Review of the Personal Property Securities Act 2009

INTERIM REPORT

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Letter of transmittal

Senator the Hon George Brandis QC
Attorney-General
Parliament House
CANBERRA ACT 2600

The Hon Josh Frydenberg MP
Parliamentary Secretary to the Prime Minister
Parliament House
CANBERRA ACT 2600

Dear Attorney-General and Parliamentary Secretary,

Interim Report on the Review of the Personal Property Securities Act 2009

I am pleased to present you with the *Interim Report on the Review of the Personal Property Securities Act 2009*.

The *Personal Property Securities Act 2009* established a single, national set of rules for secured credit using personal property. The Act sought to provide greater certainty for Australian businesses, credit providers and consumers, and so to reduce the cost of secured finance. After two years, this review provides a timely opportunity to consider the operation of the Act and the achievement of these goals.

As required by the terms of reference issued by the Attorney-General on 4 April 2014, this *Interim Report* considers the impact of the Act on small businesses and in particular issues of awareness, understanding and complexity.

The Act rewrote the rules that regulate a critical set of functions in our economy. Those functions traverse all areas of economic activity, and manifest themselves in different sectors of the economy in very different ways. For that reason, the review has received submissions from a wide range of businesses and industry organisations representing financial institutions, other participants in the credit sector, hiring businesses, and small businesses generally. The submissions expressed a range of views on the operation of the Act, but the clear underlying theme from the submissions is that much can be done to help the Act to better achieve its objectives.

While I have recommended that action be taken to support greater understanding of the Act among small businesses, I have not recommended any priority legislative action at this stage for Government consideration. Instead, the feedback relating to small business stakeholders raises broader issues about the scope and operation of the Act, and interacts with issues raised by other stakeholders in the second round of submissions received to 25 July. In light of this, I propose to shortly release a number of consultation papers outlining issues for further consideration and feedback by stakeholders. This feedback will inform my final report and recommendations to you, due on 30 January 2015.

I would be happy to meet with you to discuss my report and look forward to your ongoing interest and support as the review continues.

Yours sincerely,

Bruce Whittaker

31 July 2014

TERMS OF REFERENCE

I, George Brandis QC, Attorney-General, request Mr Bruce Whittaker to undertake a review of the operation of the *Personal Property Securities Act 2009* (PPS Act).

The review should consider:

a) the effects of the reforms introduced by the PPS Act on:

   i) Australian businesses, particularly small business

   ii) Australian consumers

   iii) the market for business finance in Australia, and

   iv) the market for consumer finance in Australia

b) the level of awareness and understanding of the PPS Act at all levels of business, particularly small business

c) the incidence and, where applicable, causes of non-compliance with the requirements of the PPS Act particularly among small businesses

d) opportunities for minimising regulatory and administrative burdens, including costs, on businesses, particularly small business, and consumers

e) opportunities for further efficiencies in the PPS Act regime including (but not limited to) simplification of the Personal Property Securities Register and its use

f) the scope and definitions of personal property covered by the PPS Act

g) the desirability of specifying thresholds for the operation of the PPS Act regime in respect of particular types of personal property

h) the interaction of the PPS Act with other legislation including the *Corporations Act 2001*, and

i) any other relevant matters.

The review must include consultation with relevant stakeholders.

An interim report is to be provided jointly to me and the Hon Josh Frydenberg MP, Parliamentary Secretary to the Prime Minister, by 31 July 2014 on the impact of the PPS Act on small businesses with recommendations on any priority actions (including legislative) that should be considered by Government in respect of issues raised in the review that concern small business stakeholders.

The final report on the review, which should include recommendations on how to improve the PPS Act, including simplification of the Act where appropriate, must be provided jointly to me and the Hon Josh Frydenberg MP, Parliamentary Secretary to the Prime Minister by 30 January 2015.

George Brandis QC

Attorney-General

[Authority: Section 343 of the *Personal Property Securities Act 2009*]

1. Executive Summary

The *Personal Property Securities Act 2009* (the **"Act"**) revolutionised the law and practice of secured transactions in Australia, when it commenced practical operation on 30 January 2012.

The Act replaced the previous fragmented and confusing sets of overlapping regimes for secured transactions, with a single set of rules that apply to security interests in personal property regardless of their form, the location or nature of the grantor or the location or nature of the collateral. This was an important piece of micro-economic reform - the expectation was that the reforms would increase the consistency and certainty of secured finance, reduce the complexity and cost of secured finance, and enhance the ability of businesses and consumers to use their assets as security and improve their ability to access cost-effective finance.

Government provided the private sector with a range of opportunities to provide input into the framing of the Act. Government nonetheless appreciated that the Act was a complex piece of legislation, and that it was re-writing the operating rules for a complex and vital area of economic activity. In recognition of this, provision was made in the Act for a review of the operation of the Act to be completed by the third anniversary of its commencement, ie by 30 January 2015. This interim report forms part of the conduct of that review.

The submissions that were provided for the purposes of this interim report reveal that much can and should be done to enable the Act to realise its goals. While the submissions largely (but not universally) support the overall framework of the Act, they identify a number of high-level policy questions and a wide range of more technical issues that are worthy of further examination.

The submissions indicate in particular that:

- the Act and the Personal Property Securities Register (the **"register"**) are too complex; and
- despite Government's efforts to raise awareness of the Act and its implications, both in the lead-up to the commencement date and subsequently, many businesses are still unaware of the Act, or do not appreciate the extent to which the Act can impact on their activities.

These concerns have been particularly acute for small businesses. Small businesses typically do not have the resources to be able to access detailed advice on how to manage the complexities of the Act and the register. This exposes them, more than larger organisations, to the risk that they might not satisfy the Act's requirements in relation to their assets, and so to the risk that they could lose those assets to a third party, or on the insolvency of a customer. A failure to follow the rules set out in the Act can also have a disproportionately large effect on a small business, by virtue of the very fact that they are small.

The clear message from the submissions is that if the Act is to achieve its potential, it needs to be clarified and simplified. Many of the specific suggestions for change in the submissions are directed at this goal.

While much can be done to simplify and improve the Act, it will always be complex - in the concepts that it deals with, in the detail of its language, and in the interlocking and interdependent nature of its content. For these reasons, it will be important to ensure that proposals for change are assessed against a structured and policy-based set of criteria that take into account both the merits of the proposed changes, and the impact that they might have on the Act more broadly. The conclusions and recommendations in Part 7 provide a framework for undertaking this assessment process, and a pathway for conducting a considered and principled analysis of potential changes. This process will provide both the framework and the material for the content of the specific recommendations that will be included in the final report.

2. Introduction

The reforms implemented by the *Personal Property Securities Act 2009* (referred to in this report for convenience as simply the **"Act"**) and the associated *Personal Property Securities Regulations 2010* (the **"Regulations"**) have wrought profound change to the fabric of Australian commercial law.

The Act established an entirely new regime for the creation, legal effect and enforcement of security interests in personal property. It replaced a complex and fragmented set of rules – rules that were scattered across more than 70 Commonwealth, state and territory statutes and the general law – with a single set of rules that apply to security interests in personal property regardless of their form, the location or nature of the grantor or the location or nature of the collateral.

The secured transactions laws across Australia before the introduction of the Act were confused and disjointed. While the rules affecting secured finance to large companies were relatively well understood within the legal and business communities and were only infrequently the source of confusion or controversy, the position in relation to the provision of secured finance to small businesses and individuals was much less satisfactory. Many state or territory laws were inherited remnants of older legislative packages that did not fit comfortably with modern commercial practices, or often with other laws of the same jurisdiction. The legal requirements in one state or territory could also be at odds with those of other states or territories, and while this may have been a less pressing concern in earlier times it presented a considerable challenge for financiers in today's economy.

Capital, property and people are all much more mobile than in the past, and financiers need to ensure as a result that their documents and procedures are capable of meeting the relevant legal requirements in multiple jurisdictions. This was not conducive to market efficiency, and resulted in unnecessary cost to borrowers and inflexible lending practices. The uncertain and at times archaic state of the previous laws also made financiers reluctant to accept some types of property as collateral.

The Act was intended to reduce the costs of borrowing and increase the range of property available to secure finance, especially for smaller businesses, by replacing the previous messy patchwork of old laws with a single set of rules that apply consistently and predictably to all types of security interest and all types of personal property, regardless of the location or nature of the personal property or the grantor. As the Government has put it, the over-arching goals of the Act were to:

- increase the consistency and certainty of secured finance in Australia;
- reduce the complexity and cost of secured finance in Australia; and
- enhance the ability of businesses and consumers to use their assets as security, and improve their ability to access cost-effective finance in Australia.

The Act did not attempt to do this by simply standardising the rules for existing legal structures. While this would have improved consistency of treatment across Australia for individual types of financial products, it would not have improved a business's ability to use all its types of property as collateral. Also, because the tradition of our legal system is to base the legal effect of a transaction on the form that the parties choose for the transaction rather than its underlying commercial substance, this approach would have failed to eliminate much of the complexity of the previous rules, as different financial products would have continued to have quite different legal effects, even where they were designed to achieve a similar commercial purpose.

Rather than retain existing legal concepts and standardise them, the Act took a very different approach. It largely ignores the form that parties choose for their transaction or even who has title to this property, and instead focuses on the transaction's commercial substance to determine whether it should be treated as a security interest. In doing this, the Act draws on principles that have been developed and implemented in a number of overseas jurisdictions, most notably in the United States (in Article 9 of its Uniform Commercial Code), Canada and New Zealand.

This was a radical shift in approach. Before the commencement of the Act, Australian secured transactions law recognised only four types of transaction (mortgages, charges, pledges and liens) as a security interest. Other types of transactions were not treated by the law as security arrangements, even if they achieved a similar commercial effect, and were governed by different sets of rules. This gave the parties to a transaction the liberty to determine the legal consequences of their arrangement by choosing the form of transaction that most suited them.

