

# The CCA retention regime

NZIQS member Webinar 21 September 2017

Reprint  
as at 1 September 2017



- Why regulate?
- Outline of retention regime
- Complying with the regime
  - Industry responses
- Issues and opportunities

## Construction Contracts Act 2002

Public Act    2002 No 46  
Date of assent    26 November 2002  
Commencement    see section 2

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### Part 1

#### Preliminary provisions

##### *Purpose*

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##### *Overview*

# Why regulate?

# Was there a problem to be fixed?

- Industry reluctant to discuss retentions in 2002  
*.....retentions fundamental to cashflow structure of the building industry.....*
- Mainzeal the catalyst, not the reason
  - Receivership 1 week after first reading – evidence of issue
  - Near universal call for Select Committee to regulation, but no clear solutions
- Retention abuse an international issue
  - Collins Report NSW (2013)
  - Anecdotal evidence of poor industry practice
- Warnings to subcontractors –
  - *Be careful what you ask for.....*

# Outline of the regime

# The CCA solution: CCA section 18A

- Objective is to protect retention money
  - Underlying objective to change retention behaviours
- Applies to all retentions, but only on commercial contracts entered into or renewed from 31 Mar 17
  - Late March 2017 amendment averted potential catastrophic damage
- All retention money held **on trust** for payee
  - Trust obligation ceases when retentions paid or given up by payee
- Alternatively by **complying instrument**
  - e.g. retention bond by bank or insurer
- Retentions released when contract obligations fulfilled
- Certain clauses void e.g. *no pay when certified*
- Interest on late retention release

Section Act 2	Part 2 s 18	Reprinted as 1 September 2017	Part 2	Reprinted 1 September 2017	Part 2 s 18H	Construction Contracts Act 2002	Reprinted as at 1 September 2017
Subpart Act 2	(2) F a	(2) If, (a)					
<b>18A Inte</b>	(3) A	(b)			<b>18H Protection of retention money</b>		
In th	(4)	(3) Par	(4)	(2)	<i>[Repealed]</i>		
an a	(5)	bef			Section 18H: repealed, on 31 March 2017, by section 154 of the Regulatory Systems (Commercial Matters) Amendment Act 2017 (2017 No 12).		
amo	S	Sec			<b>18I Prohibited provisions</b>		
perf	A	Act	(5)		(1) Any term in a construction contract is void that purports to—		
Section	S	Sec	(6)		(a) make the payment of retention money conditional on anything other than the performance of party B's obligations under the contract; or		
Act 2	(6)	Man			(b) make the date on which payment of retention money is payable later than the date on which party B has performed all of its obligations under the contract to the standard agreed under the contract; or		
<b>18B App</b>	S	<b>18FA Pr</b>			(c) require party B to pay any fees or costs for administering a trust or an instrument under this subpart.		
(1) This	S	Ret	(7)		(2) Any provision in a construction contract is void if the purpose, or one of the purposes, of the provision is to avoid the application of any of the provisions of this subpart.		
refer	<b>18D A</b>	(a)			Section 18I: inserted, on 31 March 2017, by section 18 of the Construction Contracts Amendment Act 2015 (2015 No 92).		
(2) Reg	r	(b)			Section 18I(1)(c): amended, on 31 March 2017, by section 155 of the Regulatory Systems (Commer- cial Matters) Amendment Act 2017 (2017 No 12).		
tion	P						
Section	s	Com		(3)			
Act 2	s	Sec		(4)			
<b>18C Def</b>	M	Man	(8)	(5)			
(1) All	H	Hea					
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	(4)	(a)					
	(5)	(b)	<b>18FC</b>				
	S	(c)	(1)				
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[www.legislation.govt.nz](http://www.legislation.govt.nz)

# What are retentions

- Retention money is defined:

*An amount withheld by a [payer] from an amount payable to a [payee] as security for the performance of [the payee's] obligations under the contract*

- Applies only to commercial contracts
  - i.e. not applicable where homeowner holds retentions
  - Applies to all subcontracts (business to business)
- Aims to catch workarounds

*Contract price is \$380,000 payable up to completion plus \$20,000 payable 3 months after completion. Retentions do not apply to this contract*

# When retentions are due

Liability to pay arises when properly due

- Contracts should specify when retentions will be due

Payer may “appropriate” (use) retention money to remedy defects in performance of contractual obligations

Roughly corresponds to NZS 3910:2013 clause 11.2.2

*Prohibited provisions* in contracts

- Cannot make the release of retentions (or the due date for release) conditional upon anything other than completing contractual obligations
- Cannot make payee liable for meeting cost of trust facility
  - Payer must carry cost of trust arrangement

