Senators note the comments in the main report that the ability of submitters and the committee to consider this highly technical bill has been significantly constrained by the timeframe of the inquiry, and that as a result, the committee has been forced 'to the extent possible, to examine the general thrust of issues and to articulate a few of the major concerns in more detail'. In other words, the main report is not comprehensive, and never could be in the time allowed.

1.4 Liberal Senators hold grave misgivings about how this whole process has been conducted. The time necessarily allowed for submitters with an interest in the reforms in all three inquiries has been unreasonably short given the complexity of the reforms. Further, it appears that the reform is being pushed ahead while there are still significant unresolved issues, as is evidenced by the significant flow of last minute correspondence to the committee about the matter, a major supplementary submission about PMSI registrations having been received as late as Friday afternoon, when the report must be tabled the next business day.

1.5 Liberal Senators accept and understand that some stakeholders remain opposed to the underlying policy of the reform, and there is little prospect that their concerns could ever be addressed, even in an exhaustive inquiry. However, in the view of Liberal Senators, there are significant unresolved matters that do not fall into this category, with disagreement between witnesses (eg: Lawyers and the Department) about the effect of substantive provisions of the Bill. It borders on recklessness for the Government to insist on passage of the Bill before all issues have been resolved to the point that the committee could sign off on them with confidence. In the time allowed, the committee cannot even be confident that all of the significant issues have been identified, let alone resolved.

1.6 Liberal Senators understand the desire to have the Bill passed to create legislative certainty, and also that not all States need to pass referral legislation before the scheme can commence. Liberal Senators also understand that many stakeholders are anxious to see the legislation in place so they can embark on the difficult process

of putting necessary information technology support in place. However, this is a very significant reform and there are huge financial implications for stakeholders. The costs of getting it wrong may be significant. Liberal Senators would have preferred the process to have been somewhat less pressured, to ensure the reform is as soundly thought through as possible.

1.7 Liberal Senators also express their disappointment that the regulations associated with this reform, which add much detail to the reform, have not yet been released in their final form. While these could be scrutinised separately by the Senate and the committee, it is not possible to assess the full impact of the complete legislative scheme when the regulations are unavailable.

Recommendation 1

1.8 Liberal Senators repeat their recommendation from the August 2009 report, that the government and the department release the revised draft regulations for public consultation as soon as possible.

1.9 Liberal Senators particularly wish to place on record their thanks to all of those who have given evidence to and made submissions to all three inquiries in what are recognised as undeniably sub-optimum circumstances.

Senator Guy Barnett **Senator Mary Jo Fisher**

Deputy Chair

APPENDIX 1

SUBMISSIONS RECEIVED

Submission Number	Submitter
1	Piper Alderman
2	Office of the Privacy Commissioner (Cth)
3	Office of the Victorian Privacy Commissioner
4	Australian Bankers' Association
5	Insolvency Practitioners Association
6	Australian Institute of Credit Management
7	Australian Securitisation Forum
8	Australian Finance Conference
9	Clayton Utz
10	Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jaques

ADDITIONAL INFORMATION RECEIVED

1 Answer to Question on Notice - Provided by the Attorney-General's Department on Friday 13 November 2009

2 Answer to Question on Notice - provided by Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jaques on Monday 16 November 2009

3 Answers to Questions on Notice - provided by the Attorney-General's Department Wednesday 18 November 2009

4 Answer to Question on Notice - provided by Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jaques on Monday 23 November 2009

APPENDIX 2

WITNESSES WHO APPEARED BEFORE THE COMMITTEE

Melbourne, Tuesday 10 November 2009

BILLS, Mr John, Associate Director
Australian Finance Conference

BOBBIN, Mr Wayne, Principal Legal Officer, Personal Property Securities Branch
Attorney-General's Department

EDWARDS, Mr Stephen, Legal and Market Consultant
Australian Finance Conference

GILBERT, Mr Ian, Director, Retail Policy
Australian Bankers' Association

GLENN, Mr Richard, Assistant Secretary, Personal Property Securities Branch
Attorney-General's Department