It was not uncommon for a finance-like transaction to be structured in a manner that fell outside the boundaries of secured transactions law. For example, it is very common for a manufacturer or supplier of goods to sell the goods on retention of title terms, or for an owner of goods to make the goods available to a third party by way of lease. Both arrangements allowed the owner of the goods to "secure" its position in the transaction through the fact that it retained title to the goods, rather than by taking a formal security over them. These types of transactions relied for their efficacy on the well-established principle of sanctity of ownership, enshrined for lawyers in the Latin expression *nemo dat quod non habet* (a person cannot give that which they do not have).

This ability of contracting parties to choose the structure of their transaction came however at the expense of transparency to outsiders, as the existence of a finance-like transaction might or might not be apparent to others, depending on the form that the parties chose for the transaction. The Act seeks to redress this by regulating transactions by reference to their commercial substance rather than their legal form.

Perhaps the most notable (and for many the most surprising) consequence of this approach is that ownership of an asset is no longer sufficient to protect a party, as an ownership interest in property can become subordinate to the interest of a third party, or even lost entirely, in some circumstances. This change is the underlying source of many of the concerns that have been expressed in relation to the Act.

Generally speaking, financial institutions and large companies were prepared for the Act when it commenced practical operation in January 2012. The same cannot be said, however, for smaller businesses. Despite the education efforts that had been undertaken by Government in the lead-up to the commencement of the Act, many small businesses were not ready. Many remained quite unaware of the Act, and of the impact that it could have on their business. Some unfortunate business-owners first learned of the Act when they discovered that they had lost ownership of their property to an insolvent customer, because they had not perfected their interest in their property under the rules set out in the Act.

Even small businesses that are aware of the Act have found it challenging. The Act is a complex and very detailed piece of legislation, and many Australian businesses, and particularly small businesses, have struggled to come to terms with it. Many smaller law firms face the same challenge, and the expertise to understand and advise effectively on the Act is found for the most part within the larger financial institutions and law firms, and academia. This exacerbates the difficulty that small businesses face, as they are unlikely to have the financial capacity to tap into these sources of advice.

Government is aware of these concerns. While these issues affect all businesses that engage in transactions to which the Act applies, Government is aware that they can have a disproportionate effect on small businesses. Small businesses are typically time-poor, and do not have the capital resources or administrative systems that larger businesses can draw on to understand and manage their interaction with the Act. A small business can also be much more severely affected by the loss of a single asset to an insolvent customer than would be the case for a larger organisation.

Small businesses are vitally important to the Australian economy. They employ around 4.5 million Australians, and account for approximately 43 per cent of private sector employment and around one-third of private sector output to the Australian economy. The Productivity Commission has assessed that some 96 per cent of Australia's 2 million businesses are small. These figures make it clear that the experience of small businesses under the new regime is a key issue for consideration.

For these reasons, I have been asked to prepare this interim report in relation to the impact of the Act on small businesses. As many issues that affect small businesses will affect larger businesses as well, this report focusses on matters that have been raised in the submissions as having a particular impact on small businesses - either because of the relative resource constraints affecting small businesses, or because of the business sectors that they typically operate in.

This report deals with the following matters:

- **PART 3** summarises the steps that have been taken so far in relation to the review;
- **PART 4** discusses what we mean by "small business" for the purposes of the report;
- **PART 5** summarises the key themes from the submissions;
- **PART 6** comments, based on the submissions, on the extent to which the Act has achieved its objectives; and
- **PART 7** sets out my interim conclusions and recommendations.

3. The process so far

On 4 April 2014, the Attorney-General, Senator the Hon George Brandis QC, announced a review of the operation of the Act, and issued terms of reference for its conduct.

In accordance with the terms of reference, the review is to be conducted in consultation with relevant stakeholders. The review has sought to engage with stakeholders and encourage submissions using a range of measures.

On 14 April 2014 a website for the review was established and a call for submissions published, inviting two sets of submissions to the review, the first focussing on issues particular to small business and a second focussing on all other issues. A subscription email list was also established on the website to facilitate distribution of information regarding the review to interested parties.

The review employed a targeted campaign to engage key small business stakeholders about the review and call for submissions, featuring social media advertising on Facebook and Google and the preparation of over 100 letters to small business industry organisations, advocates and advisers.

A banner notice alerting users to the review was placed on the homepage of the Personal Property Security Register website and submissions encouraged via its monthly newsletter. A notification of the review and the call for submissions was also sent to the Australian Financial Security Authority's (AFSA) personal property securities stakeholder forum for distribution to their members.

The review and call for submissions were advertised on business.gov.au through notifications to stakeholder group members and inclusion of a news item to inform readers of the review and direct them to the review website. The review was also advertised through business.gov.au related social media platforms (Facebook, Twitter and the business.gov.au subscription list).

Submissions on issues particular to small business closed on 6 June 2014. The review Secretariat received 37 submissions, 35 of which are publicly available from the review website. A summary of the submissions received has also been prepared and published on the website.

The final date for submissions in relation to all other issues was 25 July 2014. These submissions will also be published on the review website.

4. What do we mean by "small business"?

There is no distinct or universal definition of "small business". Typically, small business is defined by annual turnover or number of employees, or a combination of both factors. A range of definitions of small business are used in legislation and by government departments and agencies.

For example, the Australian Bureau of Statistics defines a small business as an actively trading business with 0–19 employees. Contrastingly, the *Corporations Act 2001* defines "small proprietary companies" to be companies with two of the following attributes: annual revenue of less than $25 million, fewer than 50 employees and/or consolidated gross assets of less than $12.5 million.

The Australian Taxation Office defines a "small business entity" as a business with annual revenue turnover (excluding GST) of less than $2 million, whilst the Fair Work Commission defines a small business as having fewer than 15 employees.

The Productivity Commission has taken the view that the best way to define small business is by reference to its inherent characteristics, rather than on a quantitative basis. It suggests this as a generic definition:

> *...an independent firm that is usually managed, funded and operated by its owners, and whose staff size, financial resources and assets are comparatively small in scale. (Schaper et al. 2010).*

The Commission goes on to acknowledge, though, that the appropriate definition of the term will vary, depending on the regulatory context in which it is to be used.

Government has not specified a definition of "small business" for the purposes of the review. Rather than constrain the content of submissions by imposing a specific definition of "small business", it has been left open to individual submissions to rely on their own understanding of the term for the purposes of formulating the issues that they wish to raise. In response, the review has received submissions from:

- individual businesses;
- industry and professional peak bodies representing sole trader, partnership and small proprietary companies;
- legal and other professional advisers engaged by such businesses; and
- small business commissioners or ombudsmen.

5. Themes from the submissions

5.1 Lack of awareness

Government was aware, when it was planning the introduction of the Act, that it would need to undertake a broad-based education campaign to inform the business and wider community of the reforms.

Over an extended period beginning in 2006, Government conducted a range of education and awareness–raising activities, including:

- a multi-facetted media campaign;
- mail-outs;
- presentations at industry conferences, seminars and stakeholder forums;
- information brochures, fact sheets and videos; and
- a Personal Property Securities (PPS) road show.

More detail of the Government's education and awareness-raising activities is set out in Annexure A.

The PPS road show was specifically targeted at small businesses, and at the accounting and other advisers that service them. Apparently, however, the seminars were generally not well attended.

This apparent lack of awareness or interest among the small business community regarding the need to come to grips with the new regime appears to have been a harbinger of things to come. Almost all of the submissions make the point that much of small business is still either entirely unaware of the existence of the Act, or does not understand the extent to which the Act can impact on their business activities.

The New South Wales Small Business Commissioner notes, for example, that:

> *...there is a very low level of awareness amongst small businesses of the [Act] and the Personal Property Securities Register.*

The Australian Finance Conference and the Debtor and Invoice Finance Association both make the same point. They refer to:

> *...a lack [of] awareness of the Act by the broader business community and many of its advisors.*

The Commercial Asset Finance Brokers Association of Australia emphasises the lack of awareness in these terms:

> *One of the key failings of the [Act] is the education of small business on its importance and small business obligations under it. Not many in small business know about it – "how can you comply if you don't know about it".*

A number of small businesses provided their own separate submissions to the review. One of those submissions came from Elphinstone Engineering, a small business in Tasmania. They say that they:

> *...have spoken to a broad range of people and are simply staggered at the lack of knowledge in the community of the existence of [the] Act.*

Even businesses that are aware of the existence of the Act often do not appreciate the impact that the legislation can have on them. The Australian Bankers' Association notes for example that:

> *Overall ... small businesses have an insufficient understanding of the Act and its provisions.*

The Combined Small Business Alliance of WA similarly observes that:

> *...generally speaking small businesses are at [a] loss in understanding how to interpret [the Act] or use it properly.*

This lack of awareness does not appear to be limited to specific industry sectors. It is identified as an issue not only in submissions from organisations that span the economy generally, but also from organisations from a wide range of specific industries or sectors, such as:

- the rural sector (submissions from the National Farmers Federation and the Australian Livestock & Property Agents Association);
- the building and construction industry (submissions from the Civil Contractors Federation and the Master Builders Association);
- the retail sector (submission from the Restaurant & Catering Industry Association); and
- importing/wholesale businesses (submission from Electaserv).

An insufficient appreciation of the Act has had particularly severe impacts on the equipment hiring industry. While the general level of awareness of the Act may be no lower in that industry than across the small business community generally, my experience has been that the hiring industry is more severely impacted by the reforms than most others.

The level of concern in the hiring industry is also reflected in the large number of submissions that were made by either hiring businesses themselves, or by organisations that identify the hiring industry as being particularly impacted. BusinessSA, for example, observes that:

> *...the average small hire business is thoroughly confused as to their exposure under the Act.*

EDX, a PPS advisory and registration business, similarly observes that:

> *...the degree of confusion amongst businesses on the application of and compliance with the Act is high, [and] this is particularly true of businesses in the equipment hire sector.*

The Australian Bankers' Association suggests that part of the difficulty stems from the fact that small businesses have not been able to accept that they are no longer sufficiently protected by being the owner of their assets:

> *One factor that seems to be prevalent is small businesses not coming to grips with the notion that title to personal property has become subordinated to the notion of a security interest. This has led to a consequential lack of knowledge by a business on how the Act is able to protect the business' interests where personal property moves beyond the control of the business.*

The Commercial Asset Finance Brokers Association of Australia suggests that the very name of the Act contributes to the confusion:

> *Confusion begins for a small business with the common name for the … Act, ie the **Personal Property** Security Register. Most small business would not identify that the … Act applies to assets or equipment used in their business, by the very nature of the name. Most equate "Personal" to apply to personal assets, not those associated to their business.*

Unhappily, these have not just been theoretical concerns. Two submissions from individual small businesses (one of which was submitted on a confidential basis) have explained how those businesses have lost assets in a customer's administration because they had not appreciated that their ownership of the assets was no longer sufficient to protect them under the new rules. Both submissions express surprise and dismay at the fact that this could be possible.