Interest applies on late release

- Effective rate as per contract i.e.
- NZS 3910 ~ 14%, subcontracts 0% (or may regulate)



# Protection of retention money

- All retention money must be held on trust:
  - Payer must provide details of trust arrangements to payees on request
  - Payer is trustee, subject to trustee Act 1956
  - Payer cannot pass on cost of trust administration to payees
  - Payer pays cost of administering trust
  - Payer may invest retention money, at payer's risk
- Retention money not available to receiver or creditors
  - Held on trust (whether or not in payer's accounts)
  - For benefit of payees from whom it is withheld
- No contracting out (s12) – regime applies to all payers holding retentions

# How to comply with trust requirement?

The Act states:

- Do not need separate trust accounts
- May be “commingled”
- May be invested (at payer’s risk)
- May be held in “cash or other liquid assets that are readily converted into cash”

What does it really mean?

- Is a separate trust account required?
- What qualifies as a *liquid asset*?
- Industry needs to establish practical guidelines

# Alternative to trust arrangement

- Retentions may be protected by “complying instrument”
  - Retention payment bond from registered trading bank or licensed insurer
  - Payee claims from surety if retentions not paid when due
  - Payer must provide details of sureties to payees
  - Surety provides details to payees upon request
- Instrument satisfies statutory obligation while instrument in effect
  - Payer must reinstate trust arrangements if bond expires or ceases to be effective
  - Payer needs process for notifying payee where retention money is appropriated to remedying defects in performance

# Accounting requirements

- Payer must have auditable and traceable records:
  - Proper accounting and records of all retentions and/or instruments
  - Comply with generally accepted accounting practice
  - Record all dealings and transactions relating to retentions or instruments
- Records must be available to payees

## Industry needs to consider

- What form of records will comply?
- What information can/should payees see?

# Complying with the regime

# Retention bonds

- Bonds provided by banks/insurers in lieu of trust requirement
  - Payment bond
  - Provides surety for payment of retentions when due
  - Payer pays fee for bond
- Insurers offer bond facility up to nominated amount
  - To cover forecast retention holding over next 12 months
  - Need to reapply for new bond on expiry
- Insurer issues certificate on request identifying current subcontractor amounts protected
  - CBL have issued at least 1 bond, others in process

# Insurance-based bonds

- Insurers will require detailed information from applicant, eg:
  - Prior 2 years financial accounts
  - Company structure, group profile, etc
  - Work in progress
  - Guarantee schedule – bonds and bank guarantees on issue, with details of start, expected return, client, etc
  - Outline of bank facilities available
  - Projects completed in past 12 months
  - Expected retentions over next 12 months (to determine size of facility)
  - Director declaration
- Payer sign Deed of Indemnity/Guarantee Indemnity
  - Directors would be liable to insurer if bond called

# Insurance-based bonds, cont'd

- Bond issued when premium paid
- Bond for finite period (12 months)
- Payer responsible for ensuring bond value is sufficient
  - Retentions in excess of bond must be held on trust
- Bond NOT 'on demand'
  - Payee must prove retentions overdue, have not been released
  - Surety will not get involved in workmanship/commercial disputes
- Insurer issues guarantee certificate on request
  - Identify payees and amounts covered
  - Payer must provide accounting information to surety
  - Form and content of certificate dependent on information provided to insurer



# A contractor perspective

- Too much focus on contractor compliance
- Difficult for contractors to assure client compliance
  - No consequences for breach except when in insolvency
  - Risk where projects are debt-funded
- Conservative legal and accounting advice suggests retentions should be in separate trust account
- Industry needs to establish guidelines:
  - Definition of “on trust”, “generally accepted accounting principles”
  - Acceptable proof of retention holding
- Bank bonds expensive and tie up cashflow
- No netting of retention places undue burden on contractors

# Impact on contractor cashflow

*Assume gross value of work completed \$1m*

## Pre-regime:

• Retentions withheld from contractor	(unsecured)	(\$60k)	(6%)
• Retentions withheld from subcontractors	(say)	<u>\$80k</u>	<u>8%</u>
• Net cash benefit		\$20k	2%

## Contractors had hoped for netting of retentions:

• Cash withheld from contractor	(secured by Principal)	(\$60k)	(6%)
• Cash held on trust for subcontractors (\$80k - \$60K secured upstream)		<u>(\$20k)</u>	<u>(2%)</u>
• Total cash <u>not</u> available to contractor		(\$80k)	(8%)