LOWDEN, Mr Patrick, Partner
Freehills

LOXTON, Mr Diccon, Partner
Allens Arthur Robinson

PATCH, Mr Robert, Principal Legal Officer, Personal Property Securities Branch
Attorney-General's Department

STUMBLES, Mr John
Private Capacity

WHITTAKER, Mr Bruce, Partner
Blake Dawson

APPENDIX 3

Supplementary Submission provided by Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques

Background

Towards the end of the public hearings into the *Personal Properties Securities (Consequential Amendments) Bill 2009* (the ***PPS Bill***) that were held by the Senate Standing Committee on Legal and Constitutional Affairs on 10 November 2009, we were asked by Senator Fisher to provide some further commentary on two issues that the Committee had raised with both us and representatives of the Attorney-General's Department at that hearing.

We responded with a Supplemental Submission on 16 November 2009.

The Attorney-General's Department made subsequent comments in relation to our Supplemental Submission in relation to one of those issues relating to clause 101 of the PPS Bill.

Our further response in relation to those issues are set out below.

Example 1

Our original example was as follows:

> *Glenn's Gold Emporium is a wholesale supplier of gold to the jewellery manufacturing market. It supplies gold on retention of title terms, and registers its security interests in accordance with the Act.*
>
> *A small but important customer of Glenn's Gold Emporium is an up-and coming boutique producer of reproduction antique rings, Patchworks. Glenn's Gold Emporium sells $100 of gold to Patchworks.*
>
> *Patchworks also maintains a number of banking facilities with Bobbin Bank. Patchworks has not given Bobbin Bank an all-assets security, but instead has given Bobbin Bank a security interest over all its stock of rings. Bobbin Bank has also perfected its security interest over the rings by registration.*
>
> *The gold price is notoriously volatile, and shortly after the sale of gold by Glenn's Gold Emporium to Patchworks, the price goes into a slump. Glenn's Gold Emporium is still owed $100 by Patchworks, but the value of the gold that it sold has now dropped to $80. This happens to still be the price on the day on which Patchworks uses the gold to make some rings. As a continuation of the*

> *price volatility, the slump reverses itself a few days later, and the gold price recovers to its previous level.*
>
> *Before Patchworks uses the gold to make rings, Glenn's Gold Emporium clearly has priority, and for its full $100.*

Under clause 99 of the PPS Bill, Glenn's Gold Emporium's security interest in the gold continues into the ring. Because of the vagaries of the world gold price and the coincidental timing at which Patchworks used that gold to make some rings, however, its priority under clause 101 is limited to $80, even though Glenn's Gold Emporium is owed $100 and the current market value of the gold in the rings is now back at $100 as well.

The Department in its response addressed the example on the assumption the gold is not mixed with anything else in manufacturing the ring..

Our point is more clear if it is assumed that the rings are manufactured not only from the gold supplied by Glenn's Gold Emporium, but also from some gold held in stock by Patchworks, and some silver supplied by Archimedes Ltd without any retention of title or other PMSI, which is alloyed with the gold. The gold supplied by Glenn's is worth $100 on supply, $80 on commingling, but at the time of sale of the ring, would have been worth $100 if separate.

Say the ring, taking into account the increased value of the gold supplied by Glenn's, the gold and silver of Patchworks, and its design, is worth $200.

At that stage, clause 99 clearly applies as the identity of the gold has been lost in the product or mass. The difficulty arises under section 101. That limits priority to the $80 value on commingling.

Under our example, Glenn's is owed $100, but is only entitled to recover $80, even though the value of its contribution has increased to $100. s103 might have helped but it does not override section 100.

A more stark example of the operation of the section in relation to non-fungibles is the following example.

Example 1A

> *Glennbank has a perfected security interest over 800 oz of gold , which secures (with other assets) $1,000,000. The other assets subject to its security are dissipated. The gold is worth $400,000 at the time of commingling, and the price of gold subsequently rises to $1000 an oz, giving a value of $800,000.*
>
> *The gold is mixed with other gold and silver and manufactured into rings. Patchwork Bank has an all assets security which has been registered after Glennbank's security, and therefore ranks second. The rings are worth $2 million.*

Under this scenario Glennbank only has priority for $400,000, less than both the amount secured and the value of the assets contributed at the time of realisation.