These are not just isolated examples. In my assessment, insolvency practitioners have been astute in their conduct of insolvency proceedings to test whether businesses that have hired goods to an insolvent company have satisfied the requirements of the Act. The same applies in relation to other secured parties, particularly suppliers who have sold goods to an insolvent company on a retention of title basis. This is not intended by any means to be a criticism of those insolvency practitioners – indeed, it is their responsibility in their role to test the claims of secured parties in this way. Anecdotal evidence does however suggest that the issue for hirers and suppliers is widespread.

The same conclusion can be drawn from some of the early case law in relation to the operation of the Act – see, for example, *Re Maiden Civil (P&E) Pty Ltd; Albarran v Queensland Excavation Services Pty Ltd* [2013] NSWSC 852.

So it is clear in my view, both from the submissions and from other evidence, that many small businesses are not sufficiently aware of the Act and its implications for them, whether positive or adverse. The potential for adverse outcomes for small businesses is also magnified by the very fact that they are small – a small hiring business, for example, may only have a relatively small pool of assets, and the loss of any of those assets in the insolvency of a customer can have a disproportionately severe impact on the financial viability of the business as a whole.

I return to the theme of awareness in the conclusions and recommendations in Part 7 of this report.

5.2 Complexity of the Act

The second major theme in almost all submissions is that the Act is too complex. This complexity has meant that even small businesses that are aware of the potential impact of the Act have struggled to determine just what that impact is, and how they need to respond to it.

Submissions expressed their concern about what they see as the unnecessary complexity of the Act in a number of ways. The Australian Small Business Commissioner notes that:

> *The legislation is particularly complex.*

The Civil Contractors Federation helpfully conducted a survey of its members in preparation for its submission. They conclude in their submission that:

> *…the survey … clearly demonstrates the Act to be far too complex for members.*

Its members report that the Act is:

> *...simply more red tape and does not effectively achieve the intent due to the complexity of the Act and related processes, and the limited understanding within industry of the requirements.*

The National Farmers Federation acknowledges that the Act deals with a technical area of the law, and that this makes it difficult to use plain English language. They go on however to make the following observation:

> *Unfortunately, because the ... Act is drafted in specialist technical language, it is hard to understand for anyone without professional qualifications in the relevant field. Given the ... Act's broad scope and its potential to cause individuals to unwittingly lose assets to unrelated third parties, further work is needed to simplify the language in the ... Act so that it is more accessible to the lay person. This is especially important for small businesses who do not have the resources to source specialist legal advice on a continuing basis.*

The submission from Master Builders Australia makes a similar point, albeit rather more forcefully. It says that the "prevailing industry view" of the Act is that it:

> *...is viewed as a dense, monolithic type of law that is perceived only to benefit financiers and the banking system.*

Master Builders Australia goes on to say that the Act is:

> *...a statute which brings with it highly technical and difficult new concepts.*

Many of the submissions identify particular examples of what they consider to be unnecessary complexity in the Act. Most of the examples can be grouped under four broad headings.

(a) Unfamiliar terms, or terms used in unfamiliar ways

The Act uses many terms of art that are unfamiliar to the general business community. A good number of those terms are unfamiliar to Australian lawyers as well. This is because much of the language in the Act has been adopted from the overseas models on which the Act is broadly based, and in particular from Article 9 of the Uniform Commercial Code in the United States. Some examples are set out in Table A below. The examples are drawn either from the submissions, or directly from the Act. They are by no means exhaustive.

TABLE A | **Examples of unfamiliar terms, or terms given unfamiliar meanings**

	Term	Approximate meaning	Comments
1.	**Chattel paper**	Writing that contains both a security interest and a monetary obligation that is secured by the security interest.	The expression was coined for Article 9 in the 1950s in recognition of the fact that motor vehicle dealers commonly provided car buyers with finance as well, and then on-sold the finance package to a finance company by handing over possession of the finance documents. This is not a recognised financing tool in Australia.
2.	**Perfection**	The ways in which a security interest can be given as robust a character as possible. The most common method is registration, but perfection over some types of collateral can also be achieved by possession or control. The Act also deems a security interest to be perfected in some circumstances, either temporarily or permanently.	This expression is said to derive from terminology used in United States bankruptcy law.
3.	**Intermediated security**	The rights of an investor who holds shares or other financial assets through a licensed intermediary, such as a custodian.	This term derives from the Hague Conference *Convention on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary.*
4.	**Negotiable instrument**	The Act captures the general law meaning of this term, but also extends it to include instruments that are transferable but not negotiable, and even to include some letters of credit.	This is very counter-intuitive to Australian readers, as a negotiable instrument is a very specific concept under Australian law. In particular, letters of credit are regarded in Australia as very different to negotiable instruments.
5.	**Motor vehicle**	Under the Regulations, the meaning of this term extends well beyond what members of the public would typically regard as being a motor vehicle. The definition is broad and technical, and the edges of the definition are unclear.[1]	This makes it difficult for businesses to know with confidence how to register correctly, because it is unclear what the correct collateral class should be.

1 The definition was recently amended as of 1 July 2014 in response to industry feedback – see the *Personal Property Securities Amendment (Motor Vehicles) Regulation 2014.*

(b) Uncertain reach of many concepts

A number of submissions also highlight what they describe as being unnecessary uncertainty in the reach of individual concepts in the Act. Some examples, drawn either from the submissions or directly from the Act, are set out in Table B.

TABLE B | Examples of uncertain reach of concepts

	Term	Uncertainty	Impact
1.	**Security interest**	This is defined in s 12 to be an "interest" in personal property that in substance secures an obligation. It is unclear whether the "interest" needs to be a property interest, or whether it can include contractual interests as well.	This is generating confusion and uncertainty in a range of commercial contexts. For example, it affects joint venture agreements, which are common in many industries and particularly the mining and resources sector.
2.	**Fixture**	This is defined in s 10 to mean property that is "affixed" to land. It is unclear whether this imports the general law meaning of the term, as developed by case law, or whether it is something different.	Property that is a fixture falls outside the operation of the Act, and is governed by the general law instead. If it is not clear whether property is a fixture, parties do not know what set of rules to apply.
3.	**Transfer**	It is unclear whether this term includes a leasing of goods by a secured party to a grantor, at least where the lease is a PPS lease. It is also unclear how the term sits alongside other, similar expressions in the Act, such as "dispose" or "assign".	This is particularly relevant to the concerns expressed in a number of submissions about the impact of the Act on subleasing arrangements.

TABLE B | Examples of uncertain reach of concepts *(continued)*

	Term	Uncertainty	Impact
4.	**Purchase money security interest**	The definition of "purchase money security interest" (or "PMSI") in s 14 includes PPS leases, but does not obviously include leases or hire-purchase agreements that are in-substance security interests unless they are also a PPS lease.	The definition derives from Article 9 of the United States Uniform Commercial Code. Pre-Article 9 law in the United States re-characterised transactions such as hire-purchase agreements or finance leases as secured loans (another form of PMSI), so the definition of "purchase money security interest" in Article 9 did not need to pick them up expressly. Prior to the Act, Australian law did not do this, however, resulting in a potential gap.
5.	**PPS lease**	This is a "deemed" security interest, in that it is deemed by s 12(3) to be a security interest whether or not it secures anything. The intended boundaries of the definition are unclear in a number of respects, for example: • what is captured by the concept of a lease or bailment for an "indefinite term"; • when a bailment is "for value"; and • if a lease becomes a PPS lease because it runs for more than a year, whether the lessor is able to register in time to get PMSI super-priority, or to comply with the "20 business day" registration requirement in s 588FL of the Corporations Act.	This lack of clarity is generating significant uncertainty for a number of industries. Foremost among these is the hiring industry, but the uncertainties affect any business whose goods are in the possession of another (eg storage or courier companies).
6.	**Seriously misleading**	Section 164(1) states that a registration will be ineffective if it is "seriously misleading". The Act does not describe what is covered by the term.	It is difficult for secured parties to know what types of faults in a registration can make it ineffective.

(c) Complex provisions

A number of submissions also identify what they see as being unnecessary levels of complexity in the drafting of individual provisions. Some examples are set out in Table C.

TABLE C | Examples of complex provisions

	Provisions	Comments
1.	**Priority for accounts financiers over inventory suppliers (s 64).**	Section 64 provides a mechanism that enables an accounts financier (such as a factoring company that provides working capital finance to a business by purchasing its receivables), to take priority over an inventory financier with a PMSI over the inventory. The priority can apply, for example, where a supplier sells its goods on deferred payments terms (ie creating an account), so that both parties have a security interest in the account - the supplier because the account is proceeds of the goods, and the financier because the account is its original collateral. To obtain the priority over PMSIs that are perfected by pre-existing registrations, the accounts financer needs to comply with some notice requirements. Those requirements are very difficult to satisfy.
2.	**Circulating assets (ss 340-341A).**	These provisions provide a regime for determining whether particular types of collateral can be "circulating assets". This question is not relevant for the Act itself, but instead is relevant to a number of provisions in the Corporations Act, foremost amongst them s 561, which provides employees with priority over a "circulating security interest" in a winding up of a company. A number of aspects of ss 340-341A are quite unclear. This makes it difficult to determine whether or not a particular asset is exposed to circulating asset risk.

