
Construction Contracts (Retention Money) Amendment Bill

29/07/2021

Submission on the Construction Contracts (Retention Money) Amendment Bill

1 Introduction

- 1.1 The New Zealand Law Society | Te Kāhui Ture o Aotearoa (**Law Society**) welcomes the opportunity to comment on the Construction Contracts (Retention Money) Amendment Bill (**Bill**).
- 1.2 This submission was prepared with input from members of the Law Society's Civil Litigation and Tribunals Committee and the Commercial and Business Law Committee.
- 1.3 The Law Society does not wish to be heard, but is available to discuss the issues raised in the submission with the Committee if that would be helpful.

2 Executive summary

- 2.1 The Law Society supports the objectives of this Bill.
- 2.2 The Bill sensibly proposes three key changes to the retention money regime contained in the Construction Contracts Act 2002 (**Act**), to:
 - (a) strengthen and clarify the existing 'on trust' requirement for retention money held by a contractor;
 - (b) improve the transparency of retention money held; and
 - (c) introduce new offences and penalties to the Act to deter and penalise non-compliance.
- 2.3 While the Law Society supports these changes, we have some comments regarding drafting of the Bill.
- 2.4 In particular, this submission provides comments on: the application of the subpart to construction contracts only, the meaning of retention money, improved transparency of retention money held, and the introduction of offences and penalties for failing to keep retention money as required by the Bill.

3 Background

- 3.1 In general, the Bill seeks to clarify and strengthen existing requirements in relation to retention money in order to better protect subcontractors.
- 3.2 The Act currently requires any party to a construction contract (Party A, usually a contractor) who is withholding retention money from the other party to the construction contract (Party B, usually a subcontractor or supplier), to hold that retention money on trust for the benefit of Party B. The retention money may be held in cash, other liquid assets that are readily converted into cash, or a financial instrument such as insurance or a payment bond.
- 3.3 Since its introduction (following the collapse of Mainzeal Property and Construction Limited in 2013, leaving large numbers of subcontractors and suppliers unpaid) the retention money regime under the Act has sought to protect money owed to subcontractors. While some retention money has been returned to subcontractors where head contractors have become insolvent, there are still non-compliance issues. This Bill seeks to provide more protection to retention money owed to payees.

4 Proposed new section 18B – Application of subpart and meaning of retention money

- 4.1 The Law Society considers that proposed new section 18B appropriately defines the scope of application of the retention money regime but queries why the proposed Bill only applies to commercial construction contracts (that is, contracts for carrying out construction work in which none of the parties is a residential occupier of the premises that are the subject of the contract).¹
- 4.2 The collapse of Stonewood Homes² is an example of a significant impact on sub-contractors in a residential context. The primary objectives of the Bill seek to provide additional protection to all payees in the context of construction contracts (broadly defined as a contract for carrying out construction work³) and does not distinguish between payees in a commercial versus residential construction contract.⁴ The Law Society recommends that the Select Committee consider the scope of the Bill and whether the Bill should apply to all construction contracts.
- 4.3 The Law Society considers that new section 18B(7), which provides for a de minimis amount, is unnecessary and should be removed from the Bill.
- 4.4 The provision refers to an amount prescribed in regulations, but the Construction Contracts Regulations 2003 have never provided for a de minimis amount. If a de minimis amount is withheld by Party A, it will have caused only a de minimis amount of loss which ought sensibly to be resolved by a straightforward reimbursement.