Firms' Example 2

We had said that the amount owed to each farmer, and the price of wheat at the time of supply by each farmer, is different.

Our example was:

A wheat exporter buys wheat on retention of title terms from Farmer A (3,000 tonnes) and Farmer B (2,000 tonnes). The wheat is fungible, and mixed so that is becomes a mass of 5,000 tonnes. The price of wheat was different when supplied and added to the mass, and each farmer is owed different amounts because they had different payment terms.

We had proposed that if the mass is sold, then Farmer A should be able to have priority over, and first recourse to, 3/5 of the sale proceeds of the mass, and Farmer B should similarly have priority over and first recourse to 2/5 of the mass, regardless of the value at the time of contribution or the amount owed.

The Attorney General's Department commented on this example in their question on notice response dated 18 November 2009. With respect, we think that the result of the example we gave is clearly not as stated by the Attorney General's Department in that response, which seems to assume the ratio of amounts owed is the same as the wheat contributed.

To illustrate, say Farmer A (who had supplied 3/5 of the wheat) is owed $2000 and Farmer B (who had supplied 2/5) is owed $3000, and the wheat as a whole is now worth $4000 (because the price of wheat has gone down) and is sold on enforcement for that amount. Under subsection 102(2) the two farmers participate in the mass in the ratio of the secured amounts. Farmer A is entitled to 2/5 and Farmer B is entitled to 3/5 of the whole even though they had supplied wheat in the reverse proportion. That has the result that Farmer A receives $1600, and Farmer B receives $2400, even though the wheat supplied by them is worth $2,400 in the case of Farmer A, and $1600 in the case of Farmer B.

Example 2A

The example becomes even more dramatic if the secured parties are not farmers with PMSIs in wheat but financiers with security interests over respective contributions of gold.

> *Say, instead of Farmer A, there is Bank A who is owed $10,000 and had a security interest in 3/5 of the gold before commingling (and other assets), and instead of Farmer B. there is Bank B that is owed $90,000, and had a security interest in 2/5 of the gold before commingling (and security over other assets), and before commingling their gold was worth $135,000 and $90,000 respectively, but on enforcement the mass was worth $50,000 in total (so that the contributions at those values are worth $30,000 and $20,000).*

In that case Bank A recovers $5,000, and Bank B $45,000. Bank B receives a windfall.

In each case the result would be radically different if the wheat or gold had not been mixed.

It is hard get past the basic proposition that the financiers of two separate loads of wheat or gold will be able to realise their securities for up to the value of their respective loads at the time of realisation, as long as the loads are kept separate. Why should they risk loss (and others make a windfall gain) just because the two loads get mixed together?

Fungible goods

We think that this principle in particular is something that is easy to understand and easy to draft. It is not complex.

The proposition is simply that contributors of fungible goods to a mass should participate according to the respective goods contributed to the mass. It should not matter who is owed what in apportioning priority, or what the price was at the time of commingling. The mass is divisible, the proceeds of realisation on enforcement are divisible, and they should be divided according to the contribution to the mass.

We are suggesting that there be a special provision that governs what happens with commingled fungible goods. We think we should take the opportunity to improve on foreign models, and this would be a clear and easy improvement. That would be an opportunity for Australia to have a significant improvement on other jurisdictions, and a valuable one in an economy in which commodities are so important. Of course, the principles do not only apply to commodities, examples in previous cases in the case law include common stores of bottles of wine and gold coins. The principle could be extended to fungible intangibles.

Non-fungible goods

The principles that should apply to non-fungible goods are more complex, and may be open to debate, but it seems to us that the principles that have been applied in the drafting of sections 101 and 102 are not the appropriate ones, as is demonstrated in our examples 1 and 1A, and again the opportunity should be taken to fix them up. A

fairer proposition for section 101 would be to look at the value of the goods at the time of realisation, not at the time of commingling.

