Proposed Changes to the Retentions Regime

By Hannah Stanley

Despite the introduction of the retentions regime into the Construction Contracts Act 2002 (the Act) in 2017.[1] many subcontractor retentions have still been left unprotected and various gaps in the legislation have been exposed. These shortcomings were highlighted by the high-profile insolvency of Ebert Construction and resulting litigation by its Receivers for directions on administering an inadequate retentions account.[2]

In 2020, the Government announced several changes to strengthen the retentions regime in the Act. These changes have been included in a recently introduced amendment to the Act[3] which we look at below.

Current retentions regime

Retentions funds are money withheld by a party to a construction contract from an amount payable to another party. It is generally a situation between a contractor (the payer) and a subcontractor (the payee). The payer withholds a percentage of the funds payable as a form of security and to ensure the work is carried out to an appropriate standard[4] and that the obligations under the contract are met. The retentions are usually paid out once the liability period has expired which can take a number of months.

The Act states that retention money is not deemed to be held on trust, it is merely required to be held on trust.[5] Too often there are situations where the retention funds are intermingled with the construction company's working capital (out of necessity in order for current and/or future projects to proceed). This would not be the case if a conventional trust arrangement were in place.[6] Related to this, the current scheme under the Act has no requirement that retention money be kept in separate bank accounts. Consequently, when it comes time to pay the retentions to the payee, the money may not be available, for example, the construction company may have gone into receivership after the project was started.

Despite these factors posing a huge risk to payees, there are unsatisfactory penalties in place for parties who do not comply with the trust requirements under the Act. At present it is relatively easy to get away with non-compliance and as a consequence, leave a payee short-changed.

The recent Bill

On 1 June 2021, the Construction Contracts (Retention Money) Amendment Bill (the Bill) was introduced. The Bill proposes to strengthen the current retentions regime by recommending a number of important changes. The recommended changes largely focus on improving the protection (or lack thereof) currently afforded to payees.

Held on trust

The Bill proposes that a statutory trust would arise as soon as funds become retention money[7]. It resolves that the retention money is trust property, regardless of whether the payer has adhered to the retention regime under the Act or not[8]. Given that the retention funds would now legally be trust property, the retention money would be kept legally separate should a company become insolvent. This protects the payee significantly more than the current regime. As trust property, the retention money will be protected against

1 The retentions regime in New Zealand is governed by sections 18A to 18I of the Construction Contracts Act 2002 which came into effect on 31 March 2017.

2 *Bennett & Ors v Ebert Construction Limited (in receivership and liquidation)* [2018] NZHC 2934.

3 Construction Contracts (Retention Money) Amendment Bill.

4 *Bennett* at [33].

5 Section 18C Construction Contracts Act 2002.

6 *Bennett* at [71].

7 Clause 18C(2) of the Bill.

8 Clause 18C(4)(b) of the Bill.


NEW ZEALAND DISPUTE RESOLUTION CENTRE
www.nzdrc.co.nz
Trust Disputes
A smarter way to resolve trust disputes is here
NZDRC
FIND OUT MORE

being intermingled with the payer company's working capital and the rules of common law and equity that apply to trusts will be applicable.

The trust ends when all the retention funds have been paid to the payee or when they cease to be payable for any other reason (for example, the payee may not have carried out the work to a sufficient standard). If a receiver or liquidator is appointed, they would become the trustee of the retention money and the payer would cease to be a trustee.[9] This is an important safeguard for payees.

Offences and penalties

The Bill sees harsher penalties for companies and directors who do not comply with the trust requirements, with non-compliance deemed to be an offence under the Act. A company could be fined up to $200,000 for non-compliance.[10] Furthermore, directors of non-complying companies could find themselves personally liable for a maximum fine of $50,000.[11] To further deter non-compliance, a wide definition of "director" is proposed, by including anyone who appears to act in the role of director and/or carries out a role similar to that of a director, whether or not that title is used.[12]w This would pose an increased risk to all members of construction management.

Separate bank accounts and complying instruments

The Bill requires that the full amount of retentions payable to the payee are held in a New Zealand bank account or other complying instrument[13], such as an insurance policy or bank guarantee.[14] Each separate bank account cannot be used for any other purpose than to hold the retention funds, and the account name must include the words "retention money trust account".

Record keeping

The Bill requires the keeping of proper accounting records to ensure that financial statements could be prepared.[15] Separate ledger accounts are to be kept for each payee (that is, each subcontractor)

9 Clause 18J(2) of the Bill.
10 Clause 18DA(1)(a) of the Bill.
11 Clause 18DA(1)(b) of the Bill.
12 Clause 18DA(3)(a) of the Bill.
13 Clause 18D(2) of the Bill.
14 Clause 18E of the Bill.
15 Clause 18FC(2)(a) of the Bill.

and each individual construction contract. Similar record keeping obligations would also apply to complying instruments.

Continuing disclosure and reporting obligations

The Act does not currently stipulate any express obligation to report the details and status of retention funds to the payee. This leaves the payee completely in the dark as to whether the payer has the correct amount of retention money available to pay them. The Bill seeks to remedy this by requiring that information about the retention monies is provided to the payee as soon as possible after the money is withheld and at least every three months after that.[16] This increase in transparency would be another positive gain for payees.

A positive change

Although the Bill would no doubt see an increase in the amount of administration involved in managing retention funds, the increased protection and flow of information it offers to payees represents good practice and mirrors overseas regimes. Payers would no longer be able to use retention money as working capital and intermingle retentions with other monies, as the funds would be deemed to be held on trust and would also be required to be held in separate accounts. Ultimately, payees will be provided with considerably more security when it comes to retentions and there would be far less risk of them not receiving retention money at the end of the liability period.

Next steps

The Bill has been referred to the Transport and Infrastructure Committee. Submissions are due by 23 July 2021, with the report due by 11 November 2021. If the Bill is passed, it will come into effect six months following the royal assent and, like the original retention changes, it is proposed that most of the new provisions will only apply to construction contracts entered into after the Bill comes into force. However, the changes regarding the role of the liquidator/receiver will sensibly apply to all liquidations/receiverships, regardless of when the contract was entered into.

ABOUT THE AUTHOR

Hannah has been part of the Building Disputes Tribunal registry for over a year. Hannah has a litigation background and has practiced in both Auckland and Melbourne.

16 Clause 18FC(1) of the Bill.