5 Clarification of ‘on trust’ requirements

- 5.1 In terms of the proposed amendments to strengthen and clarify the existing ‘on trust’ requirements, the Bill proposes to amend the Act to ensure retention money is:
- (a) placed on trust as soon as possible by a contractor for a subcontractor (or other party for whom retention money is being held);
 - (b) held on trust separately from other money or assets; and
 - (c) held in a trust account in a registered bank in New Zealand or in the form of complying instruments (such as an insurance policy or a guarantee).
- 5.2 These proposed amendments are sensible and practical. They address logically the High Court’s decision in *Bennett & Ors v Ebert Construction Limited*, where the court expressed its concern with the imprecise nature of the statutory trust requirements and in particular, the fact that actual retention funds did not need to be retained as cash.⁵
- 5.3 Requiring retention monies to be held in a separate bank account is also sensible and will avoid a common current issue where contractors co-mingle retention money with company working capital. This poses serious challenges if the company goes into liquidation and the retention money cannot be identifiable, often resulting in subcontractors or suppliers missing out on the retention money owed to them.

¹ Construction Contracts Act 2002, s 5 (Interpretation).

² Stonewood Homes Ltd went into receivership in 2016.

³ Construction Contracts Act 2002, ss 5 (Interpretation) and 6 (Meaning of construction work).

⁴ Construction Contracts (Retention Money) Amendment Bill 2021: Bills Digest 2649.

⁵ *Bennett & Ors v Ebert Construction Limited* (in receivership and liquidation) [2018] NZHC 2934 at[62]-[63].

Other issues

- 5.4 While the relationship between the Bill and the common law and equity is made clear by proposed new section 18C(4)(c), the Bill does not address the position in respect of the Trusts Act 2019. This would be a straightforward addition to the section and would remove any doubt about the application of the Trusts Act 2019.
- 5.5 Issues may well arise upon liquidation or receivership where, notwithstanding the deemed creation of a trust, trust funds have been spent. It is unclear whether this then becomes an issue of tracing and, if so, how it will be dealt with. Two competing methods could apply to determine whether trust funds have been spent:
- (a) the 'first in first out' assessment; or
 - (b) the assumption that non-trust funds would be spent first.
- 5.6 This is a foreseeable issue and the Bill could helpfully deal with the situation of:
- (a) a shortfall in retention monies (for example, \$100,000 of retention monies owed but only \$50,000 in the retention monies trust account); and/or
 - (b) no monies in the retention monies trust account but some funds available in the liquidation.

6 Improved transparency of retention money held: proposed new section 18FC – Account and records

- 6.1 The current statutory regime set out in section 18FC of the Act allows payees, usually subcontractors, to inspect accounting and other records when retention monies are being held. The contractor must provide this information on request within a reasonable time at no cost. The Bill recognises that, at present, this places an onus on the payee to inspect records and ensure they are satisfied.
- 6.2 The Bill proposes to reverse this onus and increase general transparency of retention money held by introducing continuing retention money disclosure requirements on contractors. The contractor must provide the party to the construction contract for whom the retentions are held with information about the retention money.
- 6.3 The proposed amendments suggest that reporting must be made when the money is first retained, and then at least every three months thereafter, and includes the amount of retention money being held and its form (separate bank account or complying financial statement).
- 6.4 At present, there is a lack of clarity as to how these reporting requirements will work, and it would be helpful if the Bill could expand on these requirements. A sensible way forward could be to require contractors to report monthly to payees on retention money held.

7 Introduction of offences and penalties: proposed new section 18DA – Failure to keep retention money as required

- 7.1 A key proposed amendment is the introduction of offences and penalties for non-compliance.
- 7.2 Proposed new section 18DA creates the primary offence of failing to keep retention money in accordance with proposed new section 18D. Of the three proposed offences, the section

18DA offence carries the highest maximum fine for non-compliance, being \$200,000 for companies, and \$50,000 for directors.

- 7.3 There is sensibly a broad general defence to liability if a contractor and/or its director (or an individual acting as a director) took all reasonable steps to ensure the company complied with its/their obligations.
- 7.4 The proposed section 18FC offence of failing to keep proper accounts and records carries a maximum fine of \$50,000. Given the two levels of fines present in proposed new section 18DA we query proposed section 18FC should impose obligations on directors as well party A if party A is a body corporate. The same is true of the proposed section 18FD offence of failing to report on retention money.



Frazer Barton
Vice President
29 July 2021