# CHANGES TO THE CONSTRUCTION CONTRACTS ACT 2002

**By Nick Gillies on 19 February 2015**[1]

## Introduction

Since its introduction twelve years ago, the Construction Contracts Act 2002 (**CCA**) has become a cornerstone of New Zealand's construction sector. The CCA followed similar statutory interventions in the UK and NSW by seeking principally to redress the perceived power imbalance between principals and contractors and between contractors and subcontractors.

As New Zealand enters a period of significant construction activity, a number of changes to the CCA are in the pipeline. These are designed to improve and broaden the reach of the CCA. This paper summarises those changes and their impact on contractors and consultants.

**Executive Summary / Practical Considerations**

- The proposed changes to the CCA are intended to advance the CCA's aims of promoting cashflow and providing a quick and inexpensive dispute resolution process. Once they come into force (most likely in late 2015), they will have the effect summarised below.
- The distinction between residential and commercial construction contracts will be largely dismantled. This means contractors undertaking residential projects will be able to suspend work for non-payment, and adjudication determinations will be enforceable. Residential contractors will also have available the default progress payment provisions if their contract is silent on this. However, the prohibition on fast-track charging orders under residential construction contracts will remain.
- The CCA will extend to design, engineering and quantity surveying work. Consultants undertaking such work will have the benefit of the default progress payment regime (if their agreement is silent on this), and disputes under their agreements will be referable to adjudication. In preparation for this, consultants should:
  - Revisit their standard terms and payment systems to make sure they are in line with the CCA;
  - Educate relevant staff on adjudication, and introduce adjudication protocols; and
  - Consult with their insurance broker about any changes that might need to be made to their PI policy, especially in relation to adjudication claims.
- Parties referring any dispute to adjudication will need to include a statement of the respondent's rights and obligations and a brief explanation of the adjudication process, and will need to wait two days before asking a nominating body to select an adjudicator.
- Respondents will more easily be able to obtain an extension for their response, but this must be requested within five working days of receiving the adjudication claim.
- Unsuccessful parties will have only five working days (compared with 15 currently) to oppose a determination being entered as a judgment.
- Retention monies will be required to be held on trust. The specific details are still awaited.

[1] With assistance from Mary Battersby, a solicitor at Hesketh Henry.

**Background to the CCA and its amendments**

The CCA's key drivers are promoting cashflow and reducing the time and cost of resolving construction disputes. It aims to achieve this by:

(a) Eliminating pay-when-paid clauses;

(b) Facilitating regular and timely payments by creating default progress payment provisions;

(c) Providing for the speedy resolution of disputes through adjudication; and

(d) Granting special remedies for recovering payments under construction contracts.

For the most part, the CCA has been a success. However, a number of drafting and procedural deficiencies have become evident over time. It was also a somewhat timid first step in that, for example, many important features of the CCA do not apply to residential construction contracts and consultants were excluded altogether.

In 2009 the Government undertook a review of the Building Act 2004. Submitters identified areas where the CCA could be amended to help further support the Building Act 2004 and improve industry efficiencies. This led to a dedicated ministerial review, and ultimately the introduction of the Construction Contracts Amendment Bill (**Bill**), which is currently before Parliament.

The Bill received its first reading in 2013 and revisions were recommended by the Commerce Committee later that year. The Bill was expected to come into force on 1 November 2014. However, its progress has been delayed by the 2014 general election and the Government's policy decision to include a requirement that retention monies be held on trust. Current indications are that the Bill should receive its final reading within the next few months and come into force in late 2015.

**Overview of the proposed changes**

The key changes proposed in the Bill will:

(a) Remove most of the distinctions between residential and commercial construction contracts;

(b) Extend the scope of the CCA to contracts for design, engineering and quantity surveying;

(c) Improve the enforcement of adjudication; and

(d) Require retentions to be held on trust.

In addition, there are a number of other more minor amendments, which will clarify and improve processes under the CCA, make technical and drafting corrections, and give the Government information-gathering powers in relation to adjudications.

The proposed changes are discussed in more detail below, including the policy drivers that lie behind them, and the implications for consultants, professional indemnity insurers and others in the industry.

**Residential and commercial construction contracts**

Currently, the CCA draws a distinction between residential and commercial construction contracts. All aspects of the CCA apply to commercial construction contracts, whereas the following parts of the Act are excluded for residential construction contracts:

(a) The default progress payment provisions;

(b) The right to enforce an adjudication determination;

(c) The right to suspend work for non-payment or non-compliance with an adjudication determination; and

(d) The right to a fast-track charging order over the construction site.

When the CCA was first conceived, Parliament worried that contractors might use the newly-available rights and remedies to 'take advantage' of homeowners. To guard against this, the exclusions outlined above were incorporated into the Act.