That preserves the value of the security that had been taken over goods and would have been the value had the goods remained separate. It also prevents the other unfairness that can arise to subsequent secured creditors if a secured creditor has contributed goods which have significantly declined in value after commingling. That would apply equally to gold used in rings, to resin or woodchips used in chipboard, and to wheat used in bread (though in the latter cases there is unlikely to be any difference between value as at commingling and value as at realisation).

Section 101 limits priority to an historical figure which may have little relevance to the current value at the time of realisation.

Section 102 again has arbitrary results because it looks at the value of the secured obligation, rather than the value of the security. We suggest that a more reasonable principle in section 102 would be to divide up the proceeds according to the respective values of the goods contributed as at the time of realisation.

We cannot see the policy reason for limiting priority to an historical value or, when priorities are equal, dividing proceeds according to amounts secured rather than goods supplied.

Supplementary Submission provided by the Attorney-General's Department

Inquiry into the PPS (Consequential Amendments) Bill 2009 – Question on Notice

On 16 November 2009, Senator Crossin asked the Department the following questions on notice:

> Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques have provided further information about their view of the operation of clauses 101 and 102 of the PPS Bill (reply to a question on notice provided 17 November 2009 http://www.aph.gov.au/senate/committee/legcon_ctte/pps_consequential/submissions.htm).
>
> Does the department agree that, in the example provided about Glenn's Gold Emporium, the result is not a commercially balanced outcome? In light of the view of the four law firms about the operation of clause 101, could the department provide further information about the policy justification for it?
>
> Could the department also provide information about the policy justification for clause 102?

Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques ('the law firms') have suggested that the priority amount for the purposes of clause 101 should be determined by reference to the value of the relevant goods from time to time, rather than at the time the goods were commingled. The Department considers that the law firms' suggestion is not supported by the examples they provided.

Law firms' example 1

The law firms provided the following example in support of their suggestion:

> Glenn's Gold Emporium is a wholesale supplier of gold to the jewellery manufacturing market. It supplies gold on retention of title terms, and registers its security interests in accordance with the Act.
>
> A small but important customer of Glenn's Gold Emporium is an up-and coming boutique producer of reproduction antique rings, Patchworks. Glenn's Gold Emporium sells $100 of gold to Patchworks.
>
> Patchworks also maintains a number of banking facilities with Bobbin Bank. Patchworks has not given Bobbin Bank an all-assets security, but instead has given Bobbin Bank a security interest over all its stock of rings. Bobbin Bank has also perfected its security interest over the rings by registration.
>
> The gold price is notoriously volatile, and shortly after the sale of gold by Glenn's Gold Emporium to Patchworks, the price goes into a slump. Glenn's Gold Emporium is still owed $100 by Patchworks, but the value of the gold that it sold

has now dropped to $80. This happens to still be the price on the day on which Patchworks uses the gold to make some rings. As a continuation of the price volatility, the slump reverses itself a few days later, and the gold price recovers to its previous level.

Before Patchworks uses the gold to make rings, Glenn's Gold Emporium clearly has priority, and for its full $100.

Under clause 99 of the PPS Bill, Glenn's Gold Emporium's security interest in the gold continues into the ring. Because of the vagaries of the world gold price and the coincidental timing at which Patchworks used that gold to make some rings, however, its priority under clause 101 is limited to $80, even though Glenn's Gold Emporium is owed $100 and the current market value of the gold in the rings is now back at $100 as well.

Clause 99 of the Bill provides as follows (so far as is relevant):

> **99 Continuation of security interests in goods that become processed or commingled**
>
> (1) A security interest in goods that subsequently become part of a product or mass continues in the product or mass if the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass.

Three conditions must be satisfied before section 99 will apply:

(a) there must be a security interest in goods,

(b) the good must become part of a product or mass, and

(c) the goods must be so manufactured, processed, assembled or commingled that their identity is lost in the product or mass.

When these circumstances exist, the security interest in the goods continues in the product or mass.