(d) Uncertainty in the interaction between different provisions

Finally, some submissions note that it can be unclear how individual provisions are intended to relate to each other. The principal example given, in a number of submissions, is the considerable uncertainty surrounding the way the Act applies where the grantor of a security interest leases goods to a third party in a manner that gives rise to a further security interest (eg as a PPS lease). The submissions note that it is quite unclear in such a situation whether the first security interest remains attached to the goods (now in the hands of the lessee), and if it does, on what basis. This is a source of considerable uncertainty for both general financiers and specialist equipment financiers. It is also an issue for any hiring company or other business that leases or bails its goods to third parties.

(e) Reasons for the complexity

As the National Farmers Federation acknowledges in its submission, the Act deals with a complex area of the law – one that traverses our entire economy, and that manifests itself in different sections of the economy in very many different ways. The area does not lend itself to one simple set of rules, and the Act will never be an "easy read".

The Act will always be complex. The submissions demonstrate, however, that the Act is more complex than it needs to be. In my view, a number of factors have contributed to this outcome.

First, as noted earlier, many of the concepts and much of the terminology in the Act have been adopted from overseas models. Those models were not created in a legal vacuum, but were founded in and based on the substance of the legal systems for which they were developed.

In particular, while Article 9 of the Uniform Commercial Code in the United States was regarded as revolutionary in the way that it created a standard set of rules for all types of security interests, it was also very much a creature of the state of law and commercial practice in the United States at the time it was developed. Clearly, the economic structures and legal systems in Australia in the early 21st century are very different to those that prevailed in the United States in the middle of the previous century. As a result, terminology and concepts that made sense and were relevant for Article 9 as part of United States law will not necessarily make the same sense, or have the same relevance, in the Act as a component of current Australian law.

Secondly, it appears that the architects of the Act may have tried too hard to be helpful. The Act is far longer than its Canadian and New Zealand counterparts, even allowing for the additional provisions that were included to accommodate constitutional and other administrative requirements. The developers of the Act appear to have endeavoured to produce a "best of breed" piece of personal property securities legislation, by picking out the best elements of the offshore models and then adding additional detail in an effort to explain more clearly exactly what is required. Rather than helping Australian businesses, however, this had the effect of creating very specific and detailed operational requirements, limiting flexibility and requiring changes to operating practices in order to align them with the structures required by the new rules.

The third main factor that has led to this situation, in my view, is that the development of the Act appears to have been approached as a design process, too divorced from the realities of the marketplace that it was designed for. While Government did provide the business and legal community with opportunities to comment on drafts of the legislation, the sense of many of those who were involved in the consultation process was that input from the business and legal community was not sufficiently incorporated into policy design and legislative drafting.

As a result, there is a degree of misalignment between the policy and drafting of the Act and the operating realities of the Australian business environment. This has created confusion and uncertainty, rather than certainty and clarity.

This is not intended to reflect adversely on the individuals involved in the actual drafting of the Act, or those who instructed them. Rather, it is a reflection of the magnitude and complexity of the task.

Whatever the reasons for the confusions and complexities in the Act, they have made the Act very hard to work with, even for specialists in the field but particularly for businesses, including small businesses. This is exacerbated by the fact that the complexities compound each other, by being cumulative rather than independent – the unfamiliar terms and uncertain concepts are used in complex provisions, in a way that can make it even more difficult to determine how those complex provisions inter-relate with each other. The cumulative effect is that the Act can be very difficult to understand, and to work with.

It is clear that much can and should be done to streamline the Act, and to align it more closely with the realities of the marketplace that it applies to.

5.3 Complexity of the register

Many submissions describe the register as being unnecessarily complex. This is a "real life" concern for all businesses, but particularly for small businesses, as a registration that does not satisfy the requirements of the Act and the Regulations is likely to be ineffective. This would leave the secured party with only an unperfected security interest, and so at risk of losing its asset to a third party, or on an insolvency of its customer.

The joint law firm submission from Allens, Ashurst, Herbert Smith Freehills, King & Wood Mallesons and Norton Rose Fulbright makes the point in this way:

> *The PPSR has many welcome attributes, but at the moment there are too many traps for the unwary and it is self-defeating in terms of one of the key objectives of the PPSA project: simplicity and ease of use. This is particularly acute for small businesses when they are faced with the necessity of registering security interests granted to them, and paying the costs of secured parties in relation to security interests given by them. In particular there are choices and limitations which often mean that it is difficult to complete properly a registration without professional help, errors are easy to make (many of which can be fatal to a registration) and multiple registrations can be required for a single transaction.*

Two of the submissions from small business owners (Chalkwest and Payne Investments) observe that "the process is complicated and difficult to properly understand". They both go on to say:

> *We have found that the PPSR is not simple to use, it is confusing as to precisely what type of registration guarantees title protection[2] and has increased rather than reduced our compliance costs.*

The Commercial Asset Finance Brokers Association of Australia echoes this view, maintaining that the registration process "is not intuitive and is very difficult to navigate", and is "complex and full of jargon". BusinessSA observes that small businesses find the register "very cumbersome", and that small hiring businesses have suffered "overwhelming frustration" with it.

(a) Specific issues - registrations

These concerns relate to both the process of registering financing statements to perfect security interests, and to conducting searches of the register. The aspects of the registration process that are described in submissions as producing unnecessary complexity are set out in Table D.

TABLE D | Examples of complexity in the registration process

	Topic	Concern
1.	**Layout**	Many submissions maintain that the layout of the register is not intuitive, and is difficult to follow. The Australia Finance Conference notes, for example, that the layout of the register: ...is not intuitive and seems to have been written for people who already know the answers to the questions. Third party service provider feedback is that many users are non-compliant, due to a lack of understanding of the implications of not registering, or if they try, an inability to correctly register.

2 I should note for completeness that the register does not in fact guarantee title protection. The authors of these submissions appear to have made this observation from the perspective of a lessor, for which registration can assist to preserve their title by perfecting their security interest.

TABLE D | **Examples of complexity in the registration process *(continued)***

	Topic	Concern
2.	**Distinction between "consumer property" and "commercial property"**	If a secured party wants to register a financing statement against an individual grantor, the first question that confronts the secured party when undertaking the registration is whether the proposed collateral is "consumer property" or "commercial property". The distinction turns on whether the grantor will hold the property in the course or furtherance to any degree of carrying on an enterprise to which an ABN has been allocated. While the answer to this question will in many cases be clear, that will not always be the case. Where it is not clear, the secured party may have no way of determining which of the two categories is appropriate. It is also not clear what the consequences are if it turns out with hindsight that the secured party chose the wrong category for a registration.
3.	**Collateral classes**	Submissions comment adversely on the number of collateral classes, and the fact that a registration may only be made against one collateral class at a time. As the dividing lines between the collateral classes can be unclear, secured parties sometimes need to resort to making multiple registrations in relation to the same asset, to ensure they are perfected. This results in additional cost, and adds to the cluttered state of the register.
4.	**Determining the correct grantor details**	The Regulations set out the rules for determining how a secured party should identify the grantor in a registration. Those rules are not easy to follow, even for experienced practitioners. A typical small business owner can struggle to determine with confidence whether it is registering against the correct grantor details.
5.	**How to deal with foreign names**	The register utilises only the English alphabet. This may make it impossible to register with confidence against a foreign body corporate, as the Regulations provide that the registration may need to be made against the body corporate's name in its constitution (which is likely to be in the language and script of the body corporate's home country).
6.	**Role of the free text field**	The register provides a free text field for registrations other than registrations against most types of serial numbers, or the collateral class "AllPAAP". The free text field is however not referred to anywhere in the Act or the Regulations, and its legal effect is unclear. This makes it difficult for secured parties to know whether and how they should use it. It has also lead to some registration practices that seek to use the free text field for reasons other than to describe the collateral (for example, to attempt to put searchers on notice of the terms of the underlying security agreement).

TABLE D | **Examples of complexity in the registration process *(continued)***

	Topic	Concern
7.	**Role of linking**	The register contains a facility that allows a secured party to "link" a registration to an earlier registration (such as one that might then be discharged). Businesses are confused about whether they need to link a registration, and in what circumstances.
8.	**Additional fields**	Many submissions suggest that a number of fields should be removed from the registration process, on the basis that they add little value and make the registration process more complex than necessary. This suggestion is made, for example, in relation to the fields that indicate: • whether the secured party may have control of collateral; • whether the collateral may include inventory; • whether the security interest is subordinate; • whether the security interest extends to proceeds; and • whether the security interest is a PMSI.

(b) Specific issues - searches

Table E identifies the issues that are described in submissions as making the process of searching the register unnecessarily complex.

TABLE E | **Examples of complexity affecting searches**

	Topic	Concern
1.	**Searching against the correct grantor details**	A person who wants to search the register against a particular grantor faces the same challenges as a registrant, as described in items 4 and 5 of Table D. A searcher faces the additional problem, however, that they will not know which grantor identification option a secured party may have used for its registration. This issue arises in particular in relation to individual grantors, if a secured party has registered a financing statement against details held in its AML/CTF data. A searcher will not know this, nor will they know what those details were.

TABLE E | Examples of complexity affecting searches *(continued)*

	Topic	Concern
2.	**Overstated registrations**	A number of submissions express concern at the fact that a registration does not need to be limited to the precise collateral involved, and that it is acceptable, for example, that a security interest over a particular item of property be perfected by a registration that merely identifies the collateral class to which it belongs. This means that the search results are far less meaningful, as a searcher is unlikely to be able to tell from the search results alone whether or not a particular item of property is subject to a security interest.
3.	**Clutter**	Submissions also complain about the very cluttered state of the register. Many corporate grantors, in particular, have a very large number of registrations against them. That number often far exceeds the number of individual transactions entered into by that grantor, as secured parties may have needed to make multiple overlapping registrations in order to ensure that their registration is effective.

(c) Register is a particular focus area for simplification

Much of the content of the Act itself does not directly impact the daily activities of small businesses. The same cannot be said however for the register, or for those parts of the Act that shape the operation of the register. Small businesses interact with the register on a daily basis, principally by making registrations and undertaking searches, and the design of the register and the rules that underpin it need to be as simple and certain as possible, so that businesses can use the register effectively and with confidence.