However, this distinction was ill-founded and artificial, and has rendered the CCA largely toothless in relation to residential projects. The exclusions provide little or no incentive to adjudicate and have left residential contractors with fewer remedies for non-payment. Parliament wrongly assumed that commercial consumers are more sophisticated, better resourced and have greater access to professional advisors than residential consumers. In fact, many residential construction contracts involve significant sums and contractors are often subject to the same risks as in commercial projects.

Happily, this distinction is to be removed (with one exception). This will mostly benefit contractors to residential projects, who will have available the default progress payment regime (if their contract is silent on this) and the additional remedies for non-payment. The ability to enforce an adjudicator's determination will make adjudication more attractive, which is of benefit to both homeowners and contractors.

To ameliorate the risk of ambush adjudications (especially to homeowners) the Bill also introduces some additional 'safety measures' (eg longer time periods, prescribed information, etc), which are discussed separately below.

Charging order exception

The one remaining exception relates to charging orders.

A charging order is a Court order that can be registered against the title to land to prevent the land being sold until the basis of the charging order (usually non-payment) is satisfied. Under the CCA, a party who successfully obtains an adjudication determination requiring the owner of a construction site to pay them a sum of money can obtain a charging order. This is a much faster process than if a charging order was sought through the Courts. However, it is only available under the CCA for commercial construction contracts, and that distinction is to remain.

The charging order exception has been driven by consumer protection considerations – namely, fear that a homeowner could default on their mortgage if a charging order was lodged against their home. However, it is difficult to see why residential owners are more deserving of protection when commercial owners may face the same risk for non-payment.

To come within this exception, the owner must occupy or intend to occupy the house, which would exclude investment properties, for example. The description of residential owners is to be widened under the Bill to include family trusts, which has been one of the anomalies under the CCA.

**Architects, engineers and quantity surveyors**

The proposed amendments will extend the CCA to design, engineering and quantity surveying work (**related services**), all of which are currently excluded from the definition of "construction work". This will directly affect architects, engineers, quantity surveyors and other consultants undertaking this type of work.

By extending the CCA to related services, the default payment provisions in the CCA will apply to these services where the contract is silent on this. In practice, most consulting agreements already include specific provisions about payment. Nonetheless, consultants should revisit their standard terms and payment systems to make sure they are in line with the CCA before the Bill comes into force. This includes being ready to issue compliant payment claims and, where applicable, payment schedules, and understanding the implications of failing to do so under the CCA.

The exclusion of related services from the CCA was driven by concern, fueled by professional bodies for engineers and architects, that negligence claims would be adjudicated and that the relationship between clients and consultants differed from the relationship between clients and contractors. Similar submissions have been made in opposition to the Bill.

In my view, the concerns about professional negligence claims are misplaced. The ability to adjudicate disputes should, in fact, be welcomed by consultants, who have previously been without the benefit of a fast and inexpensive dispute resolution process, especially in relation to fee claims and other discrete issues.

The Bill deliberately does not limit the type of disputes that can be adjudicated. This is to avoid unnecessary and distracting jurisdictional arguments. While that is sensible, it does leave open the possibility of adjudication being used in inappropriate cases.

Professional negligence claims, because of their inherent complexity, are not normally suited to adjudication. In most cases, a consultant would be unable to marshal the necessary material within the timeframes permitted under the CCA, and the adjudicator would be similarly constrained in reaching his or her determination. The situation would be compounded by the obligation to notify PI insurers and obtain their consent in relation to defending professional negligence claims. As a result, consultants could theoretically find themselves on the losing end of an adjudication determination, which is then enforceable until the matter is re-heard by a judge or arbitrator. That is the scenario that consulting professional bodies have been concerned about.

However, the risk of that is probably more perceived than real, and is outweighed by the benefit of having adjudication available in appropriate cases. There are several reasons why professional negligence claims are probably unlikely to be adjudicated:

(a) The Bill introduces a 'safety valve', whereby an adjudicator can grant the respondent an extension if the size and complexity of the claim require this, or if they believe the claim has been served with "undue haste" and the "respondent has had insufficient time to prepare his or her response". Quite how this will work in practice remains to be seen, particularly when it often takes many months if not years to hear a negligence claim, which is anathema to the concept of adjudication. Nonetheless, the likelihood of extended timeframes undermines the strategic benefit of adjudication and should act as a deterrent;

(b) Adjudication would only increase costs and cause delay because of the near certainty that the determination would be litigated or arbitrated;

(c) Enforcement steps would probably be required to enforce what is ultimately only an interim decision, which would consume more time and money;

(d) The inability to join other culpable parties as co-defendants is likely to be a significant deterrent in many cases; and finally

(e) UK experience suggests that professional negligence claims are rarely adjudicated and, on those few occasions, are almost always re-heard by the Courts.[2]

As currently drafted, this amendment will only affect contracts for related services that are entered into or renewed 12 months after the Bill has come into force. This gives consultants a grace period in which to make any necessary changes to their business practices.