In the example provided by the law firms, the first two conditions are satisfied, that is:

(a) there is a security interest in the gold supplied by Glenn’s Gold Emporium to Patchworks, and

(b) the gold becomes part of a product (that is, the rings manufactured by Patchworks).

However, the gold supplied by Glenn’s Gold Emporium has not been so manufactured, processed, assembled or commingled that its identity is lost in the product or mass (that is, the third condition is not satisfied). All of the gold in the rings manufactured by Patchworks is traceable to the gold supplied by Glenn’s Gold Emporium. Because of this, clause 99 does not apply to the scenario provided by the law firms.

The Department considers that the security interest in the gold granted by Patchworks to Glenn's Gold Emporium would continue in the gold despite the gold being manufactured into the rings. The gold is the same collateral despite having been manufactured into rings. To use an analogy, a security interest in a pile of sand would continue in all of the sand if the pile were divided into two piles of sand (without recourse to clause 99 of the Bill).

If Patchworks were in default under the security agreement, Glenn's Gold Emporium would be able to seize and dispose of the rings with a view to realising the amount owed to it (see Part 4.3 of the Bill). This assumes that Glenn's Gold Emporium has not contracted out of these rights (see clause 115 of the Bill). The Department understands that this is the outcome favoured by the law firms.

Law firms' example 2

The law firms have also provided the following example in support of their suggestion:

> A wheat exporter buys wheat on retention of title terms from Farmer A (3,000 tonnes) and Farmer B (2000 tonnes). The wheat is fungible, and mixed so that it becomes a mass of 5000 tonnes. The price of wheat was different when supplied and added to the mass, and each farmer is owed different amounts because they had different payment terms.

They have proposed that:

> If the mass is sold, then Farmer A should be able to have priority over, and first recourse to, 3/5 of the sale proceeds of the mass, and Farmer B should similarly have priority over and first recourse to B 2/5 of the mass, regardless of the value at the time of contribution or the amount owed.

The Bill as drafted would deliver the result suggested by the law firms in most situations as the following examples illustrate. The examples assume that the wheat was initially held separately by the wheat exporter and later mixed.

AGD example 1

If the price of wheat has fallen below that purchased from both Farmer A and Farmer B, the Bill will require the amount realised on the sale of the wheat to be paid 3/5th to Farmer A and 2/5th to Farmer B. This is the result suggested by the law firms.

AGD example 2

If the price of wheat has fallen to below that owed to Farmer A (but not that owed to Farmer B), the wheat exporter could sell 2,000 tonnes of wheat, pay out Farmer B and keep the profit. Farmer A would be entitled to enforce its security interest against the remaining 3,000 tonnes of wheat. This is the result suggested by the law firms: as each farmer has been paid out of the proportion of the wheat supplied by them.

AGD example 3

Similarly, if the price of wheat has fallen below that owed to Farmer B (but not that owed to Farmer A), the wheat exporter could sell 3,000 tonnes of wheat, pay out Farmer A and keep the profit. Farmer B would be entitled to enforce its security interest against the remaining 2,000 tonnes of wheat. This is the result suggested by the law firms: as each farmer has been paid out of the proportion of the wheat supplied by them.

AGD example 4

If the price of wheat has not changed since it was mixed, or has increased, the wheat exporter would in the ordinary course of its business sell all the wheat and pay out Farmer A and Farmer B the amounts they are owed. This is the result suggested by the law firms: as each farmer has been paid out of the proportion of the wheat supplied by them.

If the price of the wheat has not risen to the amount owed to Farmer A, Farmer A may nevertheless benefit by being paid out of profit made by the wheat exporter on the sale of the wheat supplied by Farmer B. Farmer A would therefore be better off than under the law firms' suggestion.

A scenario in which the law firms' suggestion may change the outcome delivered by the Bill is described in the following example.

AGD example 5

The law firms' suggestion may change the outcome if the price of wheat fell after it was purchased from Farmer A, rose after the wheat supplied by Farmer A was mixed with the wheat supplied by Farmer B (but not to the amount owed to Farmer A), and Farmer A enforced its security agreement against the wheat exporter.

