Retentions Regime wilts under scrutiny in first court case

JOHN MCKAY

The retentions regime, brought into effect on 1 April 2017 through an amendment to the Construction Contracts Act, wilted under the scrutiny of its first test in the Wellington High Court this month.

The Court had to struggle against "gaps in the legislation" and "imprecise language" as it sought to resolve issues which should have been resolved by the lawmakers – in particular, how, and by whom, retention monies should be allocated in a receivership.

Either we await the accumulation of case law to inject some much needed clarity into this regime, which will be a slow and expensive process, or the Government appoints an expert panel to review it and recommend improvements.

At issue

The Court was asked to do three things:

- appoint the receivers for Ebert Construction Limited (Ebert) as receivers and managers of the company's Retention Account in order that they could distribute the monies, and deduct any expenses and costs incurred in making the distribution

-determine who of the 152 subcontractors had a claim to the fund, and on what basis, and

-decide how the fund should be allocated in the very likely event of a shortfall.

The receivers' status as receivers for Ebert did not give them any rights over the fund because, although the legal title was held by Ebert, the equitable ownership of the money lay clearly with the subbies (having been withheld from payment as a security against poor work).

The Court had no problem granting this appointment. Neither of the subbies who were parties to the litigation - Auckland Ventilation Services and Taslo Steel Security Ltd - had any objection to the arrangement and it was clearly the most elegant solution available.

Allocation of the fund

The Court found that the claims of 131 of the 152 subbies were "clear and not contentious". At issue for them was not whether they would be paid but how much they would get. That would depend on how the eligibility of the remaining 21 was decided because, if any of them were found to be eligible, a "fractional adjustment" would be needed to the pay-out for each person.

The problems for the 21 stemmed from two factors:

-a progressive breakdown in Ebert's approval and payment mechanisms over the last few months before its collapse, and

-a software glitch which meant contracts entered into after the regime, that came into force on 31 March 2017, were not recognised as being subject to the Act.

The criteria the Court applied

The three "certainties" the Court applied in determining the status of the claims were:

-whether there was an intention to create a trust in relation to the retention monies

-the subject matter of that trust (i.e. the obligations created), and

-the intended beneficiaries of the trust.

Wrongly classified

The hardest outcome fell to the subbies whose retentions had been deducted but, due to the computer error, had not been transferred to the Retention Account. They fell victim to section 18FA (b) of the Act which provides that retention accounts can be used "solely to discharge obligations to the subcontractors from whose payments these funds were deducted".

Calculated but not transferred retentions

This category refers to the 80 subbies for whom Buyer Created Tax Invoices (BCTIs) recording the payment due and the amount to be retained had been created for June but had not been paid (in default of Ebert's legal obligation). The Court's finding in relation to them was that they had no claim because:

> *"where no payments were made, obviously nothing could be said to have been withheld from those payments and, obviously, no monies were paid into the Retention Account".*

Uncalculated and not transferred retentions

This refers to the 70 subbies for whom Ebert had not completed its reconciliation process for July 2018 when it went into receivership. The Court ruled out their claims on the basis that in respect of the services provided that month, "the intention to create a trust is absent" as were the necessary steps to create "retention money".

Released but not paid retentions

This affected four subbies. Their retentions had been reconciled and transferred into the Retention Account and Ebert had done the calculations to "release" them but had not got around to doing that before ceasing operations. The Court found that all three "certainties" were satisfied so they were entitled to a share of the fund.

Allocation method

The Court ruled that the funds should be allocated to the subbies with successful claims on an equal basis with interim payments at 75% of nominal entitlement "or such other percentage as seems prudent".

It also got an undertaking from the receivers that the balance in the Retention Account would not fall below the interest accrued. This was to protect the position of the parties until the question of where the entitlement for this money lay, with Ebert or with the subcontractors – a matter the Court had left for "another day".

ABOUT THE AUTHOR

John Mckay
Partner, Auckland
Litigation & Dispute Resolution

CHAPMAN TRIPP