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Introduction

The retention regime introduced under the Construction Contracts Amendment Act 2015 (CCAA), which aims to provide protection for retention money, came into effect from 31 March 2017.

NZIQS, RMBA and STCF issued a [Retentions Bulletin \(#1\)](#) in April 2017 to outline the provisions of the retention regime and answer common questions in the industry.

This Retentions Bulletin #2 answers further questions that were raised from a webinar for NZIQS members presented by Peter Degerholm, Calderglen Associates, in September 2017.

An updated summary of the Retentions regime from the Retentions Bulletin #1 is reprinted below.

The retention regime – in summary

The regime incorporates the following last-minute changes that were introduced via the Regulatory Systems (Commercial Matters) Amendment Bill (RSB):

- The regime applies only to retentions on contracts renewed or entered into on or after 31 March 2017
- Payers must, by default, hold retention money on trust in the form of cash or other liquid assets that are readily converted into cash, but may elect instead to obtain a “financial instrument” such as insurance or a payment bond to provide third party protection.

The following is a brief summary of the provisions of the retention regime, with references in subscript to the relevant sections of the Act. A full copy of the Act including all amendments may be downloaded free of charge from: <http://www.legislation.govt.nz/act/public/2002/0046/latest/DLM163059.html?src=qs>.

References in the Act to “Party A” and “Party B” are substituted with “payer” and “payee” respectively.

Retentions (“retention money”) definition and application

- The retention regime aims to provide protection for retention money CCA Subpart 2 Part 2A.
- Retention money is broadly defined s18A as “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”. It effectively covers any amount withheld or payment arrangement that acts as a retention.
- As no minimum (*‘de minimis’*) amount has been specified in regulations s18B(2), the regime applies to retentions on all new, or renewed, contracts from 31 March 2017 s11A(3).
- As the regime applies only to “commercial construction contracts” s18B(1) it effectively covers all contracts or subcontracts, other than those directly with “residential occupiers”.

Protecting retentions

- There are now two ways for payers to protect the retention money that they withhold from their payees:

Default arrangement – retention money must be held on trust

- Retention money must be held “on trust”^{s18C(1)} in the form of “cash or other liquid assets that are readily converted into cash”^{s18C(2)}.
- The retention money held on trust does not need to be paid into a separate trust account, and may be mixed with other money in the payer’s accounts^{s18E(2)}.
- Proper records must be kept of all transactions^{s18FC}.
- The trust status of the retention money ends only when the retentions are paid out, the payee gives up its claim, or when the money otherwise is no longer payable under the contract or by law^{s18C(3)}.
- Retention money held on trust is not available for payment of the payer’s debts and cannot be taken by a receiver or liquidator^{s18FA}.
- Retention money can only be used by the payer to remedy defects in the payee’s performance of its contractual obligation^{s18E(1)}.
- Retention money may be invested at the payer’s risk in accordance with the Trustee Act 1956^{s18F}.
- The payer must pay all costs in administering any trust^{s18(1)(c)}.

Alternative arrangement – retention money may be protected by a “complying instrument”

- The payer does not need to hold retention money on trust to the extent that there is a complying financial instrument^{s18C(1A), s18D} such as a bond or guarantee^{s18FB(5)}.
- The instrument must:
 - Be issued by a licensed insurer or registered bank^{s18FB(2 & 8)}.
 - Be issued in favour of, or endorsed with the interest of, the payee^{s18FB(3)(a)}.
 - Require the issuer to pay retention money to the payee if the payer fails to pay when contractually due^{s18FB(3)(c & d)}, provided that the payee complies with reasonable terms and conditions in making such claim^{s18FB(6)}.
- The payer is responsible for ensuring that all premiums are paid and up to date^{s18FB(4)}.

Requirements for accounting and records

- The payer must keep proper accounting and records of all retention money^{s18FC(1)}, that comply with generally accepted accounting practice, are auditable, and which show:
 - All retention money held on trust
 - All retention money protected by “instruments”
 - All dealings and transactions in relation to retention money or instruments.
- The payer must keep proper and readily verifiable records of all instruments^{s18FC(2)}.
- The payer must make records of accounting and instruments freely available to payees at all reasonable times^{s18FC(4)}.