## What the regime provides:

• Cash withheld from contractor	(secured by Principal)	(\$60k)	(6%)
• Cash held on trust for subcontractors		<u>(\$80k)</u>	<u>(10%)</u>
• Total cash <u>not</u> available to contractor		(\$140k)	(14%)

# Complying with ‘on trust’ – practical steps

- Track retentions
  - Separate retention money held on new contracts (31 March 2017 onwards) to ensure “liable retentions” (total and by payee) known at all times
  - Ensure traceable to individual payees, corresponding to payment schedules
  - Flag when retention money becomes due (by contract/payee/expected date)
- Hold retentions in separate ledger or bank account, or investment
  - Identified as e.g. ‘retention money on trust’
  - No definition of *generally accepted accounting principles*
- Retention account and transactions must be auditable
  - Develop reports for evidence of compliance with trust obligation
  - Automatic system reporting to allow cost-effective response to payees
- Provide accurate information to each payee upon request
  - Informative company or auditor statement available defining how retention money held
  - Amount of requesting payee’s retentions held by contract

***If this is too hard, why bother withholding retentions?***

# What one pro-active contractor is doing

*To [subcontractor]*

*We refer to your request for clarification on our company policy on subcontractor retentions following the amendments to the Construction Contracts Act 2002 (CCA) from 31 March 2017.*

*We have opened a separate Retention Trust bank account into which all retentions are placed and held in trust for all agreements entered into from 1 April 2017. We have developed a Subcontractor Report to track the agreements and the retentions to which the new CCA provisions apply. Any retentions that are required to be placed in trust are transferred to the trust account on a weekly basis.*

*An extract of the Subcontractor Report for your company as at [date] is set out below*

<u>Project</u>	<u>Agreement Date</u>	<u>Contract Ref</u>	<u>Contract Price</u>	<u>Retentions held</u>
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**So far no subcontractors have requested this information....**

# Example: Ministry of Education BOT update – Aug 2017

*Recent legislative changes require that retention money withheld under Works Contracts must be held on trust for the benefit of the contractor or via a complying instrument.*

*While the Ministry works through the implications of this change for both the Ministry and Boards of Trustees (in their capacity as Principal under the construction contract), we advise Boards of Trustees that:*

- Retention monies held by Boards of Trustees must be held separately from and not comingled with working capital. Retention monies cannot be appropriated to a use other than to remedy defects in the performance of the Contractor's obligations under the contract*
- Boards of Trustees must maintain accounting rules and records that demonstrate that retention monies are not used for any purpose other than as retentions, including:*
  - Correct recording of all dealings/transactions*
  - Compliance with generally accepted accounting principles.*

# Example: Ministry of Education BOT update – Aug 2017

Ministry is getting to grips with the change

- Conservative approach, late, light on guidelines....

Boards with capital works projects can take practical steps

Establish system and procedures:

1. Track retention money held: amount, by contractor, due date
2. Set up and monitor retention schedule for “liable retentions”
3. Establish policy defining where retention money held
  - Investment/ ledger/ separate bank account
  - Monitor that account to ensure funds  $\geq$  liable retentions at all times
4. Release retentions promptly when due

Payment certifiers should include reminder with payment schedules

# Issues and opportunities

# Industry reaction

NZ Herald 22 Aug 2017 “Building company collapses predicted”

*Some NZ companies will begin to fail in the next 12 months as the impacts of a new law begin to bite, sector largely unaware of changes*

*Not all doom and gloom. Some companies will be stronger, but some will not survive*

*Insurers will only insure companies whose financial statements are satisfactory: “....an insurance product for those that don’t really need it and no insurance for those who desperately do...”*

*“....will give rise to a two-tier industry” [as] “...subcontractors can inspect .... company records....[and] prefer those that have shown financial strength.”*

*“The challenge ..... profits earned may not be enough to bridge the funding gap”*



# Issues and opportunities

- Contractors and subcontractors generally aware; others less so
- Payment certifiers should remind Principals of trust obligation in payment schedules
- Directors need to be aware, and ensure compliance with trust obligation
- Contract-specific accounting systems are making adjustments
- Banks and insurers developing bond products
  - Must be affordable, meet industry needs
- Industry to check contract forms and processes
  - Subcontract agreements – SA2009 under review
  - Contract forms eg NZS 3910
  - Should certifiers remind Principal of surety obligation in payment schedules?
- Industry needs to consider surety needs and options
  - Interest in bonds in lieu retentions (NZS 3910 schedule 5)
  - May provide greatest benefit during defects period
- Residential builders expected to resist retentions
  - Residential contracts unprotected, some offering price for retention option subject to security

**Disclaimer:** The content of this webinar is for general information only and is not intended be relied upon or as a substitute for professional advice.

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