

## CCAA RETENTIONS REGIME – BULLETIN #1 - 1 - 24 March 2017

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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, comes into effect from 31 March 2017.

The industry was allowed a full financial year after the CCAA was passed to adjust its practices, but had to wait until late March 2017 before final details were revealed under the Regulatory Systems (Commercial Matters) Amendment Bill (RSB). The RSB passed its third reading on 24 March 2017, and should receive royal assent before 31 March 2017.

The RSB introduces the following key changes and clarifications to the CCAA as originally passed:

- 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.
- No further regulations are proposed.

### The retention regime – in summary

The following is a brief summary of the provisions of the retention regime, with references in subscript to the relevant sections of the Act. Some sections may be renumbered in the final printing of the Act. A full copy of the Act including all amendments may be downloaded free of charge from [www.legislation.govt.nz](http://www.legislation.govt.nz) when available, on or soon after 31 March 2017.

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 Part 2A.
- Retention money is broadly defined s18A as “an amount withheld by a [payer] from 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 obligations 18E(1).
- Retention money may be invested at the payer's risk in accordance with the Trustee Act 1956 18F.
- The payer must pay all costs in administering any trusts 18I(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 18D such as a bond or guarantee 18FB(5).
- The instrument must:
  - Be issued by a licensed insurer or registered bank 18FB(2 & 8).
  - Be issued in favour of, or endorsed with the interest of, the payee 18FB(3)(a).
  - Require the issuer to pay retention money to the payee if the payer fails to pay when contractually due 18FB(3)(c & d), provided that the payee complies with reasonable terms and conditions in making such claims 18FB(6).
- The payer is responsible for ensuring that all premiums are paid and up to date 18FB(4).

#### Requirements for accounting and records

- The payer must keep proper accounting and records of all retention monies 18FC(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 18FC(2).
- The payer must make records of accounting and instruments freely available to payees at all reasonable times 18FC(4).

#### Interest on late payment

- The payer will automatically be liable for interest at the contractual interest rate when retentions are released late 18G.

#### Prohibited provisions of contracts

- Any term of a construction contract will automatically be void which:
  - Makes payment conditional upon anything other than the payer'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

##### **What are retentions?**

The Act defines retention money as money withheld by a payer from a payee as surety for a payee's obligations under the contract. However other arrangements may be caught, such as a milestone payment arrangement under which 95% of the contract price is payable on completion, in which case the unpaid 5% would be a retention.

##### **Who is caught by the regime?**

The regime applies to every contract between an owner (whether a developer, public body such as a council, or government department and a builder), and to all subcontracts between builders and subcontractors; in effect anyone (other than a homeowner) who withholds retentions.

##### **Does the regime mean that retentions are now compulsory?**

No. The regime merely introduces new rules that will apply whenever retentions are withheld. It is more likely to discourage the withholding of retentions.

**Are existing contracts affected?**

No, the Act is not retrospective. The regime applies only to contracts or subcontracts renewed or entered into from 31 March 2017.

**Are housebuilding contracts affected?**

The regime does not apply to contracts with homeowners. However, it will apply to the subcontracts between residential builders and their subcontractors.

**Can residential builders agree with owners that the regime will apply?**

No. Residential builders working for homeowners cannot 'contract in' to the Act. However, they may require that retentions held by the homeowner are protected in trust account or escrow facility. That is a commercial decision for each builder to take.

**What does 'on trust' mean?**

The retentions deducted from payments belong to the payee from whom they are withheld, although they are not payable until they are properly due in accordance with the contract. They may be held in cash or other liquid assets that are readily converted into cash.

**Are accounts receivable a liquid asset?**

While certain categories of accounts receivable may qualify as a liquid asset they are constantly changing as amounts are paid, so even if they comply it may be impractical to rely upon them. Specific accounting advice would be required.

**Will the regime affect payers' cashflow?**

The general answer is yes. As cash or other assets under trust cannot be accessed by the bank or other creditors a payer's access to overdraft funding may be limited. A retention bond provided by a trading bank may have a similar effect on borrowing for working capital.

**Do builders have to protect the full amount of retentions withheld from subcontractors, or only the net difference between the amount withheld from subcontractors and the retentions withheld from clients upstream?**

The typical retention sliding scale means that builders generally hold more from their subcontractors than is held from them under the head contract. As the consensus view is that retentions held upstream will not qualify as a liquid asset, the payer must protect the entire amount of retentions withheld from its subcontractors. A builder must protect the retentions it withholds, in the form of cash or other liquid assets held on trust, but may elect to provide a retention bond to partly or fully satisfy its trust obligation.

**What happens to retentions when the payer goes into receivership or liquidation?**

Where retentions are held on trust for the benefit of the payee, it is not available to a receiver or liquidator. The Act does not indicate how the retention money will be released when a payer becomes insolvent.