Consultants are recommended to educate their staff on adjudication, including the types of circumstances where adjudication might be appropriate. Consultants should also have in place clear protocols for immediately notifying the relevant personnel if an adjudication is received, and the steps to be followed internally before referring a dispute to adjudication (see next).

[2] For example: *Whyte & Mackay Ltd v Blyth & Blyth Consulting Engineer Ltd* [2013] CSOH 54, *Gillies Ramsay Diamond v PJW Enterprises Limited* (2002) Court of Session, and *London & Amsterdam Properties Limited v Waterman Partnership Limited* (2004) BLR 1799.

Consultants are also advised to consult their broker about any changes that might be needed to their PI policy. Most policies stipulate that no material steps are to be taken by the insured in relation to a claim without the insurer's consent. However, the short timeframes for responding to an adjudication may make this difficult. This can be addressed, for example, by including in the policy a specific notification procedure for adjudications. A further consideration is the risk that pursuing adjudication (eg over a fee claim) will prompt a retaliatory negligence claim. If this is possible, it is best to notify PI insurers and get their consent *before* starting an adjudication. Again, this can be covered in the policy terms if necessary.

**Enforcing adjudication determinations**

The Bill extends and improves the enforcement of adjudication determinations in two important ways.

First, all adjudication determinations will be enforceable. Currently, only those regarding payment can be entered as a court judgment or confer a right to suspend works. Determinations about the parties' rights and obligations under the construction contract are not presently enforceable. This has been another misguided distinction within the CCA, which has meant that a successful party's only option is to have the dispute re-heard in litigation or arbitration.

This amendment reflects confidence in the performance of adjudicators after 12 years (especially in those nominated by an authorised nominating body), and it recognises the commercial benefits of a 'quick and dirty' dispute resolution process. Few cases go beyond adjudication, with most parties willing to live with the result. The amendment goes hand-in-hand with extending the CCA to related services.

Second, the time that an unsuccessful party has to oppose an application to have a determination entered as a judgment will be reduced from 15 to 5 working days. Once entered as a judgment, the determination can be enforced like any other Court order. The change means an unsuccessful party must move quickly if it wants to oppose this.

The aim of this amendment is to speed up the time in which payment can be enforced and reduce the risk that the defendant liquidates or absconds to avoid judgment. Some submitters proposed an even shorter period or none at all, so five days was viewed as a compromise.

The grounds on which a defendant can oppose a determination being entered as a judgment are very limited - namely: the amount has been paid, the contract was not a 'construction contract' or a condition in the determination has not been met. The Bill will add a further ground: where the defendant cannot comply with the determination due to a change in circumstances beyond their control. This is partly to ameliorate the fact that determinations about rights and obligations will be enforceable. The inclusion of this further ground is regrettable because it provides scope for argument as to whether non-compliance is in fact outside the defendant's control. It also misunderstands construction contracts, which invariably include a mechanism for extending time where the contractor is prevented from performing the works, otherwise time may be put 'at large'.

**Retentions**

The select committee report in 2013 noted that MBIE was investigating problems with retentions, particularly following the collapse of Mainzeal, which had been holding $18m in subcontractor retentions. However, there was no intention then that any solutions would be included in the Bill.

Growing political pressure, including two supplementary order papers by opposition MPs, eventually led the National Government to announce shortly before the general election that it would be imposing trust obligations on retention monies to prevent them being used for other purposes. Those changes will now be included within the Bill, and the drafting for this for this is currently awaited.

Retentions are a portion of the contract price (usually 5-10%) that is withheld for a period following completion of the works (often 12-24 months), which is often known as the 'defects liability period'. The retention is paid at the end of that period provided any defects that had arisen have been remedied. The issues with retentions include a lack of security in the event of insolvency, excessive

retention sums and defects liability periods, and the use of retentions by principals and contractors as working capital, which is inappropriate and masks poor performance.

At this stage the Government favours a 'deemed trust' model – ie trust monies are deemed by law to be held on trust for the benefit of subcontractors, with no obligation to keep them separate. This is preferred because of its flexibility, light intervention and low compliance costs. The alternative would be to require retentions to be held in a separate trust account or lodged with a statutory trustee.