Interest on late payment

- The payer will automatically be liable for interest at the contractual interest rate when retentions are released late^{s18G}.

Prohibited provisions of contracts

- Any term of a construction contract will automatically be void^{s18I} which:
 - Makes payment conditional upon anything other than the payee’s completion of its contractual obligations
 - Makes the retention release date later than the date when the payee has completed its contractual obligations
 - Requires the payee to contribute to the cost of administering any trust.

FREQUENTLY ASKED QUESTIONS (2)

1. Can main contractors offset retentions on what is owed to them by clients against what they owe to subcontractors?

No. The Act is clear that all retention money that is withheld by any payer in respect of a commercial contract entered into or renewed from 31 March 2017 must be held “on trust”.

2. Does say a 40 unit residential complex get defined as 'residential' or 'commercial' hence falling into the trust regime?

As there is no longer a “residential construction contract” the answer lies in the definitions at section 5 of the Act:

- A commercial construction contract is “a contract 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”.
- A residential occupier is “an individual who is occupying, or intends to occupy, the premises that are the subject of a construction contract wholly or mainly as a dwellinghouse”.

Consequently a Contractor who has a contract with a developer to construct a residential complex has a construction contract, as neither of the parties to that contract is a residential occupier. However a contractor doing fitout work for an individual apartment owner who occupies or intends to live in that apartment has a contract with a residential occupier, so the fitout contract would not be a commercial construction contract. Of course a subcontractor working for the contractor in either case has a commercial contract, neither of the parties is a residential occupier.

3. Most banks issuing bonds insert an on demand clause - would this trump any need to notify under the contract?

The Act refers to the retention bond as an “instrument”, and states:

18FB(3) The instrument must— (b) require the issuer to pay the retention money to party B if party A fails to pay that money on the date on which it is payable under the construction contract...

18FB(6) Nothing in subsection (3)(b) or (c) prevents the instrument from containing reasonable terms and conditions that relate to the manner or time in which party B must submit a claim.

A payer would be unwise to purchase a retention bond that was so open, as it could lead to the inappropriate calling-up of the bond. A payee should be required to demonstrate to the bank that the retention money is overdue, has not been paid, and that there are no reasons for the retention money not having been released.

4. Who will withhold the retention money on the trust regime? The Contractor or the Client / Owner?

Whoever withholds retention money from a payee must hold that full amount on trust:

- Any developer/owner/Principal withholding retentions from a contractor
- Any contractor withholding retentions from its subcontractors and suppliers
- Any subcontractor withholding retentions from its sub-subcontractors and suppliers

5. Retentions is only relevant to commercial projects and not residential projects. What about Mixed use projects?

The definition of a commercial construction contract merely distinguishes contracts with residential occupiers from all other construction contracts. In short, every contract is a commercial construction contract unless the client is a residential occupier (i.e. home owner). See also Q2 above.

6. Is the provider of bond instruments a third party accounting firm or a bank?

As to the provider of the bond instrument, the Act states:

18FB(2) The issuer of the instrument must be— (a) a licensed insurer: (b) a registered bank: (c) any other person, who is not an associate of party A, prescribed or within a class prescribed in regulations.

As no regulations have been under (c) any such instrument must be provided by a registered bank or licensed insurer.

The bond instrument is an option for payers who do not wish to hold retention money on trust.

section 18C:

18C(2) Retention money held on trust may be held in the form of cash or other liquid assets that are readily converted into cash.

7. Does GST on retentions need to be held?

This is a question for an accountant, but a layman's view suggests that in practice only the GST exclusive amount shown in payment schedules would be held on trust, and that the matter would only arise in the event of liquidation. As IRD hold the balance of any GST transactions, the payment by a liquidator of retentions held in trust to a subcontractor will be plus GST, and the company in liquidation would need to cashflow the GST component and claim it back from IRD. This will undoubtedly be a matter for the courts to deal with, particularly where the payer was hopelessly insolvent.

8. Why should principals and main contractors hold performance retentions when progress payments are assessed against performance?

It is difficult to say definitively why, but some parties may see it as a safeguard to enforce performance. In any event, the Act only provides security for retention money that is withheld, but does not advocate a view on the merit or otherwise of retentions.

