

## Hon Dr Megan Woods

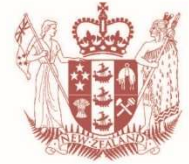
MP for Wigram

Minister of Housing

Minister of Energy and Resources

Minister for Building and Construction

Associate Minister of Finance



# Legislative Statement: Construction Contracts (Retention Money) Amendment Bill Second Reading

## Overview

The Construction Contracts (Retention Money) Amendment Bill (the Bill) amends the Construction Contracts Act 2002 (the Act) to strengthen and clarify the retention money regime by:

- clarifying that retention money is held on trust by party A for the benefit of party B, and requires it to be kept separate from other money or assets;
- clarifying that money becomes retention money as soon as possible;
- requiring retention money to be held in a separate bank account in a registered bank in New Zealand or in the form of complying instruments (such as an insurance policy or a guarantee);
- requiring party A to give information about the retention money to party B when the money is first retained and then at least every three months;
- introducing offences and penalties for the company and its directors for not complying with these requirements; and
- clarifying that if party A becomes insolvent, the receiver or liquidator becomes trustee of the retention money for the purpose of collecting and distributing it, and are entitled to be paid reasonable fees and costs for doing so.

Retention money is an amount withheld by a party to a construction contract (party A, a “payer”, for example, a contractor) from an amount payable to another party to the contract (party B, a “payee,” for example, a subcontractor), as security for performance of party B’s obligations under the contract. Retention money is commonly between two and ten per cent of the contract and is often paid after 12 months, following the expiry of the defects liability period.

The holding of retention money is voluntary and forms part of the security to ensure that a subcontractor fixes any defects with their work.

The changes to the existing trust requirement will also clarify how retention money being held under the Act must be held and can be used. There have been instances where head contractors have used retention money as working capital (i.e. as part of the money used for everyday business). The use of retention money as working capital can add additional financial risk for businesses. For example, if a head contractor becomes insolvent before paying out retention money, there can be substantive financial loss for subcontractors. The strengthened trust requirement intends to mitigate the risks associated with the use of retention money as working capital.

The Bill complements a range of other work underway to lift construction sector performance, such as work being driven through the Construction Sector Accord’s Construction Sector Transformation Plan launched in 2020.

The Bill was introduced on 1 June 2021 and was referred to the Transport and Infrastructure Committee (the Committee). The Committee received 42 written submissions and heard seven oral submissions on the Bill. The Committee reported back with recommendations on the Bill on 25 November 2021.

### Changes to the Bill proposed by Select Committee

Many submitters supported the Bill and its intent. Some submitters also recommended changes in the Bill to further improve the effectiveness and workability of the Bill.

Twenty-two changes to the Bill were recommended as part of the departmental report. The recommended changes were unanimously endorsed by the Committee and are incorporated into the Bill that was reported back to the House. These changes are:

- Submitters' wanted more clarity in the Bill regarding when an amount becomes retention money and when the resulting trust over retention money arises. **New section 18B(2)** clarifies that money becomes retention money at the time at which the construction contract allows party A to withhold payment of an amount from party B;
- Submitters wanted clarity on when retention money is required to be deposited into a bank account. **New subsections 18D(1), (2) and (3)** clarify that retention money must be deposited into a complying bank account as soon as practicable after it becomes retention money under new section 18B(2), unless party A holds a complying instrument;
- Submitters raised concerns around the misuse of retention money for things other than remedying defects and asked for better safeguards. **New section 18D(4)** now requires party A to give party B written notice of their intention to use retention money to remedy defects in party B's contractual obligations before using retention money;
- Some submitters wanted the penalties to be higher. **New sections 18DA, 18FC, and 18FD** clarify that the newly introduced penalties attach to each instance of breach of retention money requirements. As a penalty attaches to each instance of breach, penalties could potentially add up to a significant sum;
- Submitters were concerned that penalties would prevent party A from using retention money to remedy defects when they were acting in good faith. An additional defence was added in **new section 18DA(3)** for party A and its directors having acted in good faith in using retention money as permitted by new section 18D(4);
- Submitters suggested that the definition of 'director' be aligned with existing legislation. **New section 18DA(4)** now aligns the definition of director with the definition in the Financial Markets Conduct Act 2013;
- A submitter wanted clarity on whether the Bill prescribes the use of a specific trust account bank product, **new section 18E(2)** clarifies that retention money does not need to be held in a formal trust account bank product;
- Submitters wanted third parties to be allowed to hold retention money as they may be in a better position to administer the account. Because it is not the intent of the Bill to exclude third parties from holding retention money, **new section 18E(3)** expressly allows retention money to be held by third parties (e.g. solicitor, trustee company, accountant, auditor);
- The Committee was concerned that there was a lack of clarity in how retention money is to be treated in cases of insolvency where there are unattributed withdrawals from or deposits to the retention money account. **New section 18EA** clarifies how unattributed withdrawals from or deposits into the retention money account are to be treated;

- Submitters raised concerns about releasing commercially sensitive information regarding their wider business in order to comply with the new reporting requirements. In response, **new section 18FC(6)** clarifies that party A only needs give party B information about retention money held for that party B;
- Submitters said it was unclear who would decide whether a trustee's fees are 'reasonable'. Submitters also suggested including provisions similar to those in the Companies Act 1993 and Receiverships Act 1993 which allow certain parties to apply to the Court to review costs incurred. **New section 18K(3A)** now enables party B or a new trustee to apply to the courts to fix or review the costs incurred from a previous trustee (e.g. liquidator or receiver);
- Two submitters raised confidentiality and commercial sensitivity concerns about the scope of information that a new trustee is required to provide party B. In response, **new section 18K** clarifies that the new trustee is only required to provide party B with the same information they are required to provide unsecured creditors;
- Submitters wanted clarity around new trustees' liability where there have been multiple insolvency appointments. **New section 18K** clarifies that subsequent trustees are not liable for previous trustees' actions;
- Submitters suggested that an automatic change of trustee occurs where the liquidator, receiver or other appointed officeholder is replaced. This is to provide for situations where there are multiple insolvency appointments. **New section 18L** clarifies that when a liquidator or receiver (or other officeholder) is replaced, an automatic change of trustee occurs (i.e. it is not necessary to apply to the courts for a change in trustee);
- The Bill also includes a range of minor and technical amendments to the Act.