The message from the submissions is that the register is currently not meeting this need. Small businesses find the register daunting – full of jargon, and unfamiliar concepts. When registering a financing statement, the register asks them to answer questions that they cannot readily understand. Often they cannot even understand why the question is being asked. This leaves a registrant in the very unsatisfactory position of not knowing whether they have answered the questions accurately, or whether (despite their efforts) their registration is incorrect, leaving them unperfected and exposed.

Similarly, a searcher of the register cannot always be confident that they are searching against the correct grantor details. Sometimes a search generates so many results, or such broad results, that the searcher is unable to properly assess what they mean.

There is a potential for tension between these two sets of concerns, as any steps that are taken to make the process of registering a financing statement simpler and more certain could have the result that the information generated by a search becomes less useful to the searcher. It is nonetheless clear that much can and needs to be done to make the conduct of registrations and searches on the register simpler, more comprehensible and more certain.

5.4 Suggested changes to the scope of the Act

Some submissions propose changes to the scope of the Act. Most of the proposals seek to narrow the application of the Act, so that it would not apply to certain activities or types of property. Other submissions take the opposite approach, and suggest that the application of the Act should be expanded, by removing existing exemptions.

(a) Proposals to reduce reach of the Act

The proposals to reduce the reach of the Act fall into three broad categories.

PPS leases

A number of submissions query the extension of the Act to deemed security interests. In particular, representatives of the equipment hiring industry do not believe the Act should apply to them. They suggest a number of types of changes, all of which are designed to remove their core business activities from the reach of the Act. They include:

- amending the definition of "PPS lease" to remove the concepts of "indefinite term" and/or "bailment";
- amending the definition of PPS lease to only deem a lease to be a PPS lease if it has a term of more than three years, rather than the current test of one year; and
- amending the Act to provide that it does not apply to a hiring arrangement if it is part of the lessor's principal business activity.

Not all submissions, however, were in favour of these proposals.

Some submissions referred favourably in this context to the legislation that is currently before Parliament (the *Personal Property Securities Amendment (Deregulatory Measures) Bill 2014*) to remove the "90 day" alternative to the one-year test that currently applies in the definition of PPS lease in relation to serial-numbered property.

Specific business activities

A number of submissions expressed concern at what they see as being the severe and unwarranted impact that the Act has had on specific businesses, and proposed as a solution that certain business activities be excluded from the Act.

This includes the proposal from representatives of the hiring industry that the Act not apply to their regular hiring activities, as noted earlier in this section. The Self Storage Association of Australia proposed in its submission that the Act should not apply to members when they enforce the possessory lien that they take over goods placed in storage with them. Suggestions are also made in other submissions that the Act should not apply to small businesses generally, or at least that the laws that preceded the Act relating to sales of goods on retention of title terms should be reinstated for small businesses.

Minimum thresholds

Some submissions focussed on the relative difficulty and expense involved in working with the Act in relation to low-value items of property, and suggested that there be a minimum threshold for some types of property before the Act will apply to it.

(b) Proposals to expand reach of the Act

In contrast, some submissions recommended that the Act's reach be expanded rather than reduced, because its capacity to realise its objectives is compromised by the fact that a number of types of personal property are currently excluded from its ambit. They suggested in particular that the Act be extended to apply to:

- fixtures;
- water rights; and
- excluded statutory licences.

Those submissions acknowledged that changes of this nature would require consultation with and the support of State and Territory Governments.

(c) Preliminary observations

For the reasons discussed below in Part 7 of this report, I do not propose at this stage to make any specific recommendations in relation to these matters. I would however make the following observations.

It is clear from the submissions that some businesses have been taken unawares by the Act, and that others are finding that the complexities and uncertainties in the Act are making it difficult, and at times even uneconomic, for them to take advantage of it. This is clearly not desirable. There are however a number of ways in which these issues could be addressed.

My preference, at least at this stage, is not to recommend that the Act provide specific carve-outs for particular industry sectors, business activities or types of property. Ad hoc exemptions of this nature would be likely to add to the overall complexity and uncertainty of the Act rather than reduce it (although it would admittedly reduce the complexity for those who fell within the exemption). Further, an exemption might simply replace one set of complexities and uncertainties with another, as it would then be necessary to determine what replacement set of legal rules would apply to the exempted activity or property, and how those rules might intersect with the interests of others for whom the Act continued to apply.

I am however alive to the concerns expressed by the hiring industry in particular, and understand why they query whether the Act should apply to short-term hiring arrangements of the type that is the mainstay of their business. Rather than exempt specific activities, though, my preferred approach is to step back from the existing detail of the Act and ask what it is that we think the Act should apply to as a matter of principle, rather than the more detailed question of what it should not. This more general, policy-based question would also take into account the proposals in some submissions that the reach of the Act be extended.

I return to this theme in Part 7.

5.5 Other suggestions for reform

Submissions suggested a wide range of specific amendments to the Act. Many of the suggestions are aimed at addressing the complexities and uncertainties described in Parts 5.2(b) and (c) above. Others are set out in Table F.

TABLE F | Other suggestions for reform

	Proposal	Objective
Registrations		
1.	**Set a default registration period of 7 years.**	Reduce the clutter on the register, by requiring registrations to expire after 7 years, unless they are expressly renewed.
2.	**Create a new collateral class of "all present and after-acquired property relating to".**	Reduce the clutter on the register, by allowing a secured party to perfect a security interest over a range of assets relating to a particular business location, project or activity, without needing to register separately against multiple collateral classes.
3.	**Include a field for the registrant to indicate the amount secured.**	Assist a potential new secured party to assess the quantum of prior-ranking claims.
4.	**Broaden the categories of serial-numbered property.**	Make it easier for a searcher to determine whether a registration affects a particular item of property.

TABLE F | **Other suggestions for reform *(continued)***

	Proposal	Objective
Registrations		
5.	**Allow a person to register a financing statement in certain circumstances even if they do not have a security interest.**	Protect suppliers who may not have an adequate retention of title clause in their supply terms (as a result of legal complexity, or a lack of market power).
6.	**Soften the rigour of s 151 to allow a person to register a financing statement where they "may" have a security interest.**	Enable a person to register where it is not clear whether the transaction will in fact give rise to a security interest.
7.	**Improve the process around amendment demands.**	Make the process more flexible, and rectify inconsistency with other parts of the Act.
8.	**Enhance the functionalities of the register.**	Facilitate the process of making and managing registrations and searches.
Perfection		
1.	**Deem certain transactions (for example, low-value transactions) to be perfected even without registration.**	Accommodate the cost-sensitivities of making a registration against an item of low value.
2.	**Repeal s 588FL of the Corporations Act.**	Remove a provision whose function is said to have been superseded by the Act.
Taking free rules		
1.	**Reconsider the "inventory" carve-out for some of the taking free rules.**	Ensure that the use of the carve-out in each of the various taking free rules has a sound policy basis.
2.	**Reconsider the rationale for the different "value"–related qualifications in the taking free rules.**	Ensure that there is policy consistency across the various manifestations of the "value" concept in the taking free rules.
Priority rules		
1.	**Reconsider the role or relevance of "agri-PMSIs".**	Consider whether the rules respond to a real need, and are soundly based.
2.	**Give primary producers super-priority over other secured creditors.**	Protect primary producers from the adverse effects of the Act.
3.	**Allow some types of sale and lease–back to qualify as a PMSI.**	Ensure that the rigidities of the carve-out do not distort appropriate asset acquisition finance structures.

TABLE F | **Other suggestions for reform *(continued)***

	Proposal	Objective
Priority rules		
4.	**Allow property held for personal, domestic or household purposes to be the subject of a PMSI.**	Remove a carve-out that is said not to have a sound policy basis.
5.	**Reconsider the timeframes within which a security interest needs to be perfected by registration in order to qualify for the PMSI super-priority.**	Make the timeframes, and the way they are calculated, more reflective of market practices.
Dealings in collateral or other changes in circumstances		
1.	**Clarify the effect of a lease or sub-lease of collateral by a lessor on a security interest already granted by the lessor over that collateral.**	Remove current uncertainty about what happens to a security interest over collateral if the grantor leases the collateral to a third party, and what the secured party should do in response.
2.	**Amend s 32 to make it clear that a security interest can remain attached to collateral when it is disposed of with the secured party's consent.**	Ensure that a secured party can consent to a disposal of collateral without losing its security.
3.	**Reconsider the timeframes within which a secured party must respond to a dealing in collateral or other change in circumstances in order to preserve the perfected status of its security interest.**	Ensure that the timeframes are realistic.
Layout and language		
1.	**Improve the readability of the Act, by reworking the layout and using more intuitive language.**	Make the Act easier to understand and apply.

This is not intended to be an exhaustive list of issues raised, or to suggest that these are the most important issues or the ones that are most likely to be the subject of a favourable recommendation in due course. This list is simply intended to demonstrate the breadth of the range of issues that have been raised.

6. Has the Act delivered on its objectives?

As I noted in the Introduction, the over-arching goals of the Act are to:

- increase the consistency and certainty of secured finance in Australia;
- reduce the complexity and cost of secured finance in Australia; and
- enhance the ability of businesses and consumers to use their assets as security, and improve their ability to access cost-effective finance in Australia.

This section of the report considers, based on material from the submissions, whether the Act has achieved these objectives.

6.1 Consistency

It is clear that the Act has significantly improved the consistency of Australian secured transactions law. It has replaced a complex and disorganised patchwork of Commonwealth, state and territory statutes and general law with a single set of rules that apply consistently across Australia to all types of personal property and all types of grantor. The replacement of the previous fragmented array of registration systems with the single register under the Act has eliminated what had been a source of considerable confusion and complexity. Since commencement, the register has recorded over 8 million registrations, and over 14 million searches. In 2013, Australia climbed to tenth place in the World Bank's rating for 'ease of doing business' ('*Doing Business 2013 – Smarter Regulations for Small and Medium-Size Enterprises*') and the commencement of the Act is said to have been instrumental to this.

