RETENTIONS REGIME: ON THE ROAD TO REPAIR
Government Introduces Amendment Bill to Fix Shortcomings

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Introduction

The retentions regime in the Construction Contracts Act 2002 (**CCA**) is on the road to repair with the introduction of the Construction Contracts (Retention Money) Amendment Bill (**Bill**) on 1 June 2021. The Bill has passed its first reading and has now been referred to the Transport and Infrastructure Select Committee for consideration. Public submissions are invited by 23 July 2021.

The shortcomings with the retentions regime are well known and were exposed by Ebert Construction's failure in 2018 (we have covered these in earlier articles which are linked further below). The Bill is therefore welcomed and MBIE appears to have largely listened to the industry's feedback.

Highlights

- **Automatic Trust:** Retentions would be automatically held on trust as soon as an amount becomes retention money, regardless of any payment or other steps taken.
- **Retentions Account:** Retentions would need to be kept in a dedicated retentions account, and could only be co-mingled with other retentions. Proper accounting records to be kept.
- **Reporting Obligations:** The retentions holder would need to provide prescribed information about how/where retention money is held at the outset and at least every three months.
- **Offence/Penalties:** Breaching the regime would be an offence, with a fine of up to $200,000 for the holder and $50,000 for the holder's directors. "Directors" is widely defined.

Proposed Changes

See our **Quick Guide** below to the proposed changes under the Bill, which we discuss in more detail next.

Trust establishment

The current regime requires a holder to take active steps to create a trust over retention money. However, as Ebert's collapse illustrated, a failure to do that leaves retentions unprotected, which defeats the very purpose of the regime.

Under the Bill, that requirement would be swept away. In its place, a trust would be automatically created (i.e. deemed) as soon as an amount becomes retention money. In practice this would usually arise when a payment schedule is issued. However, presumably to avoid technical arguments about when the trust arises, the Bill says it is not contingent on issuing a payment schedule, calculating retentions, making a (part) payment, or setting aside of money.

Retentions account

It would be mandatory to hold all retention money in a dedicated retentions bank account. This could be a single account (for multiple parties/contracts) provided ledger accounts are kept to track the amounts held for each party and contract. Happily, MBIE appears to have abandoned their initial intention to require separate accounts for each party or contract.

Consistent with this, the Bill introduces new (and for the most part more prescriptive) requirements for notifying the bank, naming the account, and maintaining accounting records. Where the Crown holds retention money, however, the Public Finance Act 1989 would apply instead.

Gone would be the ability to co-mingle retentions with working capital, hold retentions in the form of other 'liquid assets', or to invest retention money. However, the holder would be able to keep any interest earned on the retentions money (i.e. interest would not be subject to the trust).

Alternative instruments

The alternative "complying instruments" (i.e. a bank bond or insurance policy) are retained. However, the record keeping requirements for these would be more prescriptive and they too would be subject to the new reporting obligations (see next).

Reporting obligations

The existing obligation to make retention records available on request and without charge remains. However, this would be strengthened by a new proactive reporting requirement, which is designed to provide transparency and comfort that retentions are being held in compliance with the regime.

Under the Bill holders would need to report to recipients "as soon as practicable" after an amount becomes retention money, and then at least every three months after that. Summarising, each report must include the amount withheld, the total retentions held for that party under each contract, the retentions account/instrument details, and a statement that the recipient can inspect the accounting and other records kept.

Under the Bill a payment schedule would also need to include the same reporting information.

Penalties

The current regime is largely 'toothless', with no readily available sanctions or remedies for non-compliance, especially when the holder becomes insolvent. Addressing this, the Bill introduces statutory penalties.

Breaching the new regime would be an offence, attracting a fine of up to:

a $200,000 for the holder (or $50,000 for a breach of the reporting obligations); and

b. $50,000 for a director of the holder.

Significantly, "director" is defined widely. It includes a named director, someone who otherwise exercises the powers of a director (i.e. a shadow director), someone with delegated responsibility, and someone who gives directions or instructions to directors/shadow directors/delegated persons.

Nonetheless, a holder or a "director" would have a defence if they "took all reasonable steps" to ensure compliance.

Insolvency administration

Currently, in an insolvency a liquidator or receiver needs a court order to administer retentions held on trust because the CCA is silent on this. The Bill plugs that gap by making a liquidator or receiver the trustee of retentions upon their appointment, empowering them to administer the retentions, and permitting them to deduct their reasonable fees and costs from the retention trust money. A liquidator/receiver cannot refuse to become the trustee, and can only be replaced by the court.

Application and commencement

As drafted, the changes would not take effect until six months after the Bill becomes law to give the industry time to prepare. At that six month mark:

- The *insolvency provisions* would apply to <u>all</u> commercial constructions contracts, regardless of when they commenced; and
- The *other changes* would apply to all commercial construction contracts <u>commenced</u> (or curiously "amended") on or after that date.

Initial comments and what comes next

The present regime's issues have been highlighted by the financial difficulties suffered by those who are meant to be holding retentions on trust. The Bill goes a long way to addressing those issues. The deemed trust, separate retentions account, proactive reporting obligations, insolvency administration measures, and penalties are all sensible, and the Bill is a noticeable improvement on MBIE's first draft last year.

As a result, we do not expect wholesale changes. However, there is likely to be some fine tuning. For example, there may be some push-back to the potential exposure for employees with delegated responsibilities from the proposed definition of

"director". It is also questionable whether the Crown should be subject to separate accounting requirements, rather than having a consistent approach across the industry.

Further, there is also no indication that regulations will be passed specifying an interest rate for late payment of retentions, setting a *de minimis* threshold before the regime applies, or requiring other accounting information be provided. The Bill is also silent on whether the trust applies to the GST amount on a retention sum.

Previous Articles

See our previous commentary on the Retentions Regime:

Retentions Regime: Government Announces Changes

Administration of Retentions Trust: *Oorshot v Corbel Construction*

Ebert Construction: Court provides Guidance on the Retentions Regime

Ebert Construction: Receivership and Liquidation

Ebert Construction: What you need to know

Clarification of retentions requirements for construction contracts

Changes to the Construction Contracts Act 2002

If you have any questions about the Bill or retentions generally, please get in touch with our Construction Team or your usual contact at Hesketh Henry.

Disclaimer: The information contained in this article is current at the date of publishing and is of a general nature. It should be used as a guide only and not as a substitute for obtaining legal advice. Specific legal advice should be sought where required.

QUICK GUIDE – RETENTIONS REGIME BILL: In, Out, Staying

What would be IN
Automatic (deemed) trust over retentions
Dedicated retentions bank account requirement
Retentions may be co-mingled in a single dedicated account, provided a proper ledger is kept
New requirements for notifying the bank and naming a retentions account
Modified accounting records requirements
Mandatory reporting obligations (initially and then at least every three months)
Payment schedules to include the same reporting information
An offence to breach the regime
Penalties of up to $200,000 for holders and $50,000 for 'directors' (widely defined)
Automatic insolvency administration measures
What would be OUT
Requirement to proactively 'hold' retentions on trust (per *Ebert*)
Co-mingling with other funds (including working capital)
Ability to hold retentions in other 'liquid assets'
Ability to invest retention money
Necessity for a liquidator or receiver to obtain a court order to administer retentions on trust
What would STAY
Regime applies only to commercial construction contracts
Retentions cannot be used for anything other than remedying defects
Interest on late payment of retentions per contract or rate in regulations (no regulations currently)
General requirement to keep "proper accounting records"
Alternative "complying instruments" (i.e. bank bond or insurance policy)
Obligation on holders to make records available for inspection without charge
Prohibition on contracting out of the regime