9. Where bank funding is involved, does this mean the value of retentions should be drawn down and then held in a trust account?

Yes, except to the extent that the payer provides a bond instrument from a bank or insurer. There is no requirement to establish a separate trust account with an accountant or bank:

18C(2) Retention money held on trust may be held in the form of cash or other liquid assets that are readily converted into cash.

However the trust status of the retention money must be clear, auditable and traceable at all times:

18FC(1) [A payer] must keep proper accounting records of all retention money that— (a) correctly record— (i) all retention money held on trust; and (ii) all amounts of retention money protected by instruments issued for the purpose of this subpart; and (iii) all dealings and transactions in relation to retention money or instruments; and (b) comply with generally accepted accounting practice; and (c) are readily and properly auditable.

10. If retentions on subcontracts are released at Practical Completion, how is this handled if Partial Completion is delayed? For example, we have subcontracts in place (let's assume 20 subcontracts are in place with this provision) where 50% retentions are to be released at Practical Completion.

The 50% retention release is due for payment to subcontractors when practical completion is certified, so any delay will affect the due date for release. Note however that practical completion will not be relevant to the due date for releasing retentions to certain subcontractors, such as temporary works or early trades due to the prohibited provisions:

18I Prohibited provisions

(1) Any term in a construction contract is void that purports to— (a) make the payment of retention money conditional on anything other than the performance of party B's obligations under the contract; or (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;.....

(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.

It will therefore be important to document the criteria for retention release in subcontracts, and to ensure that the release mechanism or timing will not be voided by the prohibited provisions.

11. If the Head Contractor is delayed in achieving in Practical Completion (and accruing liquidated damages), does this mean the Contractor continues to hold the retentions of all 20 subcontractors (in trust) until Practical Completion is achieved, regardless of whether or not any single subcontractor is responsible for the delayed

Practical Completion? This is a concern expressed by several subbies – that their retention release may be delayed beyond their control due to Practical Completion being delayed.

Yes, if the issue of a practical completion certificate is the relevant date in the subcontract, as that is the date at which subcontract work which is integral with the overall contract work was certified as complete. See Q10 above.

It's important to distinguish between the "due date for completion" and the actual date at which "Practical Completion" is achieved and has been certified. However where a Principal has occupied and is using a facility prior to practical completion, and there are no notified deficiencies in a subcontractor's work, it is arguable that the subcontract work is complete and retentions should be released as if practical completion had been achieved. Examples like this will provide the acid test of the prohibited provisions under section 18I.

12. I'm in the process of negotiating the conditions of contract on a residential design build project where the Principal is a Family Trust. In this instance is a family trust able to hold retentions?

Yes, the Act doesn't interfere with a payer's entitlement to withhold retentions. Therefore a family trust, like any other payer, is entitled to withhold retentions if so provided in the contract. The more important consideration is whether those retentions are subject to the statutory trust obligation.

While the definition of *residential occupier* doesn't mention family trusts, section 31(1)(b) provides a clue as it prohibits charging orders where the trustees live or intend to live in the house that is the subject of the construction contract. If this means the trustees have "residential occupier" status they would not have to comply with the trust obligation.

Contracts with family trusts deserve special consideration. First, the trustees should be personally named as parties and signatories to any contract with a family trust, as they (rather than the trust) will be personally liable for any debt arising under the contract.

Retentions are less common in residential construction, although they are often withheld where contracts are supervised by architects, but they don't enjoy the statutory protection afforded to *commercial construction contracts*. Consequently residential building contractors should now be expected to require the homeowner/Principal (including any family trust) to hold any retention money in a separate trust account.

Where do I get further information?

If you are a payer you should take specific advice from your accountant, lawyer and bank in order to ensure that you comply with the regime and can meet your cashflow requirements. The Ministry of Business, Innovation and Employment also has information on the retentions regime.

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Disclaimer

The changes to the retentions regime are new and therefore the above information is preliminary and may be subject to change. This document is for general information purposes only and is not intended as specific legal or accounting advice. We recommend that each company and its directors obtain specific legal and accounting advice before taking steps towards complying with the new regime. While all reasonable care has been taken in creating this document we do not give a warranty of reliability of accuracy or accept responsibility for any errors or omission.