As some submissions observe, however, more can still be done to improve consistency across Australia's secured transactions laws. A number of types of personal property or transaction are excluded from the operation of the Act, with the result that businesses and their advisers still need to be aware of the laws outside the Act that will apply where the Act does not, and to apply those laws where the Act has been excluded.

This re-introduces (or perhaps retains) some form-based distinctions that the Act sought to eliminate. I expect to return to this theme in the recommendations in my final report.

6.2 Certainty and complexity

The Act has been successful in sweeping away the uncertainties and complexities that plagued the fragmented sets of rules that it replaced. Many of the submissions argue, however, that the Act has replaced those old uncertainties and complexities with new uncertainties and complexities, because of the unfamiliar terminology, and the complex and difficult drafting, that I identified as themes from the submissions in Part 5 of this report.

It is inevitable, with any legislative transformation of this scale, that there will be some confusion and uncertainty at the outset, as users of the legislation come to terms with the new rules. However, the levels of frustration and anxiety revealed in the submissions go beyond mere "teething" problems. The message from the submissions is that much more can and should be done to help the Act to realise its full potential.

6.3 Cost and availability of finance

It was anticipated that the Act would reduce the cost of finance in a number of ways. The cost to financiers of providing finance would be reduced, as financiers would benefit from the removal of the need to maintain multiple sets of documents and procedures for different types of financing product in different states and territories. Financiers would be able to pass the benefit of these efficiency gains on to their customers. Financiers would also be able to reduce their funding charges to customers because the elimination of the old uncertainties would reduce the related risk premium that financiers incorporated into the pricing that they offered their customers. Borrowers would also be able to use a wider range of assets as security.

Comments in the submissions and anecdotal evidence both suggest that these benefits are yet to be fully realised. While larger financiers are likely to have generated some cost savings through the standardisation of documents and procedures, they all incurred significant costs in preparing for the introduction of the Act. Financiers also continue to incur legal costs as they come to grips with the Act. And while I have no evidence on this point, I expect that there has not been as yet any reduction in overall risk premiums charged to borrowers, as the complexities and uncertainties in the Act can still leave financiers unsure of the strength of their legal position. Finally on this point, as the Australian Bankers' Association points out in its submission, the complexity of the Act and in particular the volume and content of information on the register can delay transactions, and have the reverse effect of increasing their cost – additional cost which financiers will inevitably pass on to their borrowers as part of the transaction.

Almost all of the submissions from small businesses, or the organisations representing them, also identify cost as an issue. Unlike a financial institution, which can usually pass its transaction costs on to its customer, a business that is a secured party under the Act is likely to need to fund the associated costs itself. Those costs include professional advice such as legal fees, the costs of registering financing statements, and the internal administrative costs of dealing with the registrations. To some extent at least, these costs simply substitute for other costs that secured parties would have incurred under the previous regimes. But for suppliers with a large customer base, or for hiring businesses with a large customer base or that hire out serial-numbered goods, these costs can be significant. And the relative cost for a small business of getting a registration wrong can also be significant, as it could lead to the loss of what might be a substantial part of the business' asset pool, if a customer becomes insolvent.

Amending the Act will not reverse the fact that cost has been incurred in adjusting to the new regime. Similar to a point I made earlier, it was inevitable that the introduction of the Act, while eliminating or reducing some existing costs, would produce some new costs for users of the legislation as they came to grips with the new rules. It seems clear though that businesses, both small and large, would benefit from any steps that can be taken to reduce the costs that parties need to incur in order to benefit from the protections that are afforded by the Act.

There is no doubt that the replacement of the previous confusion of overlapping and fragmented regimes for different types of secured transactions, with a single consistent set of rules for all types of security interests over all types of personal property, has the potential to unlock value for Australian businesses and consumers by making it easier for them to use their assets as security and by improving their ability to access cost-effective finance. The submissions indicate, however, that the Act has yet to realise this potential.

7. Conclusions and Recommendations

7.1 Overall approach to recommendations for this interim report

The submissions for this interim report have proposed a wide range of amendments to the Act. A number of the submissions argued in favour of removing particular business activities from the ambit of the Act, or sought to limit the impact that the Act has on them. Many submissions also put forward suggestions that were targeted at improving and simplifying the operation of the register. Others sought to address the complexity of the Act itself, and suggested amendments that were designed to clarify its intended effect, or to streamline its language.

Many if not most of these proposals, or at least the outcomes that they pursue, appear as presented to have considerable merit. Despite this, I am not minded at this stage to recommend any specific amendments to the Act, the Regulations or the operation of the register. There are three main reasons for this.

(a) Need to consider all sides of the issues

The submissions from private businesses or business organisations understandably argue in favour of outcomes that are favourable to those businesses. In other words, they urge for changes that would ameliorate the impact of the Act on those businesses, or that would assist them to benefit more fully from it. There is nothing untoward in this – indeed, it is important for the successful conduct of this review that affected businesses communicate through their submissions just how the Act has impacted on them, and what they would like to see changed.

It is in the nature of legal relations, however, that improving the position of one person may be to the detriment of another. Within the context of the subject matter of this review, this could happen in a number of ways. A change that makes it easier for a secured party to take a preferred priority position in relation to collateral, for example, will necessarily operate at the expense of other secured parties with an interest in that same collateral. In this type of situation, the adverse impact of a proposed change on third parties can be quite clear and direct. Other types of change, however, can have a more indirect impact. A change in the functionality of the register to simplify the process of registering a statement will assist registrants, for example, by making the registration process simpler, or by enabling them to have a greater sense of confidence that their registration is effective. Any such change, however, may compromise the overall utility of the register, if it makes the data that is available on the register less informative for a subsequent searcher. As another example, "for the avoidance of doubt" provisions may provide welcome certainty for those to whom the provision applies, but they can disadvantage other users of the system by adding to the length and complexity of the Act as a whole.

A number of the submissions were alive to this and endeavoured to balance their discussion of the policy issues relevant to their proposals by anticipating and commenting on potential counter-arguments. Despite this, it would not be appropriate to decide whether the Act should be amended to address a particular issue until any potential opponents of the amendment have been afforded a sufficient opportunity to voice and justify their contrary perspectives. All sides of the debate on individual proposals should be given an opportunity to express their views and to argue their case before any final decisions are taken.

(b) Need to determine the most appropriate way to address issues

Even where it is clear that an issue needs to be addressed, there may be a number of ways in which this could be done. Where this is the case, each potential method for dealing with the issue will have its own distinct advantages and disadvantages. It will be important to examine the potential ramifications of any proposed amendment to the Act, so that we can be confident that its implications are fully understood, before a decision is taken to proceed with it.

To provide an example, it is clear from the submissions so far that many businesses in the short-term hiring industry have been taken unawares by the introduction of the Act, and in particular by the fact that they can lose ownership of their assets to an insolvent customer if they have not perfected their interest properly. Whilst I do not want at this stage to pre-empt what I might recommend on this topic in due course, if the overall policy balance does weigh in favour of addressing this concern, then it becomes necessary to decide how this should be done, as the concern could be dealt with in a number of ways. For example, it could be addressed by:

- amending s 267 of the Act to exclude PPS leases that are not in-substance security interests, or to exclude an appropriate subset of such PPS leases, from its ambit;
- repealing s 267 of the Act in its entirety;
- removing the concept of a lease or bailment "for an indefinite term" from the definition of PPS lease in s 13 of the Act;
- removing the concept of a PPS lease from the Act entirely; or
- including a specific carve-out from the operation of the Act for participants in the short-term hiring industry.

Each of these options would respond to the concerns expressed by the short-term hiring industry, at least in large part. They all have wider policy ramifications, however, and those wider ramifications would also need to be taken into account in deciding whether and if so how to proceed.

(c) Cost

Any changes that are made to the Act, the Regulations or the register will almost inevitably impose a cost burden on industry. Any redesign of the register will require AFSA to incur software design and other costs, and to dedicate a substantial amount of executive time to the management of the redesign project. As the register functions on a cost recovery basis, those costs will need to be passed on to users through the fees that are charged for transacting on the register. Depending on the nature of changes made, secured parties will also incur costs in reconfiguring their own computer systems, and in reworking their security documentation and procedures, to reflect the amended regime.

It will be important to take the potential for such costs into account when formulating recommendations for change. It is unlikely that it would be appropriate to recommend a change, for example, if the cost of implementing the change would outweigh its longer-term benefits.

This potential cost to industry would be even greater if changes were to be implemented in stages. A staged implementation of amendments could have the potential to double the cost of at least some of the changes, as AFSA would need to develop and implement two sets of register redesign projects rather than one, and industry would need to reconfigure its own systems, documents and procedures twice, rather than just on the one occasion. I do not have any specific data on what the levels of those costs might be but it is likely, based on anecdotal evidence of the costs incurred by industry when the Act was introduced and the high costs that were associated with the initial design and implementation of the register, that they would be significant. I am loath to recommend changes that would require those costs to be greater than necessary.

For these reasons, I believe that it would be premature to recommend specific amendments at this stage. Instead, I propose that the changes suggested in the first round of submissions be considered as part of the broader review of the Act that will be the second phase of this review process. My conclusions on the process for achieving this is set out in the next section.

7.2 Consultation papers

I propose that the next step in the conduct of this review be to prepare and release a series of supplemental consultation papers on the Act. The consultation papers would identify and discuss potential areas for reform as raised in the submissions, and suggest other opportunities to simplify or clarify the operation of the Act or to attune it more closely to the Australian business environment.

The papers would invite interested parties to comment on the issues that they identify. Where appropriate, based on responses received and the level of interest, it might also be desirable to convene workshops, to facilitate a more interactive discussion of the issues.

This consultation process would serve three valuable purposes. First, it would broaden and deepen industry awareness and understanding of the Act, and of the policies that underpin it. Secondly, it would assist Government to develop a consensus across the business and wider community on the content of those policies, and as a result foster a broader engagement with the Act as a whole. And finally, the outputs from the consultation process would provide invaluable input for the recommendations that I make in my final report.

A list of the topics that might be covered by the consultation papers is set out in Annexure B. The list can be expanded, if necessary, to include any additional topics that are identified in the second round of submissions.