If retentions are not segregated, their trust status may be of little help to unsecured contractors in an insolvency situation where there are insufficient funds plus inevitable difficulties tracing retention monies. Therefore, it would not be surprising if the Government ultimately changes tack and requires the funds to be ring-fenced. As a comparison, NSW recently opted for a statutory trustee regime.

To discourage non-compliance, the suite of changes for retentions are expected to include penalties where retentions are misused or the trustee obligations are otherwise breached, default interest on the late payment of retentions, and clarification that pay-when-paid clauses are prohibited (just as they are for other payments under the CCA).

One consideration that has received little attention is the common practice of principals and contractors raising a claim and asserting set-off prior to the due date for paying retentions. This often results in the contractor or subcontractor making a concession on the retentions, sometimes with the 'carrot' of future projects. Trust status is unlikely to stop this, other than possibly preventing either party from using the funds until a resolution has been reached.

**Other proposed amendments**

The other proposed amendments of note include:

(a) The definition of "construction site" will include land where construction work is to be carried out but has not yet started. This reflects the fact that designers, engineers and quantity surveyors sometimes undertake work before construction has begun, and they should not be denied the ability to obtain a charging order in such circumstances.

(b) The Bill clarifies that the "claimed amount" in a payment claim can include liquidated damages and damages for breach of implied warranties under the Building Act 2004, in addition to the amount for construction work carried out.

(c) All payment claims (not just those under residential construction contracts) will need to be accompanied by an outline of the process for responding and an explanation of the consequences of not doing so. This is arguably overkill for parties to a commercial construction contract. A failure to include this information could potentially render a payment claim non-compliant or at least expose the payee to that argument.

(d) To reduce the perceived threat of ambush adjudications:

    (i) All adjudication notices (not just those served on residential occupiers) will need to include a statement of the respondent's rights and obligations in the adjudication and a brief explanation of the adjudication process. This information must be set out prominently and in the form prescribed in the Construction Contracts Regulations 2003.

    (ii) If the parties cannot agree on an adjudicator, the claimant will not be able to ask a nominating body to select one for them until at least two working days after the adjudication notice has been served. This was a select committee initiative to create a "pause in the process" so as to limit the ability of a claimant to rush adjudication for tactical reasons.

    (iii) An adjudicator's notice of acceptance will need to contain information and be in the form prescribed in regulations made under the CCA. Such regulations are yet to be made, but are likely to require that the notice set out all relevant time frames, identify which

timeframes have already commenced, and note those the respondent can ask the adjudicator to extend.

(iv) Adjudicators "must" allow respondents additional time to respond if they consider this is "necessary": (1) based on the size and complexity of the claim, or (2) if the adjudicator believes the claim has been served with "undue haste" and the "respondent has had insufficient time to prepare his or her response". An extension will need to be requested by the respondent within five working days of receiving the adjudication claim.

While the desire to limit ambush claims might be laudable, slowing down and extending the process is inconsistent with aim of adjudication (ie a 'quick and dirty' resolution). Claimants undoubtedly have more time to prepare their case. Nonetheless, adjudications do not normally arrive out-of-the-blue; there is usually a long history of correspondence and escalation between the parties up to that point. As a result, the new measures at (ii) and (iv) above may be counterproductive and may be used by respondents to delay and frustrate the process.

(e) Claimants will have an automatic right to reply within five working days of the response. The adjudicator is entitled to refuse to consider any new material or issues in the reply, and may allow the respondent two working days to serve a rejoinder. This is sensible and simply codifies the common law position.

(f) Adjudicator's determinations will have to be dated. Most already are.

(g) MBIE will be empowered to collect from adjudicators and nominating authorities/bodies information regarding adjudications (eg the number, nature and outcome) for statistical or research purposes. Safeguards are included to preserve confidentiality, unless the determination is already in the public domain (eg through the Courts). The policy intent behind this new power is to help the Government assess whether effective contracting practices are being used and whether disputes decrease as a result of these and other reforms that are currently being made to building sector. One of the limitations in the review that led to the Bill was a lack of data on adjudications and their effectiveness.

Finally, the expected changes will only apply to construction contracts that are entered into or renewed after the Bill comes into force, although consultants may get an additional 12 months.

**Conclusion**

These amendments will remove unnecessary distinctions within the CCA and make other technical improvements. Homeowners, contractors undertaking residential projects and consultants providing related services will be particularly affected by the changes and largely in a positive way.

The requirement for retentions to be held on trust is the most significant amendment for the industry as a whole. The exact details of this are still awaited, including whether retentions are to be ring-fenced in a separate trust account, or simply deemed to be held on trust (as is currently favoured). The proposed wording should be available within the next few months.

Hesketh Henry will provide a further update once the amendments are all finalised and the date on which they come into force is known. We would be happy to discuss any issues that firms may have in the course of preparing for these changes.

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