Under the Bill, Farmer A would not benefit from any increase in the value of the wheat after it was mixed (clause 102(4)).

The law firms have suggested, in effect, that Farmer A should benefit from any increase in the value of the wheat after it was mixed.

Clauses 101 and 102

The Committee's March 2009 report on *Exposure draft of the Personal Property Securities Bill 2008* included the following comments:

> 4.13 One of the examples given of unnecessary length in a provision was that of sections relating to a 'commingling' of goods question. One overseas model addresses the issue in six lines of text, one in 40 lines of text, and the Australian draft bill in approximately 112 lines of text covering four and a half pages.

> 4.14 Again, it is a question of policy as to the appropriate balance to be struck between the two goals of certainty and simplicity. The committee agrees that it is important to ask the question generated by Professor Duggan's submission – are the benefits of greater drafting precision worth the cost?
>
> 4.15 This is another area in which the committee's view is that too much weight has been given to certainty at the expense of comprehensibility.

The Committee made the following recommendation at paragraph 4.19 of its report:

> 4.19 The committee strongly recommends that the Department reconsiders the balance between certainty of the law and the accessibility of the provisions with a view to:
>
> - using overseas provisions as often as possible to allow overseas experience to provide guidance for the Australian model.

The Government accepted the Committee's recommendation.

The provisions in the Bill relating to commingling were amended so that they now reflect as closely as possible the provisions in the New Zealand Personal Property Securities Act 1999. As outlined above, the provisions drawn from New Zealand achieve the outcome sought by the law firms in most circumstances.

While it would be possible to amend the Bill to include a special provision achieving the outcome sought by the law firms when fungible goods are mixed, the price falls before the goods are mixed, but rises after the goods are mixed, this would add to the complexity of the Bill. It would represent a departure from the overseas models and reduce the capacity for overseas experience to provide guidance for those working with the Australian legislation.

Accepting the law firms' suggestion may also result in the need to decide difficult questions of fact.

For example, Farmer A and Farmer B each supply 10 containers of grapes to a winemaker. It is not possible to work out which farmer supplied any particular container of grapes held by the winemaker. Should Farmer A be able to argue that the special rule should apply because its grapes are identical to the grapes supplied by Farmer B? Would it matter that the winemaker intended to mix all the grapes into the same barrels of wine? Would it matter if another winemaker would not mix all the grapes into the same barrels of wine? Alternatively, should Farmer B and the winemaker be able to argue that Farmer B's grapes are sweeter than those supplied by Farmer A, and that because of this the special commingling rule should not apply? The court would need to decide whether the grapes supplied by the 2 farmers were sufficiently similar as to be substitutes, and so fungible, with the result that the special fungibles commingling rule would apply.

Even if the court decides that the proposed special fungibles commingling rule should apply because the grapes supplied by the 2 farmers are perfect substitutes, this might

in some circumstances result in an outcome that is not commercially balanced. For example, the winemaker might have incurred considerable expense in transporting, storing and otherwise dealing with the grapes prior to the farmers making their claim. Would it always be commercially balanced to give priority to the grapegrowers over the expectations of the haulage and storage companies that they would also be paid out of the moneys realised from the grapes?

Non-fungible goods

In addition, it should be noted that the existing provisions of the Bill also apply in scenarios involving the commingling of goods that are not fungible.

For example, Farmer A might supply flour to a baker, and Farmer B might supply eggs to a baker. The baker uses the eggs to manufacture bread. The value of the bread may be greater than the sum of the value of the flour and the eggs. Under the Bill, the amount that may be claimed by the farmers is limited to the value of the flour and the eggs on the day that the bread is made. This outcome recognises that there may be others who also have a claim to the bread because they have contributed to the increase in the value (for example, the owner of the recipe used to make the bread, the electricity or gas supplier, and the lessor of equipment used in the bakery).

It may not be a commercially balanced outcome to give the supplier of non-fungible goods priority over any increase in the value of the goods after the commingling occurs when there are claims made by others who have also contributed to the increase in the value of goods.