This process would need to run to quite a compressed timetable. The review Secretariat will prepare and release an appropriate timetable to facilitate this process.

Conclusion 1:

That proposals for change raised in submissions and other relevant issues be developed into a series of consultation papers and released for broader industry consultation, with a view to broadening and deepening understanding of the Act and the policies that underpin it, and to inform the recommendations in the final report.

7.3 A framework for assessing proposed changes

The submissions for this interim report proposed a wide range of amendments to the Act. Each proposed amendment will need to be assessed against a number of criteria, including:

- the significance of the concern that the amendment seeks to address;
- the impact that the proposed change would have on other affected parties; and
- the impact that the proposed change would have on the ability of the Act to achieve its over-arching objectives.

The over-arching objectives of the Act are set out in Part 6 of this report. They are very general in nature, and as a result do not provide much concrete guidance for the task of assessing the merits of individual proposed amendments. For that, a more concrete set of guidelines would be needed. I believe that it is desirable to have such a set of guidelines, as they would provide all those involved in the review with a shared understanding of the principles that should be brought to bear when assessing the merits of proposed changes. They would also help to ensure that all proposals are analysed and assessed in a transparent and consistent manner.

The criteria that I propose to take into account when considering the merits of proposed amendments are set out in Annexure C. The criteria are not listed in any order of priority, and each of them will carry more weight in some contexts than others. They are also not intended to be prescriptive, and parties may consider that other factors should be taken into account in some circumstances as well. Collectively, though, they provide a framework that can be used to assess the overall merits of proposed amendments.

Parties should not feel obliged to couch their views by reference to these criteria. Clearly, though, it will assist my task of considering proposed amendments, as well as facilitate discussion of them, if parties are able to do so.

Conclusion 2:

That the criteria set out in Annexure C be used to guide the assessment of the merits of proposed amendments to the Act.

7.4 Engage with the Australian Financial Security Authority

As perhaps was expected, issues with the functionality of the register have been prominent in the submissions for this report.

Since taking over responsibility for the operation of the register in 2011/12, AFSA has managed and delivered a rolling program of enhancements to the register in consultation with key stakeholders. A number of the suggestions for improvement that have been received as part of the review process are either already under consideration by AFSA or in the process of being implemented, but many more will require careful consideration and advice both in terms of their feasibility and cost. AFSA has been involved in this aspect of the review to date and it will be important to ensure that AFSA continues to be involved in any discussions of changes that affect the register. This includes specific suggestions about the functionality of the register as well as changes to the Act which can have flow on consequences for the register's operation.

Recommendation 1:

That the review continue to engage with AFSA as appropriate, and in particular that AFSA's advice be sought on the practicalities of any proposed changes to the register and their likely associated costs and timing.

7.5 Education and awareness-raising

Despite Government efforts to inform small businesses of the Act and assist them in their use of the register, it is clear that further engagement is necessary to raise levels of awareness and understanding. Within the small business sector, the submissions indicate that the need for further engagement is greatest among businesses which, prior to the Act, were not traditionally considered as being involved in arrangements involving security interests (ie suppliers of goods on retention of title terms and the hiring industry).

(a) What type of education or awareness raising activities should be provided, and who should provide them?

A range of materials, from fact sheets to online tutorials, are currently available on the Personal Property Securities Register website. These materials are designed to assist users to gain a general understanding of the Act and its purpose, and to guide them through the registration process. Further assistance on the registration process is also available by calling the National Service Centre. Some of this assistance is currently targeted to particular business types and activities.

There is scope for this material to be reviewed and for consideration to be given to the best means of presenting the information to the target audience. This could include greater use of case studies or additional online tutorials, for example. Consideration could also be given to greater use of available communication channels between Government and business (such as the Government's recently released Single Business Service) to help raise awareness of the Act and the register and push information out to those businesses who need it.

It is not the role of the Government, though, to provide information which is tantamount to legal advice; rather, the provision of advice is a role for legal advisers. In circumstances where legal services are too expensive for individual businesses, there is a role for industry organisations to play in developing and providing further education and guidance. A number of organisations do currently provide a wide range of support services to their members. There would be value in greater collaboration and coordination between the efforts of Government and the private sector in raising awareness and providing education to small businesses.

There are a number of measures and strategies that could be employed to raise awareness and deliver education to small businesses. Further consultation is needed between Government, affected businesses and their advisers to determine the most appropriate strategy and mechanisms for ensuring that small businesses receive good explanatory information and guidance. The strategy should be multi-facetted and target those industries that are in greatest need of assistance (ie retention of title suppliers, the hiring industry and other small businesses).

(b) When should the education campaign be conducted?

It is likely, if the final report of the review leads to amendment of the Act and changes to the register, that a comprehensive education strategy would be required in the lead-up to the commencement of those changes. It might cause confusion among small business if government were to conduct two education campaigns in succession – one to address the Act in its current form, and the other to address the Act as amended.

It is however clear from the submissions that there is a need for some further education now, and that it should not wait until any changes to the Act have been agreed. In my view, action should be taken now to deliver a short term targeted education campaign directed towards those industries in greatest need of assistance. Such a campaign should be designed to ensure that small businesses are made more aware of the Act and its potential effects on their businesses. It should also focus on the means to make effective registrations for common types of security interests (eg retention of title and hire arrangements).

Recommendation 2:

That AFSA, in consultation with small business representatives (particularly those representing the interests of retention of title suppliers and the hiring industry) and their advisers, develop a targeted short term multi-facetted education and awareness raising campaign designed to:

- *make affected small businesses more aware of the existence of the Act and that it can affect them; and*
- *provide more guidance on how small businesses can make effective registrations for their most common types of security interests.*

Education and awareness-raising activities

ANNEXURE A

Activities to raise awareness of and educate business about the Act began with the Act's development led by the Attorney-General's Department. Those activities have since been continued on by AFSA, which is responsible for the operation of the register established by the Act. Development of the marketing and education strategies adopted at various points have been informed by market testing, research and evaluation.

2006-09

In April 2006, the Standing Committee of Attorneys-General released an options paper for public consultation on personal property securities reform. This was followed in May 2006 with a series of seminars on the topic in Sydney, Brisbane, Melbourne, Adelaide and Perth. During 2006-09 four discussion papers were released on different aspects of personal property securities reform. The first dealt with registration and search issues, the second with legal issues (including extinguishment, priorities, conflict of laws, enforcement and insolvency rules), and the third focused on security interests in investment property, such as shares, and other monetary obligations. Public comment was invited on the first three discussion papers. The responses of stakeholders were considered in the formulation of a draft exposure Bill. The fourth discussion paper was released in August 2008 and focused on the Regulations. An updated version of the discussion paper was released in October 2009.

In May 2008, the Attorney-General released a consultation draft of the Bill and commentary and a transitional/consequential amendments Bill. This was followed by a series of seminars in Sydney, Melbourne, Perth and Brisbane. In December 2008, a revised commentary was released by the Attorney-General's Department.

In November 2008, the consultation draft Bill was referred to the Senate Standing Legal and Constitutional Affairs Committee (the committee). The committee released its report in March 2009. A formal Bill was then prepared and introduced into the Commonwealth Parliament in April 2009. The Bill was referred to a Parliamentary Committee which held public hearings and recommended a number of changes to the legislation. The Bill was amended and passed, receiving Royal Assent in 2009.

2009-11

In the lead up to the commencement of the Act and the register, the Attorney-General's Department undertook an Australia-wide stakeholder engagement program from 2009-11. This included face-to-face meetings, monthly seminars, conferences and a PPS road show for business, industry and their advisers that toured all states and territories in May and June 2011. In all 73 events were held. An information website commenced operation in 2011 and as part of the PPS launch communications campaign, fact sheets were developed and published. Key messages and materials, including print, online and radio advertisements, were developed in preparation for the public launch of the website and register in January 2012.

2011-12

The Act commenced operation and the register was publicly launched on 30 January 2012.

A launch advertising campaign commenced on 23 January 2012 and ran until 30 June 2012. It included print, online and radio advertising targeted primarily at small to medium enterprises (SMEs). In addition, AFSA emailed approximately 1.4 million Australian businesses alerting them to the commencement of the Act. Hard-copy letters and factsheets were also sent to the 6,500 vehicle dealers and automotive spare parts businesses in the Australian automotive industry.

During 2011-12, AFSA also commenced a range of other activities including:

- presentations provided at a range of industry conferences, seminars and stakeholder forums;
- the development of an information brochure;
- continued collaboration with the state, territory and Commonwealth registers that transitioned to the register;
- development and placement of journal articles about the Act and the register;
- launch of regular e-newsletter communications; and
- development of industry specific fact sheets in collaboration with industry peak bodies (such as those covering artists, hiring businesses and farmers).

2012-13

In 2012-13 AFSA continued many of the communication and engagement activities noted above as well as commencing regular stakeholder forums on PPS policy and the operation of the register and the translation of the factsheets into nine languages.

2013-14

In 2013-14 key activities included an upgrade of the register information website, the introduction of a quick motor vehicle search facility, release of four educational videos on use of the register, and preparations for the end of the transitional period (30 January 2014).

End of the transitional period communications activities involved an email and direct mail campaign. AFSA sent 1.6 million awareness and call to action emails to Australian businesses about the transition period via the ATO's Australian Business Register lists. It also sent 58,000 letters and brochures to law and accountancy businesses. The *PPSR Update* email communiqué was sent to 5,500 subscribers every two months. Finally, a Google Adwords campaign was also conducted.

