GreenwoodRoche
PROJECT LAWYERS

News & Insights

Retentions Regime to be Strengthened

The Government recently proposed to introduce changes to the Construction Contracts Act (*CCA*) seeking to strengthen the retentions regime. The Construction Contracts (Retention Money) Amendment Bill (*Bill*) proposes a number of clarifications and requirements on the retention regime under the CCA. We run through the main elements of the changes.

What are retentions?

Retentions secure performance obligations under a construction contract. A retention is used as a form of security for a party such as a Principal to ensure that the other party (Contractor) performs its obligations under the construction contract. Retentions are generally held until final completion or until the end of the defects liability period.

Issues have arisen where the party holding a retention (*Party A*) has become insolvent, and the party whose funds are being held (*Party B*) is left unable to access those funds due to the being comingled with the holding party's other funds.

The Bill purports to deal with these types of scenarios.

Key Proposed Changes

If the Bill passes in its current form, it would mean any party holding a retention, Party A, must hold that retention:

- as soon as possible, either:
  - in a separate bank account or accounts at a registered bank in New Zealand; or
  - in the form of a complying instrument (such as a guarantee or insurance policy) that requires an insurance company or a bank to pay to Party B an amount equal to the retention money if Party A does not pay the retention money to Party B when required by the construction contract;
- on trust (thereby placing fiduciary obligations on Party A as a trustee);
- with adequate recording measures; and
- along with updates to Party B on the status of the retention every three months after first advised.

The aim of this change is to ring-fence the funds ultimately due to Party B after final completion so that they cannot be used by Party A for daily business.

The Bill reiterates that all common law rules and equity doctrines apply to the fiduciary relationship between the parties. Party A must act in the best interests of Party B, and Party A cannot use retention funds for any purpose other than to remedy any defects in Party B's performance or payment obligations.

Importantly, as retentions will be subject to a trust, they cannot be used by a liquidator or receiver to meet Party A's other debts, thereby protecting Party B from Party A's creditors. If Party A becomes insolvent, the liquidator or receiver becomes the trustee of the retention.

Party A must keep all of Party B's retention money under a particular contract in the same account. While there can be other retention money in that account, the bank account cannot be used for any other purpose. If a single account is used for multiple parties' retention funds, Party A must keep proper accounting records showing to which party and which contract each payment into or out of the account was made. If Party A becomes insolvent, the liquidator or receiver must continue to collect, manage, and disburse the retention as if they were Party A.

Consequences of non-compliance

There are severe consequences if the above process is not followed. Failure to comply is an offence, with a maximum penalty of up to $200,000 for the company and $50,000 for each director. It will be a defence to prove that: (a) Party A took all reasonable steps to ensure that it complied with its obligations, or (b) if the defendant is a director, they took all reasonable steps to ensure that Party A complied with its obligations.

What next?

If implemented, the legislation will provide construction companies with strict but clear guidelines on how they need to treat retentions while providing reassurance to contractors that the funds will not be misused – or at least that sanctions exist if they are. From there, it is up to the contracting parties to decide whether this is the best form of security and incentive for the applicable contract works, taking into account the cost of administration and risk.

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