Is the CCA retention regime going to work?

By James McMillan and Stuart Robertson

As headlines have swiftly changed from 'construction boom' to 'construction crisis', a BDO survey shows that approximately a third of building contractors are not holding retentions on trust for subcontractors.

Unfortunately, should insolvency practitioners advise that there are no records of retentions being held on trust, the burden will fall on subcontractors to take action against the company and/or its directors

Commercial construction contracts entered into after 31 March 2017 are subject to the new retentions trust regime. This regime requires all retention moneys deducted to be held 'on trust'. The purpose of the regime is to protect parties down the contractual chain in the event of insolvency up the chain.

Previously, when a head contractor became insolvent, retention money was considered part of the head contractor's general funds. As such, it was available to pay secured and preferential creditors. Subcontractors, as unsecured creditors, rarely ever saw their retentions returned. Take, for example, Mainzeal, where 755 subcontractors lost $18.3 million of retentions.

Held on trust, retention money is instead considered to belong to subcontractors and therefore not available to insolvency practitioners to pay out to other creditors.

The appointment of receivers to Ebert Construction has recently dominated construction industry news. The receivers have been reported as confirming 'There are funds in a retention trust account under the new act and we will need to work through that with the lawyers, but it's over $3.5 million. That's money to pay creditors if they are entitled to it.'

Heartening news for subcontractors? Definitely. More worrying, however, is the recent failure of at least two other companies in the last two months where no public comment has been made confirming they hold retentions on trust.

GETTING YOUR MONEY BACK

How then do you get your retentions back? The Construction Contracts Act (CCA) doesn't say what happens when a retention holder becomes insolvent. What is clear is that retentions money can only be used to remedy defects in the performance of a subcontractor's obligations under a contract; they are not payable to any other creditor, and cannot be withheld for any other reason than non-performance.

Subcontractors need to check their contracts. For example, under clause 14.3.1(d) of NZS 3910:2013, in the event of a receivership or liquidation, the receiver or liquidator must, within 10 working days, 'make arrangements satisfactory to the contractor for continued payment of amounts due under the contract.'

No notice is required from the subcontractor to the receiver or liquidator – this obligation arises automatically. That said, it would be prudent to immediately alert the receiver or liquidator to this obligation. This period is the subcontractor's opportunity to secure its ongoing position as to payments, should the project continue.

If an arrangement cannot be agreed within the 10 working days, the subcontractor should be given written notice of default to the engineer to the contract. Under clause 14.3.3, if that default is not remedied within a further 10 working days, the subcontractor can require the engineer to suspend the whole of the contract works and terminate the contract. A recent Court of Appeal decision has confirmed that the subcontractor can elect to suspend or terminate; suspension is not a precondition to termination.

DEALING WITH NON-COMPLIANCE

What about the head contractor that has not complied with the retentions trust regime? Here the subcontractor is in some difficulty. The CCA requires head contractors to keep proper accounting records of all retentions held (including if a complying instrument, such as a bond, is held instead of cash).

Subcontractors can require a head contractor to make available its accounting records for inspection at all reasonable times and without charge. A prudent subcontractor should at least once, during the contract, inspect a head contractor's records to see that retentions are held.

Should there be any indication the head contractor is failing to comply with the CCA or is having financial difficulties, such requests should be made on a more regular basis. Breach may also allow the subcontractor to give a notice of default (check your contract).

The writers are aware of requests being made of head contractors to make their records available that have been ignored. In the event of a head contractor becoming insolvent, enquiries should be made of the appointed insolvency practitioners.

Unfortunately, should insolvency practitioners advise that there are no records of retentions being held on trust, the burden will fall on subcontractors to take action against the company and/or its directors. This is because the CCA provides no remedies in the event the retentions trust regime is breached or ignored altogether.

Subcontractors will need to look to the Companies Act 1993, which provides grounds for pursuing directors who have not met their obligations. Both liquidators and creditors can pursue action against directors in certain circumstances.

RECOVERY ACTION

The introduction of the retentions trust regime was a significant step towards improved security for the most vulnerable in the contractual chain. Reputable companies were always likely to comply with the retention money regime. It is the disreputable companies/directors that will ignore the regime.

We are yet to see recovery action taken against directors whose companies have breached the regime, but we will be carefully following developments.

This article is not a substitute for tailored and independent legal advice. If you have any questions about this topic, contract the writers.

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