Suggested framework for consultation papers

ANNEXURE B

1. Transactions to which the Act applies

- Nature and scope of an "in-substance" security interest
- Types of deemed security interests
- Range of exclusions in s 8
- Governing law issues [if submissions suggest these are an area of concern]

2. Creation of a security interest

- Rules for attachment
- Rules for enforceability as against third parties

3. Modes of perfection

- Rules for perfection by possession
- Rules for perfection by control
- Perfection by registration
- Temporary perfection
- Deemed perfection

4. Dealings in collateral

- Terminology (eg transfer vs assign vs deal vs dispose of)
- Section 32
- Taking free rules
- Sections 79 to 81
- Accessions
- Processed and commingled goods
- Proceeds
- Vesting rules

5. Priority rules

- General issues
- Perfection by control
- PMSIs
- Section 64
- Sections 69 to 77
- Agri-PMSIs
- Transferred collateral
- Accessions [to the extent not covered under 4]
- Processed and commingled goods [to the extent not covered under 4]
- Proceeds [to the extent not covered under 4]

6. Enforcement of a security interest

- Inclusions in and exclusions from Chapter 4
- Ability of contractual enforcement remedies to operate alongside Chapter 4
- Detail of the enforcement remedies and other provisions in Chapter 4

7. The register

- Registrations
- Amendments
- Removal of registrations
- Searches
- Entitlement to register
- Defects in registrations

8. Particular types of collateral [to the extent not covered elsewhere]

- Chattel paper
- Accounts
- Negotiable instruments
- Letters of credit
- Documents of title
- Intermediated securities
- Investment instruments

9. Interaction with the Corporations Act

- Circulating assets
- Section 588FL of the Corporations Act

10. Other provisions

- Section 275
- Section 339
- Section 343

Principles to guide the assessment of proposed amendments

ANNEXURE C

1. Overall objective

(a) The objective of the Act is to facilitate the creation and enforcement of security interests in personal property, and to provide rules to regulate their legal effect.

Commentary

*The rules for the **creation** of security interests should not attempt to prescribe the form that parties must use. Rather, the Act should simply identify the outcome that a transaction needs to achieve, if it is to create a security interest that is effective for the purposes of the Act, and otherwise leave it to the parties to choose how they want to document the arrangement between them.*

*The rules regarding the **legal effect** of a security interest should encompass the effectiveness of the security interest as against third parties such as other secured parties, buyers and lessees.*

*The rules regarding **enforcement** should be facilitative, in that they should not limit the enforcement remedies that the parties may agree to include in their transaction. Rather, the rules should provide a set of enforcement remedies that are available for a secured party to use in transactions where the security agreement itself does not contain enforcement mechanisms, or instead of contractually agreed remedies if the secured party prefers.*

The Act should also deal with appropriate ancillary matters, such as:

- *how to decide when the Act applies; and*
- *matters relating to the operation of the register.*

(b) The focus of the Act should be on interests that in substance secure obligations. When considering the extent to which the Act should also apply to interests in property that do not secure obligations, the following factors should be taken into account:

- whether the interest is of a type that is sufficiently common in or important to our economy that it is appropriate to consider extending the regime to include it; and
- whether the overall benefit of including the interest in the Act (or in chosen aspects of the Act) will outweigh any detriment from doing so.

Commentary

One of the key "mischiefs" that is the target of legislation such as the Act is the so-called "evil of apparent ownership" – the risk that a third party may be misled by the apparent owner of property into believing that the apparent owner can give the third party a better interest in the property than is actually possible. This risk can arise if the third party has no independent means to determine whether another person might already hold a conflicting interest in the property. The Act aims to reduce this risk, by providing that a secured party puts its security interest at risk if it does not take steps that make it possible for a third party to learn of its existence. Those steps are referred to in the Act as "perfection".

There are many other types of circumstances, beyond the granting of security interests, in which a person can appear to have a greater interest in property than is actually the case. For example, a person may simply be in possession of another person's tangible property, either temporarily or on a long-term basis. A person may hold another person's intangible property as custodian, or as their nominee.

It would not be practicable for the Act to deal comprehensively with all circumstances in which apparent ownership of property is divorced from its true ownership. This reality was acknowledged by the Law Reform Commission of Saskatchewan in its report "Proposals for a Saskatchewan Personal Property Security Act" in July 1977, in which it made the following observation:

It is totally unrealistic to attempt to bring within the scope of the Act every kind of transaction in which deception results from a separation of interest and appearance of interest. However, it is realistic to include in the registration and perfection system of the Act certain types of transactions which, because of their commercial importance, are likely to continue to produce significant disruption if left out.

Rather than ignore other types of potentially-misleading transactions completely, however, the practice in jurisdictions that have legislation like the Act has been to include a subset of those other transactions within the legislation. In some jurisdictions (such as Saskatchewan), the selected subset consists of transactions which, as noted in the quotation above, are likely to produce significant disruption if they are left out, because of their commercial importance. In other jurisdictions, the selection has been adopted from predecessor legislation, without necessarily undertaking a full fresh scrutiny of whether the factors that led to that selection in the other jurisdiction were also relevant in the adopting jurisdiction.

When considering proposals to amend s 12(3), we should consider whether the proposed amendments would help to ensure that s 12(3) captures the appropriate types of interests, and only the appropriate types of interests.

2. Balance

The rules should strike an appropriate balance between the interests of secured parties, and the interests of third parties that take or may want to take a competing interest in collateral, such as:

- other secured parties; or
- buyers or lessees.

Commentary

This is the principle that is likely to inspire the most debate. Different market sectors will understandably want to ensure that their commercial positions remain as robust as possible under the Act. However, it will not always be possible to structure the rules in the Act in a way that provides all parties with the level of protection that they desire. Indeed, in many situations (such as the application of the priority or taking free rules), it may only be possible to protect one person at the expense of another. The rules need to find a balance between the legitimate expectations of the affected stakeholders.

3. Simplicity

Each rule should be expressed as simply as is possible without compromising the ability of the rule to achieve its purpose. It should be clear for each rule what the purpose of the rule is, and how that purpose fits with the overall purposes of the regime. The rules should apply consistently, across all types of personal property and security interest, unless there are good reasons to the contrary (such as a desire to facilitate particular business practices or policy objectives). Taken as a whole, the rules should produce clear and predictable outcomes for business and other stakeholders.

Commentary

It is important to express rules as simply as is possible, so that it is as easy as possible for readers to understand what the rules mean, and how they can work with them.

Commerce, however, is complex. The Act needs to reflect and respond to that reality, and not stifle commercial creativity by imposing "one size fits all" requirements. Because the complexity of commercial life will necessarily require that there be corresponding complexity in the Act, it will be important to monitor the extent of that complexity, and to resist the urge to over-complicate the Act by providing exceptions or sub-rules to deal with particular fact patterns, or by including "avoidance of doubt" clarifications, unless they are truly necessary. As far as possible, potential uncertainties or complexities should be dealt with through careful formulation of the primary rules, rather than by means of exceptions or supplementary qualifications.

This is again a question of finding the right balance. We should resist the urge to over-complicate the Act, but also be mindful of the need, to quote Albert Einstein, to "make everything as simple as possible, but not simpler".

4. Comprehensiveness

The rules should be as all-embracing as possible. They should apply to all types of personal property and all types of security interest, unless there are clear policy reasons for an exception.

Commentary

This is a broader application of the "simplicity" principle Carve-outs from the Act complicate the Act itself. They can also complicate outcomes for those who want to take an interest in the property, or to enter into a transaction, that is carved out. This is because excluding a type of property or transaction from the Act does not mean that the property or transaction can then operate free of any legal rules at all. Rather, it means that a different set of rules need to be identified and applied, and that could well result in increased complexity and uncertainty for those involved, rather than less.

5. Flexibility

The rules should be as flexible as possible. They should accommodate current market structures and business practices, but also be flexible enough to respond to changes to them. They should allow parties the freedom to structure their agreements as they see fit, unless there are policy reasons to the contrary (such as the need to protect consumers). They should include as few formal requirements as possible.

Commentary

Some care needs to be taken in the pursuit of this principle, as too much flexibility can degenerate into uncertainty. Also, while it is important that the Act not focus entirely on current market practices and conditions, and that it be able to accommodate new developments as well, the primary focus of the Act should be on ensuring that it produces appropriate and meaningful outcomes for Australian businesses and consumers today.

6. Transparency

The rules should aim to provide transparency in relation to the existence of security interests, through mechanisms that enable third parties to determine whether an item of a person's property may be subject to a security interest.

Commentary

This principle targets the "evil of apparent ownership" mentioned earlier. A key objective of the Act should be to provide mechanisms that make it possible for third parties to determine whether a security interest may exist over a particular item of property. This is the role performed by the three main modes of perfection under the Act – registration, possession and control.

A third party will however not always be able to detect whether an item of property is subject to a perfected security interest. For example, the Act provides for circumstances in which a security interest will be deemed to be perfected, either temporarily or permanently, in a manner that will not be apparent to third parties.

It is also possible for a security interest to be perfected by control in a manner that is not visible to outsiders. And even registration provides no more than an indication that a security interest might be attached to property. Trade-offs of this kind are inevitable, given the need to balance the practicalities of the perfection process against the information needs of third parties. When assessing the mechanics of the various modes of perfection, however, it is important to remember why perfection is there, and to ask whether it is achieving its purpose.

7. Fit

The rules should be able to function in harmony with the balance of our law.

Commentary

The Act is not a self-contained set of rules that operate in isolation from the balance of our laws. Rather, the Act is just one component of our legal system generally, and needs to be able to function in harmony with it.

The Commonwealth Government has gone to considerably lengths to amend other legislation to adopt the terminology and concepts of the Act. State and Territory Governments have done this to a rather lesser degree.

The Act needs to be able to produce meaningful outcomes when interpreted and applied against the background of our laws generally. Other parts of Australia's commercial law framework, and the expectations that underpin our that law, are very different to the laws and expectations that applied in the United States in the 1950s, when Article 9 was introduced. The same can be said (albeit to a lesser extent) in relation to the corresponding legislation in Canada and New Zealand. Terminology or structures that achieve meaningful outcomes in the overseas legislation may not work here. The drafting of the Act needs to take this reality into account.

This is clearly something of an aspirational set of targets. The complexity and innovativeness of the Australian economy, together with the inherent ambiguity of the English language, make any of these principles difficult if not impossible to realise in full. There is a degree of overlap between some of the principles, but others are in tension with each other, in that it may only be possible to pursue one principle in some circumstances if this is done at the expense of another. Where these conflicts do arise, they will need to be resolved by determining where the appropriate balance lies, looking back as needed to the over-arching objectives referred to in Part 6 of this report.