**What happens if the payee doesn't remedy defects?**

The payer has the legal right to use some or all of the retentions to remedy defects where the payee has failed to do so after being properly notified of the defect.

**Are there any special accounting requirements?**

Every payer who holds retentions must have proper and auditable accounts showing all retention money transactions, and provide information to payees free of charge on request.

**Does a payer need to set up a trust account for every payee?**

No. The Act does not require retention money to be held in a trust account at all. The retention money may be mixed with other money, but must be traceable through accounts that are auditable. The consensus view is that best practice is to hold retention money in a separate bank account and not to mingle retention money for different payees to avoid traceability problems.

**Are special accounting arrangements necessary?**

The short answer is yes. The Act requires every payer who holds retentions to have proper, auditable accounts that show all retention transactions, and to make those records available, free of charge and on request, to the payees

from whom the retentions are withheld.

Some contract accounting systems may be adequate for tracking the amount of retention money withheld by subcontractor and in total. It will take some time for industry practice to evolve, but it is expected that the primary accounting records for those purposes will include payment schedules, and some form of subcontractor statement showing the retentions held, by job and in total, and related transactions.

However, due to the unforeseen late amendments, accounting and reporting systems will need to be updated. For example, to ensure that withheld retention money corresponds with arrangements for trusts or liquid assets, or instruments such as retention bonds, and to provide reports to their payees.

#### **What are the alternatives to the trust obligation?**

An alternative is for payers to provide a complying instrument, such as a retention bond provided by a bank or insurer.

#### **Can a payer have some on trust and some protected by a retention bond?**

Yes. The payer is relieved from its trust obligation up to the value of any complying instrument, so may have some retentions covered that way, and the balance held on trust. They must of course ensure that their accounting systems and records identify the manner in which each payee's retention money is protected.

#### **How would a payee claim under a retention bond?**

The payee would apply to the bank or insurer if the payer fails to release the retentions, or if the payer goes into receivership or liquidation. There are particular rules for complying financial instruments.

#### **How will payees know whether a retention bond has been taken out?**

The payer must provide their payees with full details of any instruments or retention bond taken out.

#### **How will payees know how their retentions are protected?**

Payers must provide details to payees showing how their retentions are protected, including the amount protected under trust and/or covered by an instrument such as a retention bond.

#### **What happens if the payer doesn't take out the retention bond or keep it current?**

The retention bond (instrument) is an alternative, so if there is no valid bond the payer would have to comply with its default obligation to hold the retention money on trust, making the payer potentially liable for failing to comply with its duty as trustee.

#### **Are head contract forms affected?**

No significant changes are expected to industry-standard NZS 3910 and related NZ Standard documents, or to the NZ Institute of Architects standard forms on account of the retention regime, although no formal review has yet been undertaken.

#### **Do subcontract agreements need to be modified?**

Yes, in many cases, although this will take time to work through. Clauses in contracts that make the release of retentions conditional on anything other than completing contractual obligations will automatically be void. For example, temporary works or early finish trades such as scaffolding, demolition or piling may be entitled to release when their work is completed.

As most trades are completed at practical completion and have a defects remediation period, their final retention release will become due when they have completed their defect list at the end of the defect notification period. As this is earlier than most current subcontract agreements it should incentivise subcontractors to provide defect-free work, and to attend to their defects promptly as soon as they are notified. This will of course require payers to take greater care in defining the scope of subcontract work.

#### **Must builders release their subcontractors' retentions when they complete their subcontract work?**

No, that would only apply where a subcontractor does not have a defect remediation obligation, such as a demolition subcontractor or scaffolder. Most other trades are complete when a practical completion certificate is issued.

However, the final retention release may be due when they have remedied all properly notified defects at the expiry of the defect notification period. The conditions to be met for release should be set out in the relevant subcontract agreement.

**What happens if retentions are released late?**

The payer will be liable for interest at the rate set out in the contract, or if there is no agreed interest rate, at a default rate set by regulations. As no regulations have been issued the default rate, where a contract is silent on interest, is actually 0%. The provision for interest is intended to encourage the timely release of retentions.

**What are the options for payers who don't want to hold retentions?**

Payers don't have to hold retentions at all, and they may agree with their payees to provide a bond in lieu of retentions (as in Schedule 5 to the NZS 3910 conditions of contract).

**What is the benefit of retention bonds?**

A retention bond effectively protects the payee's retentions in the event of the payer's insolvency. Insurers claim to be able to provide retention bonds to approved applicants based on balance sheet information, at a cost comparable with bank bonds but without the cash flow impact.

**Are retention bonds available and at what cost?**

Insurers advise that they are already able to provide bonds. You should contact your insurance broker.

**Where do I get further information?**

Further information will be made available as the effect and meaning of the Act becomes clearer in the coming weeks and months. 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 warrantee of reliability of accuracy or accept responsibility for any errors or omission.